State of the Region Report™

2014

The Top of Europe – Emerging from the Crisis, Adapting to a New Normal

TILLVÄXT VERKET

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State of the Region Report 2014

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Competitiveness and Governance

These two issue areas are high on the agenda of co-operation initiatives in the Baltic Sea Region, especially when the 16^{th} Baltic Development Forum Summit takes place on June 3-4, in Turku, Finland, alongside the Annual Forum of the EU Strategy for the Baltic Sea Region. At this event, the European Commission will, as a co-organiser, present a policy document, which will propose ways as that co-operation may better be organised, ensuring that both the Commission and the EU Member States of the region are working equally hard to realise the objectives of the EU strategy. The Baltic Sea Region is a test case in the EU for how to develop regional co-operation in a way that makes sense for all actors. Hence, it is not only important to the region itself, but also to others who want to copy the 'Top of Europe'.

The issue at stake is also called *multi-level governance* and, as the word itself reflects, this is not easy to grasp. But basically it means that several levels – from local, regional, and national to supra-national – need to be working together in a co-ordinated cross-border manner towards shared objectives. If this works, and if we understand how to involve the many different stakeholders, then it is possible to reap many benefits. And one of the outcomes can be higher competitiveness, prosperity, economic growth and more jobs for all parties involved.

This dual objective - governance and competitiveness - has always been part of the State of the Region Reports throughout the years: first, to analyse the region's competitiveness, and second, to present the cross-border co-operation of the many organisations involved. The basic thinking is that you – country/region A – can improve your economic performance if you work constructively and consistently with your neighbours B, C and D, because your neighbour has a huge impact on your success rate – whether you like it or not. The present political conflicts with Russia over Ukraine illustrate this point too well.

Over the years, the State of the Region Report has reminded all actors that competitiveness upgrading has to stay at the heart of regional co-operation. This basic message is still very much needed, especially in order to draw a central government in as an active player. Unfortunately, this is not always the case, which is one of the root causes of the governance-problems. Although all the countries are slowly coming out of the economic crisis, jobs, growth, and competitiveness are still *the issues* for governments that want to get re-elected. If we want their attention, we need to follow their priorities closely.

Central government is also eager to have a closer dialogue with the private sector to ensure that we are setting regional priorities right. This reflects another governance problem in the Baltic Sea: we need to organise platforms, agendas and support schemes that attract the participation of private sector actors. Some effort has been made in adjusting the different structural funds programmes to enable this closer dialogue, but it remains to be seen whether it works. As to the dialogue, BDF wants to play a facilitating role, and the joint event with the Commission in Turku aims to address these considerations.

As always, the State of the Region Report gives us inspiration, and it has done its part to facilitate the wider dialogue with decision-makers and business on Governance and Competitiveness. We thank Christian Ketels – and his colleague Timo Summa – for a fine 11^{th} report and for the information, facts and recommendations.

Finally, we would like to express appreciation to the co-sponsors of this year's report, the European Investment Bank and Tillväxtverket, and mention – for the sake of good order – that the conclusions and recommendations do not necessarily reflect the views of the sponsors.
We wish you a good read.

Hans Brask
Director
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Introduction

When leaders from the Baltic Sea Region meet at the 16th Baltic Development Forum Summit in Turku, the usual dialogue about economic opportunities will have to share the stage with difficult discussions about the political context for collaboration. Russia's actions with regards to the evolving situation in the Ukraine, and the consequences these actions have had for the relations between Western Europe and Russia, touch the core of how collaboration in the Baltic Sea Region should and will appear.

Compared to these broader political concerns, the State of the Region Report has a more limited perspective, tracking overall competitiveness and collaboration across the entire Region, including north-western Russia. What are the narrow economic implications of the current political situation disrupting relations with Russia?

- The Russian economy is paying the price for Russia's policies in the Ukraine. It was already struggling before, with macroeconomic headwinds and a lack of structural reforms pushing down growth rates. The massive capital flight and the uncertainty about sanctions and other policy measures will only make it harder for Russia's economy to do well. This hurts the Region both through lower economic activity in its Russian parts and through less economic opportunities for trade within the Region.
- Economic relationships between Russia and the rest of the Region are exposed, and can easily face deeper challenges. Already, a number of the Russian individuals subject to sanctions have economic interests in other parts of the Baltic Sea Region, particularly Finland. Further policy action could easily curtail economic relations more significantly. But the overall exposure of most parts of the Region through trade or financial linkages with Russia is still relatively limited, with energy supply a key exception. Finland and the Baltics export between around 10% (Finland) and somewhat less than 20% (Lithuania) of their total exports to Russia. For the rest of the Region, the figures are below 5%. Imports from Russia tend to be a smaller share of total imports, with Lithuania being an exception whose imports are driven by transshipments.
- The economic promise of the Region is likely to have suffered in the eyes of investors. Political risk has increased, especially in those parts of the Region most related to Russia. On top of that, the long-term economic potential of the wider neighbourhood, including other parts of Russia, Belarus, and the Ukraine, looks less promising.

Overall, the economic implications of the current crisis are meaningful but likely to be modest in the overall context of economic trends, at least for most parts of the Region: Russia's economy has experienced the highest relative impact, with the economies of Finland and the Baltics also facing some meaningful effects. Beyond Russia's direct neighbours there are individual firms like Carlsberg (Denmark) or Oriflame (Sweden) that do a lot of their business in Russia. Nevertheless, the economic costs are far outweighed by the political damage that has been done. For both sides the economic implications play second fiddle to the political issues and principles at stake.

While the reaction to Russia's actions in the Ukraine will be a dominant political issue to deal with, the Region also has to review its economic performance and trajectory. As in previous years, the State of the Region Report provides a fact-rich assessment of the Region's competitiveness. Its ambition is to help both decision makers in the Region and those looking at it from the outside to make well-informed choices about investment, policy priorities, and longer-term strategies.

The 2014 State of the Region Report again takes the pulse of the 'Top of Europe' as it enters a potentially 'new normal' of lower growth. The crisis has been overcome, but the recovery has been much slower and less powerful than the recoveries from previous downturns. The Report tracks these developments and looks at the outlook for the post-crisis growth trajectory in the medium term. One important aspect is the Region's position in the global, knowledge-driven economy. New data shed led on the Region's performance in trade, investment, and innovation. Finally, the economic analysis provides details on the current competitiveness of the Region, covering both macroeconomic and microeconomic aspects.

Finally, the Report provides an update on economic development-focused collaboration efforts across the Region. The EU Baltic Sea Region Strategy, which holds its 5th Annual Forum jointly with the BDF Summit, has provided the critical context for many regional organisations, initiatives, and projects. The governance of this process has become an important issue for discussion, both to improve what is happening around the Baltic Sea and to draw lessons for other 'macro-regional strategies' that the European Union has launched across Europe.

What is the Baltic Sea Region?

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). 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.

This Region is home to 57.6 million people; the size of its population puts the Region somewhere between Spain and the UK. About 43% of the Region's inhabitants live in the Nordics, 12% in the Baltics, and the remainder in the parts of Germany, Poland, and Russia bordering the Baltic Sea. Total employment in the Region is at 27.7 million employees, a slight decrease compared to last year and about 2%, or 600,000 below the peak reached in 2008. Over the last decade, however, the rise of the labour force has been an important factor, with 1.3 million more people in the labour force than in 2001.

In 2013, the Region generated an annual GDP (PPP adjusted) of around €1.3 trillion ($1.8 trillion). This is 1.5% more than in 2012 and represents about 11% of the EU-27 economy. The Nordic countries account for 62% of the total. Northern Germany accounts for roughly 14%, slightly larger than Northwestern Russia's share of 12%. The Baltics contribute 7% and Northern Poland, the remaining 5%.

Thus defined, the Baltic Sea Region overlaps with a number of administrative groupings: the Council of Baltic Sea States matches the Region most closely but , as an intergovernmental agency, has no official limitation on the subregions of Germany, Poland, and Russia that it includes. The Nordic countries have a long-standing collaboration with an institutional base in the Nordic Council and the Nordic Council of Ministers. In a number of areas the three Baltic countries, which have created some similar structures among themselves, have become an official part of this collaboration. To the north, the Barents Euro-Arctic Council (BEAC) includes a platform for Norway, Sweden, Finland, and NW Russia to collaborate. The Arctic Council stretches out even further, including Denmark (Greenland) and Iceland from the Baltic Sea Region, as well as Canada and the US in addition to the countries represented on the BEAC.

There is no scientific way to exactly determine the boundaries of the Baltic Sea Region. We proceed conservatively, including only those regions that appear closely integrated with other regions around the Baltic Sea. Iceland and Norway are included because they have close relations to many countries around the Baltic Sea and are eager to participate in regional co-operation. Regions in Germany, Poland, and Russia not bordering the Baltic Sea are not included, because their economic ties with the Baltic Sea Region are limited. This makes the definition used here more restrictive than the ones used by other institutions. For comparisons, the Report looks – depending on data availability – at the EU-15 (old member countries), the EU-8 (new central European member countries, excluding Bulgaria and Romania), regions within Europe (Iberian Peninsula [Spain, Portugal], British Isles [UK, Ireland]), NAFTA (US, Canada, and Mexico), Oceania (Australia, New Zealand), the Asian Tigers (Hong Kong, Singapore, Taiwan, and South Korea), and occasionally the OECD. Where possible, the Danube Region – stretching from southern Germany to the Black Sea – has been included in the comparisons as well.

The structure of the State of the Region Report

Broadly following the structure developed over the last few years, **section A** written by Helge Pedersen from NORDEA, looks at the current economic climate in the Region, an important influence on the policy environment for long-term competitiveness upgrading.

Section B then discusses the recent trends in the competitiveness of the Baltic Sea Region. Its first part looks at the most recent medium-term trends in prosperity outcomes, including an analysis of labour productivity and mobilisation as their key components. The second part covers data on trade, investment, and innovation; all important indicators of current economic activity and symptoms of the Region's underlying competitiveness. The final part then proceeds to cover competitiveness fundamentals, the macro- and microeconomic conditions that ultimately shape the Region's attractiveness for companies and its ability to generate prosperity for its citizens.

Section C put together by Timo Summa from Finland, provides an update on the profile of collaboration across the Baltic Sea Region. It tracks the activities of the main twenty regional organisations and projects over the last year. As a new feature, the cooperations of the Region's parliaments have been included. Their active links to the European Parliament have become more important. The second part looks at the activities of the EIB and the NIB in the Baltic Sea Region. These two IFIs do not only contribute a very tangible way to the financing major projects supporting priorities in environment, transport and energy policies, but also contribute to professional preparations of infrastructure projects as well as corporate governance. Finally, section B highlights the challenges governmental and public-private organisations face when adapting to the EU's new financial framework for the years 2014–2020, as well as to potential changes in the governance structures of the EUSBSR. A central theme for the assessment of the collaboration across the Region is the implications that the current situation might have for the upcoming Communication by the European Commission, which will look at the governance structure of the EU Baltic Sea Region strategy.

The Report closes with a summary of key observations and an outlook on the forces that are going to affect the Region's development going forward.

Section A: The current economic climate of the region

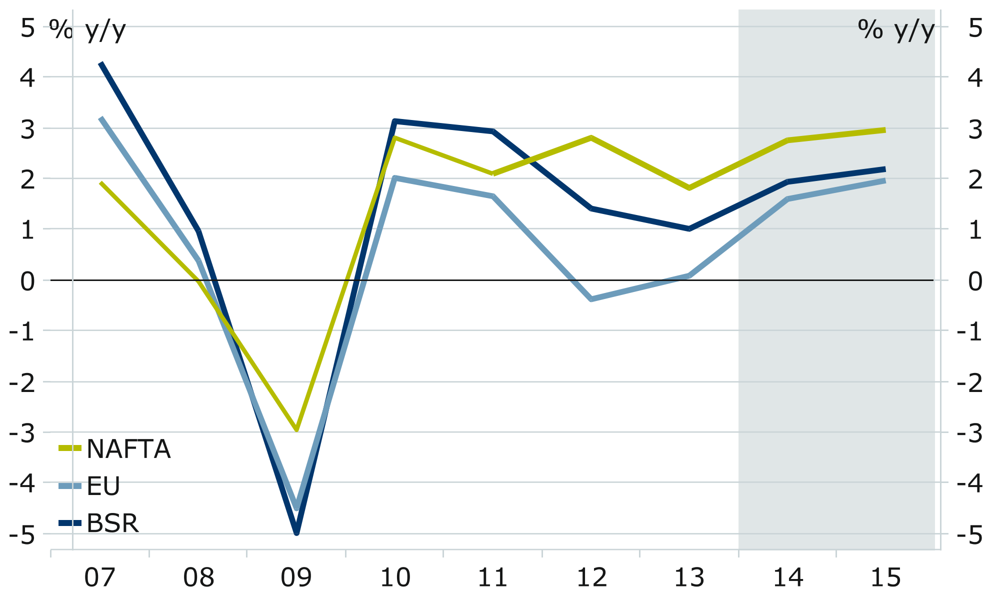
This section of the State of the Region Report describes the current economic climate in the Baltic Sea Region, covering several dimensions of the short-term economic dynamics and their reflection in key macroeconomic metrics. It provides key background to understand the impact of current sentiments on the longer-term economic trends and underlying competitiveness of the Baltic Sea Region.

Short-term growth dynamics

The Baltic Sea Region had, until the Great Recession, grown at rates close to the global average, significantly above the level shown in the North American and Western European economies. After a dramatic reduction of economic activity during the crisis, in 2010 the region recovered more quickly than peer regions and retained solid growth rates throughout 2011. In 2012, the pace of growth halved to roughly 1.2%, below the level of growth in North America, as the Baltic Sea Region was tracking the European slowdown, even if it remained at a higher level of economic dynamism than its European peers. Growth slowed even further in 2013, to just under a mere 1%. But the downturn reached its nadir in Q1 2013, and throughout the remainder of the year the region showed signs of a nascent recovery. The outlook for 2014 is relatively benign, with overall growth in the region running at around 2% and possibly accelerating further into 2015.

Within the Baltic Sea Region, the variations in growth rates narrowed further in 2013. While the gap between the fastest and the slowest growing economies in the region in 2009 was 19 percentage points, it had dropped to 8.5 points in 2011 and 5 points in 2013. The Baltic countries, which had seen a powerful recovery after the significant crisis in 2009, saw their growth rates fall

Figure 1: Economic growth for selected regions, real GDP % y/y



Source: Nordea Markets and Macrobond

to between 1% and 4% in 2013. Poland and Russia also saw a slowdown to around 1.5%. Germany and Denmark saw modest growth of around 0.5%, while Finland reported a contraction. After several years of high growth the Norwegian economy slowed down markedly towards the end of 2013, leaving Iceland and Sweden as the only countries in the region boasting accelerating growth.

Slower growth in the Region and the surrounding European economy, coupled with generally falling commodity prices, led to a fall in inflation rates, despite a continuation of highly expansionary monetary policies.

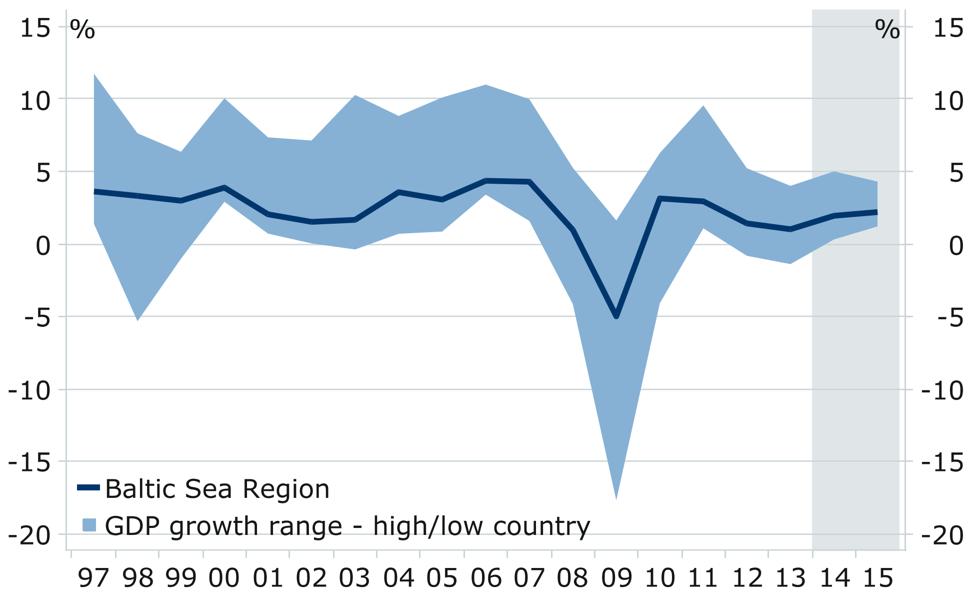
For 2014, most countries in the region are expected to register a moderate increase of growth rates. The only exception is Norway, where a marked dampening of economic activity could be under way. The gap in growth rates between the fastest and slowest economies in the region is expected to drop to around 3 percentage points in 2014 and 2015. This suggests a dominance of broad business cycle trends across Europe over country-specific factors. While the crisis and the immediate recovery were very different experiences throughout the region, the medium-term growth outlook seems relatively muted everywhere.

Table 1: Real GDP growth, %y/y

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

Source: Nordea Markets

Figure 2: Real GDP growth range



Kilde: Nordea Markets og Macrobond

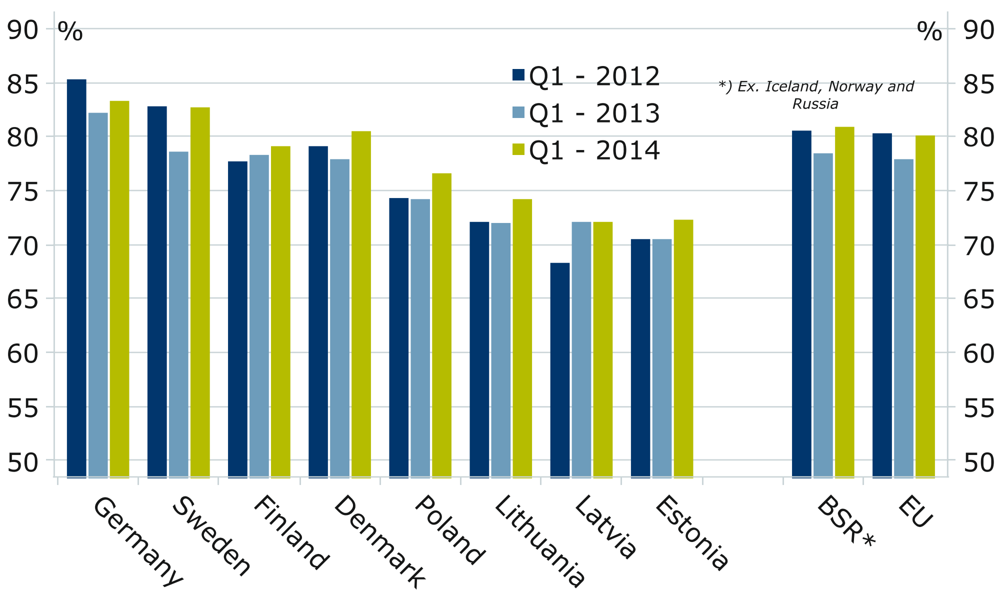
In previous years, growth in the Baltic Sea Region has been driven more by domestic demand than elsewhere in Europe and the OECD, where there has been a strong focus on the need to rebalance among those economies. However, during 2013 domestic demand slowed considerably in the Baltic Sea Region. Private consumption growth slowed to just 1.4%, on a par with the OECD area but still significantly higher than the EU-27 average. For 2014 the outlook is more positive, and private consumption is expected to grow by 1.8%, which is still ahead of the expected EU-27 average of close to 1%. In the OECD area, average consumption growth is expected to develop in line with the trend seen in the Baltic Sea Region. Public consumption growth has been less important, but in the Baltic Sea Region it is forecasted to grow by 0.7% in 2014, after expanding by close to 1% in 2013. This rate is higher than that in both the OECD area and EU-27, where austerity programmes have hit public consumption hard over previous years.

A key driver of the slower pace of growth in the Baltic Sea Region in 2013 was the sustained deceleration in private investment, where the growth rate dropped from 2.2% in 2012 to 0.2% in 2013. This is a significant drop and below the OECD average growth rate, which was still a meagre 0.8%; yet it still compares favourably to the EU-27 average of private investment, which saw an outright decline of another 3%.

It is very likely that concerns about the medium-term economic outlook affected companies' investment decisions, since the weakening investment dynamics are remarkable given the current monetary policy environment. The combination of low nominal interest rates and quantitative easing measures, i.e. the provision of large amounts of liquidity by central banks, introduced as emergency measures in the wake of the 2008 crisis, seems to be the new normal. But even the promise of low interest rates for a considerable period of time has not been enough to drive business investment. Part of this might be the result of a financial system increasing margins and using liquidity to improve balance sheets; a behaviour encouraged by regulators. But there are also signs that companies 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 into companies' investment decision is the level of capacity utilisation in manufacturing. But here

Figure 3. Capacity utilisation



Source: Nordea Markets and Macrobond

signs of a turnaround are emerging. After several years of weak capacity utilisation, it has risen across the board in most countries in the region. For the Baltic Sea Region as a whole capacity utilisation was back above 80% in Q1 2014 – up slightly from 78% in the year-earlier period. A pick-up in investment is therefore expected to materialise throughout 2014 – albeit there is no reason to expect a significant increase. Trade recovered strongly in 2010 after the dramatic drop during the crisis. However, since then growth rates have come down and reached a low in 2013, with both exports and imports slipping to just around 1%. For 2014, trade is expected to pick up again, driven by expectations that the international environment will improve. Dynamics in the OECD countries and EU-27 were the opposite, driven by the adjustments to current account deficits in these regions. The Baltic Sea Region continues to post a current account surplus of more than 5% of GDP, a rate that has remained remarkably stable over the past decade. Not least, the Scandinavian countries are running huge current account surpluses – a factor which, in combination with the countries' solid public finances, has been of great significance for the their status as safe havens in the financial markets.

Private consumption plummeted in 2012 and 2013 after strong growth in the preceding years. Consumption growth in Russia was especially strong; however, the trend was broken in 2013 when growth almost halved from previous years. In 2013, the Baltic countries saw the strongest recovery of private consumption, while Denmark

Table 2: Growth rates of GDP components, selected regions

	BSR		EU		OECD	
Real growth, % y/y	2013	2014	2013	2014	2013	2014
GDP	1,0	1,9	0,1	1,5	1,2	2,3
Consumption						
Private	1,4	1,8	-0,1	1,1	1,4	1,9
Government	1,3	1,2	0,4	0,6	0,2	0,4
Fixed investment	0,2	1,8	-2,6	3,0	0,7	4,5
Trade						
Exports	0,9	3,3	1,8	4,2	2,0	4,5
Import	1,0	3,3	0,6	4,0	1,3	4,2

Source: Nordea Markets

Table 3: Real private consumption growth, % y/y

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

Source: Nordea Markets

Table 4: Real government consumption growth, % y/y

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

Source: Nordea Markets

Table 5: Real investment growth, % y/y

	2010	2011	2012	2013	2014E	2015E
Baltic Sea Region	1,5	7,7	2,2	0,2	1,8	3,2
Denmark	-2,1	3,3	0,8	0,7	0,6	2,2
Estonia	-7,3	38,0	10,8	-0,2	2,4	5,7
Finland	1,7	5,8	-0,8	-4,6	-2,5	4,8
Germany	5,2	7,1	-1,3	-0,5	4,6	5,3
Iceland	-9,4	14,3	5,0	-2,5	6,2	7,1
Latvia	-18,1	27,9	8,7	-0,2	6,0	4,5
Lithuania	1,9	20,7	-3,6	12,0	10,0	8,0
Norway	-4,5	6,3	4,5	4,7	-0,2	-1,2
Poland	-0,4	8,5	-1,7	-0,4	6,0	8,5
Russia	6,4	8,3	6,7	-0,3	0,1	1,6
Sweden	6,7	8,2	3,3	-1,3	3,6	4,1

Source: Nordea Markets

and Finland remained the regional laggards. In 2014, private consumption is expected to recover again, and, with the exception of Finland, all the countries in the Region are expected to see decent growth rates, with the Baltic countries taking the lead.

Government consumption increased at a relatively fierce pace in the region in 2013 – not least driven by 2% real growth in Sweden. This trend is expected to continue in 2014, when Norway will adopt a more accommodative fiscal stance. Public consumption in Poland and Latvia is also expected to expand quite strongly.

After a year of high growth in 2011, fixed investment slowed substantially in 2012 and barely grew in 2013. Only Lithuania experienced a surge in fixed investment, of 12% in 2013, while Norway saw decent growth: close to 5%. In the rest of the countries, investment activity developed very modestly and growth almost stalled for the Region as such. The outlook for 2014 is slightly better, although still rather bleak. Only Lithuania will see double-digit growth rates, but activity in Latvia, Iceland, Germany, Poland and Sweden is also expected to pick up. Conversely, the investment outlook for Denmark, Norway, Russia and especially Finland is rather poor.

Due to the raging Euro crisis, exports slowed substantially in 2012 and deteriorated further in 2013, where only Lithuania and Poland saw a strong uptick in exports. The outlook for exports in 2014 is more promising, as a strong recovery is expected for most of the countries in the region. Only Lithuania is expected to see a slowdown in growth

Table 6: Real export growth, % y/y

	2010	2011	2012	2013	2014E	2015E
Baltic Sea Region	7,8	5,5	2,0	0,9	3,3	4,3
Denmark	3,0	7,0	0,4	1,0	3,1	3,4
Estonia	23,7	23,4	5,6	1,9	2,1	5,2
Finland	7,9	2,8	-0,2	0,3	3,4	5,5
Germany	14,8	8,1	3,8	1,0	4,6	6,0
Iceland	0,5	3,8	3,8	1,2	3,1	3,2
Latvia	12,5	12,4	9,4	0,9	3,5	4,2
Lithuania	17,4	14,1	11,8	8,5	3,5	5,0
Norway	0,4	-0,1	1,7	0,8	2,0	3,0
Poland	12,1	7,7	3,9	4,3	4,1	4,5
Russia	7,0	0,3	1,8	2,9	2,8	2,5
Sweden	10,0	6,1	0,7	-0,9	3,8	4,6

Source: Nordea Markets

Table 7: Real import growth, % y/y

	2010	2011	2012	2013	2014E	2015E
Baltic Sea Region	10,0	7,7	1,4	1,0	3,3	4,1
Denmark	3,5	5,9	0,9	1,5	2,4	3,4
Estonia	21,1	28,4	8,8	3,1	2,2	5,4
Finland	6,8	6,2	-0,7	-1,8	2,2	4,9
Germany	12,3	7,5	1,8	1,0	5,2	6,5
Iceland	4,5	6,7	4,7	0,8	2,4	3,1
Latvia	11,8	22,3	4,5	-0,3	4,5	4,5
Lithuania	17,9	13,7	6,1	9,1	5,0	5,0
Norway	9,0	3,8	2,3	2,5	1,8	0,7
Poland	13,8	5,5	-0,7	0,7	3,6	4,5
Russia	25,8	20,3	8,7	5,0	4,1	4,7
Sweden	11,5	7,1	-0,6	-1,2	3,7	4,3

Source: Nordea Markets

– which can be seen as a natural correction after years of very solid growth rates. As a consequence of the slowdown in domestic demand, imports plummeted across the region during 2013. Only Lithuania and Russia posted strong import growth numbers – with Finland and Latvia recording outright falls in imports. The better growth prospects for 2014 imply that imports will also pick up well in most countries, except in Norway, where this will be due to the expected dampening of economic activity during the year.

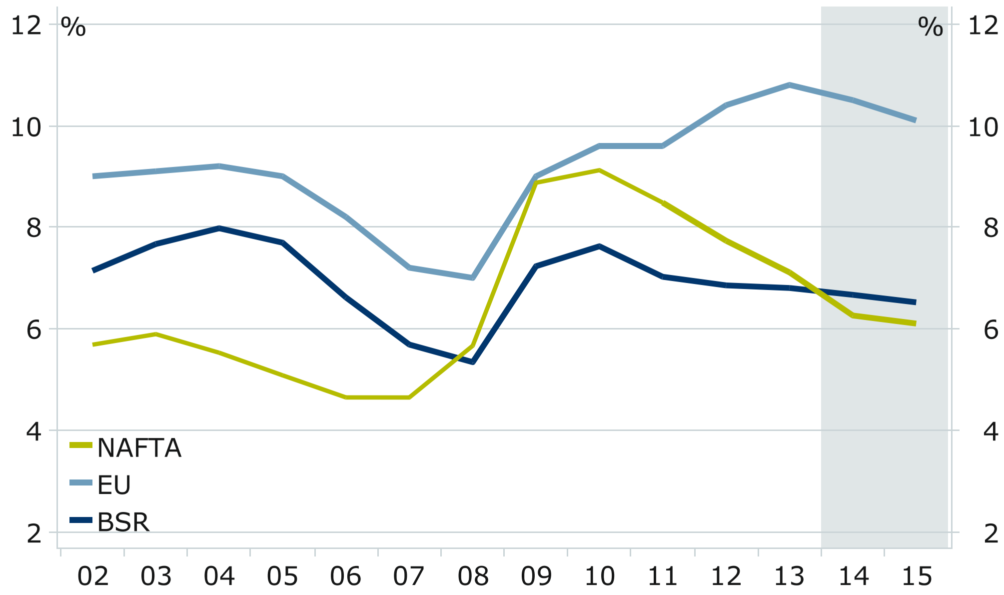
Impact on labour markets and public finances

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 global crisis. But while unemployment continued to increase in the rest of Europe, pushed up by the sovereign debt crisis and austerity programmes, it declined in the Baltic Sea Region. In the Baltic Sea Region, unemployment is stabilising at around 7%, while it is close to 12% in the EU. Unemployment in North America, historically the region with the lowest unemployment rates, dropped back to close to the level of the Baltic Sea Region in 2013.

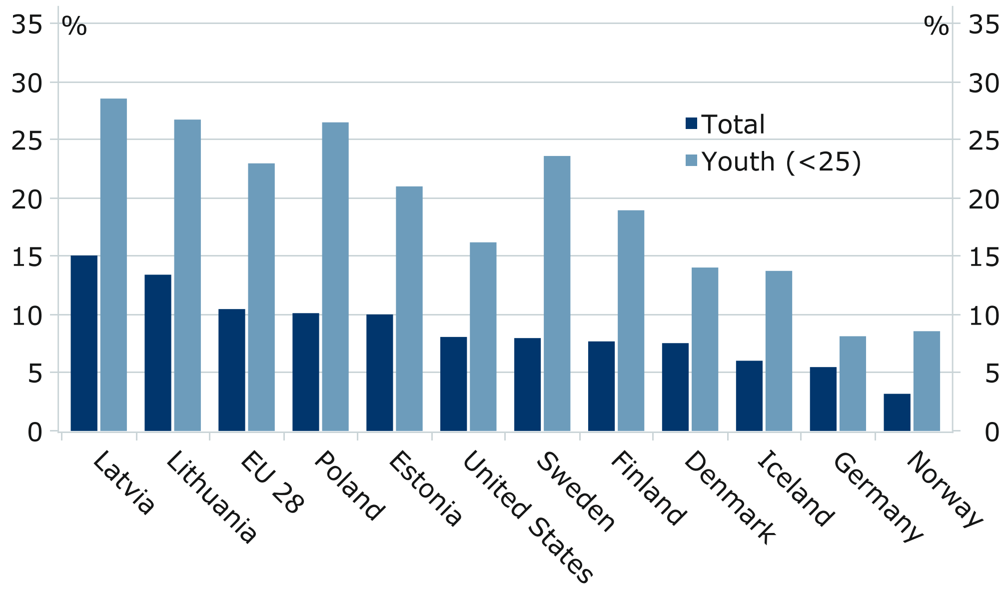
As regards the individual countries in the Baltic Sea Region, performance again varies. In the Nordic countries, Norway is close to full employment, with an unemployment rate of about 3.5%. Unemployment in Iceland has continued to fall and is now below 6%. In Denmark, unemployment is close to 7%, slightly above the historical average, while Sweden and Finland both

Figure 4: Unemployment rates for selected regions, %



Source: Nordea Markets and Macrobond

Figure 5: Unemployment rates, youth and total in percent of labour force



Source: Nordea Markets and Macrobond

suffer an unemployment rate above 8%. For Sweden this is relatively high compared to that of previous years and only about 1 percentage point lower than during the height of the global crisis. Germany, long a country suffering from high unemployment, has been able to more than halve its unemployment rate from close to 11% in 2005 to 5% in late 2013. Poland, another country with persistent labour market problems, has seen unemployment rise to almost 14% from around 9% before the crisis.

This indicates that the structural problems have not been overcome. However, in the Baltics, unemployment levels have fallen since the crisis, but at above 10% remain close to the EU average. Estonia in particular has experienced remarkable development, as its unemployment rate has halved since 2010, driven by the strong economic recovery in 2011 and 2012 and renewed migration of labour, which could easily put pressure on the labour market if it continues.

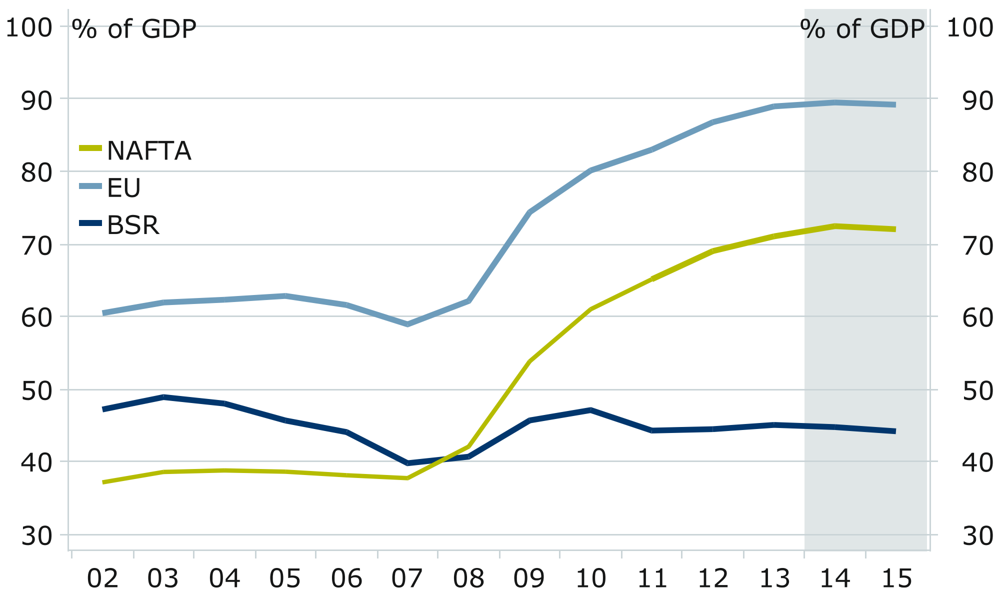
A key challenge in many parts of the Baltic Sea Region is the high level of youth unemployment. In Poland and the Baltic countries, as well as in Sweden and Finland, the youth unemployment rate is above 20%. In Sweden, the unemployment rate for young people under 25 years of age is three times as high as the labour force average. In Europe, only Romania and Italy 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 this trend, with youth unemployment rates between 2.5 and 2.7 times higher than overall unemployment. While the absolute levels of unemployment are a good deal below the levels in the Southern European crisis economies, there are many studies that indicate that unemployment in a person's early years of labour market activity has a prolonged effect on said person's lifetime career path.

On government deficits and debt, the Baltic Sea Region continues to outperform its peers. Due to a significant surplus registered by the big petroleum exporter Norway, the Baltic Sea Region again ran an overall budget surplus in 2013. Germany experienced a balanced budget, while Denmark, Estonia, Sweden and Latvia had close to balanced budgets. Poland had, by far, the largest deficit in the region in 2013, exceeding 4% of GDP.

Debt levels in the Baltic Sea Region have stabilised since 2011, while they continue to grow in the EU and the NAFTA region. In Southern Europe, spending cuts are hard-pressed to keep pace with falling tax receipts and rising social security expenditures in the wake of contracting economies.

Iceland continues to suffer the highest public debt level in the Baltic Sea Region as a result of the financial sector collapse in 2008/2009. In 2012 the country's debt ratio began to fall for the first time since the crisis, and this trend is expected to continue in 2014 and 2015. At slightly below 80% of GDP, Germany's public debt burden is the second highest in the region. Since 2010 debt levels have stabilised, and the constitutional balanced budget rule aims to accomplish a gradual reduction of current debt levels. Finland was the country in the region where debt levels increased the most in 2013, rising by about 4 percentage points to reach 57% of GDP. Estonia has

Figure 6: Public debt in % of GDP for selected regions



Source: Nordea Markets and Macrobond

the lowest gross debt level in the region, at just 10% of GDP. Among the countries in the Baltic Sea Region, only Germany and Finland are likely to surpass the 60% debt-to-GPD threshold set up by the EU. This makes the region one of the best performing in the world when it comes to national economic governance. Germany, Denmark, Finland, Norway and Sweden all belong to the small group of ten countries in the world which have been assigned a AAA rating by the three large rating agencies Moody's, Standard & Poor's and Fitch.

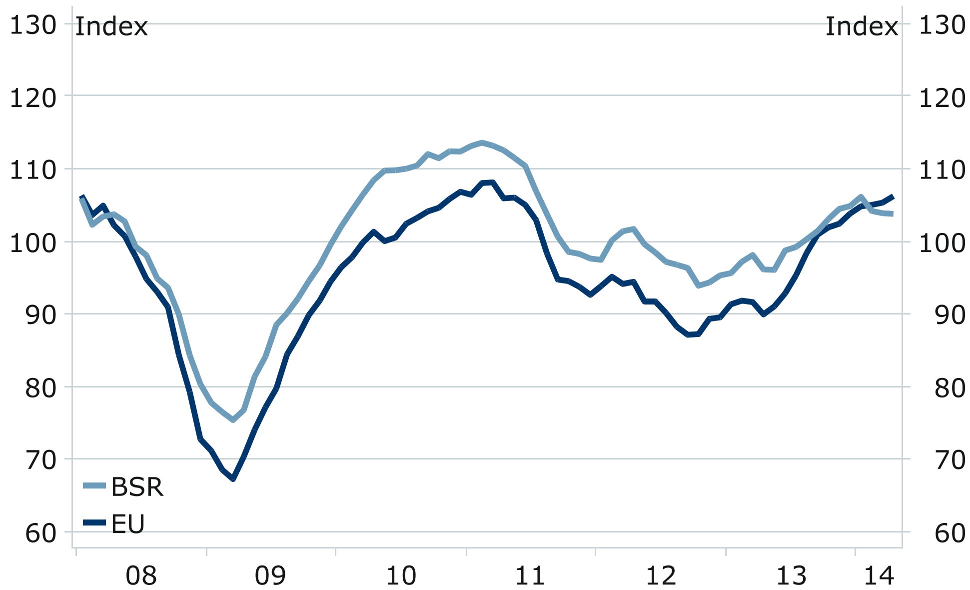
Economic sentiment

Since the most recent State of the Region Report, published in the first half of 2013, economic sentiment in the Baltic Sea Region has improved; however, this improvement has been less rapid than that observed in the rest of Europe. And at the beginning of 2014, for the first time since early 2008, sentiment was actually better in the EU than in the Baltic Sea Region. This is to a large extent due to much improved economic sentiment in Southern Europe, which escaped from the recession during the beginning of 2013, as well as a 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 in southwest Europe.

Still, the overall economic sentiment indicator remains solidly above 100, which is the dividing line between expansion and contraction. The threshold was passed during spring 2013 and overall sentiment is now as high as it was in August 2011.

Across the Baltic Sea Region, sentiment in Germany, Denmark, Lithuania, Sweden, Latvia and Estonia is above 100, the level signalling expectations of continued economic expansion. Denmark, Germany, Poland and Sweden are the countries in the region where sentiment has improved the most over the past 12 months. Sentiment is currently weakest in Poland and Finland. Both countries' economic sentiment indicators are well below the EU-27 average, which stood at 105.3 by March 2014. Latvia's and Estonia's ESI readings were also below the EU average for this month. Finland and Latvia are the countries where sentiment has dropped the most since last year's State of the Region Report. Compared to the post-crisis high, which was reached in late 2010/early 2011, the Baltic countries are now at between 93% and 98% of that level, while the

Figure 7: Economic sentiment score for EU and Baltic Sea Region



Source: Nordea Markets and Macrobond

readings from the rest of the region range from 83% in Finland to 91% in Germany and Denmark.

Assessment

The Baltic Sea Region's post-crisis recovery slowed down significantly during 2012, only reaching its trough by mid 2013. Since then, a fragile recovery has begun. However, while the Baltic Sea countries 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 progress in the labour market.

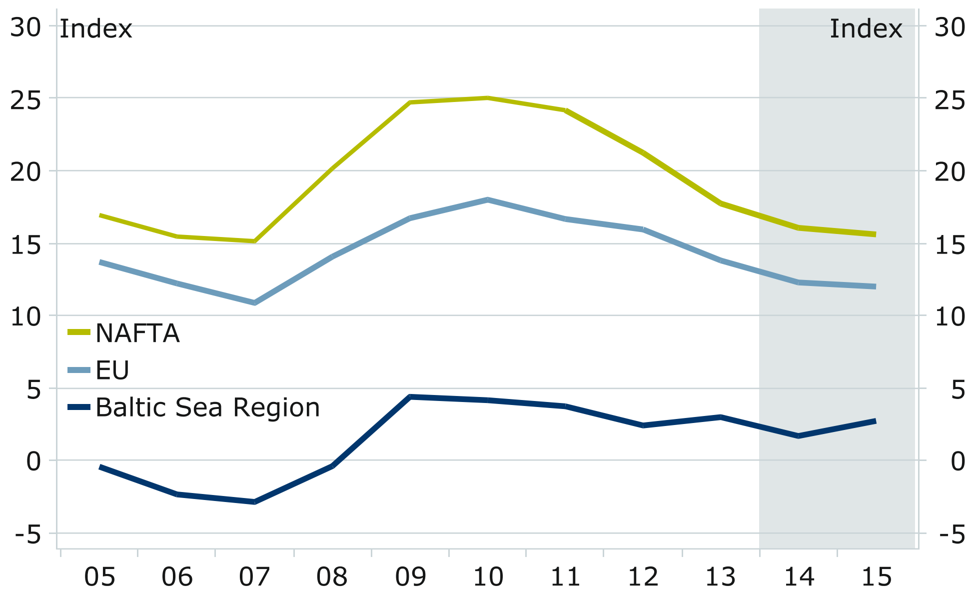
Overall, the Baltic Sea Region still remains in a significantly better shape than the rest of Europe and to a certain extent also North America. This is – despite the challenges that affect the region – due to solid government finances, a combined surplus on the current account and a relatively low unemployment rate. Inflation (often viewed as a bad thing in economics) is also low compared to the Region's peer group of countries. Not least, the so-called economic misery index[1] paints a much better picture for the Baltic Sea Region compared to both the EU and North America, see chart.

The solid public finances of countries in the Region have had a strong impact on creating a perception of the Region as one of the strongest in the world in the financial community. And among the only 10 countries in the world having obtained a AAA rating from the major rating institutions, five of them are located in the Baltic Sea Region: Germany, Sweden, Norway, Finland and Denmark

In the Nordics, good economic governance was, to a large extent, the result of reforms implemented in the wake of these countries' own crises in the 1990s. In the Baltics they were the result of low initial levels of debt – they did not assume any of the debt incurred by the Soviet Union – but also of stringent budget control, especially in Estonia, where the constitution requires a balanced budget.

Poland's debt is capped at 60% of GDP by the 1997 constitution and Poland has a self-imposed debt threshold of 55% of GDP. The government

Figure 8: Misery index for selected regions



Source: Nordea Markets and Macrobond

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

must take action to balance the budget once this level is exceeded. Germany's debt is much larger, but financial markets have so far seen the strength of its economy and its new balanced budget constitutional rule as sufficient to manage its debt dynamics. Norway and Russia are both special cases due to their larger revenues from natural resource exports.

Stronger fiscal positions have allowed governments in most parts of the region to react more forcefully to the 2008 crisis, and they have helped stabilise expectations about future economic trends. This has kept domestic demand at robust levels, easing the pressure on labour markets and ultimately also reducing the burden on public budgets from lower tax receipts and higher social security spending. The Baltics are a special case, but their austerity efforts benefit from the stronger export demand that their neighbours in the region provide.

Despite these stabilising domestic dynamics, the Baltic Sea Region is clearly not immune to the international business cycle. The fact that most of the countries are small, open economies heavily dependent on global trade makes them vulnerable to changes in the international economic and political environment. Based on the assumption that an international recovery is underway, the baseline scenario for the Baltic Sea Region remains a gradual pick-up in economic activity throughout 2014 and 2015 – but the risks are, for the moment, being skewed to the downside. This is not only due to the ongoing conflict between Russia and Ukraine. At the time of this writing, the 'soft' sanctions imposed on Russia by the G7 and the reciprocal Russian sanctions does not seem to affect the European business sentiment in any noticeable way. However, any escalation of the conflicts might bring the expected recovery to a standstill in the region and, due to the historical ties between Russia and the Baltics, Poland and Finland, these countries are deemed to be the most fragile if more drastic sanctions, involving trade of goods and services, are enacted.

Section B: Competitiveness Diagnostics for the Baltic Sea Region

This section of the State of the Region Report provides an overall diagnostic of the Baltic Sea Region's competitiveness. It is based on three levels of data: first, a decomposition of recent trends in economic outcomes provides insights on how the Region is ultimately doing on indicators that track the standard of living of its citizens. Second, a look at a number of measures of current economic activity helps to understand important channels through which ultimate economic performance is achieved. Third, the analysis of a broad range of competitiveness fundamentals and natural conditions looks at the level of factors that are the fundamental drivers of prosperity.

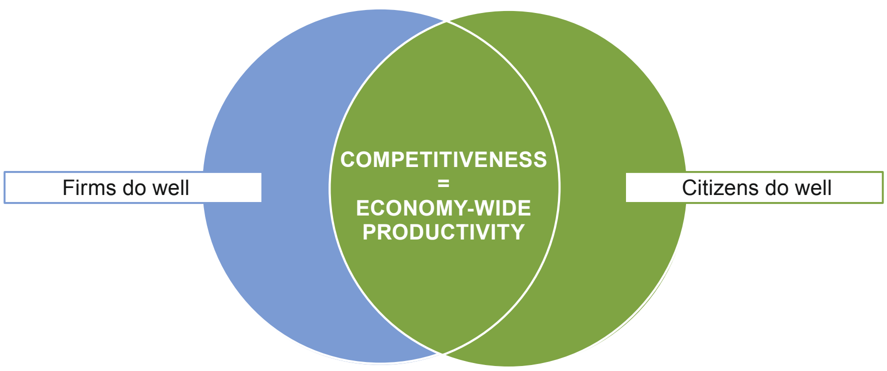
The State of the Region Report provides a perspective on the competitiveness of the economies in the Baltic Sea Region. For policy-makers in the Region, it aims to present key data and puts them in a structure that supports fact-driven choices about what policy areas to focus on to improve the Region's competitiveness. For business leaders and investors, its ambition is to provide insights into the attractiveness of the Region as a place to do business.

Competitiveness is a widely used but often poorly defined term in the economic policy debate. This lack of clarity on what competitiveness is confuses the discussion, and is a fundamental barrier for a more effective dialogue about the policy choices a location should make. For this report, **we define 'competitiveness' as the level of economy-wide productivity (output per working age citizen) that a location can support given its underlying economic fundamentals**.

This productivity-based definition of competitiveness is anchored in the view that to be useful for economic policy discussions competitiveness should be tightly connected to the level of prosperity that a location can sustain. The research shows clearly that prosperity differences across locations are closely connected to productivity differences, especially when productivity is understood not only as labour productivity, i.e. output per employee, but is defined more broadly to include the productivity of the economic system to mobilise the available labour force, i.e. output per working age citizen.

High productivity allows two conditions to occur simultaneously that most observers associate with high competitiveness: first, it allows citizens to enjoy a high standard of living. Second, it allows companies to compete successfully on national and international markets. While it is temporarily possible to benefit one of these groups to the detriment of the other, sustained competitiveness is based on both groups being able to build on the underlying strengths of their location.

What is Competitiveness?



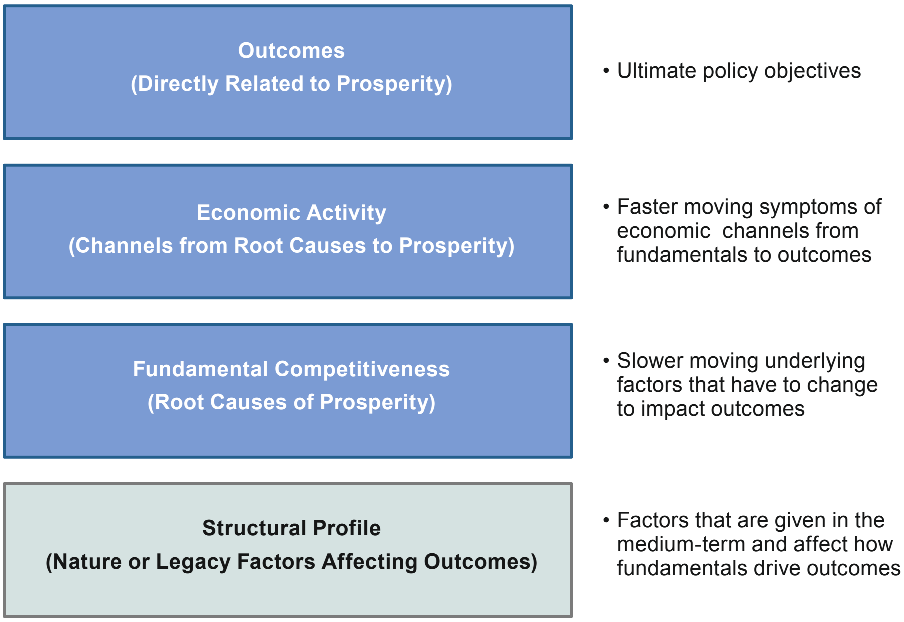
The term 'competitiveness' is used in the public debate in many ways that are different from the perspective outlined above. It is important to be mindful of these other perspectives to enable a broad and inclusive debate about policy implications. One alternative that is often seen in European policy documents relates competitiveness to maintaining macroeconomic stability, measured though solid public finances, low inflation, and importantly also the absence of current-account deficits and quickly growing unit labour costs. While the focus on these indicators of macroeconomic stability is understandable given the experience of the European sovereign debt crisis, it is important to put them into the broader context of the factors that drive prosperity over time. Macroeconomic instability undermines productivity and productivity growth, because it leads companies to invest less in the future. In fact, the policy uncertainty that remains in place in Europe is a key reason for the current macroeconomic weakness and could easily have serious longer-term implications for the region's competitiveness. Macroeconomic stability, however, is not enough to drive high levels of productivity and productivity growth. At best, it is a condition conducive to growth. At worst, however, measures taken to achieve macroeconomic stability can have significant costs in other dimensions of competitiveness, if they lead to necessary public or private investments not being made. In short, macroeconomic stability is important to avoid costly crises, but it is not sufficient to support high levels of prosperity.

Another view of competitiveness is strongly focused on costs. China has traditionally been described as competitive because of its low labour costs. But whether China's recently rising wages have made Chinese companies less competitive rivals to their European peers is at least questionable. The US has been argued to have gained competitiveness because of falling energy prices in the wake of the shale gas-boom. But whether this has materially improved the standard of living for US employees beyond the direct costs benefits for energy consumption is at least not obvious. The key is that for companies it is the ratio of competitiveness to costs that drives the attractiveness of a location. In China, there is a race between both of them, with the long-term development of the ratio between them still in the balance. In the US, the lower energy costs do raise the country's attractiveness for firms. But unless more firm investment also enables higher productivity, the benefits to US citizens will not go beyond the one-time benefit of the natural resource windfall. In short, costs are important for the attractiveness of a location to firms, i.e. one critical dimension of competitiveness. But if lower costs are achieved through lower wages, they represent a mere transfer of prosperity from workers to firms with no positive impact on overall competitiveness.

Measuring competitiveness empirically is as important as defining the term conceptually. In line with previous editions of this Report, we measure competitiveness through a broad battery of 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 indicators* 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 the data would.

For a meta-region like the Baltic Sea Region, it is also important to think about the level of geography at which competitiveness should be measured. Here again, it is important to be explicit about the way one intends to use the data. From a conceptual perspective, a key consideration is whether the fundamental competitiveness within a geographic region is sufficiently homogeneous that it leads to similar outcomes. This approach favours the use of relatively small regions with boundaries that do not necessarily coincide with administratively-defined regions. From a pragmatic policy-oriented perspective, it is useful to follow the geographic divisions of administrative regions because it is the level at which

How to Measure Competitiveness?



economic data is being collected and economic policy choices are being made. This approach favours the use of the NUTS regions, for which data is provided for Europe. And it suggests focusing on higher levels of government, including nations, where a lot of the critical policy choices are being made.

For the Baltic Sea Region, the data has over the years clearly shown the huge heterogeneity of outcomes across the Region. Standards of living differ widely, as do the conditions under which companies operate. These differences are most pronounced between the Nordics/Germany on the one hand and the Baltics/Poland/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. While both firms and policy makers need to be aware of these differences at the sub-national level, this Report focuses its analysis largely on the country level. The main reason is the desire to give an impression of the overall competitiveness situation in this part of the world, and to provide policy-makers with a focus on the entire meta-region factual support for their decisions.

The remainder of this section is organised according to the three main dimensions of competitiveness measurement outlined above. In the discussion of economic outcomes we look at average measures of prosperity and its main components, labour productivity and labour mobilisation. We also look at broader measures of prosperity, both related to GDP and going beyond GDP. The section on economic activity provides a perspective on trade and foreign investment as measures of the Region's global position. It also analyses investment and innovation outcomes as symptoms of the forward-looking potential seen in the Region. The final section then discusses a range of indicators related to competitiveness, both macro- and microeconomic.

1 Economic outcomes: Standard of living in the Baltic Sea Region

The central measure of prosperity we use is gross domestic product (GDP) per capita, adjusted by purchasing power parity. Other measures look at broader indicators of prosperity and the 'Beyond GDP' progress of the economy. Additional insights into the drivers of prosperity can be derived from a decomposition that separates the impact of labour productivity and labour mobilisation on overall GDP per capita.

Prosperity

The Baltic Sea Region remains one of the more prosperous regions in Europe. Its GDP per Capita (PPP adjusted) level currently stands at 97.5% of the EU-27 average, compared to just above 87% in 2005 and 83% in 2000. The dynamics in comparison to the EU-15, the more prosperous economies in the European Union, are roughly similar; the Region's prosperity level is now at 88% of this group's level. Heterogeneity across the Region remains large: the Nordic countries and Germany are among the most prosperous countries in Europe and globally. The Baltic countries, Poland, and Russia register prosperity levels at the lower range of the EU, with Latvia as the poorest country in the EU, apart from Bulgaria and Romania, reaching a prosperity level similar to Chile, Malaysia, and Mexico.

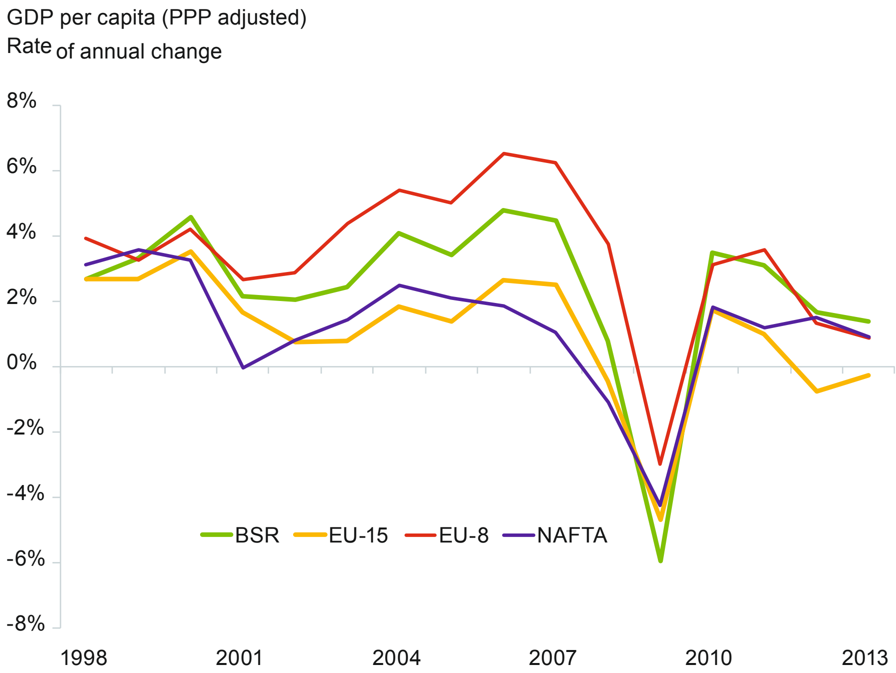
Box: Accounting for oil and gas in Norwegian and Russian GDP measures

Overall GDP measures the total output of an economy, and in this respect provides an important indicator of both total productivity (labour productivity times labour mobilisation) and prosperity. Large oil and gas sectors, however, complicate the interpretation of this data. From a production/productivity perspective, the sale of oil and gas represents the exchange of an asset, i.e. natural resources, into capital, not the production of anything that didn't exist before. This exchange is not free; it is capital intensive. But it employs only a very small share of the labour force, such that measures of average labour productivity are hugely affected by the presence of a large natural resource extracting sector. From an income/prosperity perspective, many countries, including Norway and Russia, put a share of their natural resource export revenues into a fund. This reflects that nature of natural resources exports as an asset swap rather than the generation of wealth. It also means that this part of GDP is not available for current consumption. Both of these factors suggest that one has to be careful in the treatment of oil and gas activities in GDP when making cross-country comparisons.

For this Report, we have decided to adjust the total GDP (PPP adjusted) for both Norway and Russia to have more comparable data on prosperity and labour productivity. In Norway, there are both data on the share of the oil and gas sector in GDP and a distinction between the mainland economy and total economy. We used the mainland economy data, which accounts for about 80% of total GDP, and adjusted the data in the Conference Board's main Total Economy Database accordingly. For Russia, the adjustment is more difficult. Direct revenues from oil and gas were around 10% of GDP. However, there has been an ongoing discussion about whether the official numbers of the oil and gas share in GDP might be underestimating their true importance, because companies in the sector shift a lot of their profits to related service providers in other sectors. We adjust the total GDP data in the Conference Board's main Total Economy Database by a conservative 15%. For both countries, we keep the adjustment fixed over time; growth rates reported are thus unaffected.

Prosperity over Time

Selected Regions



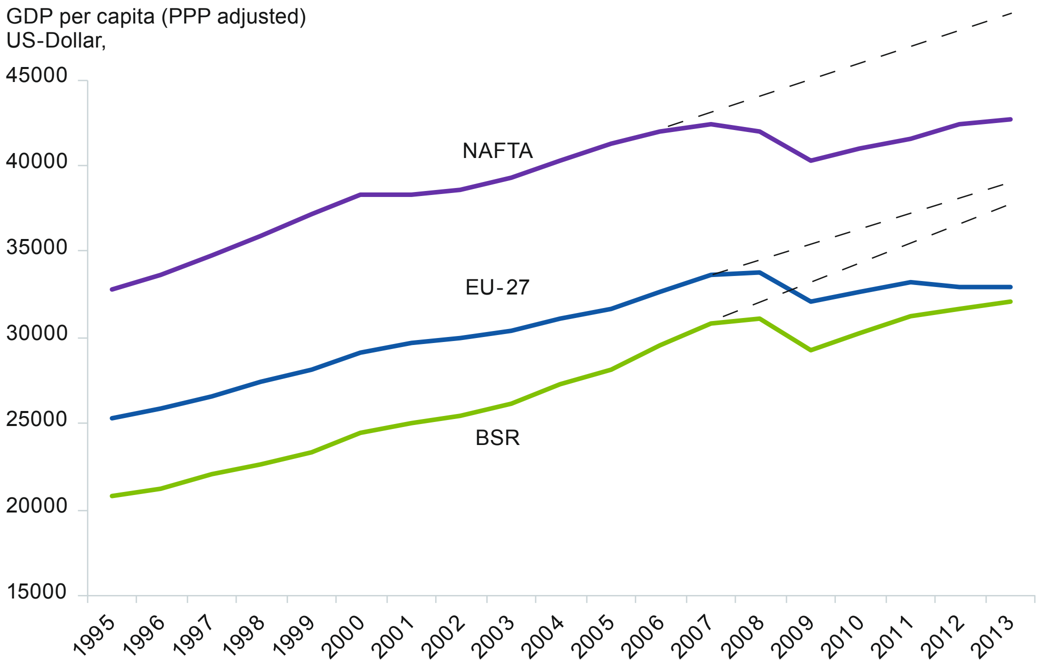
Source: Conference Board (2014) State of the Region-Report 2014

The Region's prosperity growth rate has slowed down further to 1.3% in 2013. The overall level of growth remains far ahead of the EU-27 average and slightly ahead of the North American and the EU-8 central European economies. The Danube region and the British Isles, two other European macro regions with respectable growth, were, at 0.7% growth, also behind. The Asian tigers, ASEAN, and Oceania have grown faster than the Baltic Sea Region, but the gaps have largely been more moderate than in the longer-term average.

While these numbers put the performance of the Baltic Sea Region in a fairly positive light, they still bear the very visible marks of the recent crisis. First, the Region seems to have suffered a permanent income loss: while the Region is back on a growth path, this growth has not been strong enough to compensate for the lost growth of the crisis years. As a consequence, the average citizen of the Baltic Sea Region is today roughly 15% poorer than she or he would have been without the crisis. Second, the Region's growth rate seems to have slowed down more permanently. While the NAFTA region seems almost back on its prior growth rate (which was lower than the Baltic Sea Region), the Baltic Sea Region seems to have lost about 1 percentage point of annual growth. The catch-up rate of the Baltic Sea Region to the NAFTA region has dropped from roughly 1% per year to 0. For the EU-27, however, the picture is significantly more sobering: there, prosperity growth has come close to a halt after tracking the NAFTA performance prior to the crisis.

Relative to its European peers, however, the Baltic Sea Region continues the process of catching up to the average EU prosperity level that has been visible over the last 15 years. Over the entire period, the Baltic Sea Region has reduced the gap in the GDP per capita level by close to 1% every year. Unsurprisingly, the catch-up rate has been highest for the Baltic countries and Poland, where it has reached close to 3.5% on average, despite the deep crisis that hit the Baltics in 2009. But even the Nordics, already ahead of EU-27 prosperity levels, gained close to 0.5% on their European peers. In 2013, the gap in growth rates between the Baltics and the rest of the Re-

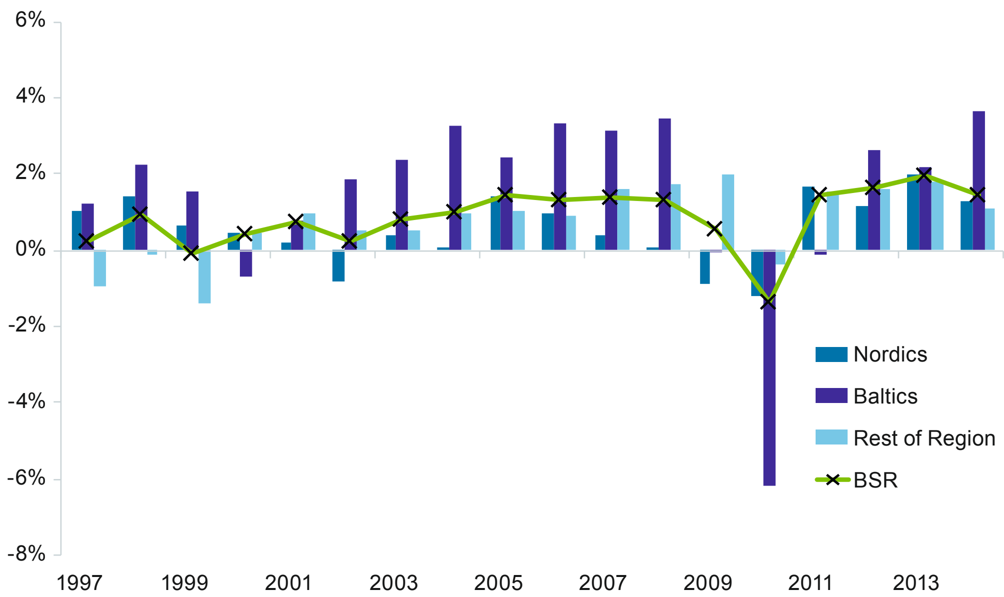
The Permanent Prosperity Loss from the Crisis



Source: Conference Board (2014) State of the Region-Report 2014

Baltic Sea Region Prosperity Catch-Up

Annual Change of GDP per Capita (PPP adj) relative to EU-27



Note: Norway and Russia levels adjusted for natural resource sector; Luxembourg excluded
Source: Conference Board (2014) State of the Region-Report 2014

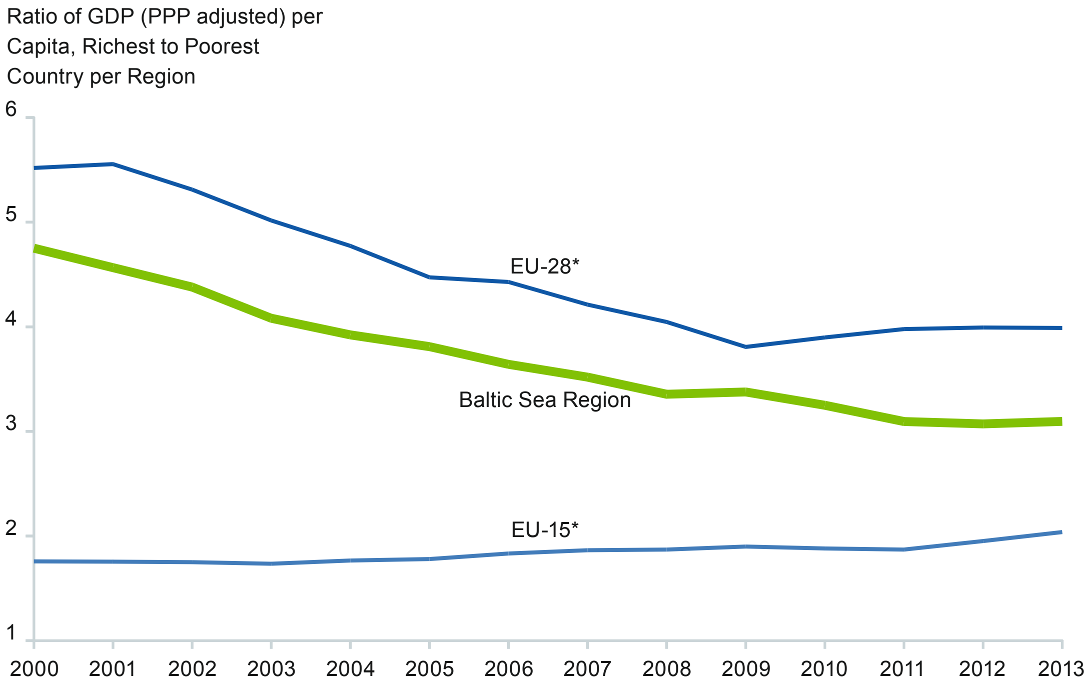
gion, including the Nordics, became again very pronounced.

As was discussed in last year's Report, these data suggest not only that the Baltic Sea Region has created the conditions for catch-up, but that its leading economies are also on a higher growth path than their European peers. Less comforting, however, it also suggests that the underlying growth dynamics of the Baltic Sea Region seem more tied to the low European level than to the more dynamic developments elsewhere in the global economy.

Within the Baltic Sea Region, prosperity rankings have remained unchanged in 2013: Norway, Iceland, and Sweden continue to lead the highest prosperity ranking. They are followed by Germany, Denmark, and Finland. Poland and Estonia lead the group of lower prosperity countries in the Region, followed by Lithuania, and finally Latvia and Russia, which are at levels similar to each other. As a consequence, prosperity dispersion across the Region remains significant, but the overall pattern of catch-up continues to reduce these differences. Before 2000, prosperity levels in the richest country in the Region, Norway, were more than five times higher than those of its poorest country, Latvia. This ratio had decreased consistently until the crisis temporarily stopped this process. Since then, catch-up dynamics are back in place, but have slowed down in the last two years. Across the EU-28, the trends were similar until 2009, but then catch-up stopped. In the EU-15, a group of countries which much lower prosperity dispersion, the trend is pointing slightly in the opposite direction; the more prosperous countries are growing faster than the laggards.

In terms of the growth rate of GDP per capita, the Baltic countries remained on top in the Baltic Sea Region. Country-specific trends have been important and have led to a heterogeneous profile of changes in GDP growth rates. As a consequence, the dispersion of growth rates has since decreased further. While the gap in growth rates across the Region had been at 19 percentage points at the height of the crisis in 2009, it has

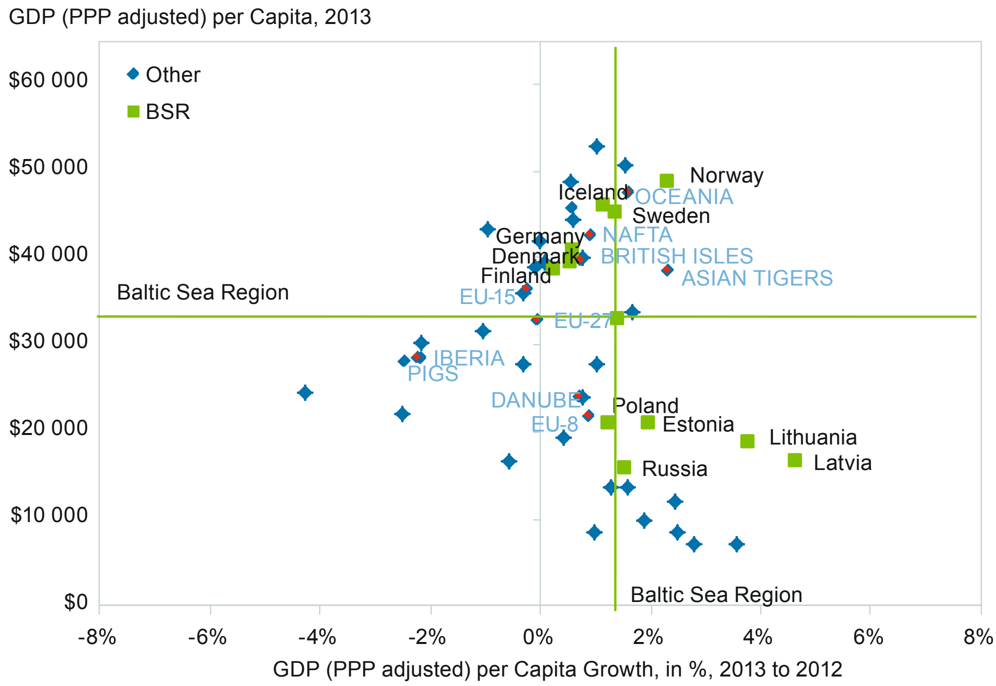
Prosperity Dispersion Within Cross-National Regions 2000 - 2013



Note: Norway and Russia levels adjusted for natural resource sector; Luxembourg excluded
Source: Conference Board (2014)
State of the Region-Report 2014

Prosperity Level and Growth

Selected Countries



Source: Conference Board (2014) State of the Region-Report 2014

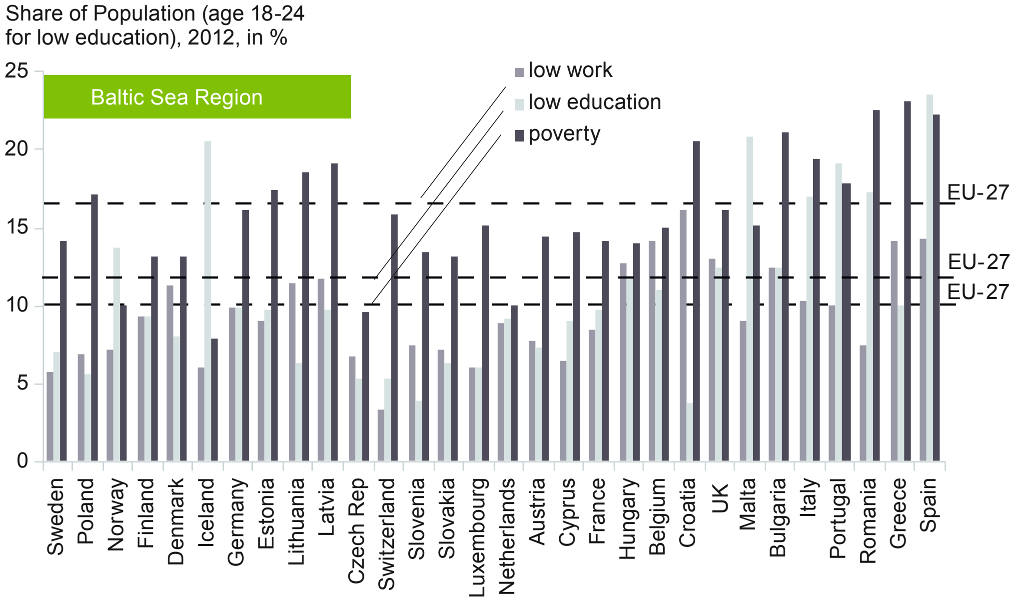
now dropped to 4.4 points. While growth slowed down in the Baltics, it improved slightly in Denmark and Finland, the countries with the weakest growth dynamics in both 2012 and 2013.

The standard of living available to large parts of society is given by more than GDP per capita. First, especially in the US, there has been a marked divergence between average and median GDP per capita trends. Robust headline GDP per capita growth can mask widely different trends for different parts of society. On income inequality (measured by the income share of the top to the bottom quintiles of the population), most parts of the Baltic Sea Region compare favourably to their peers elsewhere in Europe. Only Latvia sticks out, with a significantly more unequal income distribution; however, it has also register the fastest drop on income inequality among all EU countries since 2009. In the meantime, Denmark has been, after Ireland, the EU country where income inequality has risen the most during this period.

Another way to gain a deeper perspective on the economic dimension of prosperity is to look at those in society that are outside of the economic mainstream in different ways and have few opportunities to enter that mainstream. The European Union provides data on individuals in families where the adults are largely outside of the active labour force, on the share of young people (18-24) that have already stopped their education and training and thus are likely to possess few advanced marketable skills, and the share of the population at risk of poverty after social transfer. The Baltic Sea Region generally ranks well, in line with the leading Central and Western European economies. But there are issues on specific dimensions in a number of countries as well: on families with low exposure to the labour market, Latvia, Lithuania, and Denmark rank higher than the EU-27 average. On young people with little education, Iceland and Norway register remarkably high rates. On risk poverty, the Baltics and Poland report a significant share of their populations in an exposed position.

Moving beyond GDP, the Social Progress Index is a recent attempt to comprehensively measure how countries are doing on meeting

Social Exclusion across Europe



Source: Eurostat (2014) State of the Region-Report 2014

Standard of Living Beyond GDP

Social Progress Index 2014

	Social Progress Index	Basic Human Needs	Foundations of Wellbeing	Opportunity
Iceland	3	7	2	9
Norway	5	10	4	10
Sweden	6	5	9	7
Finland	8	4	11	8
Denmark	9	1	8	13
Germany	12	12	7	16
Estonia	19	28	10	22
Poland	27	36	15	28
Latvia	31	41	22	41
Lithuania	33	48	24	38
Russia	80	72	87	81

Ranks out of 133 countries
Source: Social Progress Index (2014) State of the Region-Report 2014

their population's basic needs (e.g., food, health, shelter, security), on providing the foundation for wellbeing (e.g., education, environmental conditions), and on giving them opportunities (e.g., freedom, personal rights, higher education). With all of the Nordic countries among the global top ten and Germany not far behind, the Baltic Sea Region outperforms its already solid economic performance. The Baltics and Poland also rank among the top third globally. Only Russia ranks far behind, with a huge gap also to its own GDP per capita ranking.

Prosperity accounting

Prosperity can be mathematically decomposed into labour productivity and labour mobilisation. We operationalise these concepts through GDP per hour worked (PPP adjusted) (productivity) and hours worked per capita (mobilisation). The data on hours worked are not very reliable, especially for Russia and the Asian countries, but give a directionally interesting perspective.

Compared to other regions, especially in Europe, the Baltic Sea Region continues to perform better on labour mobilisation than on labour productivity. Oceania and NAFTA (following the recovery of the US labour market) as the only regions that outperform the Baltic Sea Region on both dimensions; the Danube region and, by a whisker, the EU-8 are the only regions to perform worse on both. In all other regions

Prosperity Decomposition

Selected Cross-national Regions in 2013

GDP per Capita (PPP)	=	Employment-Factor	x	Productivity-Factor (PPP)
Oceania		Asian tigers		Core Euro-zone
NAFTA		Oceania		Oceania
British Isles		NAFTA		EU-15
Core Euro-zone		**Baltic Sea Region**		British Isles
Asian tigers		EU-8		NAFTA
EU-15		British Isles		EU-27
EU-27		EU-27		Iberian Peninsula
Baltic Sea Region		EU-15		PIGS
PIGS		Core Euro-zone		**Baltic Sea Region**
Iberian Peninsula		PIGS		Danube Region
Danube Region		Iberian Peninsula		Asian Tigers
EU-8		Danube Region		EU-8

Note: Working hours for Russia are estimated
Source: Groningen Growth and Development Centre and The Conference Board (2013), authors' calculations

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Prosperity Decomposition

Baltic Sea Region Countries in 2013

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

Note: Working hours for Russia are estimated
Source: Groningen Growth and Development Centre and The Conference Board (2013), authors' calculations

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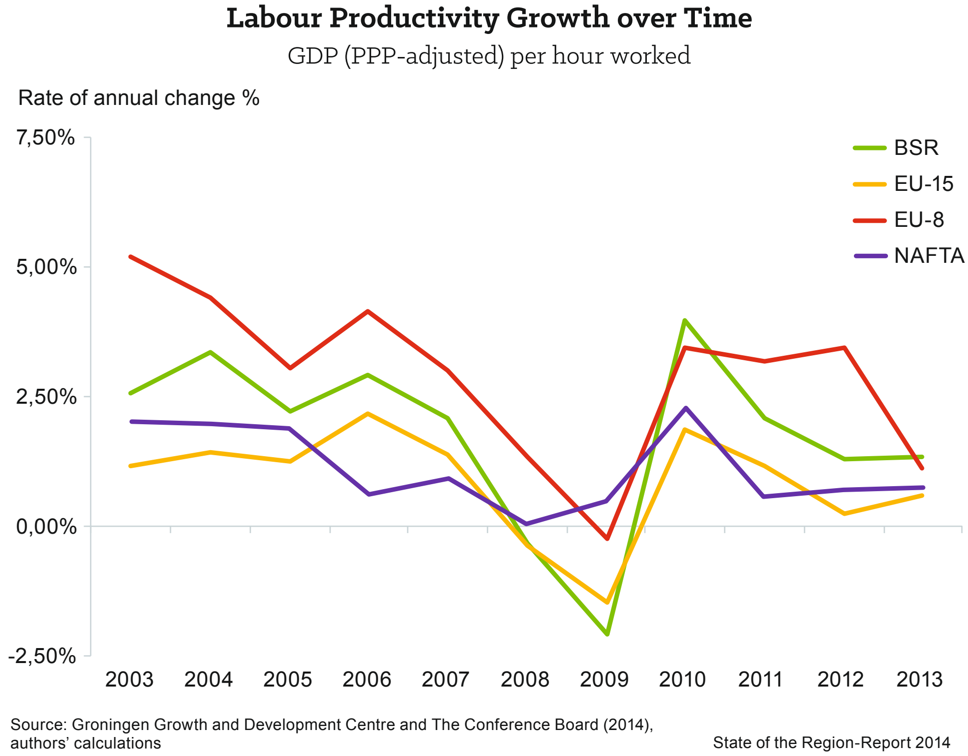


there tends to be a clear inverse relationship between the performance on labour productivity and labour mobilisation.

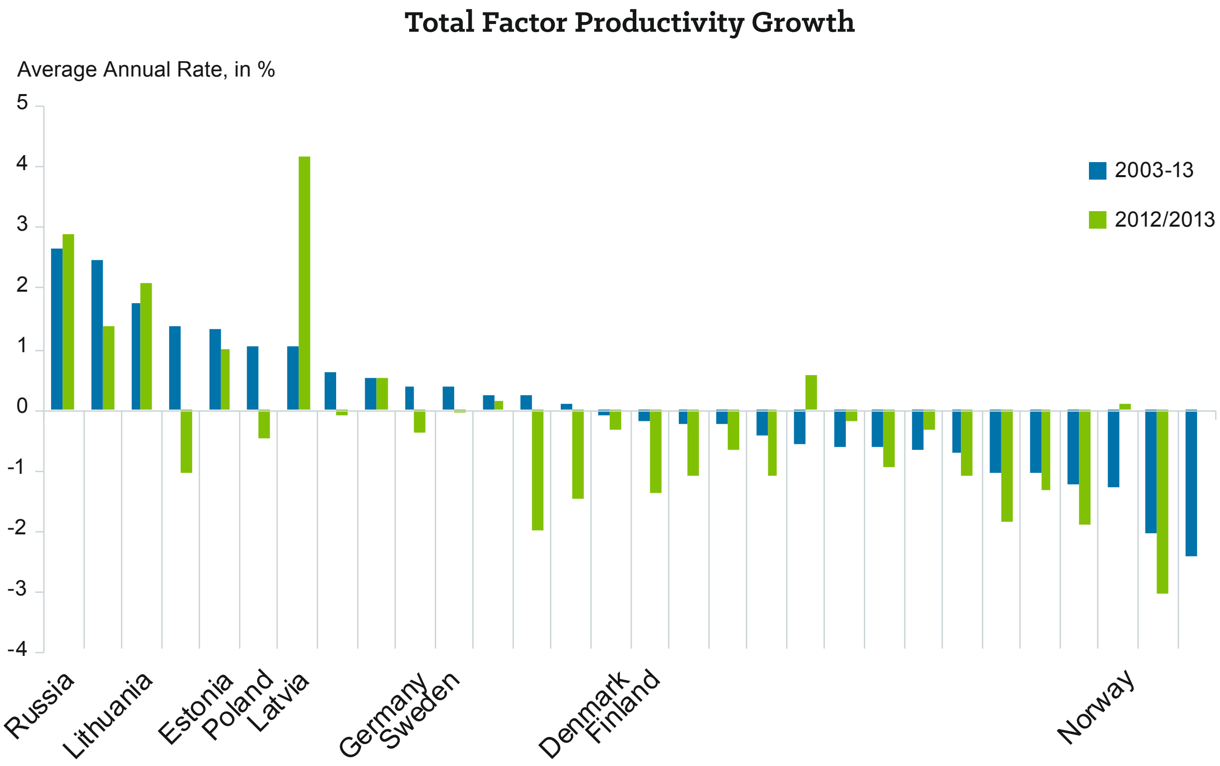
Within the Baltic Sea Region, four countries stand out with a disparity between these two components of prosperity: Russia and Estonia in one group, and Germany and Denmark in the other. Russia (with less reliable data on hours worked) ranks top on labour mobilisation and bottom on labour productivity. Estonia is third from the top on the first measure and, respectively, third from the bottom on the other. Germany and Denmark rank 2nd and 3rd from the top on labour productivity but have the same ranks from the bottom on labour mobilisation. The other countries have more balanced rankings across the two areas, with Iceland and Sweden in the top half on both.

Labour productivity across the Baltic Sea Region, measured by GDP (PPP adjusted) per hour worked, increased by 1.4% in 2013, roughly similar to last year. This is not only lower than in 2010 and 2012, when the economy was recovering from the crisis and productivity growth was the result of increasing capacity utilisation. It is also lower than the 2.5% annual productivity growth rate average that the Region registered between 2000 and the 2008 crisis. Within Europe, the EU-8, the Danube Region, and the Iberian Peninsula saw their fast productivity growth from last year drop to levels below the Baltic Sea Region.

Within the Baltic Sea Region, Norway continues to register the highest level of labour productivity, measured by GDP per hour worked, closely followed by Germany, Denmark, and Sweden. The 2013 labour productivity growth rates were largely between 1.5% and 2.0%, with only Germany and Iceland registering much lower rates.

Labour productivity changes can be driven by changes in a worker's capital stock or skill. The part of labour productivity not explained by these two drivers is called total factor productivity (TFP). TFP is often understood to reflect the broader capabilities of using input factors efficiently; it is considered particularly important, because it becomes increasingly important as an economy's capital and skill stock reach high levels, which make further improvements harder.

The Baltic Sea Region has performed quite well on TFP growth relative to its European peers as well as key non-European OECD countries. Russia ranks highest overall, but as TFP is a re-



Source: Conference Board (2014)

sidual measure it might pick up dynamics of rising oil prices that weigh heavily in Russian GDP. The Baltics and Poland show the solid growth that one would expect for countries in catch-up mode. Latvia's very high TFP growth in the last two years is likely to reflect its recovery from the crisis. The country had relatively low TFP growth rates prior to the crisis, when capital deepening was high but largely concentrated in real estate. It now seems to be on a more robust path of productivity growth. Germany and Sweden had low positive growth rates, while Denmark and Finland registered falling TFP rates. Norway was far behind; at least one important factor might be the capital investments in the oil and gas sector that do not lead to an immediate increase in GDP. An in-depth analysis of the OECD that accounted for the impact of the oil sector found Norwegian multi-factor productivity, a comparable measure, to be higher than in Sweden, Denmark, and Finland. The same study showed Denmark exhibiting consistently falling productivity levels relative to the OECD average. The box below, with some key insights from the final report of the Danish Productivity Commission, provides further insights into this worrying trend.

Box: Productivity in Denmark – report of the Danish Productivity Commission

Prof. Anders Sørensen, Copenhagen Business School and Danish Productivity Commission

The Danish Productivity Paradox[1]

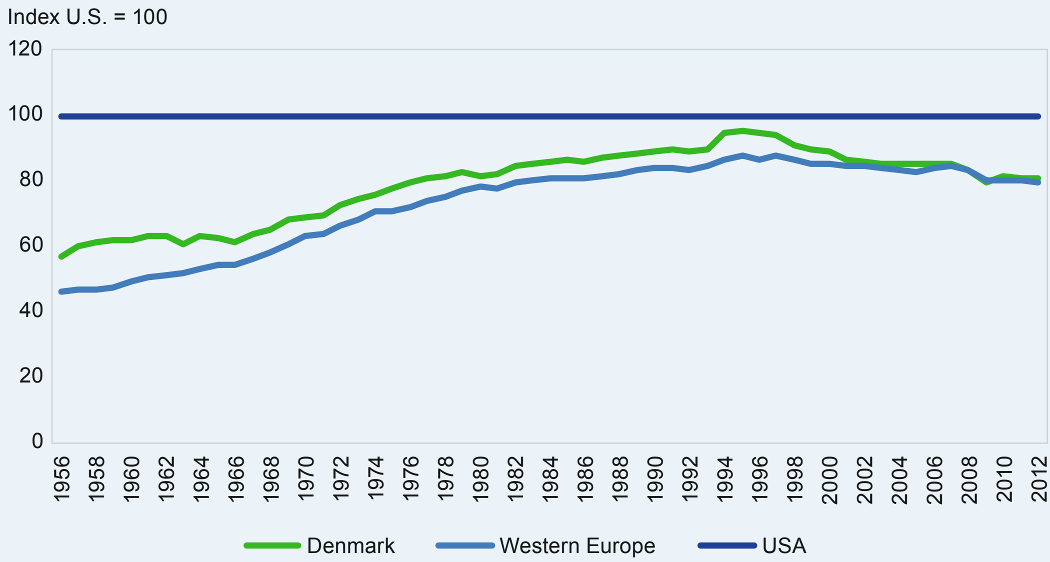
Denmark has – much like many other European economies – a productivity problem when compared to the United States. The negative development in productivity began in the mid-1990s, and Danish productivity only grew by 0.9 percent per year during the period from 1995 to 2012. In contrast, the U.S. sustained a productivity growth rate of around 1.9 percent during this period. The development is presented in Figure 1.

Danish productivity performance has also been relatively weak when compared to other European countries. In the early 1990s, the level of Danish productivity was among the highest in the European Union. Today, Denmark attains a productivity level that is fairly average in the European Union. And there are no signs of improvement.

Because of this weak productivity development, the Danish government appointed a productivity commission to analyse Danish productivity trends and to come up with specific productivity-enhancing recommendations.[2] The commission was active from early 2012 until the end of March 2014.

A key result established by the Danish Productivity Commission (2014) is that productivity growth has been weak in many service sectors.

FIGURE 1: Labor productivity in Denmark in relation to the United States and Western Europe, 1956-2012

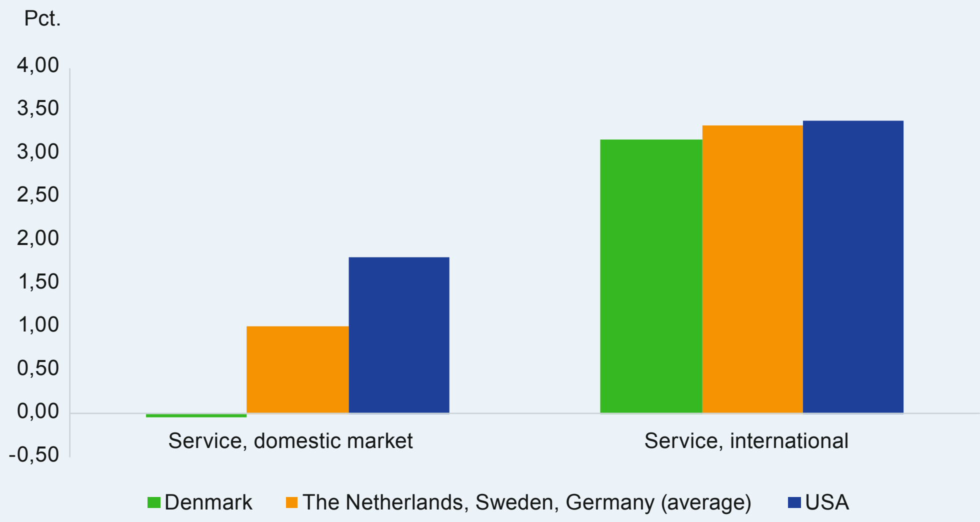


Source: The Danish Productivity Commission (2014).
Note: Western Europe includes Belgium, Denmark, Finland, France, Greece, the Netherlands, Ireland, Italy, Norway, Portugal, Switzerland, Spain, Great Britain, Germany and Austria.

1 By Anders Sørensen, Member of the Danish Productivity Commission (April 2012-March 2014), Professor, Department of Economics, Copenhagen Business School, Denmark

2 http://produktivitetskommissionen.dk/media/133600/Kommissoriet%20på%20engelsk.pdf

FIGURE 2: Productivity Growth in Service Sectors 1995-2012



Note: Average labour productivity growth. A service industry is internationaliszed if (1) if more than 25 percent of output is exported, or (2) if more than 25 percent of value added is generated by foreign- owned firms.
Source: The Danish Productivity Commission.

FIGURE 3: Productivity Growth in Denmark and USA, 1995-2012

Note: The shaded area corresponds to the additional productivity growth (average annual growth in hourly productivity from 1995 to 2012) that Denmark would have had if the private service industries had improved their productivity at the same rate as the corresponding industry in the U.S. during the period 1995-2012.
Source: The Danish Productivity Commission (2014)

This conclusion is not new and international studies have pointed out that many European countries have lagged behind the United States in the service sector, see for example van Ark et al (2008) and van Ark (2011). An important modification is, however, that this performance has been especially weak in service industries oriented towards the domestic market. This is, for example, retail trade, consulting engineers, and hotels.

This observation is illustrated in Figure 2, which presents productivity growth rates for the service sector. Growth rates are presented separately for service industries oriented towards the domestic market and service industries exposed to international competition. Specifically, service industries exposed to international competition are defined as industries in which more than 25 percent of the output is exported, or where more than 25 percent of industry value added is generated by foreign-owned firms. It is evident from this figure that productivity growth is especially low in service industries that are oriented towards the domestic market; both when compared to Danish service industries exposed to international competition and to service industries oriented towards the domestic market in other countries. It is also clear that Danish productivity growth in the service industries exposed to international competition is almost as high as in similar industries in the United States and in other European countries. It is services oriented towards the domestic market that are lagging behind.

In fact, a very large share of the productivity gap would be closed if productivity growth in domestic-oriented service sectors had been of a similar magnitude to that in the United States. If the Danish service industries oriented towards the domestic market had growth rates of a magnitude similar to that of the equivalent US services industries, the Danish productivity growth rate would have been 0.6 percent points higher. As a result, the Danish aggregate productivity growth rate would have been 1.5 percent per year, as compared to the US growth rate of 1.86 percent. This is illustrated in Figure 3. In other words, a large share of the gap in productivity growth – almost two thirds – is accounted for by weak productivity performance in services industries oriented towards the domestic market. This is despite the fact that these industries only account for a third of the Danish economy.

This weak productivity performance in domestic market-oriented services industries has resulted in a strong focus on this part of the economy by the Danish Productivity Commission. Since domestic market-oriented services are lagging behind, the potential for raising productivity here is considered to be particularly high. This has resulted in a number of recommendations from the Danish Productivity Commission with a focus on stronger competition, more internationalisation, and better regulation of this part of the economy.

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Bart van Ark (2011) "Up the hill and down again: A history of Europe's productivity gap relative to the United States, 1950-2009", in Productivity and Competitiveness, Madsen and Sørensen (eds). Nordic Economic Policy Review

Bart van Ark, Mary O'Mahony, and Marcel P. Timmer (2008) "The Productivity Gap between Europe and the United States: Trends and Causes" *Journal of Economic Perspectives—Volume 22, Number 1—Winter —Pages 25–44*

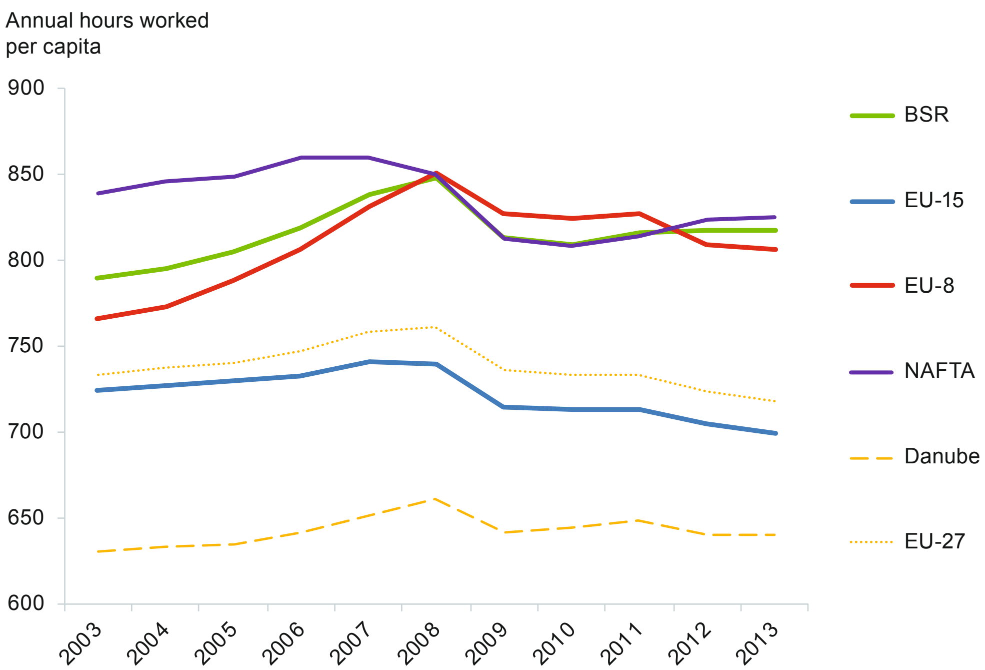
Labour mobilisation in the Baltic Sea Region, measured by annual hours worked per capita, was essentially flat in 2013, just as in the year before. The Region now ranks highest on hours worked per capita among the European regions tracked, but is still behind the NAFTA and Oceania regions.

Within the Baltic Sea Region, Russia, Iceland, and Estonia report the highest labour mobilisation rates, followed by Sweden and Norway. Lithuania, Denmark, and Germany rank at the bottom. If these countries at the bottom had labour mobilisation rates comparable to the top group, their prosperity could be 20% higher (assuming unchanged productivity rates). During 2013, Latvia, Lithuania, Iceland, and Norway registered meaningful growth in labour mobilisation. For the first three, these gains are still only starting to make up for the huge losses during the crisis years. For Norway, they are a sign of an increasingly tight labour market that is driving wage costs beyond the level of productivity gains. Germany's years of improving labour market mobilisation, interrupted only once in 2009 at the height of the crisis, seems to be petering out. The wide-spread introduction of minimum wages in Germany could put a further break on labour market dynamics.

While the Region's labour mobilisation compares well with its peers overall, it is important to note that it has ceased to be the strong contributor to prosperity growth that it was prior to the crisis. The strong gains in that period, driven by both brisk demand growth and labour market reforms, are unlikely to return anytime soon. Especially in countries like the Baltics, Finland, Sweden, and Poland, with unemployment rates of 8% or more, there should in principle be room to improve labour mobilisation. In the latter three countries, however, labour mobilisation is within 5% of the highest labour mobilisation level reached historically. The dynamism from aggregate demand is unlikely to pick up dramatically, and structural reforms will often be controversial.

Labour Utilization over Time

Selected Regions



Note: Russia data estimated at 2000 hours per employee and year
Source: Groningen Growth and Development Centre and The Conference Board (2014), authors' calculations

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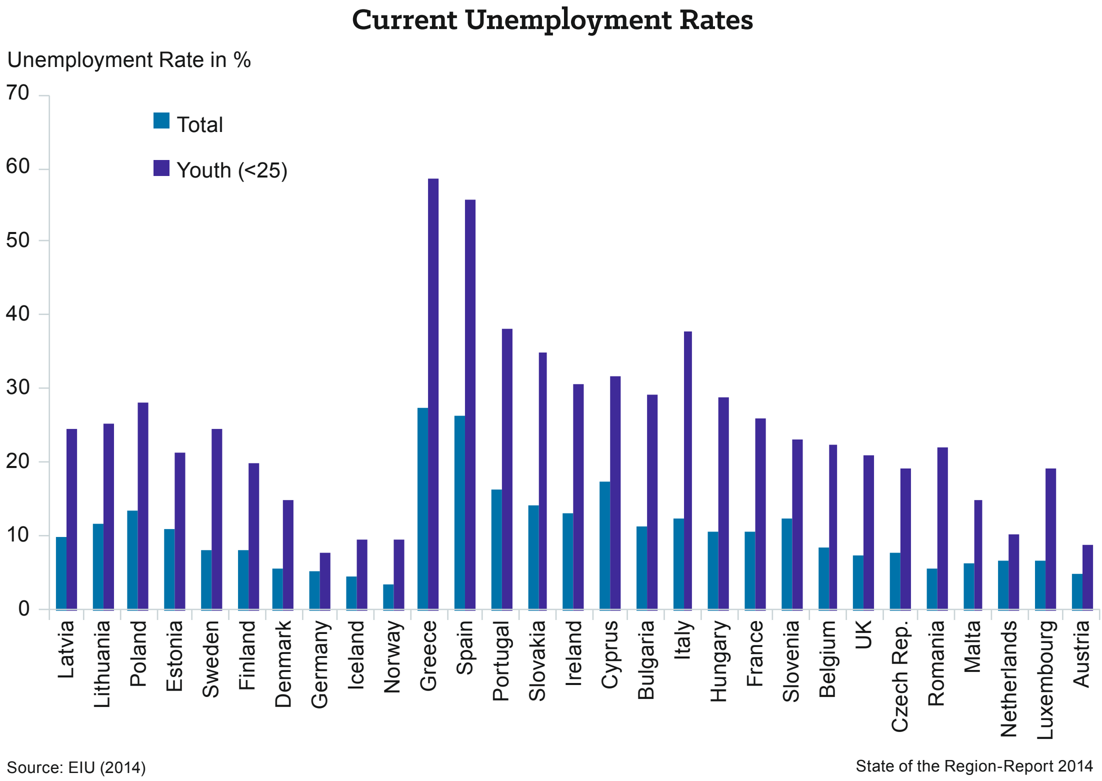


Assessment

The Baltic Sea Region continues to register solid prosperity outcomes, especially in comparison to other parts of Europe: it remains 'the top of Europe' in more than geographic terms. Its performance is more in line with that of other leading groups of countries in the OECD, like NAFTA and Oceania, than with the economically weaker parts of Europe. The Region performs, if anything, even stronger on broader measures of GDP and beyond-GDP measures of social progress. Nevertheless, issues of social exclusion exist in the Region as well. In terms of factors driving prosperity, the biggest advantage of the Baltic Sea Region relative to its European peers is its ability to combine high productivity with high labour market mobilisation, especially in the Nordics.

Despite these positive headline results, there are sobering signs that the Baltic Sea Region is entering a 'new normal' of permanently lower growth rates. The immediate push from the post-crisis recovery has been smaller and shorter-lived than in (less severe) crises of the past. Labour mobilisation, a solid source of growth dynamics prior to the crisis, has stabilised with little prospect of larger sustained gains in the coming years. Labour productivity continues to grow, but at a rate that seems to settle a good deal below pre-crisis levels. There are signs that the Region suffered not only a direct one-time loss of prosperity during the crisis years, but also an on-going loss from a permanently lower growth rate. This impact on the growth rate seems stronger than in the NAFTA region; this is why any fast convergence to the NAFTA prosperity level is unlikely. But it is much less pronounced than in most other parts of the EU, where prosperity levels are barely rising. What seems to weigh more heavily on the European economies is uncertainty about the future, which reduces investment and growth dynamics by more than in the US and its neighbouring economies.

The Baltic Sea Region is a highly heterogeneous region, with highly prosperous countries in the Nordics and much less prosperous ones in the Baltics. These differences remain large but there are clear signs of convergence. This catch-up process has been highly visible since the mid-1990s, was interrupted by the crisis, and is now back, albeit at a slower pace than before. While other less prosperous parts of Europe seem to be stuck in a post-crisis growth hiatus, the Baltics in particular seem to have returned to a path of solid prosperity gains.

2 Intermediate indicators of economic activity

Prosperity is created when competitiveness fundamentals give rise to economic activities that ultimately result in wealth. These economic activities change relatively rapidly, reflecting short-term changes in the overall economic climate. But they also contain information about longer-term structural changes that provide insights into competitiveness and prosperity potential. This section includes an analysis of five groups of intermediate indicators of economic activity to gain insights into the underlying competitiveness of the location.

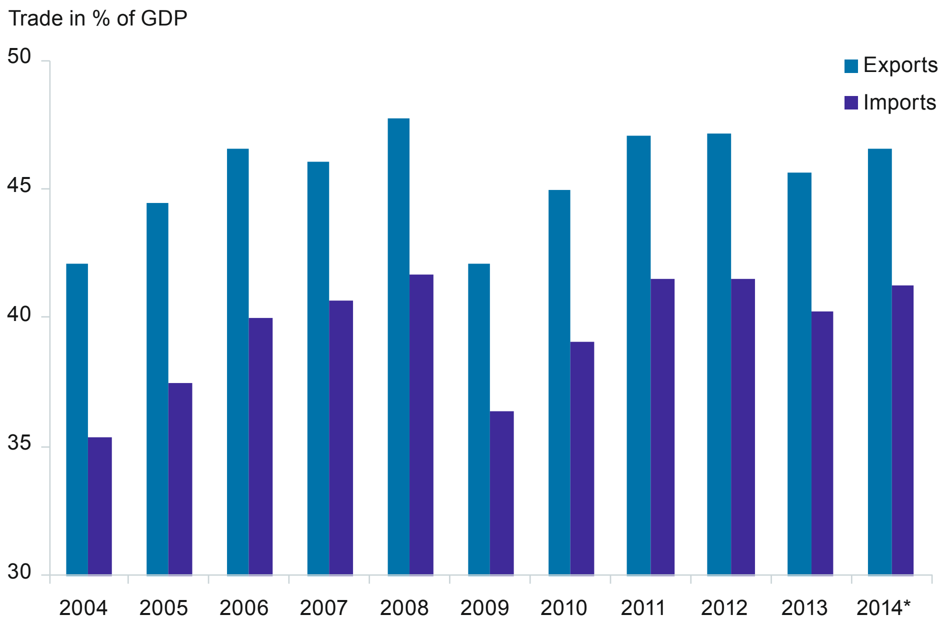
Trade

Small open economies with high levels of trade intensity (the ratio of exports and import values relative to GDP) dominate the Baltic Sea Region. Total trade is forecasted to reach 88% of GDP in 2014. This is still about 1.5 percentage points below the high point reached right before the recent crisis in 2008 but ahead of the historical averages. Actual 2013 trade intensity turned out to be a good deal lower than forecasted at this point last year; trade dynamics have overall not been as strong as expected. It is also interesting to note that, at least among the OECD countries and accounting for country size, the trade intensity of the Baltic Sea Region is only average: only Germany and Estonia register higher than predicted trade intensity whereas Iceland and Norway have comparatively low overall trade. The overall trade surplus of the Region dropped slightly, to 5.3% of GDP, a tad lower than right before the crisis in 2008 and the lowest level reached until now over the past 15 years.

Total world trade grew by less than 3% in 2013, compared with the roughly 15% annual growth rate in the five years prior to the crisis. This has led many observers to question whether we can expect a return to growth in world trade that far outstrips the growth of global GDP, or whether this dimension of globalisation has entered into a phase of much slower development.

The total value of exports from the Region in 2013 (including cross-border trade within

Trade Intensity of the Baltic Sea Region

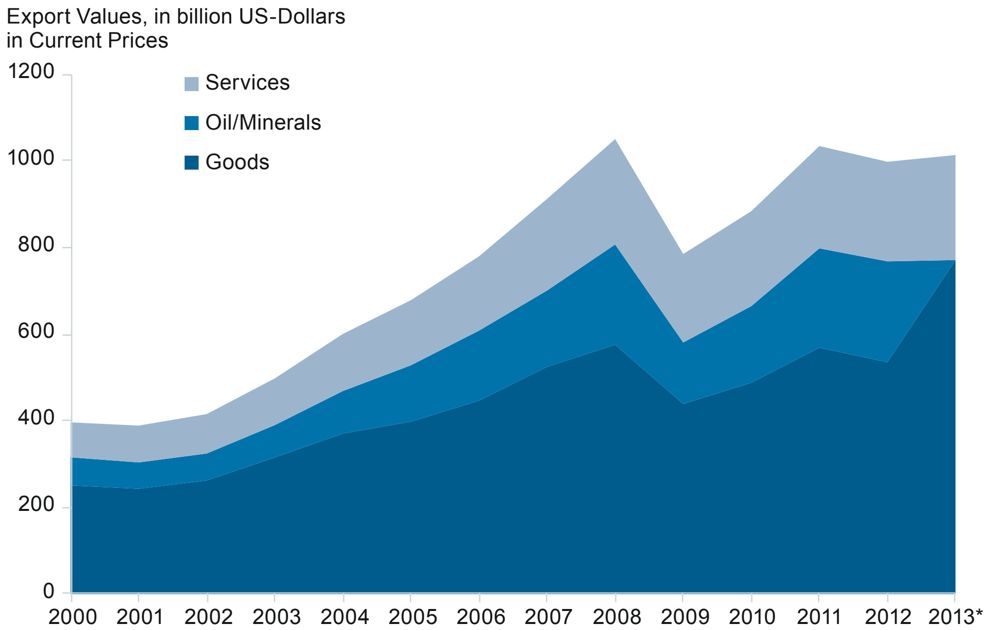


Source: EIU (2014) State of the Region-Report 2014 the Region) reached slightly more than $1trn. This was an increase of about $15bn relative to 2012; positive, but modest in view of the trade contraction in 2012 (-$36bn). The longer-term trends support the view suggested by the data on trade intensity: the period of fast export growth seems to be over, with trade stabilising at a much higher level before the dramatic growth in world trade that occurred between 2002 and 2008.

The Baltic Sea Region is more oriented towards service exports than both the EU-27 and the world economy overall. But even for the

Baltic Sea Region Exports

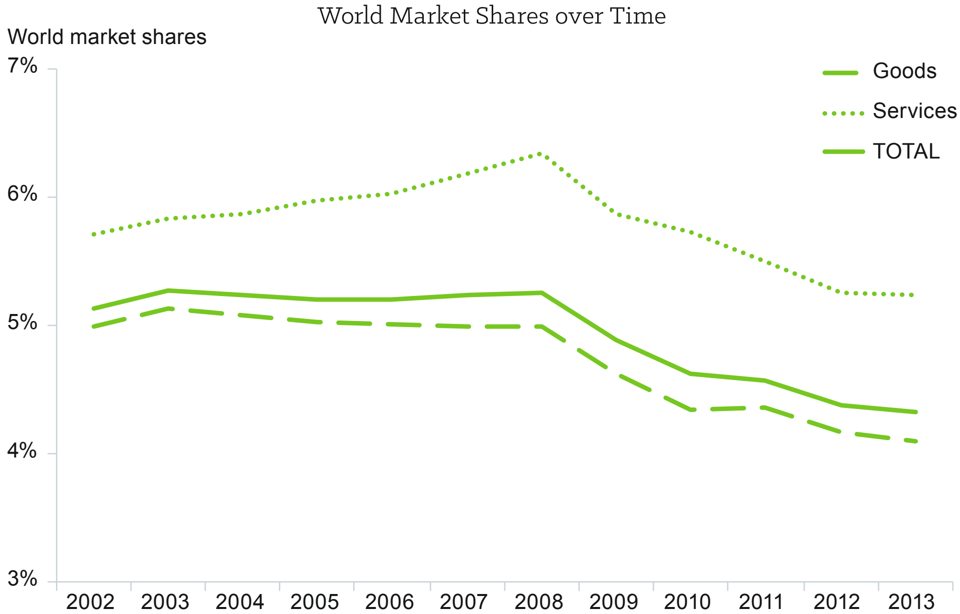
Total Value over Time



For 2013 the WTO has so far published only aggregate goods exports, not a breakdown by sectors including oil and minerals
Source: WTO (2014) State of the Region-Report 2014

Baltic Sea Region Exports

World Market Shares over Time



Source: WTO (2014) State of the Region-Report 2014

Baltic Sea Region, goods trade continues to be about three times as large in terms of overall value. The breakdown by product groups (here the data are available only until 2012) also shows the significant role that national resource exports play for the Baltic Sea Region. In 2012 oil, gas, and minerals accounted for 23% of total Baltic Sea Region exports (30% of goods exports), compared to 15% (19%) a decade ago. Note that these figures continue to include only 10% of Russia's exports, capturing the relative share of the north-western region in the overall Russian economy. For the global economy, natural resources accounted for 18% of trade volume in 2012 versus 8% in 2002.

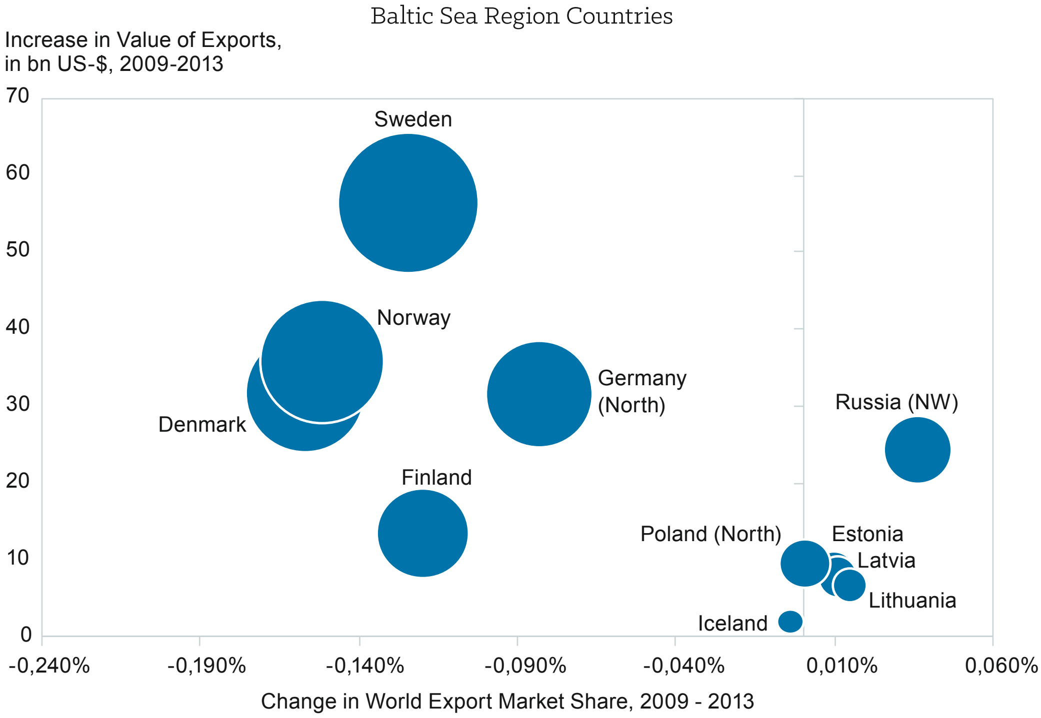
The Baltic Sea Region has continued to lose global market share in 2013. While trade volumes have improved slightly, world trade overall has strengthened more. Much of this has to do with stronger trade dynamics within Asia and in so-called South-South trade outside the traditional OECD economies. Slow overall GDP growth in Europe has, in the meantime, limited the trade opportunities in many of the Baltic Sea Region's traditional markets. Excluding natural resource exports from the analysis, the Baltic Sea Region's world market share would have been lower, about 0.4 percentage points lower, for goods. This gap has increased somewhat in 2012 and has been fluctuating between 0.36 and 0.43 percentage points over the last decade.

The speed of market share loss has slowed down, and is much lower than in the 2009/2010 crisis years. While these latest trade figures are consistent with a structural loss of market position by the Baltic Sea Region, it is very likely to also be affected by the temporary impact of the slowdown in Europe, still by far the Baltic Sea Region's largest market.

Looking back at the trade recovery that occurred between 2009 and 2013, all Baltic Sea Region were able to register healthy increases in export values. Sweden, the largest economy and exporter in the Region, last year exported about $60bn (or 30%) more than in 2009. But all of the advanced economies have lost market share, with the larger Nordic countries hurt the most. In contrast, Russia and the Baltics registered market share gains. For Russia and Norway, develop-

Export World Market Shares Over Time

Baltic Sea Region Countries



Note: Bubble size reflects absolute export value in 2013
Source: WTO (2014)

ments on global oil and gas markets have played an important role: roughly 70% of Russia's and 95% of Norway's growth in export value between 2009 and 2012 was accounted for by the growth of natural resources exports.

The analysis in previous editions of this Report has shown that outside of oil and gas, the following sectors dominate exports from the Baltic Sea Region: metals and metal manufacturing, automotive, business services, logistical services, forest products, and production technology. The Region has the highest revealed comparative advantages in fishing products, forest products, furniture, containers, marine equipment, and power generation equipment. The largest market share gains over the last decade were made in power generation equipment and fishing products. The largest market share losses were registered in marine equipment and communication equipment, followed by forest products and bio-pharmaceuticals. Previous analysis also showed the concentration of exports on neighbouring countries, a pattern not specific to the Baltic Sea Region.

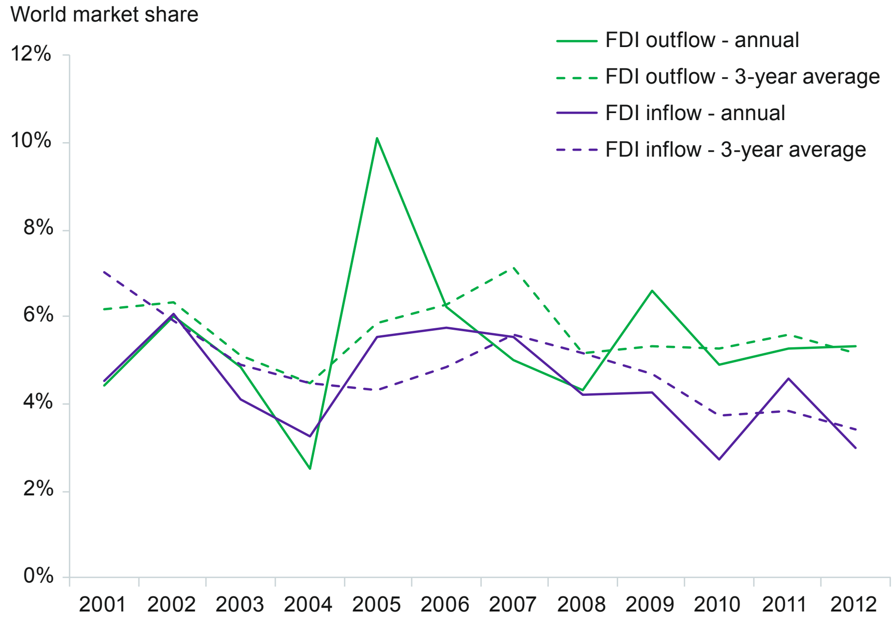
Foreign Direct Investment

Foreign direct investment (FDI) continues to be an important way through which the Baltic Sea Region participates in the global economy. The international FDI databases, maintained by UNCTAD, cover data up to 2012, one year less than most other statistics used in this Report.

The Baltic Sea Region continues to be an important source and destination of foreign direct investment, accounting for about 5.25% of global inward and outward FDI stocks. In terms of the more volatile flows, there are indications of a gap opening up between outward and inward flows; while investors from the Region increase their foreign engagement in line with the global market, more of these flows are going into other parts of the world economy. The value of the outward FDI stock is holding up better, which could be a signal of positive performance by operations abroad owned by owners from the Baltic Sea Region. But the trend is troubling for a Region whose performance relies on its close integration into global value chains.

Within the Baltic Sea Region, Sweden and

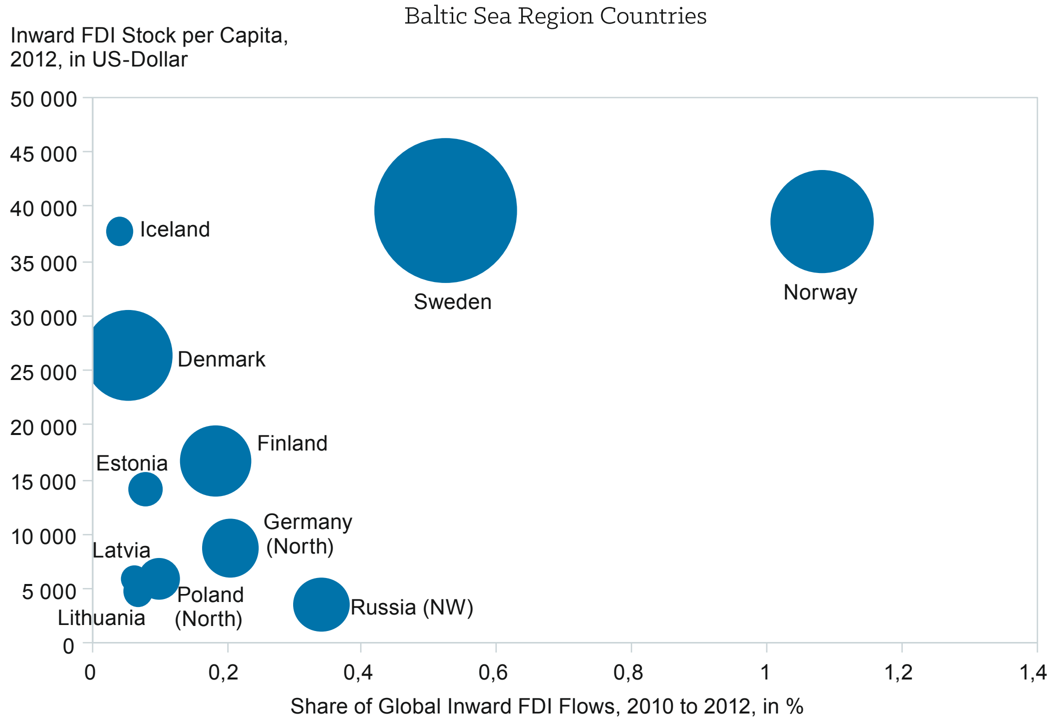
Baltic Sea Region FDI Flows



Source: UNCTAD (2014), author's analysis. State of the Region-Report 2014

Inward FDI Position over Time

Baltic Sea Region Countries



Note: Bubble size reflects the 2012 world market share in the global inward FDI stock.
Source: UNCTAD (2014)

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Norway are the most important recipients of FDI. Swedish inflows increased substantially between 2010 and 2012, and the country has the highest per capita inward FDI stock in the Region. Norway has been gaining ground, with more stable inflows over time. Denmark still ranks high on inward FDI intensity but has been struggling recently to attract new inflows. Estonia continues to outperform its Baltic peers in attracting foreign investment.

Domestic Investment

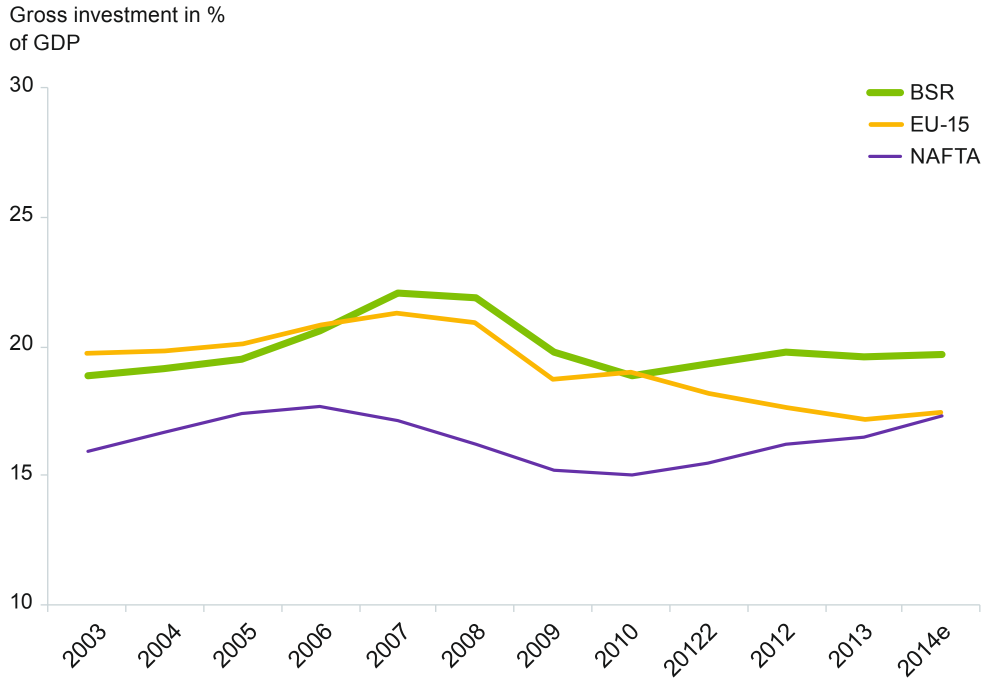
Investment remains an important way to improve productivity. Higher capital intensity is one important factor, and changes in technology and operational practices driven by new equipment are another. The share of capital investments tends to be high when countries still have a relatively modest capital stock, but have created conditions in their economies where the profitability of adding new equipment is high. For more advanced economies, investment in what the OECD has started to call 'knowledge-based capital' is then gaining importance relative to the physical capital stock. Knowledge-based capital includes, for example, intellectual property, data, and specific competencies.

The Baltic Sea Region rate has seen a slight decrease in investment rates in all countries except Norway. This was lower than expected, and saw the Region align closer to the low investment dynamics of Europe rather than North America. Here, too, the plateauing of the recovery is showing its effects. Investment is not only at a modest level generally, but especially low for this phase of a post-crisis recovery where a share of investment in GDP at about 4 percentage points higher than the current level would be normal.

Data on knowledge-based capital (KBC) has been provided by the OECD only until 2010, and for a smaller set of countries. In the Baltic Sea Region, Sweden seems to have the highest ratio of knowledge-based to physical capital investment, at about 0.9. For comparison, the US has a ratio of 2.0, i.e. twice as much investments are made into KBC than physical capital. Denmark, Finland, and Germany follow not far behind,

Domestic Investment over Time

Selected Regions



Source: EIU (2014) State of the Region-Report 2014

between 0.75 and 0.9. Only Norway, for which the latest data is from 2005, ranks much lower, at less than 0.5. While this is driven by lower R&D spending relative to GDP, it is also driven by the effect of the oil sector on capital investments and total GDP.

Innovation

Creating new knowledge, new knowledge-based capital, and ultimately new products, services, and ways to provide them to consumers is critical for future value generation. Innovation, upon which productivity growth is based, stretches from academic invention to new patents and, ultimately, new types of business activity. While many of the indicators used to track innovation are biased towards academic research, they still contribute to the understanding of the competitiveness profile of a location. The EU's Innovation Union Scoreboard provides a broad range of data on innovation outcomes. While the data come with a time lag (depending on the indicator, the latest data now available are from the period between 2009 and 2012), the time series indicates that the outcome patterns are highly stable over time.

The Baltic Sea Region (excluding Russia) excels in patenting intensity, which is strong both relative to population size and to the size of the economy. This is the case for patenting in general but also for patents in areas related to what the EU calls 'societal challenges', here largely issues related to energy efficiency and the environment (not included in the table). It also ranks well on highly cited publications, a measure of scientific outcome in areas less driven by patents. The Region does, however, do less well on innovative business assets and the share of SMEs that are innovative. This pattern is most visible for the Nordic countries but less so for Germany, the country in the Region that ranks highest overall on innovation outcomes.

Innovation Outcomes

Baltic Sea Region Countries

	Science		Business Assets		Business Action
Ranking among 34 European countries	Highly Cited Publications	Patenting	Trademarks	Designs	Innovative SMEs
Germany	8	4	7	4	1
Sweden	6	1	8	9	6
Denmark	3	5	9	3	13
Finland	12	1	12	10	11
Estonia	19	15	6	12	9
Iceland	9	13	23	24	2
Norway	9	10	30	29	20
Poland	28	26	25	11	33
Lithuania	23	28	24	26	28
Latvia	33	25	22	21	32

Source: Innovation Union Scoreboard (2014), author's analysis.

Assessment

The current pattern of the Baltic Sea Region's performance on intermediate indicators of economic activity reflects a combination of longer-term structural trends and shorter-term cyclical factors.

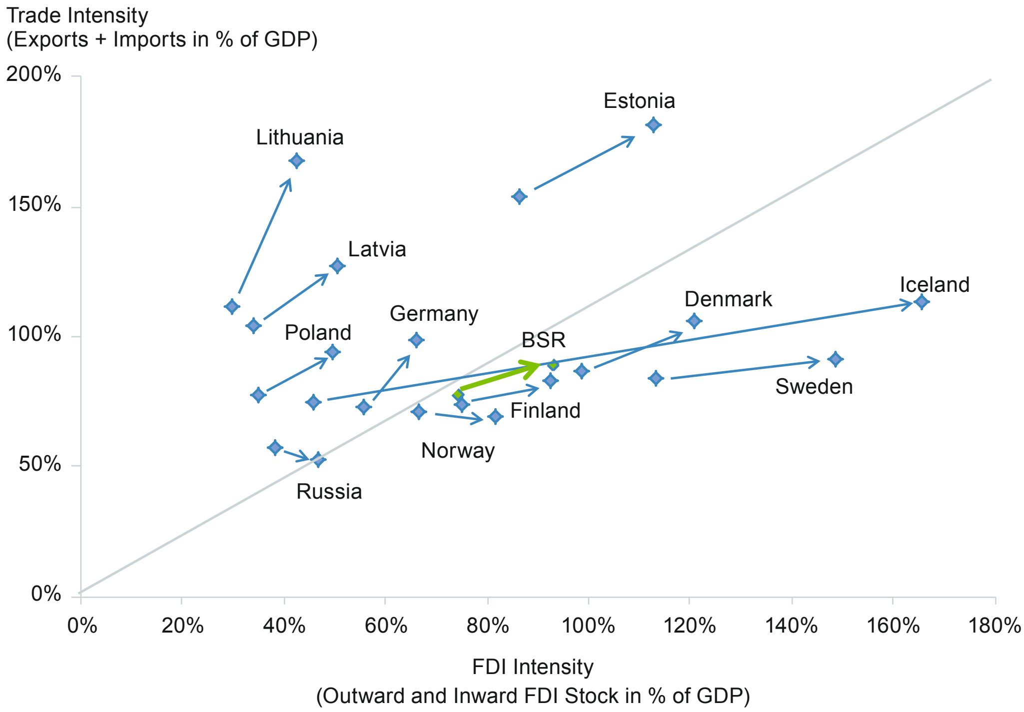
Trends in **trade and foreign direct investment** will, over the medium term, be driven by the competitive profile of the economies of the Baltic Sea Region, but also by broader trends in the next phase of globalisation. First, the data suggest that the Nordic countries are moving towards an FDI-driven internationalisation model, while the Baltics, Germany, and Poland remain more focused on a trade-driven model. As was discussed in previous editions of this Report, the FDI-driven model fits for economies that have strong innovative capacity, but are less attractive as a location for manufacturing activities. Trade-driven economies are able for either both innovation and production, or are positioned as production hubs as either suppliers or integrators.

Second, there are also trends in the global economy that will affect the Region. The shift of economic activities to Asia, a natural result of the region's size and economic dynamism, will reduce the relative size of the Baltic Sea Region economy. And many observers argue that world trade will grow less briskly overall than it did in the past, driven by an end to further trade liberalisation and falling transportation costs. Together these two factors indicate that it will be more difficult for the Baltic Sea Region to leverage globalisation as a key driver for its growth.

Trends in **investment and innovation** will, over the medium term, be driven by the continued transition to a knowledge-driven economy. Investment in physical capital remains important to embody new knowledge and technologies in the production process as well as in increasing the capital stock for economies in catch-up mode. But it is an increasingly noisy indicator for knowledge-driven economies where companies invest in knowledge-based capital, i.e. intellectual property, organisational capital, and other types of knowledge assets like brands, trademarks, proprietary databases, etc.

Modes of Internationalization

Baltic Sea Region Countries, 2004 - 2012



Source: EIU(2014), UNCTAD (2014)

State of the Region-Report 2014

The Baltic Sea Region is generally well-positioned to succeed in the transition towards increasingly more knowledge-driven economies. Physical investment is more stable than elsewhere in Europe, which is critical for the parts of the Region that are catching up. Investment in knowledge-based capital is also solid; here the data are still more fragmented but the available information suggests that the Region is ahead of most of its European peers in this regard as well. But there are challenges ahead for the Region as well: business R&D spending relies heavily on a small number of large companies; here the trend has recently been downward in Sweden, the Region's largest R&D spender. And successful innovation processes increasingly engage large numbers of small and large companies and research organisations; enabling collaboration within these innovation ecosystems will require adjustments in policies and programmes, in the Baltic Sea Region as well as in many other economies.

3 Competitiveness fundamentals

Prosperity outcomes and economic activity as measured by intermediate indicators are ultimately driven by the competitiveness fundamentals of an economy. The complex mix of fundamentals can be organised in two broad categories: macroeconomic and microeconomic factors. Macroeconomic factors set the general context for firms but do not affect productivity and innovation directly. This group includes both the quality of social and political institutions and the quality of macroeconomic policy. Microeconomic factors have a direct impact on the productivity with which companies can transform inputs into economic value. This group includes the quality of the business environment, the presence and dynamism of clusters, and the sophistication of companies.

Overview

The Baltic Sea Region remains a highly competitive part of the European and global economy. Finland and Sweden top the global rankings of an aggregate measure of competitiveness fundamentals based on the WEF Global Executive Opinion Survey data.[1] Norway follows in fifth place, with Denmark and Germany in places 11 and 12. Estonia (25th) and Iceland (30th) mostly kept their positions, which put them close to economies like France, Chile, and Korea. Latvia (40th) made a more significant jump to now rank ahead of Lithuania (41st). Poland (50th) has dropped slightly, and is now more clearly behind the Baltic counties. Between them are economies like China, Turkey, and South Africa. Russia continues to come in last in the Region, but has moved up significantly, to now be ranked 88th globally, with an overall level of competitiveness slightly below Kenya and Romania.

Overall, the countries of the Baltic Sea Region can easily sustain their prosperity, given their level of competitiveness. The Nordic countries might be able to create more prosperity, while for Russia the prosperity, even at its current level, is to a significant degree supported by natural resources rather than the quality of the country as a place to do business. Norway also benefits from its oil and gas assets but has, over the last few years, been able to also improve its competitiveness significantly.

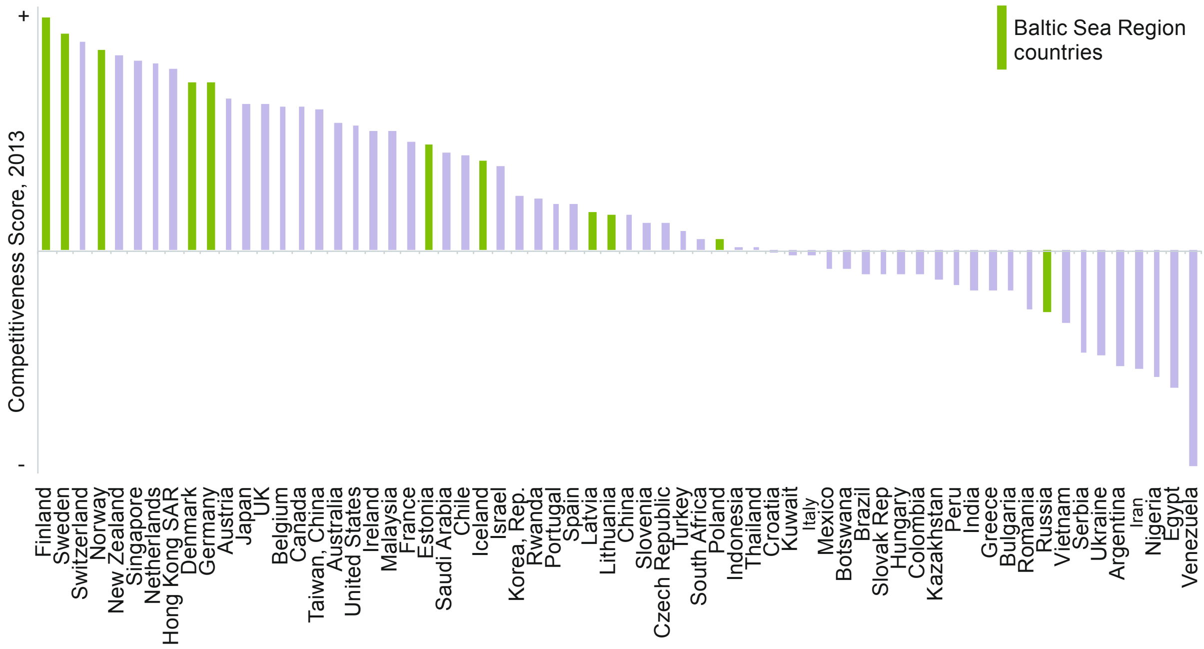
In the top group, Finland retained its position as the most competitive economy in the world. This is an impressive but also somewhat puzzling achievement. The economic climate in the country is clearly stressed: its global champion Nokia has lost much of its former size and core business, and the concerns about the future path of the economy are widespread. At face value, the competitiveness data should provide some confidence that the country will bounce back once it has overcome the current challenges that are more macro-economic or individual firm-specific. But the concern remains that the survey data were collected before the sale of Nokia's handset division and the further slowing down of the economy.

Sweden ranks 2nd, regaining most of the ground that had been lost the year before. The absolute changes are small and seem at least in part driven by some changes in the WEF's survey structure. Nevertheless, there is little doubt that the overwhelming impression of the aggregate data is one of a highly competitive business location. Norway gained one rank relative to last year, with very small changes overall. Denmark was able to halt its slide in the ranks and regained some of its position to now be ranked 10th. Still, the rankings of business environment conditions are significantly below their historical position before the crisis. And the macroeconomic policy ranking shows further challenges ahead. Germany dropped out of the top ten, with the moderate deterioration most visible in its level of microeconomic competitiveness. It remains to be seen how the recent policy changes of the government, especially in relation to the labour market and to social security systems, will influence this assessment in the future.

1 The latest available data have been collected in the first half of 2013. We use the country averages for that year and to perform the aggregation we use the method outlined in Delgado, Mercedes, Christian Ketels, Michael Porter, Scott Stern (2012), The Determinants of National Competitiveness, NBER Working Paper.

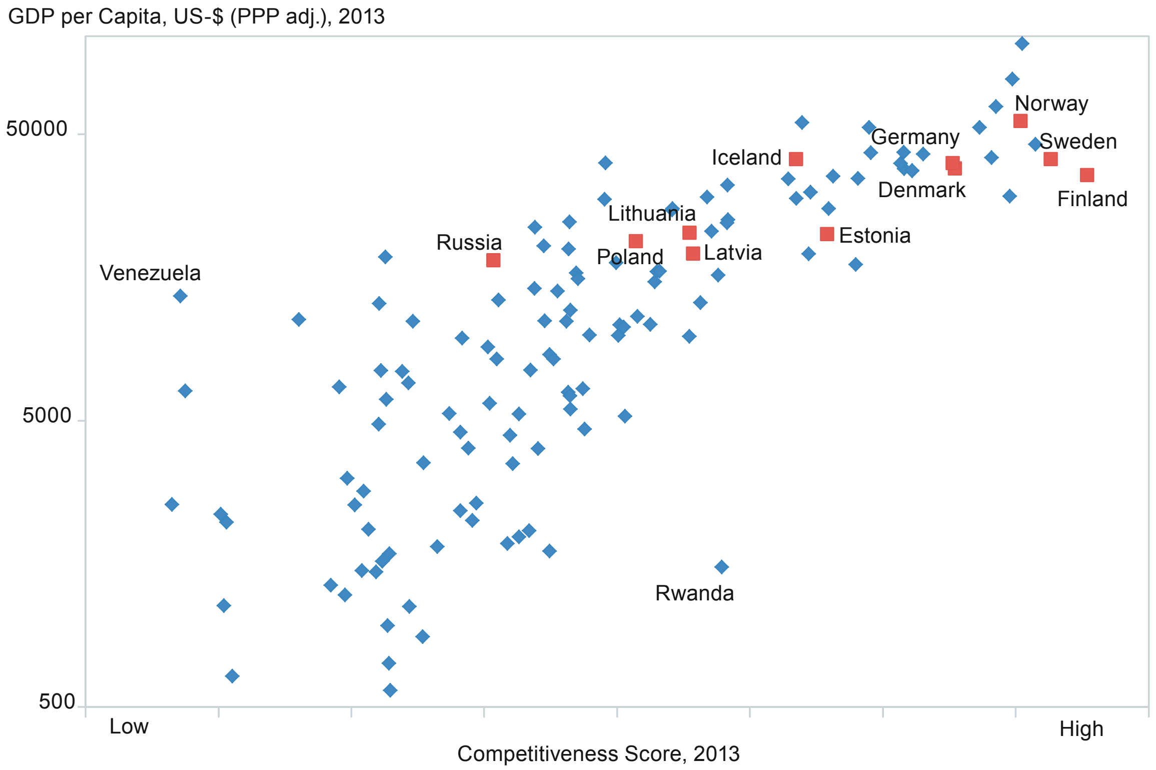
Overall Competitiveness 2013

Selected Countries



Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis. State of the Region-Report 2014

Overall Competitiveness and Prosperity, 2013



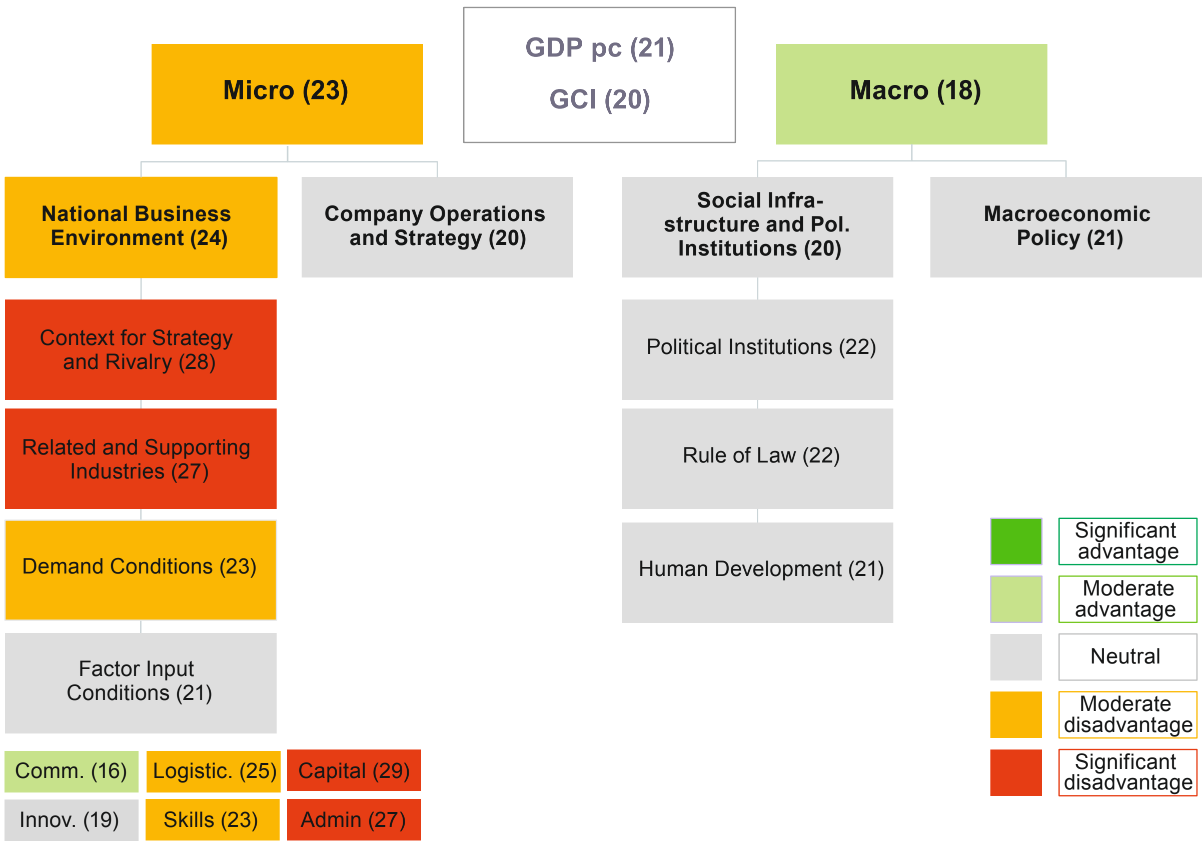
Source: Delgado et al, based on data from the WEF Global Competitiveness Report State of the Region-Report 2014

In the following group of countries, Estonia's position remained unchanged overall, but the trend, especially for business environment conditions, was positive. Iceland was also stable but showed few positive signs, outside of the successful macroeconomic consolidation. Latvia continued its impressive rebound. Its rank has now surpassed the pre-crisis level and matches the strongest prior position registered in 2003. Improvements were shown across all dimensions of competitiveness. Lithuania saw improvements as well but the speed of change was not quite as high as for its Baltic neighbour. Poland then follows at some distance. The small loss of position across all dimensions is not remarkable in itself, but it has pushed the country further away from the positive perceptions it had gained as an island of resilience during the crisis.

Russia continues to rank a good deal behind its Baltic Sea neighbours. But the 2013 competitiveness data was a remarkably improvement relative to prior years. Gains were registered in many dimensions of competitiveness which points towards a broader, more positive assessment of the quality of the location rather than the impact of a few targeted policy changes. Such across-the-board changes, which we have also seen in other countries in the Region, can be driven by a more fundamental change in policy or reflect a more temporary improvement in the business climate. The business climate in Russia has significantly worsened since the currently available data was collected in early 2013. Growth was already faltering before the outbreak of the Ukraine-crisis. Since then, capital flight and heightened political uncertainty have made matters worse. It will remain to be seen how business leaders assess the competitiveness of the country in the on-going wave of surveys.

In aggregate, the Region has retained its rela-

The Baltic Sea Region's Competitiveness Profile 2013



Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis. State of the Region-Report 2014 tively balanced portfolio of strengths and weaknesses. Macroeconomic competitiveness, an area where the Region made gains both short-term and relative to 2008, continues to be a relative strength. The assessment across the different elements of this area has become more balanced; political institutions improved the most and had been the relative weakness before. Microeconomic competitiveness improved as well but continues to lag behind somewhat. Here, company sophistication ranks consistently higher than business environment quality. The context for strategy and competitiveness, as well as the presence of related and supporting industries, remain relative challenges but have improved as well.

Macroeconomic competitiveness: Institutions

The Baltic Sea Region gets traditionally solid marks on the quality of its institutional structures, a position that has according to the 2013 been further strengthened. It now ranks very similarly across the different components of social infrastructure and political institutions, following more significant improvements in the assessment of the rule of law and political institutions. Institutional structures have been shown to be critical for longer-term development trends because they shape the context in which policies that directly drive macro- and microeconomic conditions are shaped. Such institutions include laws, accepted practices, and the broader architecture of government and politics. Their formal underpinnings tend to change only rarely and their actual processes only slowly in between times of broader realignment. But the public perception of their quality as it is captured in the WEF's leader survey can change more quickly in response to individual incidents.

Within the Region, there continues to be a high degree of heterogeneity in terms of institutional quality. The larger Nordic countries and Germany are all in the top ten; Sweden and Norway among the top five and Denmark and Germany, both at the bottom of this top group, have switched position relative to last year. Sweden and Denmark both benefited from their rankings on the rule of law and political institutions again after deteriorations last year. Iceland and then Estonia are next, both close to the regional average. In the following group both Lithuania and Latvia have made significant steps ahead, especially in the assessment of political institutions. Poland's

Social Infrastructure and Political Institutions

Ranking of Baltic Sea Region Countries, 2013

	Finland	Sweden	Norway	Denmark	Germany	Iceland
SIPI	**1**	**3**	**4**	**9**	**10**	**18**
Political institutions	1	2	4	9	11	24
Rule of law	1	4	5	10	16	14
Human development	4	13	11	15	7	12

	BSR	Estonia	Lithuania	Latvia	Poland	Russia
SIPI	**20**	**24**	**40**	**41**	**47**	**81**
Political institutions	22	20	47	50	66	80
Rule of law	22	22	44	43	41	90
Human development	21	31	40	44	47	60

Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis.

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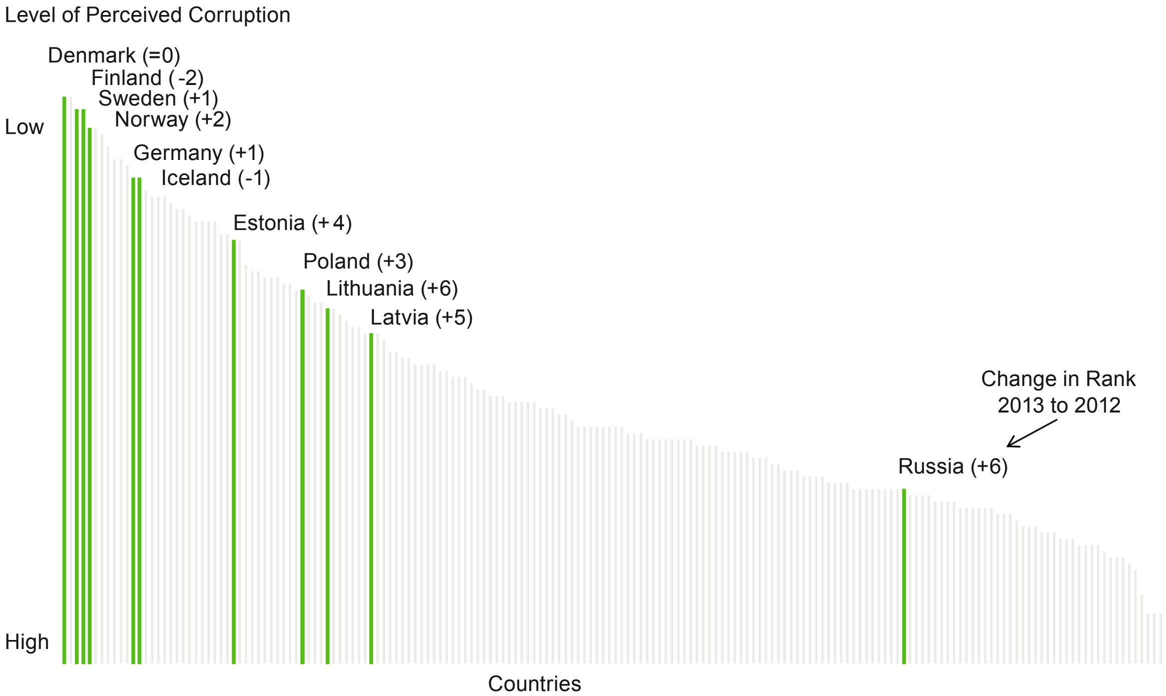
Corruption Perception Index 2013



Source: Corruption Perception Index (2013)

position has remained unchanged but is now relatively further behind its Baltic neighbours. Russia continues to rank, by far, as the lowest in the Region, but has made the most dramatic gains. Its rankings on the rule of law and political institutions have improved by a staggering 14 and 21 ranks, respectively. For political institutions, this might to some degree still represent a return to normality after the especially poor values in 2011 around the time of the Presidential election. But it is still an overall somewhat surprising result, given the news out of Russia.

An important indicator of institutional quality is the presence of corruption. The pattern revealed in the WEF executive opinion survey data is reflected here as well: here, the Nordic countries and Germany are among the global leaders; the rest of the Region is more heterogeneous, with Russia lagging far behind. Pretty much all countries in the Region made small gains compared to the previous year; only Finland and Iceland saw a marginal drop in rank.

Macroeconomic competitiveness: Macroeconomic policy

The Baltic Sea Region's solid overall macroeconomic policy has been one of the key assets it was able to build on in its robust response to the global economic crisis. Robust fiscal policy and low inflation are conducive to strong long-term economic performance. Short-term changes in macroeconomic indicators are, however, driven much more by the current macroeconomic climate, as analysed in Section A of this Report. Effects on competitiveness materialise more slowly, as short-term events slowly change the expectations about longer-term fiscal and monetary conditions in an economy.

The underlying monetary policy regimes differ significantly across the Region. Germany, Finland, Estonia, and, since the beginning of 2014 Latvia as well, are part of the Eurozone, where the European Central Bank (ECB) sets monetary policy based on an inflation rate target of 'below, but close to, 2% over the medium term.' Denmark and Lithuania set monetary policy to keep the exchange rate to the Euro stable, essentially shadowing ECB policy. Denmark and Lithuania remain officially committed to joining the Eurozone at some point, with Lithuania targeting a 2015 entry. Iceland, Poland, Norway, Sweden and Russia follow different versions of inflation targeting, using slightly different targets and inflation measures. Iceland has buried it plans to join the EU and with it the Eurozone. In Poland the Prime Minister has recently announced that while joining the Eurozone remains his long-term objective, it will not be targeting it directly 'for the next several years.' Sweden has, in the recent past, seen an on-going debate inside and outside of the Central Bank between those that argue for more restrictive monetary policy to address rising real estate prices and those that see a need to ease policy in order to strengthen an economy with low inflation and significant unemployment. Joining the Eurozone is not on the short-term political agenda, and a commitment to staying outside has even been made in the current campaign for the European parliament by one of the parties in the governing coalition. In Russia, a change in the leadership of the Central Bank in June 2013 has not led to any major policy changes. Recently, the Central Bank unexpectedly raised its key policy rate in a move to stem the massive capital outflows and pressure on the Russian currency that has built up in the context of the Ukraine crisis.

Macroeconomic policy conditions remained broadly positive in this second year of modest positive growth. In terms of fiscal policy, the slow growth, coupled with the still difficult labour market conditions in some countries, has put pressure on budgets. But only Sweden saw a more expansionary fiscal policy stance, while most countries continued down the path of fiscal consolidation. Related to the debate about monetary policy, there are discussions as to whether Sweden's surplus target for fiscal policy should be amended. Government debt increased somewhat in Finland and Sweden. The Baltic Sea Region, including the countries with currently somewhat more expansionary policies, remains in much better fiscal shape than its peer regions. In terms of monetary conditions, inflation rates fell further, reflecting the modest pace of overall economic expansion. A few countries in the Region, especially Sweden, have registered very low inflation rates, triggering a discussion about the possibility of the country heading into a deflationary trap. For next year, however, the forecast indicates slightly rising inflation rates in line with an economy slowly gaining some more momentum.

Macroeconomic Policy Indicators 2013

	Denmark	Estonia	Finland	Germany	Iceland	Latvia	Lithuania	Norway	Poland	Russia	Sweden
Fiscal Policy											
Government budget balance (in % of GDP)	-0.30	0.30	-2.20	0.10	-1.70	-0.10	-1.70	13.00	-0.10	-0.50	-1.40
Government debt (in % of GDP)	44.80	9.10	56.40	79.60	128.60	39.00	40.00	32.60	48.00	8.10	41.30
Monetary Policy											
Inflation (annual change in %)	0.80	2.90	2.20	1.60	3.90	0.00	1.20	2.30	1.10	6.80	-0.10

	BSR	EU27	NAFTA
Fiscal Policy			
Government budget balance (in % of GDP)	1.26	-3.08	-3.90
Government debt (in % of GDP)	43.44	81.85	71.90
Monetary Policy			
Inflation (annual change in %)	2.00	1.80	1.70

Source: EIU (2014), author's calculations

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Microeconomic competitiveness: Business Environment Quality

Business environment quality captures a large number of individual aspects that interact in complex and often sector-specific ways to provide value for companies. Michael Porter's diamond, a conceptual tool that has its 25th anniversary next year, organises these many aspects into a more transparent structure. One of its main innovations was to focus on the breadth of factors and the complex interaction among them, rather than to search for one single 'silver bullet' that every location could rely on to enhance its quality as a place to do business.

The Baltic Sea Region has always provided a relatively balanced set of qualities across the different dimensions of the business environment. The latest data from the WEF survey in early 2013 and other assessments published in the course of the last year confirm this view. This balance has been a strength as well as a weakness: it provides generally good conditions for all companies to reach high levels of productivity and was a significant competitive asset when other locations where far behind on many aspects of business environment quality. But it also communicates less of a specific advantage to individual sets of sectors, economic activities, and firms, especially as other countries have reduced the gap on overall business environment quality. The Region and the individual countries within it might want to think more about their strategic positioning in the future.

Physical infrastructure (Logistical, Communication, Energy)

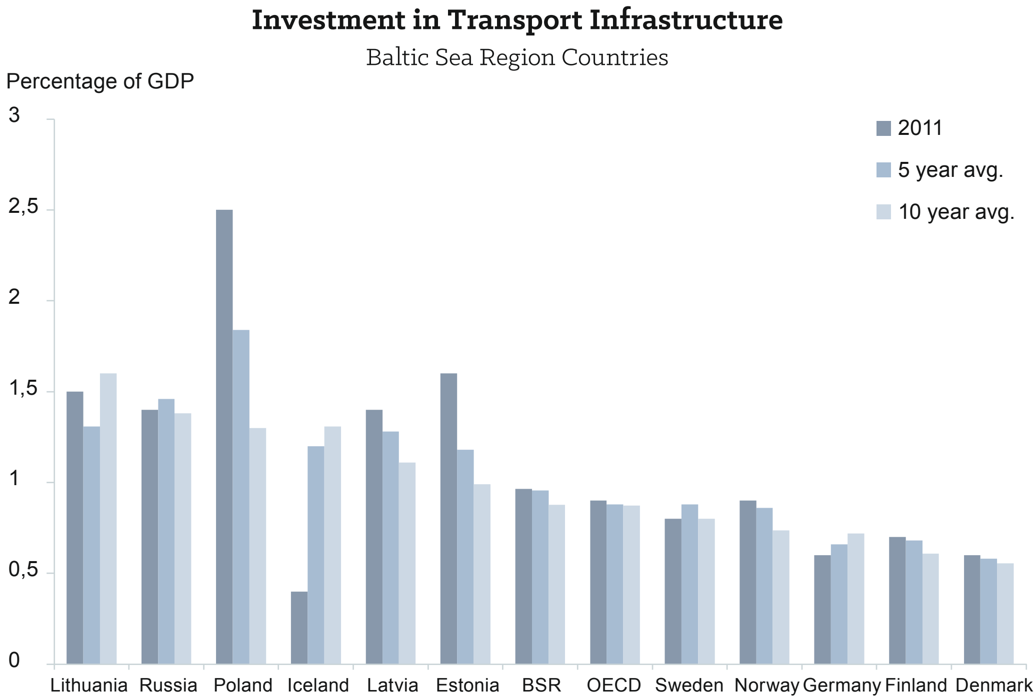
Physical infrastructure overall remains solid across the Baltic Sea Region, especially for communication. Overall ranks have improved across the board in these two areas in 2013, following the slight deterioration in previous years. Russia, Poland, Denmark, and Norway gained the most in logistical infrastructure in 2013. For the two Nordic countries this has, however, not been enough to compensate for prior rank losses in this area.

Physical Infrastructure

Baltic Sea Region Countries

Indicator	EE	LV	LT	DK	FI	IS	NO	SE	GE	PO	RU
Logistical infrastructure	**41**	**39**	**30**	**15**	**3**	**25**	**27**	**16**	**9**	**65**	**58**
Quality of roads	46	90	34	19	10	35	65	18	12	82	108
Quality ofrailroads	39	30	23	25	6	NA	37	22	9	55	28
Quality of port infrastructure	16	30	34	9	5	7	17	13	15	73	69
Quality of air transport infrastructure	82	38	67	24	4	14	6	18	13	79	72
Quality of electricity supply	51	49	40	5	1	12	6	13	26	42	63
Quality of domestic transport network: business	32	35	18	14	4	27	48	16	9	63	38
ICT infrastructure	**16**	**38**	**33**	**11**	**10**	**2**	**14**	**4**	**12**	**44**	**35**
Internet access in schools	2	26	21	17	3	1	5	4	39	47	40
Mobilephone subscribers per 100 population	10	69	12	42	6	68	47	38	29	26	4
Percentage of households with computer	28	35	42	4	9	2	5	5	11	33	45
Internetusers per 100 population	23	28	35	4	7	1	2	3	14	37	53
Telephonelines per 100 population	30	43	52	20	65	6	37	17	4	66	34

Note: Numbers in red and green indicate a change of ten ranks or more down resp. up since 2012. State of the Region-Report 2014
Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis.



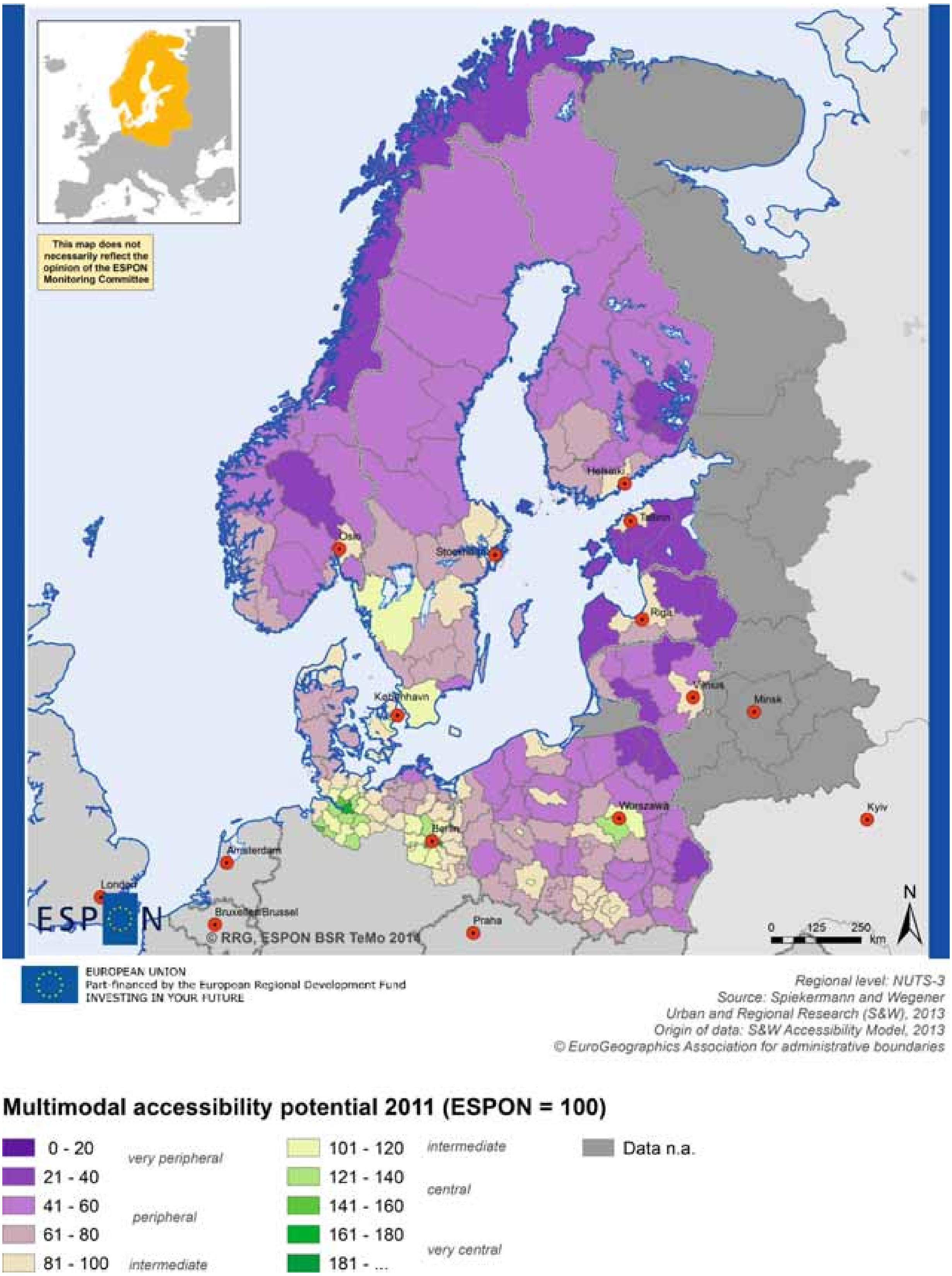
Note: Annual maintenance costs generally account for an additional 1/3 of investment costs; total 2011 investment spend was roughly Euro 10bn
Source: OECD (2014)

Infrastructure spending, an issue that was a topic of a special chapter in the 2012 State of the Region Report, has been under discussion in a number of Baltic Sea Region countries. In Sweden, the government announced plans to spend more than SEK500bn (EUR 55bn) on infrastructure over the next decade; a move likely influenced by the upcoming election. In Germany, the premier of Schleswig-Holstein made headlines by calling for an extra tax on motorists to finance further infrastructure spending. In Denmark, significant spending is tied to the Femernbelt crossing profiled in last year's Report. The available OECD data shows transportation infrastructure spending in the Region to have reached EUR14.5bn in 2011. This is broadly in line with the OECD average and has also been slightly rising as a share of GDP, with Iceland and Germany being the only exceptions. The higher spending in the Baltics and Poland reflects the significant catch-up still necessary in terms of infrastructure.

These investments happen in the context of a Region that is in many of its parts classified as 'peripheral' in its access to transport. Partly this is driven by the low density of population, especially in the Northern parts of the Nordics and rural parts of the Baltics. In the Baltics, the gap between well connected metropolitan regions and poorly connected rural regions is particularly striking.

For a region of largely small, open economies, trade-related infrastructure and capabilities are particularly important. The World Bank's Logistical Performance Index is based on a survey of international freight forwards and other sources. The most recent data on the Region confirm an overall solid position and shows almost all countries gaining position, especially the three Baltic countries and Norway. Denmark has lost some position, which brings the World Bank assessment more in line with the WEF data. The Region ranks best in logistical competence and customs procedures, with somewhat weaker scores in infrastructure and, surprisingly, competence in international shipments.

On ICT infrastructure, a traditional hallmark of the Region, there have been only small ranking changes, with only internet availability in schools reported to have changed in Sweden and Russia. Other changes, especially with regards to market penetration rates, have more to do with shifts in consumer behaviour than the quality of access. While there is variation


This map does not necessarily reflect the opinion of the ESPON Monitoring Committee
Helsinki
Tallinn
Oslo
Stockholm
Riga
Vilnius
Minsk
København
Warszawa
Kyiv
Berlin
Amsterdam
London
Bruxelles/Brussel
Praha
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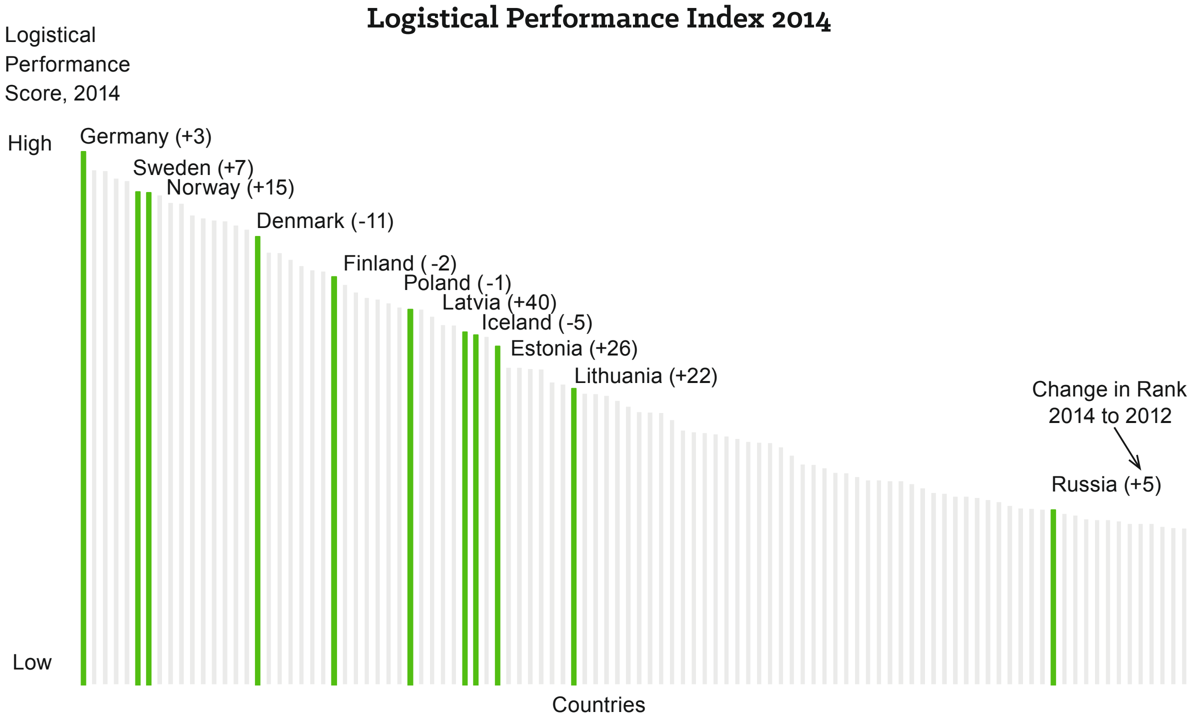
0 125 250 km
N
EUROPEAN UNION
Part-financed by the European Regional Development Fund
INVESTING IN YOUR FUTURE
Regional level: NUTS-3
Source: Spiekermann and Wegener
Urban and Regional Research (S&W), 2013
Origin of data: S&W Accessibility Model, 2013
© EuroGeographics Association for administrative boundaries
Multimodal accessibility potential 2011 (ESPON = 100)
0 - 20
21 - 40
very peripheral
41 - 60
61 - 80
peripheral
81 - 100
intermediate
101 - 120
intermediate
121 - 140
141 - 160
central
161 - 180
181 - ...
very central
Data n.a.

in terms of the access and usage of ICT infrastructure as measured by, for example, the ITU's ICT Development Index, the differences across countries in the Region are smaller than in other areas.

Energy has been a topic of previous State of the Region Reports. Overall, the quality of electricity supply in the Region continues to receive a solid score. Key issues discussed are the interconnection infrastructure across the Region, the

Logistical Performance Index 2014



Source: World Bank (2014)

ICT Development Index, 2013

Source: ITU (2013) State of the Region-Report 2014 transformation of the energy system to reduce CO2 emissions, the dependence on energy imports, especially from Russia, the impact of the German decision to abandon nuclear energy on energy markets and the use of different sources of energy, and the impact of energy cost levels relative to other countries, especially the US, with its growing access to natural gas, on the attractiveness of Europe for industrial activity. While all of these issues are critical for the Baltic Sea Region, most of them tend to be addressed at the national or EU level.

Skills and education

There is wide recognition that a highly skilled labour force is critical for the economic future of the Baltic Sea Region, and that high skill levels have been an important foundation for the solid economic performance of the Region so far. But the survey data from business executives continues to reflect clear concerns about whether the Region remains ahead of its global peers on this dimension. While the year-to-year changes have been mostly small, the five year perspective shows across the board a negative trend.

Baltic Sea Region Countries

Indicator	EE	LV	LT	DK	FI	IS	NO	SE	GE	PO	RU
Skills and education											
Quality of the education system	46	61	63	19	1	16	17	21	11	94	83
Quality of math and science education	27	19	20	36	1	26	47	40	18	70	62
Quality of management schools	52	50	66	22	11	21	25	18	30	89	100
Tertiary enrolment	29	41	23	17	2	12	16	18	56	19	14

Note: Numbers in red and green indicate a change of ten ranks or more down resp. up since 2012.
Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis.

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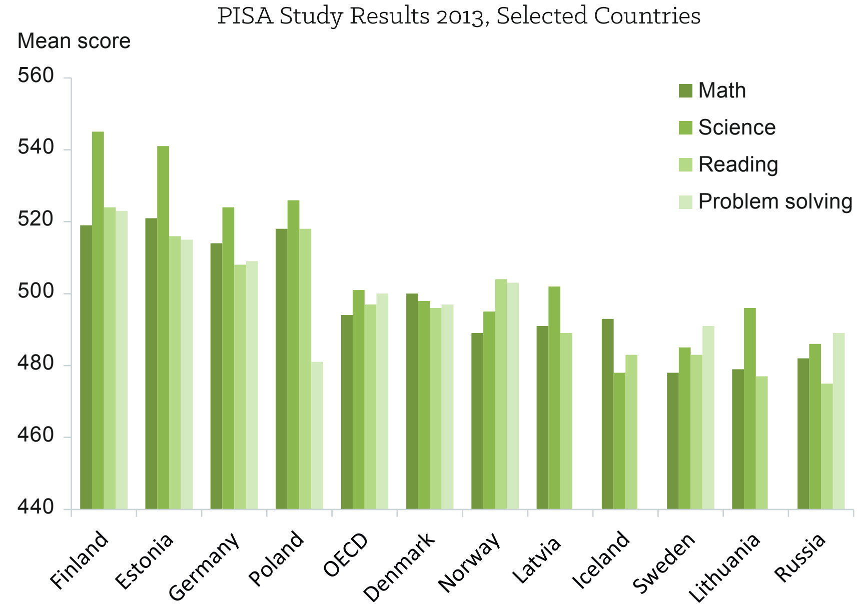
Educational Performance

PISA Study Results 2013, Selected Countries



Note: Iceland, Lithuania and Latvia are not included in the Problem Solving Scores
Source: OECD (2014)

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The assessments of educational performance across countries conducted by the OECD showed in its most recent analysis a heterogeneous picture for the countries of the Baltic Sea Region. Some, especially Finland but also Estonia, Poland, and to some degree Germany, are among the leading countries internationally. Some, like Denmark and Sweden, have lost position. And others, like Poland and Russia, have gained. The new assessment of problem solving capability has also shown that there is no automatic trade-off between learning facts and methods (math, science, and reading) and learning creative problem solving.

Given the demographic profile of the Baltic Sea Region, future skill supply will not only depend on education but also on the ability to attract and retain talent. A project supported by the Swedish Institute is currently looking at some of the implications for the Region; the box insert below discusses some of the data analysed in the context of that work.

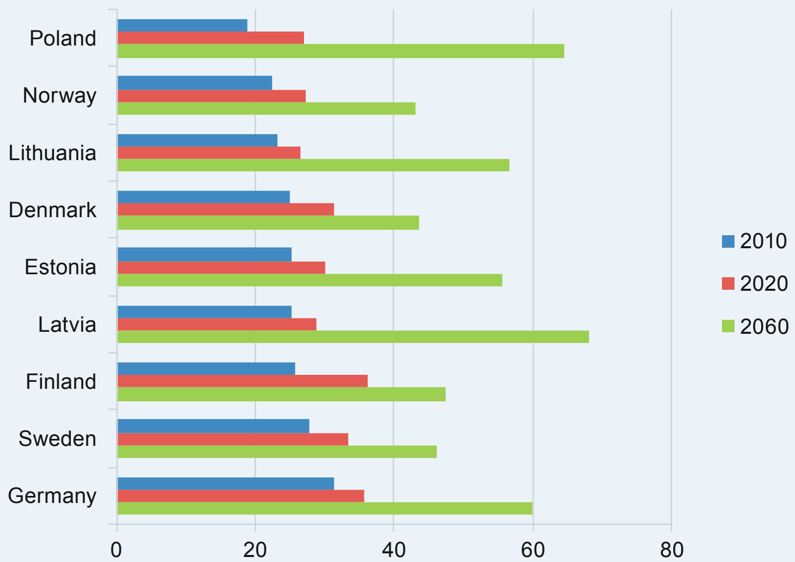
Box: Talent Retention and Attraction in the Baltic Sea Region

By Marcus Andersson, Head of Operations, Tendensor and Laura Kirss, Programme Director Education Policy, PRAXIS

When economies become more dependent on innovation as a source of competitive advantage, access to highly skilled people – talents – becomes a critical factor.

With the bulge of baby boomers soon to be retired, combined with lower birth rates, an increasingly widening talent gap with global ramifications is emerging. In Europe, 2010 stands out as a turning point: it was the first year with fewer labour market entrants than workers retiring out of the market. The figure below compares the Baltic Sea countries in terms of old age dependency ratios, referring to the projected number of persons aged 65 and over expressed as a percentage of the projected number of persons aged between 15 and 64 (active labour force). As the Eurostat data reflect, these countries' dependency on older people is expected to double in the next 50 years. The countries most threatened by old age dependency are the Baltics, Poland and Germany.

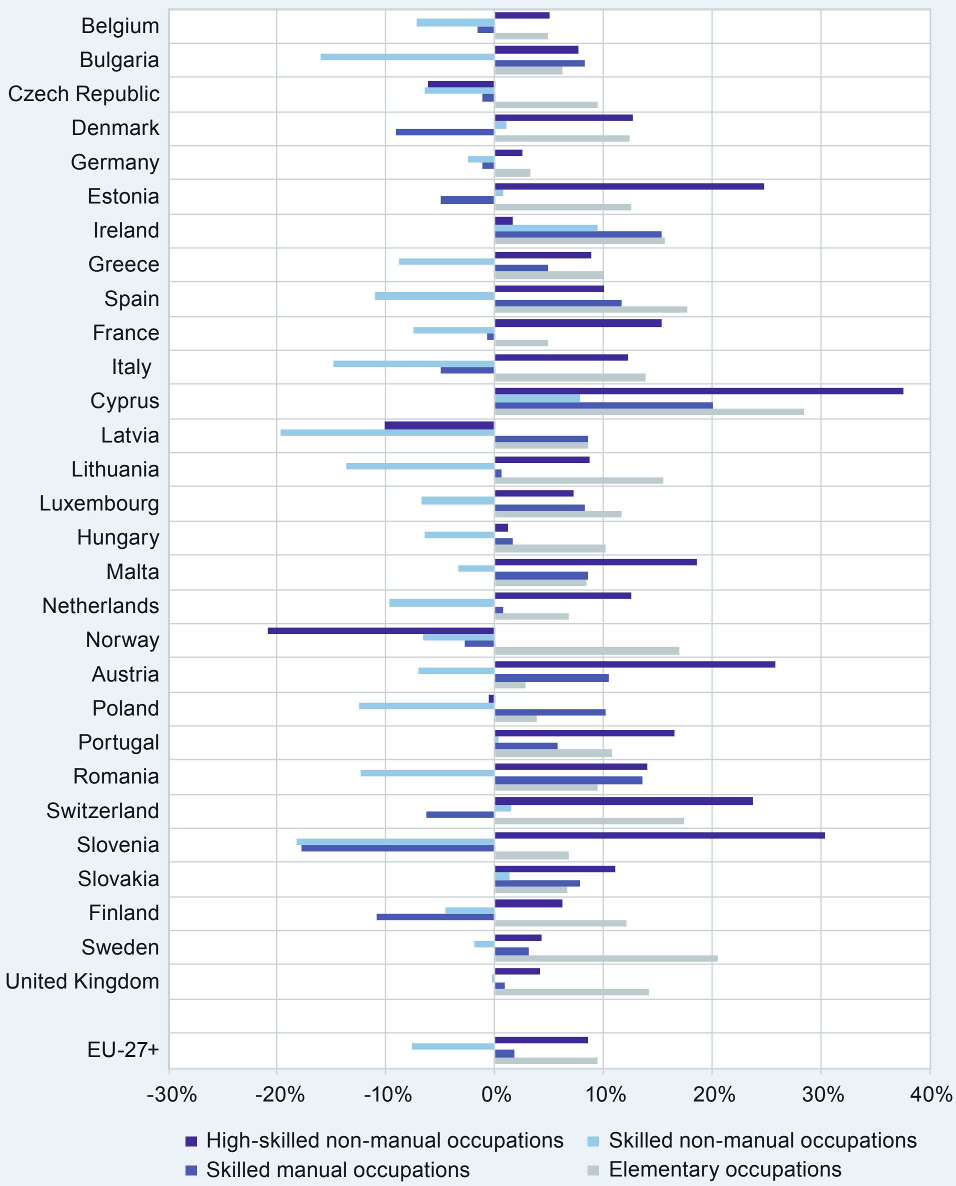
Figure 1. Projected Old-age Dependency Ratio



Source: Eurostat.

As a consequence, the global competition for talents is intensifying, as employers will soon have to recruit from a shrinking workforce. Experts have been trying to predict the need for different types of manpower needed in the future. Cedefop (see figure below) forecasts that in 2020 in the BSR, most countries will be in greater need for highly skilled labour. With the exception of Norway, Latvia and Poland, where the Cedefop forecast predicts a decrease in the need for highly skilled labour, all other countries are facing labour shortages in highly qualified employee sectors and would need significant additions to their current manpower pool to meet the needs of the economy. Estonia, with its 25% projected increase in high-skilled occupations, stands out among the BSR countries. Denmark reflects the second highest projected change, with a 12% increase.

Figure 2. Projected change in occupational structure by country, 2010-20 (%)



NB: Changes in employment (NA-based estimates).
Source: Cedefop (IER estimates based on E3ME and EDMOD).

In this environment, countries and regions are increasingly engaged in the competition to attract and retain talent.

How fit are the BSR countries for this competition? A survey done by World Economic Forum[2] among business executives in 148 countries that assesses a country's capacity for talent attraction and retention shows large disparities in the BSR countries. In the assessment of country capacity for talent attraction, Germany barely makes it into top 20 and the majority of BSR countries rank lower than 50th place, lagging far behind European peers such as UK (5th place), Norway (11th place), Ireland (12th place) and the Netherlands (18th place).

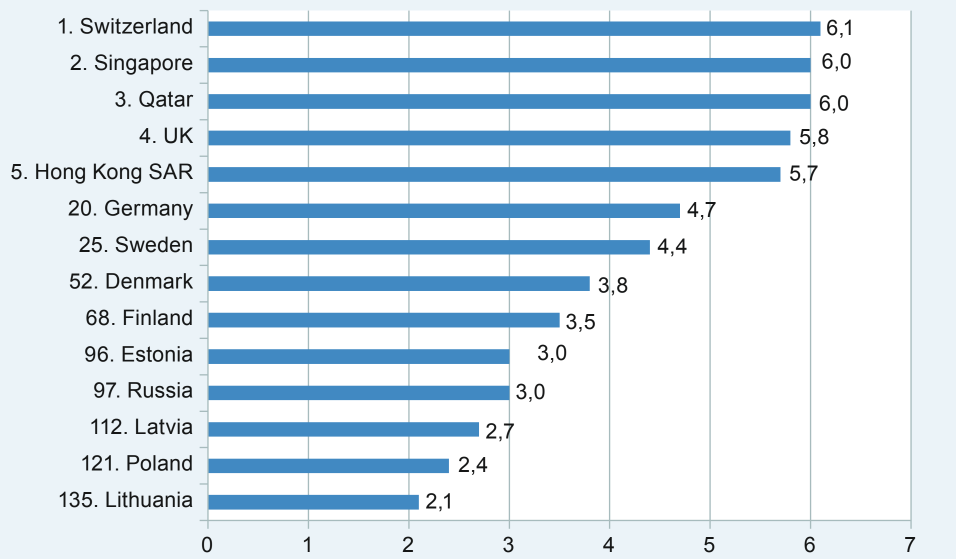
In addition, a recent study on policies and strategies for talent retention in the BSR countries and main city regions shows that the issue has received increasing attention in the policy debate the last few years. Despite this, little has been done in terms of policy changes or implementation of hands-on activities by city governments, business associations or universities to better retain talent in the region's countries, with the possible exception of Denmark, Finland and to some degree Germany.

If the region's countries fail to attract or retain the skilled talent needed, the implications for competitiveness may become considerable: new investments by firms are held back when the right skills cannot be found, FDI flows may decrease into areas that lack skills and innovation activities can be hampered.

While the capacity to attract talent seems to be the main concern to the executives, BSR countries seem to nonetheless encompass some important potential to actually turn the situation around in the future. A recent study by INSEAD has compiled a Global Talent Competitiveness Index (2013) to assess comprehensively what countries do to produce and acquire talents (different inputs) and the kind of skills that are available to them (different outputs).

As expected, the more affluent Nordic countries rank higher in the index compared to the central and eastern countries. The top ranking countries – Denmark and Sweden – are great at providing a very facilitative and supportive environment (regulatory, market, business) for talents; additionally they are rather good at attracting and growing highly qualified labour.

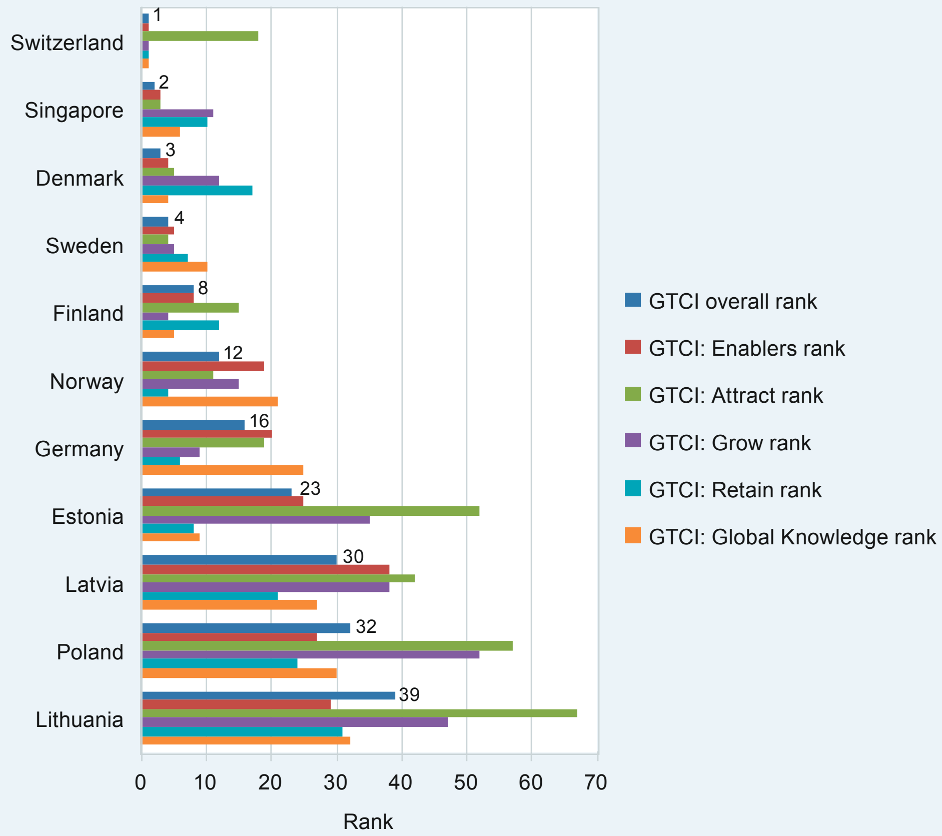
Figure 3: Perceived country capacity to attract talent



Does your country attract talented people from abroad? [1 = not at all; 7 = attracts the best and the brightest from around the world]
Source: World Economic Forum, Executive Opinion Survey, 2013

2 2013

Figure 5. BSR countries ranking in Global Talent Competitiveness Index 2013 and its sub-indices (out of 103 ranked countries)



The key to the future lies in maximising the potential of BSR countries in making their talent-friendly enabling context function even better. Moreover, the talent growth environment (i.e. high quality education systems) and the functioning of the economies (capacity to produce global knowledge in terms of high quality labour force, innovation, and entrepreneurship) should be utilised better and in the interests of the region's development.

In addition, more hands-on efforts to attract and retain talents are needed. For example, the region's countries need to present and communicate the advantages of the region even better to the target groups, which can be done by pooling resources in joint marketing campaigns. However, keeping in mind the very different income and economic development levels of the different BSR countries, it is important to recognise that the pursuit of talents can and does occur across the region as well. Therefore, in view of the overall BSR development, it is important to cooperatively find ways of facilitating the attractiveness of the whole region while highlighting the key characteristics and special features of each country, so that the overall supply of talents to the region will increase.

As for better talent retention, the capacities of cities and regions to welcome and integrate talents need to be upgraded. One response to this challenge is presented by the project One Baltic Sea Region (ONE BSR). An EU-supported project for transnational cooperation in the region, it aims to increase the Baltic Sea Region's competitiveness by branding it as one unity by pooling resources for attracting investors, tourists and talents to the region. The specific aim of the talent oriented part of the project, coordinated by the Swedish Institute, is to increase triple-helix co-operation in talent retention by facilitating better policy-making processes and providing tools that will make cities, development agencies, businesses, universities and ministries work better together.

To this end, a 'toolkit on talent retention' that strives to guide local and regional authorities in setting in motion new initiatives and collaborations aimed at retaining talent in the BSR countries and city regions will be published in late spring 2014. The toolkit, developed by Tendensor AB, will comprise detailed advice on how to use different tools and services to cater to talent needs and what actions are needed to implement new activities.

The project will also publish policy recommendations for what individual city regions and countries can do to improve talent attraction and retention, such as an Estonian case study on Talent Policy Management by Praxis Center for Policy Studies.

Innovation infrastructure

Innovation is the critical driver of productivity and thus prosperity growth. Innovative capacity also increasingly determines where the value from economic activities is captured. The Baltic Sea Region continues to rank well on several measures of innovative capacity and output. Innovation takes different shapes at different stages of economic development, so it is not a surprise that the Region is also characterised by significant heterogeneity in terms of its performance in this area.

The WEF's survey data provide a sobering picture of the Region's innovation system: it is perceived as solid, but compared to other dimensions of competitiveness it is not a significant competitive advantage for the Region. Average rankings hover around 20, which is also the overall competitiveness rank of the Region. If there is an area of relative weakness, it is the availability of scientists and engineers, especially in the less advanced parts of the Region. This could reflect the brain drain that has occurred over time, and which has gained new strength during the crisis. What is not viewed as a particular weakness by the business leaders surveyed but receives a lot of public policy attention is the collaboration between academia and business.

The assessment by the European Union in its Innovation Union Scoreboard provides a more positive perspective, at least for most of the Nordic countries and Germany. The Region tops the rankings; only non-EU member Switzerland gains overall higher marks. Enablers, the availability of financing and other support in particular, are a particular strength. Research system

Innovation System

Baltic Sea Region Countries

Indicator	EE	LV	LT	DK	FI	IS	NO	SE	GE	PO	RU
Innovation system											
Quality of scientific research institutions	30	43	31	17	11	32	22	16	8	63	53
University-industry research collaboration	34	62	28	20	1	26	14	10	9	77	55
Availability of scientists and engineers	102	93	61	35	1	39	47	16	15	63	79
Utility patents per million population	27	47	57	11	8	22	15	7	9	56	51

Note: Numbers in red and green indicate a change of ten ranks or more down resp. up since 2012.
Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis.

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Innovation System
Ranking of Baltic Sea Region Countries

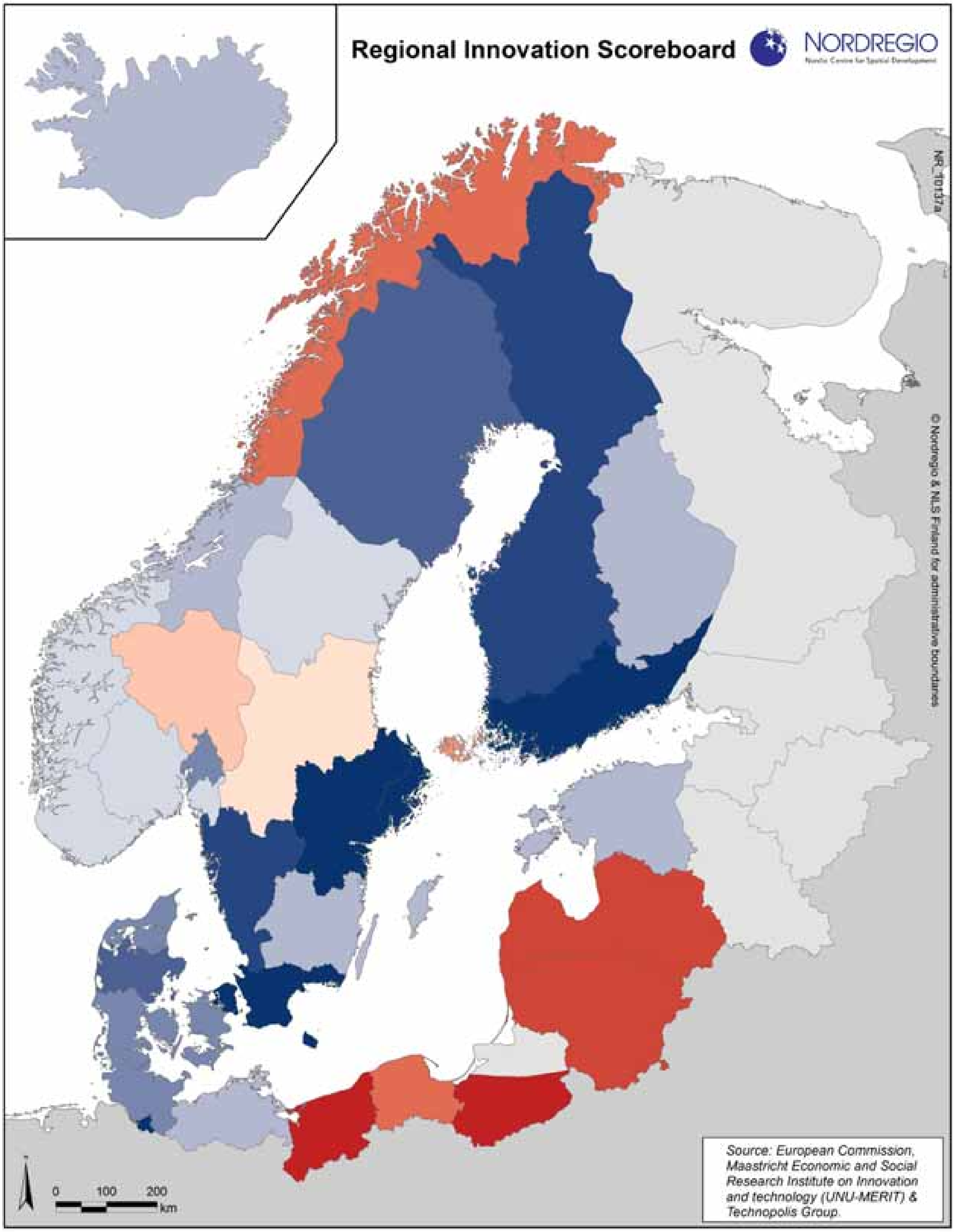
	Enablers				Firm Activities		Outputs	
Ranking among 34 European countries	Human resources	Research systems	Finance and support	Firm investments	Linkages & entrepreneurship	Intellectual assets	Innovators	Econ. Effects
Sweden (2)	1	6	4	2	5	5	3	8
Denmark (3)	12	3	5	7	3	2	7	4
Germany (4)	13	15	9	3	9	4	1	3
Finland (5)	3	12	3	4	11	6	9	6
Iceland (12)	32	4	1	8	1	19	6	15
Estonia (15)	18	19	2	6	14	9	17	25
Norway (17)	11	2	15	30	16	21	20	27
Lithuania (28)	7	26	14	14	27	27	31	34
Poland (29)	20	31	19	18	32	23	32	30
Latvia (33)	21	34	22	33	31	26	33	32

Source: Innovation Union Scoreboard (2014), author's analysis.

quality, the presence of innovative SMEs, and economic effects in terms of employment, revenues, and exports are somewhat weaker. This is consistent with a view that the Region provides a good environment for supporting innovation and has companies, especially large ones, that are willing to compete on these innovations. But it seems that the economic activities related to these activities do not necessarily materialise within the Region. This 'BSR innovation paradox' today has less to do with academia-business linkages and more with the attractiveness of the Region as a location for production.

The OECD provides, in its most recent Science and Technology Indicators, another quantitative view on developments in the innovation system, focused on a number of key variables. In terms of relative spending on R&D, the Baltic Sea Region remains in the top of the international league tables. But its leading countries show worrying trends: Finland's R&D intensity has peaked in 2009 and dropped since then, especially in 2012, the last year for which data is provided. Sweden's R&D intensity has been on a slow downward slope over the last decade, and especially in business spending on R&D the trends has been negative. Danish relative spending, too, has peaked in 2009 and has stabilised at a somewhat lower level. Spending intensity in Estonia has in the meantime increased significantly, but there are questions as to the economic benefits these positive activities have triggered so far for the wider economy. Other countries in the Region have had stable R&D spending levels; some countries outside of the Region, China and Korea in particular, have drastically increased their financial commitment to R&D.

While the Baltic Sea Region ranks overall highly on measures of innovative capacity, there are huge differences at the level of sub-national regions. Metropolitan centres tend to rank strongly, driving up the position of the larger subnational regions that they are part of. Maybe most remarkable is the strong position of some of the Northern Finnish and Swedish regions that are not home to large cities.



Regional Innovation Scoreboard* (RIS) 2011, European Commission's index based on 12 innovation indicators

Leader – High
Leader – Medium
Leader – Low
Follower – High
Follower – Medium
Follower – Low
Moderate – High
Moderate – Medium
Moderate – Low
Modest – High
Modest – Medium
Modest – Low
No data

The RIS index is based on 12 out of 24 innovation indicators from the European national level Innovation Union Scoreboard (IUS), including data on tertiary education; R&D expenditures as % of GDP; SMEs and innovation/patents; Public-private co-publications; PCT patent applications; Employment in knowledge-intensive activities.The index includes four performances groups, ranging from Modest (low performance) to Leader (high perf.), each with subgroups (Low/Medium/High).

* EE, IS (2012), LV and LT (national level only) included from IUS according to their estimated position in RIS.
Division of Finland: NUTS2 2008

Box: The European Spallation Source (ESS) – an update

Allen Weeks, European Spallation Source (ESS)

The European Spallation Source (ESS) officially breaks ground in September 2014. Located in Lund, Sweden, the ESS will create new scientific opportunities for scientists from Europe and all over the world. It will provide state-of-the-art experimental tools for thousands of scientists every year. It is one of the largest research infrastructure projects being built in Europe today.

Material science with neutrons has a long tradition in Europe, with many of the world's leading researchers located there. Despite Europe's strong lead in this field, many existing facilities there are nearing the end of their life cycle. In addition to a capacity problem, new technological developments are allowing neutron facilities to move away from nuclear reactor-based technology to accelerator-based sources.

In 1998 the OECD Megascience Forum produced a report for research ministers of the OECD countries for the future needs of materials science using neutrons in a global context. This study recommended that a megawatt-class spallation neutron source be built in each of the three developed regions of the world: Europe, North America, and Asia. The OECD Ministers agreed, and facilities have already been built in Japan (J-PARC), and the United States (Oak Ridge National Laboratory).

In Europe, plans for ESS started in 2003, and there was a competition for the site. In 2009 a consortium of 17 countries chose Lund, Sweden to construct the facility. Denmark and Sweden agreed to co-host the facility and to finance nearly half of the estimated EUR 1.8 billion construction cost. This will be the first large, international research facility in Scandinavia and the Baltic Region, shifting Europe's 'Big Science' landscape farther north. It is also the first such facility outside of larger countries, such as Germany, France, or the United Kingdom.

In the period between the site selection and the end of 2012, the ESS organisation was established and conducted a detailed design study and project cost estimate. After years of planning and study, the ESS Partner Countries have agreed on the scope, performance and contribution level that each country will make towards the construction of the facility. Those contributions will be made through a combination of cash and in-kind. And now, construction is already underway. The official kickoff takes place in the fall of 2014.

ESS is a multi-disciplinary materials research center. It is based on the world's most powerful neutron source. This new facility will be around 30 times brighter than today's leading facilities, enabling new opportunities for researchers in the fields of life sciences, energy, environmental technology, cultural heritage and fundamental physics.

The neutron source and its complementary detection instruments enable scientists to see and understand basic atomic structures and forces. It can be compared to a giant microscope for the study of different materials – from plastics and pharmaceuticals, to engines, to molecules. ESS is a significant step forward in the discovery process.

The ESS facility's design and construction include a linear proton accelerator, a heavy-metal target station, a large array of state-of-the-art neutron instruments, a suite of laboratories, and a supercomputing data management and software development center. However, in the context of its history and future as a scientific organisation, it is more than an advanced research tool. It is a brand new organisation, being built from the ground up.

Neutron science is the science of everyday life. It is important for the development of new and better computer chips, cosmetics, detergents, textiles, paints, fuels, drugs, batteries and plastics. Industrial drivers such as fuel cells, superconductors, innovative structural engineering, climate, transportation and food technologies, pharmaceuticals, medical devices and clean energy, are all dependent on advances in the capacity and capability of the science of neutron imaging. The many thousands of products created and improved through materials science using neutrons are essential to our basic quality of life, and our economic growth.

At the same time, research conducted using neutrons is puzzling out some of the most long-standing and complex problems that science and medicine have ever confronted. Among these are the as yet unknown mechanisms of how DNA sustains life at the molecular level, and the precise position, structure and function of the proteins that determine its structure. The solutions to some of the most daunting life science challenges of the next century rely on the superior mapping and three-dimensional modeling of proteins that the more powerful and sophisticated neutron imaging at ESS will provide.

The construction of ESS and the future operations of the facility will provide regional businesses with a wide range of opportunities and enable increased competitiveness for industry in the area. The facility will also contribute to growth in the region and act as a platform for science and technology innovation. In strengthening the research and development brand of the Öresund Region, ESS will create jobs, educational opportunities and technological developments.

Financial Markets

Access to capital is a critical source of economic growth and productivity enhancements. A robust financial system is also important for supporting prosperity and a stable macroeconomic environment. In most parts of the Region the financial system has come through the crisis in relatively good shape; in Iceland it completely imploded and in the Baltics it had at least a significant role in the overheating prior to the crisis. Overall, the Region's banks have been much less affected by the financial crisis, especially the second-round European sovereign debt crisis, than their peers in other parts of Europe. Still, executives' views, as exposed in the WEF survey, point it out as an area of slight disadvantage. The recent data shows continued concerns about the soundness of banks in parts of the Region, and some weaknesses in the regulatory environment. Relative to last year there are few significant challenges;

Financial Market Infrastructure

Baltic Sea Region Countries

Indicator	EE	LV	LT	DK	FI	IS	NO	SE	GE	PO	RU
Financial market infrastructure	**33**	**52**	**88**	**28**	**6**	**65**	**10**	**8**	**29**	**62**	**94**
Regulation of securities exchanges	36	55	73	17	2	59	9	11	42	39	85
Financial market sophistication	40	52	77	32	16	75	11	20	22	53	83
Soundness of banks	38	63	117	91	6	119	7	16	58	52	103
Ease of access to loans	39	88	104	67	13	74	9	12	45	92	51
Venture capital availability	22	60	83	84	8	75	5	6	36	102	62
Financing through local equity market	54	86	70	62	22	58	15	11	36	64	78
Protection of minority shareholders' interests	53	85	89	36	2	59	6	7	41	94	119
Domestic credit to private sector	40	48	62	2	31	32	38	17	29	57	66

Note: Numbers in red and green indicate a change of ten ranks or more down resp. up since 2012.
Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis.

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the slight improvements on average are driven by more substantial gains in Latvia and Russia. A key concern for policy makers remains the access for capital to SMEs, a topic analysed in more depth in last year's Report. There is also significant policy focus on risk capital, where countries across the Region have taken different paths and could potentially learn more from each others' experience.

The most recent ranking of global financial centres confirms Stockholm's position as the financial capital of the Region. Ranked 30th globally, it has gained position compared to a number of global peers. After similar gains Oslo is, however, not far behind: it is ranked 33rd. Copenhagen (61st) has dropped significantly and is now only about ten to twenty ranks ahead of Helsinki and St. Petersburg. Copenhagen is viewed as more of a transnational specialist while Stockholm and to a lesser degree Oslo are deep local hubs.

Administrative efficiency

The administrative rules and regulations in an economy have an important impact on the cost of doing business. Importantly, they are usually much easier for a government to change than other dimensions of competitiveness. This makes it particularly puzzling why the Baltic Sea Region, with its overall high marks on institutional quality, has not been able to address its relative weakness in this area. Business executives continue to complain about the administrative burden associated with government regulation. While there have been some improvements compared to 2012, especially in countries that have traditionally ranked the worst, the medium-term comparisons shows little substantial gains.

The World Bank provides, in its Doing Business study, a thorough comparison of the actual costs and complexities that government regulations and practices create across a number of standardised activities. On average the Baltic Sea Region does well; even Russia, the Region's traditional laggard in this area, has made a significant jump ahead, gaining almost twenty ranks compared to the previous assessment. But there are some areas related to financial market regulation and, maybe even more perplexingly, to starting a new business, where the Region is clearly behind others. With all the political attention focused on entrepreneurship and start-ups, this seems like an obvious area in which quick action could be taken.

The Swedish government has recently invited the World Bank Doing Business team to provide an assessment of the administrative rules and regulations in the country. They came back earlier this year with their analysis, providing praise

Administrative Infrastructure

Baltic Sea Region Countries

Indicator	EE	LV	LT	DK	FI	IS	NO	SE	GE	PO	RU
Administrative infrastructure	**10**	**36**	**32**	**20**	**6**	**18**	**17**	**12**	**50**	**73**	**79**
(Low) Burden of customs procedures	13	48	39	19	3	9	16	5	36	63	95
(Low) Burden of government regulation	8	73	101	87	5	48	58	12	51	118	112
(Low) Number of procedures required to start a business	34	22	22	22	10	34	34	10	104	22	77
(Low) Time required to start a business	32	64	32	19	67	12	37	78	72	110	73

Note: Numbers in red and green indicate a change of ten ranks or more down resp. up since 2012.
Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis.

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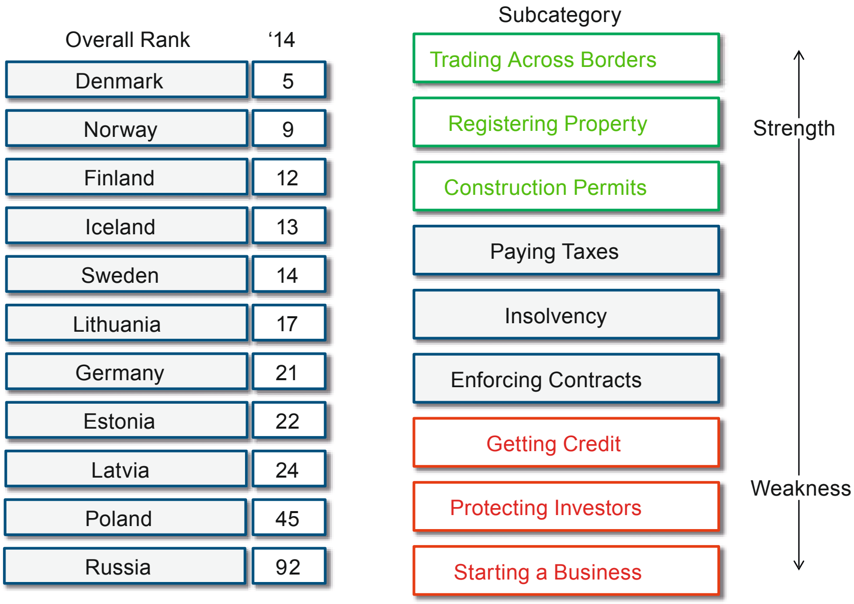
but also many suggestions for improvement. In the box below they summarise key observations from their work. This type of review might also be useful for other countries in the Region.

Cost of Doing Business: Government Regulations

Baltic Sea Region Countries



Source: World Bank (2014)

Box: Doing Business in Sweden – An assessment by the World Bank

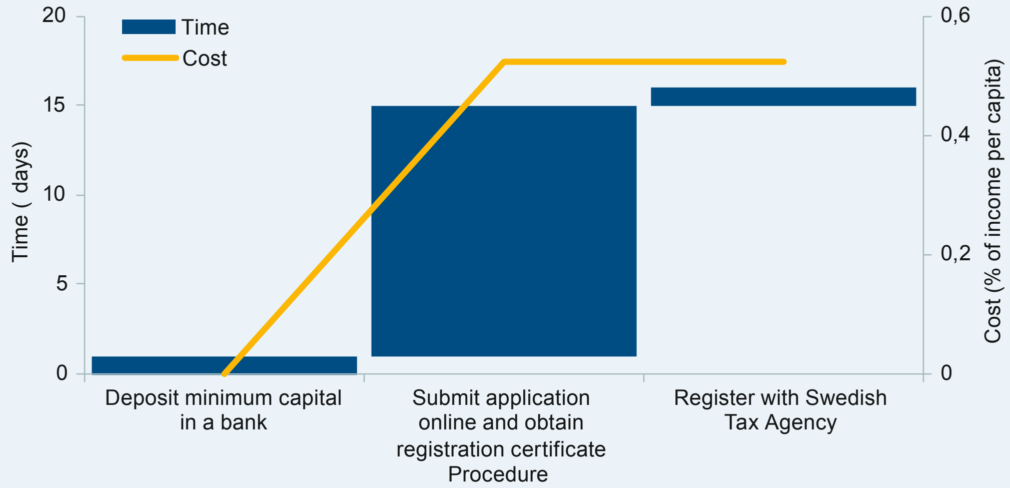
Hulya Ulku, World Bank

Over the past 20 years Sweden has implemented sound economic policies resulting in buoyant economic growth, low public debt and shared prosperity. However, despite Sweden's many virtues, there are still areas in which it can do better. The aim of a recent World Bank report, which was commissioned by the Swedish Government, is to provide an analysis of Sweden's business environment in comparison with best practices. This has been done in 2 main ways. First, by looking at areas of the business environment captured by databases compiled in the Global Indicators Group of the World Bank Group —*Doing Business*, Foreign Direct Investment (FDI) Regulations, and *Women, Business and the Law*. And second, by examining other critical areas where there is a large body of data, knowledge and insight that casts relevant light on several key policy challenges facing the country in coming years.

Business entry regulation

In Sweden the start-up process remains more burdensome than in many comparator economies. Despite a relatively high ranking on the overall ease of doing business, Sweden ranks only 61st (out of 189 economies) on the ease of starting a business, its lowest ranking in the areas measured by *Doing Business*. Sweden's document clearance process remains relatively slow. It takes 14 days for *Bolagsverket*, the company registrar, to review the application for incorporation and issue the registration certificate. In addition, Sweden has a fairly high minimum capital requirement. The amount required, though reduced in 2010, remains among the highest in the Nordic region. The economies that make it easiest to start a business—such as New Zealand, Singapore, Canada and Australia—have start-up procedures that can be completed in 2–3 days and require no minimum capital.

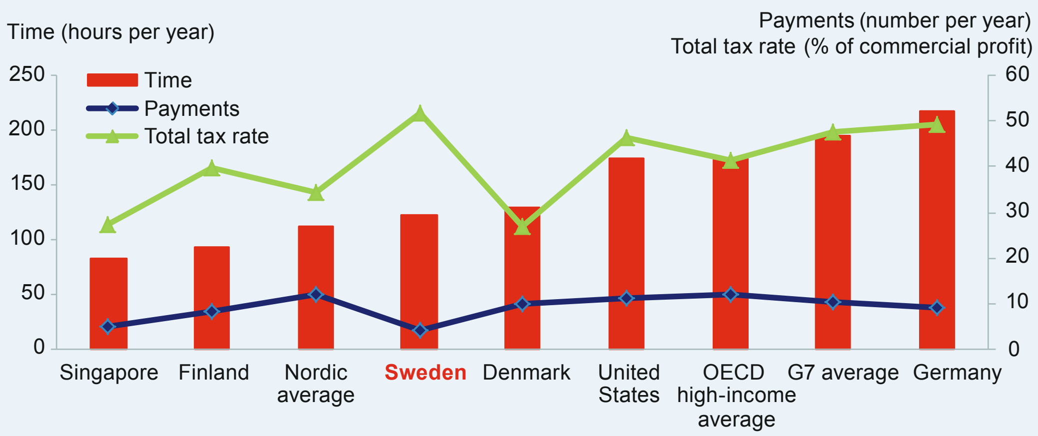
Box: Doing Business in Sweden – An assessment by the World Bank



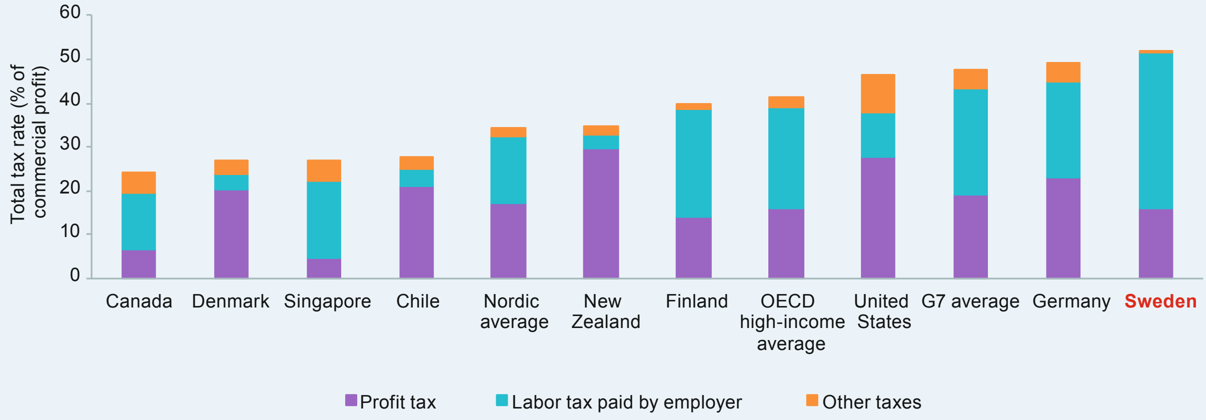
Tax regulation and incentives

Sweden provides a relatively simple and transparent structure for complying with tax obligations. Swedish firms must make only 4 payments a year as measured by *Doing Business*, clearly a global best practice. They also spend less time preparing, filing and paying taxes—122 hours a year as recorded by *Doing Business*—than the OECD high-income average (175 hours) though not as low as Singapore (82 hours) and Switzerland (63 hours).However, Sweden's total tax rate as calculated by *Doing Business* is one of the highest among OECD high-income economies, at 52% of commercial profit in 2012. Social security contributions account for 68% of the total tax, higher than the average shares in OECD high-income economies (56%) and G7 economies (50%). Statutory rate for social security contributions paid by employers in Sweden is 31.42% of remuneration (which is 14.1% in Norway and 21.34-23.74% in Finland). High labour taxes fund social benefits, but they may also promote the informal sector and affect certain groups adversely, such as the low-skilled, single mothers, older workers, youth, and new entrants. Sweden has low environmental and property taxes, the latter of which can be associated with growing house prices and increases in household debt of the country.

Tax regulation and incentives



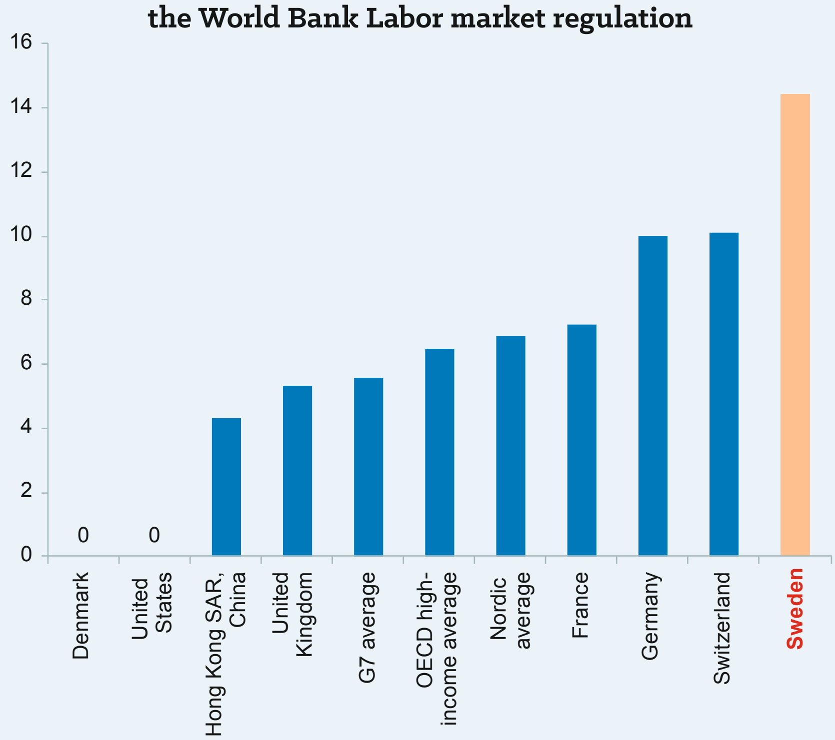
Box: Doing Business in Sweden – An assessment by the World Bank



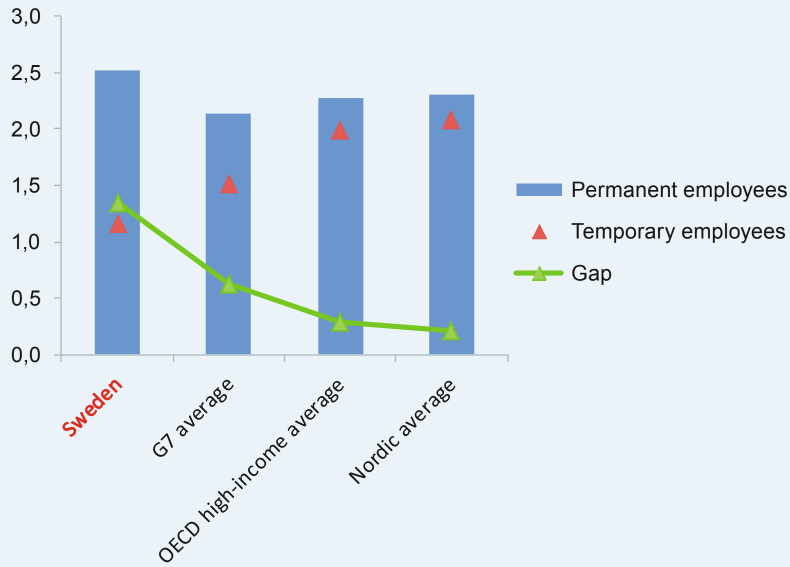
Labour market regulation

Sweden's labour market regulation is more rigid than the OECD high-income average in 7 areas covered by *Doing Business*: the maximum duration of fixed-term employment contracts, the restrictions on work on the weekly holiday, the length of the workweek, the length of paid annual leave, the notification required for collective dismissals, the obligation to reassign or retrain and to follow priority rules for redundancy and re-employment, and the duration of the notice period before dismissal. Sweden allows fixed-term contracts for permanent tasks, like about three-quarters of the OECD high-income economies. However, in 2007 it reduced the maximum cumulative duration of fixed-term contracts from 36 months to 24, thus limiting employers' flexibility in creating certain types of employment contracts. Before dismissing a redundant employee, Swedish employers are required to provide an average of 14.4 weeks' notice as measured

Box: Doing Business in Sweden – An assessment by the World Bank Labor market regulation



Box: Doing Business in Sweden – An assessment by the World Bank Labor market regulation



by *Doing Business*. Among OECD high-income economies, only Luxembourg requires longer notice (17 weeks). Sweden is also among the 6 OECD high-income economies (17 worldwide) that require an employer to reassign or retrain a worker before making the worker redundant and that apply priority rules for both redundancies and re-employment. In addition, Sweden requires an employer to notify a third party and carry out good-faith negotiations with the relevant trade union before dismissing a group of 9 redundant workers. In contrast, 82 economies—including 12 OECD high-income economies—apply more flexible redundancy rules. Denmark balances worker protection and labour market flexibility through its 'flexicurity' model, which combines flexible regulation, safety nets and active social policies.

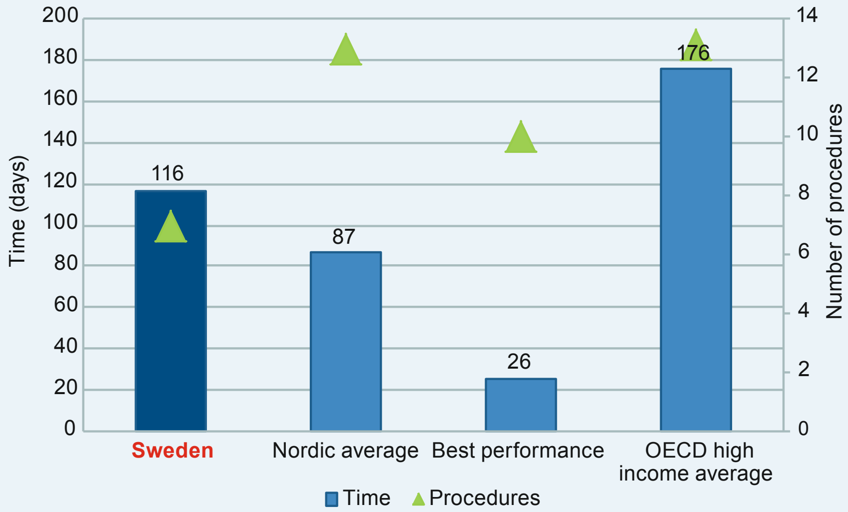
Urban planning and construction permitting

Administrative barriers to new construction may play a part in the housing shortage in Sweden. A comparative review of the Swedish construction permitting process vis-à-vis the best practice economies in construction regulations, such as New Zealand and Singapore, reveals several areas for improvement. First, the process in Sweden involves designing or modifying a spatial plan (detailed development plan) for each construction project separately, rather than having a spatial plan in place that has been ratified beforehand and covers the entire municipality. As a result, getting construction projects approved can take several years. Second, there is too little coordination between Swedish municipalities and counties in spatial planning. This leads to fragmented and strictly local planning decisions and can result in a construction approval process that is unpredictable and varies substantially across municipalities. Third, almost half of all construction projects in Sweden are appealed at the planning stage, and the appeals can take 3 years or more to resolve. The high rate of appeals against planning decisions is due in part to the discretionary, case-by-case process for approving spatial plans for most construction projects.

Regulation for firms' access to finance

Doing Business measures several areas of regulation affecting access to finance for small and medium-size enterprises—including getting credit, registering property, protecting investors, and resolving insolvency. Sweden ranks 42nd on the ease of getting credit, lower than many other OECD

Box: Doing Business in Sweden – An assessment by the World Ba
Urban planning and construction permitting



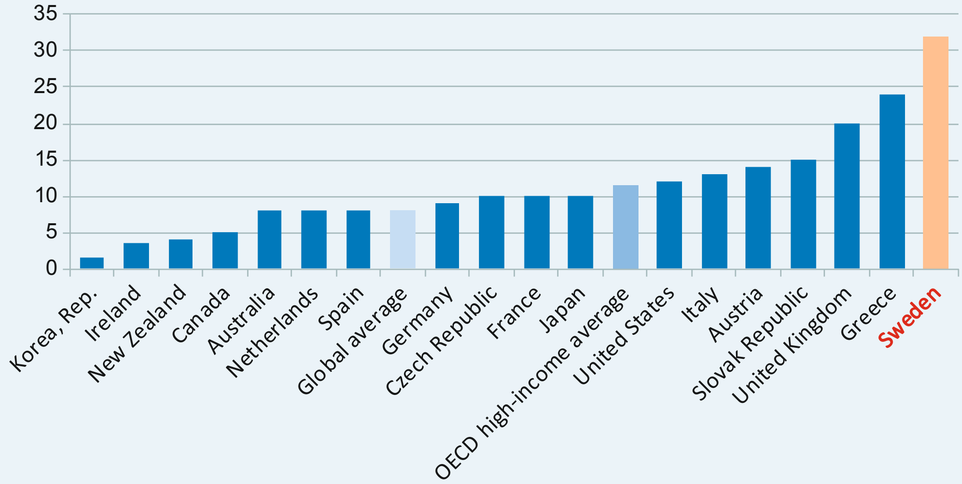
high-income economies. Two factors can explain this: Sweden does not have a unified legal framework for secured lending, and the country's largest credit bureau (UC) collects and distributes credit information only from financial institutions. Equity investment may also be suppressed by outdated laws. Sweden ranks 34th on the strength of investor protections as measured by *Doing Business,* lower than New Zealand, the United States, the United Kingdom, Norway and Denmark. In Sweden it is more difficult for minority shareholders to hold directors liable for damages caused to a company through self-dealing than is the case in many other comparator economies.

Registered property is the most accepted form of collateral, and firms able to offer it have a better chance of obtaining a loan. Sweden ranks 38th among 189 economies on the ease of registering property, lower than all other Nordic economies. This is due to relatively slower registration process (28 days compared to the average of 6.1 days in other Nordic economies) and higher cost of registration (4.3% of property value, nearly twice the average of other Nordic economies). These times are expected to improve once the new information technology system for registering applications is completed. Effective insolvency proceedings promote economic activities and access to finance. Sweden ranks 20th on the ease of resolving insolvency, lower than the average of other Nordic economies (7th). Completing the insolvency process takes longer (2 years) and costs more (9% of the value of the estate) in Sweden than in many other high-income economies, including all G7 and Nordic economies. In addition, creditors recover smaller shares of their loans (75.5%) compared to the average of other Nordic economies (88.3%). Eliminating duplicate or unnecessary steps and setting reasonable deadlines could shorten the duration of insolvency proceedings, help lower the cost and increase the recovery rate.

Regulation of foreign direct investment

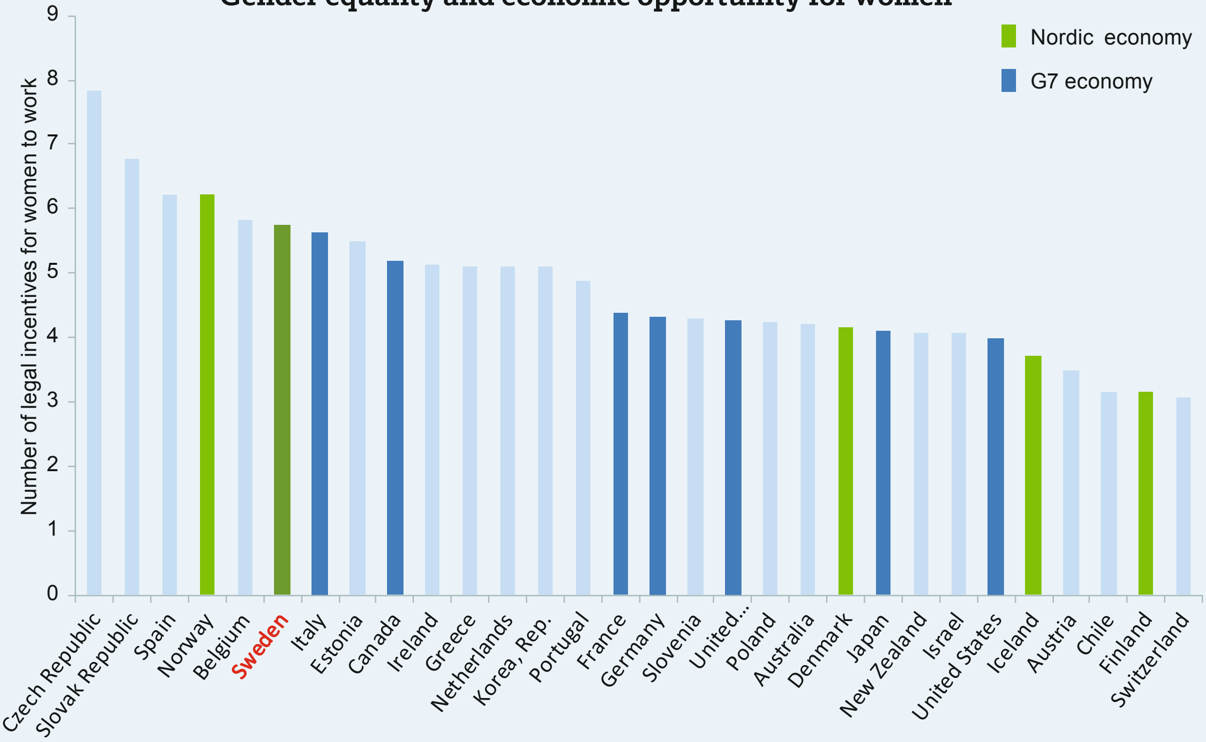
Sweden is widely recognised as a favourable environment for investment. The new data of the World Bank Group's Global Indicators Group on FDI regulations confirm that Sweden's regulatory framework for foreign investors is strong. Sweden is open to foreign equity in the 32 sectors included in the FDI Regulations database, and establishing a foreign subsidiary in Sweden is no more burdensome than establishing a domestic company. Sweden's laws, regulations and institutions for alternative dispute resolution set the standard for international best practice. Like most OECD high-income economies, Sweden maintains a fully open foreign exchange regime; there are no controls on

Box: Doing Business in Sweden – An assessment by the World Bank
Regulation of foreign direct investment



FDI-related capital flows, and investment-related payments may be made freely. However, practical impediments to FDI remain. These include a fairly extensive, though non-discriminatory, system of permits and authorisations needed to engage in many activities and the dominance of a few very large players in certain sectors, such as construction and food wholesaling. For work permits, Swedish laws on employing skilled expatriates are transparent and generally follow best practices. But obtaining a temporary work permit takes much longer in Sweden than in other OECD high-income economies. Processing times by the Migration Board can vary greatly depending on an applicant's nationality and employer. For example, obtaining a temporary work permit can take up to

Box: Doing Business in Sweden – An assessment by the World Bank
Gender equality and economic opportunity for women



32 weeks for an information technology specialist. By comparison, the average for OECD high-income economies is 11.5 weeks, and the global average captured by the FDI Regulations database is only 8 weeks.

Gender equality and economic opportunity for women

The *Women, Business and the Law* project of the World Bank Group's Global Indicators Group identifies regulatory barriers to women's opportunities as entrepreneurs and employees. A review of the data shows that Swedish laws and regulations establish a framework conducive to women's economic participation on equal terms with men. This is reflected in the relatively high participation of women in employment in Sweden compared with other Nordic economies as well as with OECD and G7 economies. Despite the favourable legal and regulatory environment, the gender gap in wages in Sweden, while close to the OECD average, remains greater than that in all other Nordic economies except Finland. Occupational segregation—women's under- or over-representation in sectors, occupations or levels of responsibility—also remains prevalent in Sweden, and research shows that this can account for a significant share of the gender gap in wages.

Competition

Most markets in the Baltic Sea Region are open but also relatively small. Formal trade barriers in the Baltic Sea Region are low. The EU's internal market covers most of the Baltic Sea Region, including most of the trade with the EFTA members Iceland and Norway. The WEF survey data continues to show that rivalry remains somewhat lower than openness; most likely a result of the modest country size. The drop in the intensity of local competition in Finland is somewhat surprising; it could signal that some companies have

Competition: Rivalry and Openness

Baltic Sea Region Countries

Indicator	EE	LV	LT	DK	FI	IS	NO	SE	GE	PO	RU
COMPOSITE RANK	**19**	**31**	**53**	**25**	**11**	**64**	**13**	**7**	**17**	**48**	**112**
Rivalry											
Effectiveness of antitrust policy	29	64	87	30	1	51	11	2	12	63	108
(Low) Extent of market dominance (by firms)	55	69	105	13	21	88	15	20	3	18	80
Intensity of local competition	29	21	31	38	108	74	56	23	16	59	86
(Low) Distortive effect of taxes and subsidies on competition	25	49	100	32	12	69	22	10	52	91	104
Openness											
(Low) Tariff rate	8	8	8	8	8	35	5	8	8	8	81
Prevalence of foreign ownership	9	27	92	32	50	134	41	21	51	54	125
Prevalence of trade barriers	18	37	108	45	3	121	40	23	88	80	124
Quality of FDI rules	18	54	104	56	30	140	41	21	48	85	112

Note: Numbers in red and green indicate a change of ten ranks or more down resp. up since 2012.
Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis.

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exited the local market in the difficult current demand conditions. The most positive sign is the perceived change in the quality of FDI rules in a number of countries across the Region. Somewhat puzzling is the deterioration in the perceived level of trade barriers in some countries, especially Lithuania and Germany. While the intention of the survey was to capture protection of the own market, it seems more likely that the respondents have focused on trade barriers that they face in other countries.

Labour Markets

Labour markets in the Baltic Sea Region have highly heterogeneous structures that are not well captured by some of the international assessments that rank them as highly inflexible. Especially in the Nordic countries and in Germany, labour unions remain more powerful than in many other OECD countries. However, the survey data reveals the relationships between these labour unions and their employers to be better than elsewhere. This model is now being put to the test in some countries, where some years of wage restraint or improvements in the economic situation seem to create more room for higher wages. In Norway, wages have already increased much fast than productivity. In Germany, there has also been a clear shift towards the introduction of minimum wages across the economy, a policy that has been highly criticised in the past. Economic research is divided on the merits of minimum wages; many oppose them on 'first principle'-grounds but others see them to work in specific cases where the negative impact on employment is low.

The Region is facing a number of structural problems on the labour market for which collaboration could make a lot of sense: youth employment is very high in some countries, but low in Germany. But transferring the German apprenticeship model to other contexts has proven difficult. Demographic changes create opportunities and pressure to increase the pension age and find better ways to leverage older employees in the workforce. The growing role of migration requires many countries in the Region to find new ways to integrate foreign workers. And gender parity is still an issue that requires action, despite the perceived favourable position that many parts of the Baltic Sea Region have compared to their international peers.

Demand Sophistication

Demand conditions, in particular the sophistication of demand, are a critical driver of innovation. The Baltic Sea Region continues to rank especially high on the stringency of environmental regulation. Sweden, Norway, and Estonia are also perceived as having particularly successful government efforts to raise the profile of IT. For the Region overall this remains an area of weakness, despite strong improvements over the short and medium term. An important policy lever is public procurement, which across the Region accounts for between 12 and 15% of GDP, according to the latest OECD data. EU member countries are legally required to open all procurements above a certain size to companies

Labor Markets: Regulation and Incentives

Baltic Sea Region Countries

Indicator	EE	LV	LT	DK	FI	IS	NO	SE	GE	PO	RU
Regulation											
Cooperation in labor-employer relations	28	**38**	**86**	3	25	11	5	6	20	94	96
Pay and productivity	7	**14**	12	57	58	46	82	69	43	55	33
Incentives											
(Low) Impact of taxation on incentives to work and invest	21	**114**	124	126	**85**	**106**	60	103	**61**	**81**	113

Note: Numbers in red and green indicate a change of ten ranks or more down resp. up since 2012.
Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis.

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Sophistication of Demand

Baltic Sea Region Countries

Indicator	EE	LV	LT	DK	FI	IS	NO	SE	GE	PO	RU
Demand sophistication	**17**	**63**	**47**	**26**	**4**	**24**	**5**	**6**	**16**	**78**	**83**
Government procurement of advanced technology products	25	92	110	82	26	68	17	36	21	100	84
Government success in ICT promotion	4	50	33	22	10	14	2	3	31	103	85
Laws relating to ICT	3	52	37	20	7	26	5	8	30	74	81
Buyer sophistication	100	92	94	52	5	45	13	9	23	89	47
Stringency of environmental regulations	23	36	33	1	5	20	9	4	7	45	99

Note: Numbers in red and green indicate a change of ten ranks or more down resp. up since 2012.
Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis.

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across Europe; the Baltic Sea Region could go further to turn this legal condition into an effective market. Norway and Germany are perceived to have the most effective approaches to turning this into demand for advanced technology products. Sweden and Iceland have lost significant ground; in Sweden this might have to do with the responsibility for the relevant regulations having being shifted to competition authorities, which traditionally focus on short-term price and efficiency rather than innovation.

Cluster presence

Research over the last decade has provided robust statistical evidence that the presence of clusters, i.e. regional agglomerations of companies and other institutions in industries connected through different types of linkages and spillovers, are associated with higher levels of overall regional economic performance.

A recent report by the European Cluster Observatory (www.clusterobservatory.eu) provided an in-depth analysis of the cluster landscape

Related and Supporting Industries

Baltic Sea Region Countries

Indicator	EE	LV	LT	DK	FI	IS	NO	SE	GE	PO	RU
Related and supporting industries	**33**	**67**	**41**	**18**	**11**	**37**	**14**	**13**	**3**	**62**	**99**
Availability of latest technologies	30	42	38	29	1	7	4	2	11	101	110
Local supplier quantity	62	103	29	24	97	111	75	42	11	40	94
Local supplier quality	22	48	31	11	8	26	19	6	4	51	101
Local availability of specialized research and training services	34	55	32	16	5	42	17	9	3	36	70
State of cluster development	73	90	95	35	9	69	15	20	4	102	119

Note: Numbers in red and green indicate a change of ten ranks or more down resp. up since 2012.
Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis.

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across the Baltic Sea Region, with deep dives into information technology, health care, environmental services, and maritime clusters. The Region overall hosts 15 of Europe's 100 strongest clusters, measured by employment specialisation and wage levels. Some of the larger metropolitan regions in particular have developed robust portfolios of clusters.

The WEF Survey data show that the emergence of internationally competitive clusters in the Baltic Sea Region is facing challenges: while access to leading technologies is generally not an issue in the leading economies of the Region, their moderate size puts limits to the number of relevant suppliers that companies can rely on. Critical mass and breadth are harder to achieve under such conditions. The attractiveness for international collaborators and integration in global value chains is even more important than for clusters elsewhere.

Box: A Knowledge-Based Norway – the role of clusters

Prof. Torger Reve, BI Norwegian Business School

Unlike some of its neighbouring countries, Norway has demonstrated very strong economic development over more than a decade. With a GDP per capita exceeding $100,000, Norway ranks only second to Luxemburg in economic prosperity. Although much of the Norwegian wealth comes from a profitable North Sea oil and gas industry, Norway has developed strong market and technological positions in several industries, with most industries showing high productivity figures over many years. Unemployment is almost non-existent, drawing many young workers from Sweden, Poland and the Baltic countries to work in the service and construction industries. The Norwegian Pension Fund Abroad now exceeds NOK 5 trillion (about $ 850 billion), which amounts to NOK 1 million per capita. The Norwegian Sovereignty Fund now owns more than 1.4 % of total shares on the world's stock exchanges, and only the annual gains (with a maximum of 4%) should be used for government spending according to the Action rule adopted by the Norwegian Parliament. The global financial crisis had little effects in the Norwegian economy, but interest rates remain low as in most other European countries. The Norwegian government budgets show a surplus every year. Falling oil and gas prices tend to be one of the few risks facing the Norwegian economy.

Normally, natural resource economies like Norway should have been hit by overspending, inflation and Dutch Disease, but this is not the case for Norway. Rather the country has followed a cluster based approach to industrial development, stimulating technological development and internationalisation of its industries. Three industries stand out as particularly strong clusters: the offshore oil and gas industry, the maritime industry and the seafood industry. Norway is practically self-sufficient through renewable energy, with its long-term clean energy coming from hydro power, so oil and gas can be exported at pleasantly high prices. At the same time, the offshore technology and service industries have shown high growth rates, gaining new competitive positions in the global offshore oil and gas industry, in particularly in drilling technology, subsea technology and offshore vessels. There is a strong presence of international oil service firms such as Schlumberger, NOV and FMC Technology, and many of these firms now deliver offshore technology globally from their Norwegian base. The investments in oil technology and oil services rest on a strong industrial knowledge base and a highly skilled work force. As GE CEO Jeff Immelt said when he recently opened a new subsea technology centre in Stavanger: "Norwegian engineers are expensive, but their quality is very high". He expected Norway to be globally competitive in offshore oil and gas technology for many years. Recently, however, several large offshore project contracts have been placed at Asian yards, demonstrating rising costs and declining productivity in this industry as well. Other more traditional industries have been going through large transitions for the same reasons, and industries such as paper and pulp have downsized. The solution for many Norwegian companies has been to upgrade technologically and to target high value markets. This can be well illustrated by some of the specialised shipyards and the maritime equipment industry, going for new designs, innovative technology and more advanced markets.

While the West Coast of Norway is dominated by the three Ocean Industries: Offshore oil and gas technology, Maritime technology and Salmon fish farming, Oslo remains the hub for knowledge based services, such as Finance, ICT and Engineering and Consulting, serving the three Ocean Industries globally. Oslo is lagging behind Stockholm and Copenhagen in some of the knowledge based service industries, but Oslo currently has a much higher growth rate than its Nordic and Baltic neighbours. DNV recently acquired its German competitor GL, making DNV-GL the world's largest ship classification agency. The Norwegian financial industry has shown record high profits, forming a solid capital base to build a more global financial centre. Asset management may be a new growth sector for Norway, given its growing capital base.

Norway has not succeeded in developing a global foothold in the new renewable energy industries, such as solar and wind, although some technological positions in clean tech have been developed, attracting, among others, large Chinese investors. The health-related biotech industries still remain a niche industry, although there are possibilities for some Nordic linkages in this industry.

Norwegian consumer demand remains brisk, although the housing and real estate markets have recently weakened. Norwegians tend to put their main savings into homes and vacation homes, rather than putting their savings in stocks and bonds. New pensions schemes may change these practices. The health sector still has its bottle necks, and the cost of health service is increasing. New reforms in the health sector are under way, but there are no simple solutions.

The new conservative coalition government under the leadership of Prime Minister Erna Solberg has promised large reforms in the public sector, reducing red tape, creating larger municipalities and implementing new technology. Wealth taxes and inheritance taxes have already been cut. Although Norway has some of the highest labour market participation rates, especially among women, there is a growing concern over sick leaves and people going into permanent disability pensions at an early age. Upgrading educational quality, increasing the supplies of engineers and investing more in R&D is a national priority.

A large national study of industrial competitiveness, titled 'A Knowledge-based Norway' was recently completed by a group of researchers at BI Norwegian Business School, and the recommendations were clear: increase knowledge investments at all levels, from Kindergarten to PhD, strengthen R&D, especially in the Ocean Industries, where Norway already has a dominant position, and targeting innovation in existing and emerging industrial clusters. A new third level cluster program, Global Centers of Expertise, will be implemented in the summer of 2014. Systematic continuing education, targeting both the business sector and the public sector, is about to be implemented, starting with teachers.

Read more at http://etkunnskapsbasertnorge.wordpress.com/hovedside-2/summary-in-english/

Over the past few years, the Baltic Sea Region has become home to a wide range of cluster efforts that receive government support of some kind. Last year's State of the Region Report provided an overview of the relevant government programmes across the Region. Below is an example from Finland that shows how the ideas of collaborative innovation are implemented in the latest round of policy programs.

Box: New Support for innovation ecosystems in Finland - The Innovative Cities program (INKA)

Christopher Palmberg, TEKES

Finnish innovation policies are developing new approaches for stimulating innovation and renewal of the Finnish economy. One good example of this is an increasing focus on ecosystem creation and orchestration, especially in areas where the public sector plays an important mediating role between society and business. This is perhaps best exemplified by the Innovative Cities Program (INKA) that was launched in 2014, to be continued until 2020.

The aim of INKA is to generate new business and new companies from high-quality competence, thus creating more jobs. The program is underpinned by close local co-operation and pooling of resources between science, education, companies and the government. The methods used will include stimulating new development environments, creating pioneering markets, and national and international co-operation in leveraging expertise where urban areas or cities are used as platforms.

Development environments may include demonstration and testing platforms for new technologies and services, and new operating models for competence-based entrepreneurship. Major investments for the future made by cities, for example in energy and water supply, waste management, housing, transport and health care, have so far not been exploited as development platforms for innovations. Development and piloting will be carried out in authentic development environments, in co-operation between users, companies and the public sector. In order to create a pioneering market, the cities are also expected to use innovative procurements more often. The aim of these measures is to stimulate new ecosystems as the basis for innovation and exports.

Demand-driven, solution-centred and multisectoral themes that combine several competence areas within urban areas were selected for the programme, based on a competitive call. This bottom-up procedure is different from the traditional technology- or sector-oriented approach, where thematic areas are selected top-down. The themes draw extensively on both Finnish and international expertise.

The Ministry of Employment and the Economy has approved five national themes for the program and named the urban regions responsible for leading the work in them. Seven other urban regions have been approved as partners (the cities in a leading role are shown in bold letters):

Bioeconomy: Joensuu, Jyväskylä and Seinäjoki Sustainable energy solutions: Vaasa, Lappeenranta and Pori Future health care: Oulu, Kuopio, Helsinki Metropolitan area, Tampere and Turku Smart cities and industrial regeneration: Tampere, Lahti, Oulu, Helsinki Metropolitan area and Turku Cyber security: Jyväskylä

The funding of the INKA program will consist of EUR 10 million contributed by the government and 10 million contributed annually by the urban regions. In addition, EU Structural Funds financing will be earmarked for programme implementation. A review of the program themes and urban subregions will take place in 2017.

Tekes will be responsible for the operative management and administration of the program. Strategic steering and program evaluation will be the task of a steering group comprising representatives from the Ministry of Employment and the Economy, the Ministry of Social Affairs and Health, the Ministry of Justice, the Ministry of Transport and Communications, the Ministry of the Environment, as well as Sitra and Tekes.

Microeconomic competitiveness: Company Sophistication

While most economic policy analysis is focused on business environment conditions, recent research has revealed large differences in firm-level performance that are systematic across countries. Levels of company sophistication are very heterogeneous across the Baltic Sea Region, more so than many other dimensions of competitiveness. Finland, Sweden, and Germany rank highest according to the WEF survey data; Denmark follows not far behind. This is broadly in line with academic studies that track business sophistication, measured through the adoption of modern management and operational practices. Russia and Latvia had the largest improvements last year, while Iceland dropped the most; whether these survey responses are reliable indicators of changes in company sophistication or reflect the general climate in these economies remains to be seen.

Assessment

The competitiveness of the Baltic Sea Region remains solid and has slightly improved compared to previous years. The economic outcomes, in particular the level of prosperity reached, are well-supported by current competitiveness fundamentals.

On an aggregate level, the Region has a balanced position across the different dimensions of competitiveness. Macroeconomic factors tend to be stronger, for the Nordics on the quality of both institutions and macroeconomic policy, for the Baltics on macroeconomic policies. Across microeconomic factors the profile is a bit more heterogeneous, with strengths in company sophistication and a number of factor input conditions, especially communications infrastructure and parts of the innovation system, and weaknesses in the context for strategy and rivalry and the presence of supporting and related industries.

Company Sophistication

Baltic Sea Region Countries

Indicator	EE	LV	LT	DK	FI	IS	NO	SE	GE	PO	RU
Company operations and strategy	**34**	**55**	**39**	**10**	**2**	**28**	**8**	**4**	**6**	**71**	**82**
Strategy and operational effectiveness	**41**	**57**	**37**	**9**	**6**	**26**	**11**	**4**	**5**	**68**	**78**
Firm-level technology absorption	33	60	35	13	9	3	7	1	12	107	101
Company spending on R&D	45	64	70	10	3	41	19	6	5	102	66
Nature of competitive advantage	54	57	65	5	3	43	22	12	8	88	75
Value chain breadth	88	57	38	12	7	42	23	8	2	56	101
Capacity for innovation	29	70	40	11	4	59	15	6	5	67	64
Production process sophistication	55	68	42	14	4	23	5	8	3	57	92
Extent of marketing	53	51	36	25	17	27	11	4	6	49	70
Degree of customer orientation	32	28	16	10	25	15	18	9	27	49	78
Organizational practices	**25**	**34**	**41**	**8**	**1**	**27**	**6**	**4**	**15**	**65**	**75**
Extent of staff training	31	41	52	16	2	29	7	5	15	72	89
Willingness to delegate authority	23	34	51	2	4	11	3	1	17	59	82
Extent of incentive compensation	36	47	29	25	7	88	58	34	9	56	39
Reliance on professional management	23	33	45	5	4	26	2	3	19	74	87

Note: Numbers in red and green indicate a change of ten ranks or more down resp. up since 2012.
Source: Unpublished data from the Global Competitiveness Report (2013), author's analysis.

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What are some of the key lessons from this data, beyond the encouraging headline figures on competitiveness? First, competitiveness is shaped by the specific natural conditions and legacies in which countries and regions operate. In the Baltic Sea Region this plays out in a number of ways: there is the effect of natural resources; oil and gas in Russia, Norway, and to a smaller degree in Denmark, shale oil in Estonia, minerals in Sweden, biomass in Finland, Sweden, and the Baltics. They have a significant impact on the economies and their specialisation patterns. In Russia and Norway the industrial sectors outside of natural resources face a difficult structural environment. In the other countries the resource-based industries remain a large part of the respective economy, despite the broad focus on knowledge-driven activities elsewhere in the economy. Another important aspect is the modest overall economic size and low density of the Region. Without a large internal market, the Region has to work harder to attract economic activities that are mobile but benefit from proximity to consumers. The large geographic space raises the costs of delivering many key services, from health care to transportation. And with large metropolitan areas increasingly seen as an important driver of innovation, the relatively small size of the leading city regions can be a disadvantage.

Second, there is a large degree of heterogeneity in terms of competitiveness profiles across the Region. This is not a surprise and well in line with the large differences in prosperity that continue to characterise the Region, despite the robust catch-up dynamics under way. But it is often not fully internalised in the economic policy discussions around the Region (and in the European Union more broadly): simplistic benchmarking and policy blueprints that are transferred from one part of the Region to another are unlikely to work. Countries and subnational regions need their own policy agendas, driven by the unique competitiveness challenges that each of them is facing. There can be a lot of learning and knowledge exchange on tools and policy approaches, but at the level of selecting policy priorities, location-specific choices are a critical condition for success. The new phase of regional policy that the European Commission is currently implementing under the heading of 'Smart Specialisation' is, to a large degree, exactly about such location-specific choices. The Baltic Sea Region can benefit from forcefully applying this idea, and many parts of the Region already do.

Third, and related to the prior argument, the Region, especially its leading economies in the Nordics, are facing increasing questions about their specific positioning in the global economy. They are strong on many dimensions of competitiveness, and this was a key reason for why they were able to be among the key beneficiaries of globalisation: as global markets opened up, they had qualities that were in short supply and were far ahead of most other locations. But the global economic landscape has changed: the Nordics remain top of many overall competitiveness rankings, but the gap has narrowed to different countries on individual dimensions. There is a danger of being good on most things but excellent on almost nothing – with value chains breaking up there is always another place that is better for an activity, even if on average, across all activities, no other location is preferable. The Nordic countries would benefit from thinking about the role they intend to play in the global economy, and then prioritise their policy actions accordingly. They can approach this task from a position of strength; the region has many competitiveness assets and clear opportunities to serve markets from cleantech to big data-related services to advanced manufacturing and smart retail. But all of these markets are contested, and success will in most cases only materialise when there is a clear strategy that aligns thinking and action across the private and public sectors.

4 Summary

The Baltic Sea Region continues to be the Top of Europe in more than geographic terms; it leads the European Union on competitiveness. It enjoys a high level of overall prosperity and continues to be on a higher growth path than most other parts of Europe. Its prosperity is widely shared, and the Region registers strong performance in beyond-GDP dimensions of social progress as well. Given the significant level of heterogeneity across the Region there are, however, also still subregions where prosperity is low and social inclusion remains a significant challenge. But convergence is again happening, unlike in other parts of Europe.

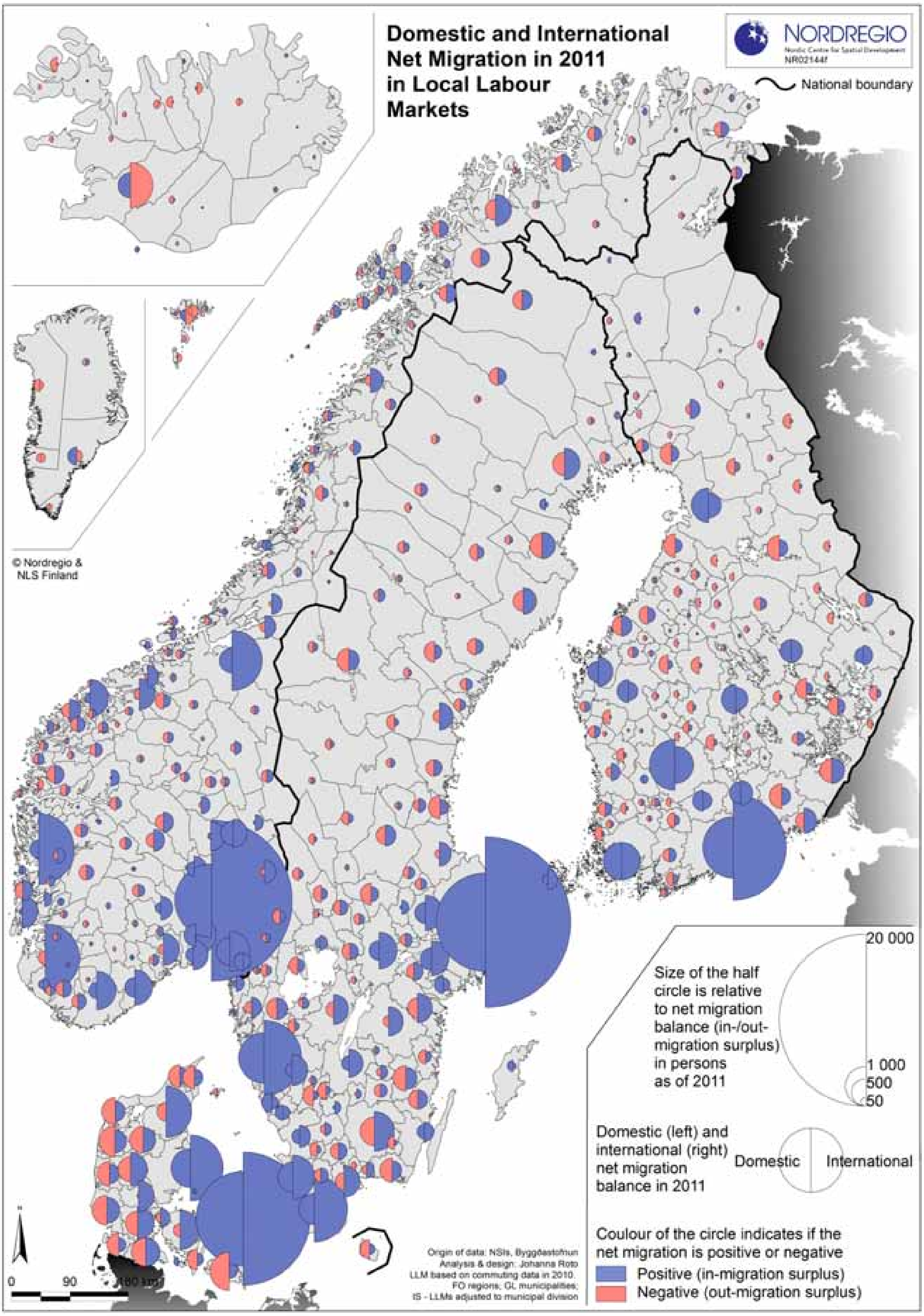
The Region's competitiveness is also reflected in its strong position in the global economy. It is deeply engaged in global trade, and registers a solid trade surplus. It accounts for a disproportionate share of global FDI, both inward and outward. But export market shares are slowly eroding, and the Region's relative attractiveness for inward FDI seems to be declining as well. The Region has seen increasing investment rates, but capital investment has stayed a significant degree below the levels usually expected in the wake of a deep crisis. Investment in knowledge-intensive capital remains high, and even here the Region is ahead of other parts of Europe. But there are worrying signs, both in falling private sector R&D spending rates in some countries and in lower innovation rates closer to the market than in scientific research.

The Region's underlying competitiveness remains strong and well balanced, fully sufficient to support the level of prosperity currently achieved. Strong macroeconomic competitiveness is a key pillar of the Region's, while it also excels in many dimensions of microeconomic competitiveness. But there are also weaknesses, some related to the natural conditions in the Region and others policy-induced. More can be done to streamline government rules and regulations, integrate the markets of the Region, and create advanced demand conditions that can help companies launch innovative products and services around the Baltic Sea. For the Nordics, an important issue is to find a distinct competitive position in the global economy, as many other locations are catching up and significantly improving their own competitiveness to target specific markets and types of economic activities.

The Region's competitiveness will, in the future, play out in a 'new normal' of lower growth dynamics. Past macroeconomic and structural drivers of growth have either disappeared or lost some of their steam: large gains in labour mobilisation are unlikely, at least in the medium term. Although there is potential in the labour force, it is more difficult to mobilise than before. And whether underlying labour productivity can be pushed up to prior levels or beyond is highly questionable: new job creation occurs largely in structurally less productive local sectors of the economy, and this shift effect is hard to overcome by faster innovation in traded, but also local, activities. This 'new normal' is not incompatible with growth. But while this growth might be higher than in the rest of Europe, it is likely to be lower than before the crisis and insufficient to achieve further catch-up to leading non-European regions.

What are the trends that are going to affect the trajectory of the Baltic Sea Region's economies in the future? They are largely not new, but the continuation of forces that have had an impact on the Region for a number of years: First, the transition to a knowledge economy will continue. This is likely to generate rising returns to skills in the labour force, putting pressure on the egalitarian societies of Northern Europe and raising the stakes of fixing weaknesses in the education systems, where they exist. Through changes in the innovation process, it will further transform firm demographics and co-operation across firms, creating new challenges for effective collaboration and new demands for designing effective innovation policy instruments. And it will, through the differential speed of innovation across different sectors, force the Region to broaden its perspective on innovation, and do more to unleash innovation and change, in local sectors and activities less exposed to leading-edge science as well.

Second, globalisation is going to continue but could enter a new stage. The relative weight


Domestic and International
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20 000
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to net migration
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in persons
as of 2011
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500
50
Domestic (left) and
international (right)
net migration
balance in 2011
Domestic
International
Coulour of the circle indicates if the
net migration is positive or negative
Positive (in-migration surplus)
Negative (out-migration surplus)
0
90
180 km
LLM based on commuting data in 2010.
IS - LLMs adjusted to municipal division

of economic activity is increasingly shifting to Asia, drawing attention away from Europe and with it, also from the Baltic Sea Region. The fall of trade barriers and trade costs that have pushed trade volumes to grow significantly faster than GDP are unlikely to sustain their past speed. This will make it harder for the export-oriented economies of the Baltic Sea Region to leverage international opportunities as key drivers of growth. In an increasingly competitive and differentiated global economy, locations also will need to find their place. For the Nordics, this could be anything between an FDI-driven innovation hub like Israel and a full-scale innovation-to-lead manufacturing base like Germany. For the Baltics, the options as a supplier to Nordic and Central European value chains (with some opportunities in Russia and its neighbouring countries) seems to be more of a given. Russia, Poland, and Germany, too, seem to have found their (very different) roles. While there are many positions that can support high prosperity, the paths individual countries choose will have a significant impact on the economic outcomes they can achieve.

Third, climate change and a heightened focus on environmental sustainability will continue to shape the context in which the economies of the Baltic Sea Region operate. The changes in regulations and energy prices drive huge investment needs in energy and transportation systems, and will drive significant restructuring throughout many industries. They will also drive many economic opportunities in green tech and for appropriately positioned companies in pretty much any industry. But competition is high, even now. While the Baltic Sea Region has the benefit of a strong brand and robust consumer demand for environmental solutions, these are only some of the conditions necessary to achieve success in these emerging markets.

There are other trends affecting the Region: Demographic changes that will put pressure on social security systems and create difficult demands for how to insure the skill supply in the future. Increasing urbanization will further increase the differences between sparsely populated rural regions and growing urban regions, raising challenges to provide cost-efficient access to infrastructure, public services, and housing. The recent migration trends in the Nordics are already a telling example of these dynamics. The domestic population is concentrating ever more in a fairly small number of urban regions. Foreign immigration is also the strongest in these core cities and elsewhere replaces the domestic population lost to urbanization.

And there are more idiosyncratic challenges, like the appropriate management of macroeconomic policies in the recovery process and a political pathway to shape a productive relationship with Russia in view of its behaviour in the Ukrainian crisis.

While the mix of opportunities and threats is challenging, the Baltic Sea Region has every reason to approach them with confidence. Its past success has been testament to the strong foundations that have been built.

Section C: Collaboration in the Baltic Sea Region

Ten years ago, four Baltic Sea Region states joint the European Union, enhancing an already well-developed integration, not only in economy and trade, but in practice also in other policy areas as well. A greater EU internal market – free movement of goods, services, people and investments – increased the economic dynamism and made the then-new EU Members' catch-up process proceed more quickly. At the same time, northwestern Russia's economy, with St. Petersburg as a hub, experienced rapid growth and added to the interaction and investments in the region. As a result, a Baltic Sea macro-economic region has been developed despite the fact that not all of the countries in it are members of the EU, and there are different currencies in use.

We have seen concrete results of deeper regional integration: the cross border labour market, electricity and other energy networks, better port facilities and transport corridors, and common policies for environment, green growth, maritime policy, education, youth, health and culture. Today, the challenge is to maintain this positive trend when the economic environment remains less favourable in terms of exports and investments, public funding is strained and the dynamic drive of the Russian economy and St. Petersburg region seem to be over for the time being. Better competitiveness, more entrepreneurship, innovations and smart growth are needed now more than ever. In addition to continuous needs for enhanced energy efficiency, energy security, especially for gas, is a major priority in the region.

There are some governance challenges as well. The EU Strategy for the Baltic Sea Region EUSBSR and a number of the key project clusters supported through the EU's Interreg Program have for years formed a comprehensive and solid framework for policy-making and for a wide range of projects described in this Section. For the years 2014-2020, the European Commission has worked on a new policy framework, priorities and governance models for the EUSBSR. From now on the strategy will be gradually run more by Member States and macro-regions than by the Commission. Many organisations are facing these changes when adopting to new programing and financial management rules.

The political and economic heterogeneity of the countries in the Baltic Sea Region, together with a high number of public, private, academic and civil society stakeholders, have enhanced dynamism and competition. This fragmentation can, at best, create new openings and increase sound competition. However, at the same time this heterogeneity has been a major challenge for effective co-ordination and for coherent, joint, medium-term policy-making.

In the European as well as the regional policy context, Northern Dimension and Arctic policies are complementary and closely linked to Baltic Sea Regional activities. Based on fifteen years of work, the ND has focused on four Partnerships to facilitate project implementation: environment, public health and social well-being, transport and logistics, and culture. Baltic universities, research centres and business community all contribute to the ND's projects. In addition to four ND Partners (the EU, Russia, Norway and Iceland), also participating are several EU Member States, Regional councils and several International financial Institutions, especially EIB, NIB, EBRD and NEFCO.

Another 'umbrella' policy with close links to the Baltic Sea Region is the rapidly developing Artic Sea co-operation. The common challenge is to keep these 'umbrella' policies coherent and well co-ordinated, so that they support each other in creating value and enabling synergies for their participants. Some organisations reporting their activities in this Section expressed fears that other policies' funding needs mean fewer resources and political support for Baltic Sea actors. The ideal approach is for successful ND and Arctic policies to improve the overall environment and open major new business opportunities for Baltic Sea companies.

The Baltic Sea Region Strategy, adopted in 2009, was the very first macro-regional strategy adopted by the EU. The Danube region followed in 2011, and now two other macro-regional strategies are developing. This means not only more competition within the EU but also opens new opportunities to learn from others' best practices. This Section shows that the Baltic actors have a lot to offer.

Baltic Sea Region stakeholders have to prove, more than ever before, their regional value-add and synergies to stay on the top in the face of a tough economic environment and steep competition for public funding. Public-private partnerships (PPP) still have huge untapped potential.

This part of the 2014 Report gives an update on the state of collaboration on political coherence, sustainable development and competiveness upgrading across the Baltic Sea Region. The first section provides an overview of activities that have been pursued by regional organisations. The second section tracks the evolution of the Baltic Sea Region strategy process. The third section profiles the activities of the Region's leading international financial institutions: the EIB and the NIB. This part of the Report is heavily based on contributions from the organisations, networks and projects described. We would like to thank them for describing their activities in this context.

1 EUSBSR – regional networks and initiatives

This section provides an overview of the activities that have been pursued by key regional organisations over the last year through individual and collaborative initiatives. It is based on material provided by those same organisations.

EU Strategy for the Baltic Sea Region

Governance of the EU Strategy for the Baltic Sea region (EUSBSR)[1]

The General Affairs Council of October 2013 invited the Commission to 'facilitate the discussions on improving the governance of the macro-regional strategies and to report to the Council by the end of 2014, including streamlining the reporting, reviewing and follow-up'. Following this request, the Commission will publish a Communication on the governance of macro-regional strategies by end of May 2014. It will provide concrete suggestions on how to improve the governance of the existing and upcoming strategies and therefore speed up their implementation. The Communication will be discussed at the 5th Annual Forum of the EU Strategy for the Baltic Sea Region (EUSBSR) in Turku (3-4 June) and at the 3rd Annual Forum of the EU Strategy for the Danube Region (EUSDR) in Vienna (26-27 June).

Several meetings discussing the governance of these strategies have already been held between December 2013 and February 2014 with the National Contact Points (NCPs) representing each Member State in the respective macro-regional strategies (EUSBSR, EUSDR, EU Strategy for the Adriatic-Ionian Region).

It is worth noting that the EUSBSR NCPs have prepared a non-paper on the governance of the EUSBSR. NCPs agree that political leadership belongs to Member States. However, they also take into account that it is an EU strategy, which means that a strategic guidance and monitoring by the Commission is needed, and which would also help to bring the Strategy to the policy-making level. Directorate General for Regional and Urban Policy (DG REGIO) plays its role in a transparent manner but stronger involvement of other relevant Directorates-General (DGs) is called for (for instance, they should participate in the steering groups' meetings on relevant Priority Areas / Horizontal Actions). The NCPs also agreed to have a rotating Chair for NCPs' meetings on a 6 month basis. They emphasise the role of Priority Area Co-ordinators / Horizontal Action Leaders, who should have steering committees consisting of officially appointed representatives of Member States and relevant DGs of the Commission. NCPs should also work closely with the relevant management authorities of various programmes to ensure support for the Strategy, as well as with parliaments aiming to enhance the Strategy's importance at the political level.

In order to ensure stronger cohesion between macro-regional strategies and EU programmes, the Commission is currently screening the Partnership Agreements and Operational Programmes for 2014-2020 from the macro-regional approach perspective. This is done to make sure that the objectives of macro-regional strategies are embedded into the Partnership Agreements and Operational Programmes funded by the European Structural and Investment Funds (ESIF). However, the Commission believes that the embedding strategies should not be confined to the ESIF programmes. The objectives of these strategies should be embedded in all relevant EU (such as Horizon 2020, COSME etc.), national, regional and local policy frameworks.

Transnational co-operation programmes, while retaining their existing objectives and those supporting projects, which fall under the thematic objectives, should also be used

1 A comprehensive update of the EUSBSR by the European Commission can be found in the BDF State of Region Report 2013, pp. 89–93.

effectively to support implementation of the Strategy. INTERACT will also continue to provide conceptual and developmental facilitation overall, and to allow the exchange of good ideas and approaches between regions.

Governmental and parliamentary organisations

Council of the Baltic Sea States CBSS

The **Council of the Baltic Sea States** (CBSS; www.cbss.org) was created in 1992. The CBSS provides an intergovernmental platform for regional co-operation between the eleven countries of the Baltic Sea Region as well as the European Commission. It works through network- and project-based activities and aims to boost the competitive advantage of the region.

The five priority areas for the organisation – environment and sustainability, economic development, energy, education and culture, and civil security and the human dimension – have been reviewed under the Finnish presidency.

Finnish Presidency of the Council

Finland holds the CBSS Presidency for 2013-2014. The Presidency takes the guiding principles of coherence, co-operation and continuity as focus points to be applied horizontally. The aim is to enhance the coherence and synergies among different actors in the Baltic Sea Region. A common goal of a clean, safe and smart Baltic Sea is supported by paying special attention to three priorities: Maritime Policy, Civil Security and People-to-People contacts. The development and use of green technology and alternative fuels in shipping in the Baltic Sea has been especially prioritised.

An event organised by the Finnish Presidency of the CBSS and HELCOM, in co-operation with the Baltic Development Forum (BDF) and the Northern Dimension Partnership on Transport and Logistics (NDPTL), entitled 'Sustainable Baltic Sea shipping. Green technology and alternative fuels with focus on air emissions' took place on board the LNG-fuelled passenger ship Viking Grace on January 16th, 2014.

The event brought together nearly 100 participants from the public and private sectors, policy-makers, administrations, the business community, and representatives with financial and research & development expertise. The aim was to develop a 'Draft Roadmap for future actions'. The discussions focused on two main themes: technology development and financial issues to promote pilot projects, acquisition of ships and retrofitting, as well as R&D in this field. A new co-operation forum, the 'Green Technology and Alternative Fuels Platform in Baltic Sea Shipping' was also launched at the event. The Platform provides a forum for a structured dialogue between the public sector and private stakeholders. http://www.trafi.fi/en/sustainableshipping

In the field of civil security, the emphasis is on nuclear and radiation safety, border control cooperation, as well as prevention and management of maritime accidents. One of the concrete projects in this context has identified the emergency preparedness measures implemented by the Baltic Sea States in preparing for large-scale maritime accidents.

Another focal point for CBSS actions is on climate change and the continued work on the climate change adaptation strategy for the Baltic Sea Region, specifically on the work of the **CBSS Expert Group on Sustainable Development - Baltic 21**. In 2013, the region reached one main milestone in becoming more resilient to future societal challenges. In September, the EU Strategy for the Baltic Sea Region flagship, Baltic 21 Lighthouse and EU project Baltadapt, submitted the Baltic Sea Region strategy on the adaptation to climate change for further action to BSR member states and CBSS-Baltic 21 as Leader of the EUSBSR Horizontal Action Sustainable Development. CBSS-Baltic 21 is now facilitating the continued policy process by arranging a series of macro-regional round tables on climate change adaptation with relevant national ministry representatives. The first round table took place in December 2013 in Stockholm, hosted by the Swedish Ministry for the Environment. The second round table was arranged in co-operation with the Polish Ministry for Environment in Warsaw on 29th April 2014. In May 2014, CBSS-Baltic 21 arranged in parallel a Pan-Baltic round table on climate change to discuss how to address climate change in the Baltic Sea Region in a more coherent and effective manner with relevant pan-Baltic organisations and other relevant stakeholders from different levels of governance and sectors. Through these activities, CBSS-Baltic 21 aims to establish a **Baltic Sea Region Climate Change Dialogue Platform**. It will contribute to the implementation of the EU climate policies on a macro-regional level, promoting co-operation in the area of climate change (adaptation & mitigation), informing policy development, catalysing the exchange of information and best practices. Furthermore, it will foster synergies among existing initiatives, explore further co-operation opportunities, and contribute to the identification and development of concrete joint initiatives in the field across the whole Baltic Sea Region. Awareness and preparedness to climate change differ across the Baltic Sea region. Therefore, co-operation between member states, sub-regions and relevant pan-Baltic players, including on knowledge sharing and transfer as well as on capacity-building and policy mainstreaming, must be promoted. CBSS is actively driving this process, further establishing itself as a main co-operation arena on climate change in the Baltic Sea Region. http://www.cbss.org/environment-and-sustainability/eusbsr-hasd/; www.baltadapt.eu

The Baltic Sea region has great potential to be a model region for **green economy** and to be a world leader when it comes to the development of knowledge-intensive products and services, eco-innovations, as well as environmental technology, which can increase competitiveness and create new business opportunities that reduce negative environmental impacts at the same time. CBSS-Baltic 21 has driven forward the green economy agenda of the Baltic Sea Region by promoting green public procurement, energy and resource efficiency as well as bioenergy, while facilitating project to policy process through EU-funded projects like Baltic GPP and Bioenergy Promotion.

Public purchasing power in the EU region amounts to over EUR2 trillion every year. With this purchasing power, the public sector can make a huge difference in greening markets. To achieve this goal, several instruments, tools and solutions are available – among them **Green Public Procurement**. The EUSBSR flagship and Baltic 21 Lighthouse project **Baltic Green Public Procurement, Baltic GPP** developed and established a wide **capacity-building program on Green Public Procurement** across the Baltic Sea Region (BSR). This includes a collection of good cases in green public procurement from across the Baltic Sea Region, the development of an online web training curriculum, as well as the implementation of a number of 'train the trainer' seminars in individual project partner countries. The training was produced for public procurers to give a basic understanding of how and at what stages sustainability may form a part of public procurement. CBSS-Baltic 21 facilitated two additional training seminars in non-project partner countries over the course of the project, ensuring the further dissemination of project results and GPP as a green economy tool across the region. At the request of the Latvian Ministry of Natural Protection and Nature Conservation, one training session was carried out for policy makers and procurement experts on green procurement in Riga, Latvia. A second training took place in St. Petersburg, Russia, bringing together interested Russian procurement experts, engaged in building a system for sustainable development in Russia. Both events took place in December 2013. www.balticgpp.eu

In order to support the sustainable production, commercialisation and use of bioenergy in the BSR, the CBSS-Baltic 21, in co-operation with BASREC, initiated the EU-funded **Bioenergy Promotion I & II project**. **Policy recommendations on principles and criteria on sustainable bioenergy production** and use in the Baltic Sea Region were put forward to the BSPC recommendations that were introduced and discussed at the BSPC-CBSS-BASREC Energy Efficiency Seminar, hosted by the Finnish Parliament on 3-4 March 2014 in Helsinki. The Finnish Minister for Foreign Affairs, Erkki Tuomioja, commended the interaction between CBSS and BSPC in this respect, and recognised the recommendations as important political levers to promote energy efficiency, not least at the local and regional levels. http://www.cbss.org/environment-and-sustainability/baltic-21-lighthouse-projects/

The project **EFFECT – BSR Dialogue Platform on Energy and Resource Efficiency**, funded as a **Thematic Partnership** by Swedish Institute intends to map, foster and communicate good practice solutions in eco-efficiency. They are to attract and enable cities, villages and BSR sub-regions, as well as other relevant actors from the local, regional, national and pan-Baltic levels, to jointly develop and implement policies and concrete actions towards becoming more energy- and resource-efficient, while stimulating a greener economy. In the long term, these activities will contribute to the creation of resilient societies and the promotion of the Baltic Sea Region as a green region. The outcomes of EFFECT so far are a Policy Review on Energy Efficiency for the Baltic Sea Region and a Project and Policy Review on Low Carbon Economy in the Baltic Sea Region. The project is implemented as a flagship under EUSBSR HA Sustainable Development, led by CBSS-Baltic 21. http://www.cbss.org/environment-and-sustainability/eusbsr-hasd/

Additional responsibilities under the European Union Strategy for the Baltic Sea Region (EUSBSR)

One of the major developments that have had an impact on the structure and operations of the CBSS continues to be the EU Strategy for the Baltic Sea Region. The CBSS and its various expert groups and network bodies are increasingly utilised as facilitators of co-operation among EU and non-EU Member States for some of the strategy's actions – notably in the fields of sustainable development, economic development, and civil security and crime. The CBSS Secretariat is Priority Area Co-Co-ordinator for PA Secure, which, together with Sweden, tackles emergency preparedness through an all-hazard approach. It is also joint Horizontal Action Leader with the Turku Process for HA Neighbours. Under PA Crime, the Task Force against Trafficking in Human Beings (TF-THB) is continuing with its current flagship ADSTRINGO, which focuses on trafficking for labour exploitation.

Nordic Council of Ministers NCM

The Nordic Council of Ministers (NCM; www.norden.org) is the platform for inter-governmental co-operation between the Nordic countries. NCM has a broad range of activities within 11 different Ministerial Councils. Traditionally, the areas of Education & Research, Culture, and Innovation cover over half of the total budget of about 1 billion Danish Kroner yearly (approx. 130 million Euros). Over the last few years, collaboration on competitiveness, green growth and welfare issues has received substantial focus.

Since 2007, the Prime Ministers identified several different prioritised areas for new initiatives and actions. Initiatives to meet the challenge of globalisation and to make countries more competitive were the first prioritised area. In October 2011, the Nordic Prime Ministers commissioned the Ministerial Councils to develop a number of tangible areas in which the Nordic countries would work together to generate Green Growth and Prosperity. The Prime Ministers' proposal included Nordic test centres for green solutions; education, training and research for green growth; flexible consumption of electricity; green-technology norms and standards; green procurement in the public sector; techniques and methods for waste treatment; the integration of environmental and climate considerations into development aid, and funding for green investment and companies. These projects will finish in 2015.

The newest priority action is Sustainable Nordic Welfare, the Nordic Council of Ministers' program for new welfare solutions. The program covers the period 2013-2015 and enables practical Nordic co-operation as well as Nordic dialogue, to facilitate the exchange of knowledge and learning. The program aims at ensuring that education lead to work, that health and care skills match the needs of the welfare state, and that health care maintains a good level of quality. Sustainable Nordic Welfare complements the Nordic countries' national efforts to renew welfare.

In 2013, a budget for prioritised initiatives was introduced under the Ministers of Nordic

Co-operation. Within the so-called 'priority budget', a part is reserved for the country that holds the presidency. The rationale is to increase the presidency's capacity to initiate and launch new initiatives. The rest of the priority budget is reserved to initiate new, large, politically-prioritised Nordic initiatives.

In 2014, one of the Icelandic presidency's priorities is a comprehensive initiative on bio-economy. The initiative will seek to find methods to harness biological resources, regardless of whether they stem from air, land or water. Another priority is the Nordic Welfare Watch. This initiative will, amongst other things, collect and develop unique welfare indicators that can be used as a basis for measures and strategies in the welfare area in the Nordic countries. A third priority is the development of a special Nordic playlist which will help to promote Nordic music worldwide.

The NCM mainly focuses on collaboration among the Nordic countries, but at the same time works very actively with their neighbours in the Baltic Sea Region. The co-operation with Estonia, Latvia and Lithuania takes place in areas of common Nordic-Baltic interest, with a special focus on cross-border issues, and economic and social development. The co-operation with the northwestern regions of Russia focuses on promotion of democracy, human rights and civil society, as well as cross-border issues such as organised crime, human trafficking and environmental matters. NCM plays an active role in the implementation of the EU Baltic Sea Strategy Action Plan, for instance in the fields of bioeconomy and culture. NCM is also strongly committed to the Northern Dimension. In addition, the NCM's co-operation with Poland and Germany is being developed.

The NCM has taken the lead in a horizontal action on bioeconomy, as well as in several flagship projects of the EU Baltic Sea Region strategy. In addition, the NCM strives to keep the strategy high on the political agenda of the region. Among the flagship projects led by NCM are co-operation in the areas of forestry, plant genetic resources, veterinary contingency planning, and culture and creative industries. In addition, NCM plays an active role in involving Russian partners in these projects, for instance in a project on BSR City Branding. The ambition of the NCM is that the Nordic region, and the Baltic Sea Region as a whole, benefit from this work.

Baltic Sea Parliamentary Conference BSPC

The Baltic Sea Parliamentary Conference (BSPC) was established in 1991 as a forum for political dialogue between parliamentarians throughout the whole Baltic Sea Region. BSPC gathers parliamentarians from 22 parliaments and 5 parliamentary organisations around the Baltic Sea. BSPC thus constitutes a unique and comprehensive political platform on which all the EU- and non-EU countries of the Baltic Sea Region can co-operate on an equal footing. Hence, BSPC contributes to a transparent, democratic and progressive political process, as well as to practical solutions, in the Baltic Sea Region.

The mission of the BSPC is to raise awareness and opinion on issues of current political interest and relevance for the Baltic Sea Region. It should support and strengthen democratic institutions in the participating states and promote dialogue between governments, parliaments and civil society. BSPC drives various political initiatives and efforts to support a sustainable environmental, social and economic development of the Baltic Sea Region.

BSPC also interacts with other parliamentary and governmental organisations in the Baltic Sea Region and the Northern Dimension area, such as the CBSS, HELCOM, BDF and the NDPHS.

The priority issues in the Work Programme for the BSPC in 2013-2014 are Environmental protection, Economic development and innovation, Energy efficiency, and Culture and the Human Dimension.

Instead of having permanent committees, BSPC operates political Working Groups to target specific policy areas for a limited period, in order to elaborate joint BSPC policy recommendations within those areas.

The BSPC Working Group on Green Growth and Energy Efficiency submitted its final report and political recommendations to the 22nd Baltic Sea Conference in 2013. The political recommendations of the Group stressed the need to strengthen awareness-raising efforts on energy efficiency, to boost co-operation for developing common technical standards and building codes, to improve the connections of national grids across borders, and to develop legislation that facilitates innovative financing of energy efficiency measures. The report can be downloaded at http://www.bspc.net/page/show/520.

Innovation is at the forefront of BSPC activities in 2013-2014. In a general sense, innovation is a means of strengthening economic progress, competitiveness and social welfare. It is therefore an inherent part of the efforts to secure the position and develop the advantages of the Baltic Sea Region in a wider international and global perspective. Innovation should be promoted in both the private and the public sector. Innovation is not confined to industrial production, but should be encouraged in administrative sectors and for social governance as a whole.

The 22nd BSPC in 2013 decided to launch a Working Group on Innovation in Social and Health Care. Its overarching objective is to elaborate political positions and recommendations pertaining to innovation in social and health care. The scope of work of the Working Group should cover issues such as social innovation, innovation in health care systems and services, and innovation in social welfare systems and services, with focus on elderly people. Great attention will be paid to prevention in social and health care. The Working Group will present the first part of its political recommendations at the 23rd BSPC in 2014. The final and consolidated recommendations will be submitted to the 24th BSPC in 2015.

The Baltic Sea Parliamentary Conference is the annual general assembly in the Baltic Sea region for broad political debate on Baltic Sea Region issues.

The 22nd BSPC was held in August 2013 in Pärnu, Estonia, under the heading Innovation and Competitiveness in the Baltic Sea Region. The presentations and Resolution of the 22nd BSPC can be accessed at http://www.bspc.net/page/show/650.

The 23rd BSPC will be assembled on 24-26 August 2014 in Olsztyn, Poland, under the auspices of the Polish parliament. The theme of the Conference is A Fair, Smart and Sustainable Baltic Sea Region. Information about the 23rd BSPC can be retrieved at: http://www.bspc.net/page/show/721.

The BSPC Conferences are as a rule concluded with the unanimous adoption of a Resolution, which is directed to the governments of the Baltic Sea Region, the CBSS and the EU, and disseminated to other relevant national, regional and local stakeholders in the Baltic Sea region and its neighbourhood. The Conference resolutions are political tools, which enables the BSPC to take and support political initiatives, and to approach the governments and regional organisations on issues of common interest.

In BSPC´s opinion, a basic tenet of enhanced co-operation in the Baltic Sea Region is to encourage the evolution of a deliberate division of labour between all the stakeholders in the Region. The purpose should be to strengthen their comparative advantages and, by synergies, their combined capacity to manage the challenges of the Region. Correspondingly, there should be a synchronisation of priorities of the overall policies of the Region, such as the EU Strategy for the Baltic Sea Region, the Northern Dimension, the HELCOM BSAP, and the Russian Strategy for North-West Russia.

BSPC constitutes a platform for candid political debate, which is a prerequisite for the pursuit of pragmatic approaches and compromises for complex issues. Hence, BSPC contributes to a transparent, democratic and rewarding political process, as well as to practical solutions, in the Baltic Sea Region. Or in the words of Chancellor Angela Merkel at the 9th Baltic Sea States Summit in 2012: the parliamentary dimension of co-operation in the Baltic Sea Region contributes greatly to the democratic legitimacy of co-operation.

The BSPC Website (http://bspc.net) is a central conduit for disseminating news and information on BSPC's organisation, activities and results, as well as a dynamic archive of BSPC documents and opinions.

VASAB
VISION & STRATEGIES AROUND THE BALTIC SEA

Vasab

VASAB (www.vasab.org) is an intergovernmental co-operation providing ministerial platform and an expert network that 11 Baltic Sea Region countries can use to co-ordinate spatial planning and development – the EU countries Denmark, Estonia, Finland, Germany, Latvia, Lithuania, Poland and Sweden, as well as Norway, Russia and Belarus. It is guided by the conference of ministers and steered by the Committee on Spatial Planning and Development of the Baltic Sea Region, where German regions adjacent to the Baltic Sea, northwestern Russian regions and the city of St. Petersburg are also represented. Chairmanship of VASAB follows the pattern of CBSS: Finland is the current chairing country, and on 1 July 2014 chairmanship will be transferred to Estonia. The next ministerial conference of VASAB will be held in September 2014, and the main theme of the conference is maritime spatial planning.

Based on the policy document Long-Term Perspective for the Territorial Development of the Baltic Sea Region (LTP) that was adopted at the 7th Conference of Ministers Responsible for Spatial Planning and Development in 2009 VASAB has developed the VASAB Action Plan. It has three strategic directions: 1) Promoting urban networking and urban-rural co-operation, 2) Improving internal and external accessibility, and 3) Enhancing maritime spatial planning and management. In the area of horizontal activities, VASAB continues the promotion of best practices for land-based spatial planning, and sustainable development, and has facilitated the establishment of the monitoring mechanism for the territorial development of the Region developed within the ESPON BSR-TeMo project.

Together with HELCOM, VASAB leads the Horizontal Action 'Spatial Planning' – Encouraging the use of Maritime and Land-based Spatial Planning in all Member States around the Baltic Sea and develop a common approach for cross-border co-operation in the context of the EU Baltic Sea Region Strategy.

The joint HELCOM-VASAB Maritime Spatial Planning Working Group significantly contributes to the introduction of coherent maritime spatial planning in the Baltic Sea. It has worked out common HELCOM-VASAB Baltic Sea Broad-Scale Maritime Spatial Planning Principles that have been adopted both by HELCOM and VASAB, as well as by the Regional Baltic Maritime Spatial Planning Roadmap 2013-2020 to guide regional activities to implement maritime spatial planning in all coastal states by 2020. Under the supervision and close involvement of the working group, guidelines on the application of ecosystem approach in transnationally coherent Maritime Spatial Planning (MSP), guidelines on transboundary consultations and co-operation in the field of MSP, as well as guidelines on public participation for MSP with transboundary dimension are being developed.

VASAB carries out joint MSP capacity-building activities by promoting competence through initiating and participating in MSP projects (e.g. PartiSEApate), organising events to present good practices, sharing information and experiences as well as supporting educational activities.

Baltic Sea States Sub regional co-operation BSSSC

The Baltic Sea States Sub regional Co-operation (BSSSC) is a political network for regional authorities in the Baltic Sea Region. The BSSSC co-operates closely with other Baltic Sea and European organisations in order to promote the common interests of the regions around the Baltic Sea. In 2013-2015 the chairmanship of the BSSSC is held by the Helsinki-Uusimaa Region, Finland.

During the Helsinki-Uusimaa chairmanship six policy areas are highlighted by the BSSSC. Focus is laid on:

- maritime policy (e.g. maritime spatial planning and maritime safety)
- energy and climate issues (e.g. renewable energy sources)

- youth affairs (e.g. youth entrepreneurship and youth unemployment)
- Northern and Arctic Dimension (e.g. the Barents and the Norwegian Sea issues and the North-East Passage as a transport corridor)
- cohesion policy (e.g. establishing a platform for exchanging experiences on cohesion policy implementation in the regions)
- transport and infrastructure issues (e.g. improving connectivity, strengthening accessibility and promoting the transport corridors of the BSR)
- culture and regional identity (integrating the region, developing and strengthening a regional identity in the BSR, supporting social and economic innovation and the work of EUSBSR PA Culture).

In addition to the policy sectors, BSSSC is in 2014 revising its Terms of References in order to focus its future work and to better serve its purpose as the voice of the regions in the BSR.

Co-operation with other Baltic Sea organisations has traditionally been very important for the BSSSC. In 2013 the BSSSC, BDF, B7, CBSS, CPMR Baltic Sea Commission and UBC agreed on co-operation in the sectors of maritime issues, culture, youth affairs and energy and climate issues. As the regional council of Helsinki-Uusimaa also holds the secretariat of the CPMR Baltic Sea Commission, the secretariats of the BSSSC and CPMR BSC will be combined during 2013-2014.

The BSSSC Annual Conference, the organisation's main forum for exchange of ideas and interests, will be held in Jurmala, Latvia on the 16th of October 2014.

Union of the Baltic Cities

The Union of the Baltic Cities (UBC; www.ubc.net) is the leading organisation of cities and local authorities in the Baltic Sea Region. It was founded in Gdansk in 1991, and is one of the first pan-Baltic organisations born after the cold war.

UBC has two main goals: to promote, through co-operation and exchange, the sustainable development and prosperity of its member cities and their inhabitants, as well as to ensure that the interests of the Baltic Sea Region and its cities are listened to in the capitals and in Brussels. UBC participates very actively in the implementation of the EU Strategy for the Baltic Sea Region, which it sees as a major step forward in promoting goal-oriented and target-oriented co-operation.

UBC counts among its members big cities such as St. Petersburg, Tallinn, Riga, Vilnius, Helsinki, Malmö and others, but also many middle-sized and smaller towns. It has altogether more than 100 fee-paying members, including Russian and Norwegian cities.

The highest organ of the UBC is the bi-annual Congress. The theme of the most recent Congress (1-4 October, 2013 in Mariehamn, Åland Islands) was 'Investing in young people: Combating youth unemployment and marginalisation – from words into action'. The debates were based on a much-praised 'UBC Programme to promote youth employment and well-being', prepared by experts representing ten Finnish member cities.

The Congress nominated a Task force to continue UBC work on youth issues. It shall report to the forthcoming XIII Congress in Gdynia (2015).

The Mariehamn Congress elected an Executive Board for the period of 2013-15, consisting of the President, three Vice-Presidents and one member city from each country. The Board meets normally three times a year. The General Secretariat is hosted by the City of Gdansk in Poland.

The UBC member cities co-operate on a wide range of political, economic, social, cultural, and environmental issues. UBC promotes the exchange of know-how and experiences between the cities through seminars, courses, and publications.

Its many projects and practical work are carried out through thirteen thematic Commissions. They are hosted by different member cities, thus engaging them in the practical activities of the UBC. Some of them have Secretariats consisting of full-time professionals.

UBC is continuing a dynamic internal renewal process with the aim of strengthening its capacity to react to new challenges and to participate in key processes, such as implementation of the EUSBSR. By continuing to deliver added value – and "value for money" - to its member cities, it aims not only to strengthen its own work but also to contribute to the development of the Baltic Sea Region – bearing in mind that cities are key engine of growth and innovation in an ever more urban and global world.

With this in mind, UBC has started to implement a set of dynamic changes, both in the way it operates internally and in how it is organised. For example, now UBC Commissions report annually to the Board, which evaluates their results, impact and future plans and allocates resources accordingly.

The Mariehamn Congress also obliged the Board to streamline the organisational structure through mergers so that, starting at the beginning of 2015, UBC shall have 5-7 well-functioning Commissions covering the main areas of its work.

UBC has also started to implement in practice its Communication and Marketing Strategy to inform its members, stakeholders and the public better.

The EU Strategy for the Baltic Sea Region has provided a very useful framework for regional co-operation, and the concept of multi-level governance can significantly boost joint efforts. UBC has defined participation in the EUSBSR implementation as its priority, and, thus, is involved in many ways. Some of its member cities function as leaders in various priorities, horizontal actions or flagship projects.

UBC, consisting of member cities from all the countries in the Baltic Sea Region, has from the very beginning stressed the need to co-operate 'across borders'. We share the analysis of the EUSBSR, that many of the goals of the EU Strategy can be reached only by working with our neighbouring countries, such as Norway, Belarus and the Russian Federation, and that this co-operation is based on a "win-win" concept. In times of heightened international tension, it is important to sustain functioning ties and dialogue and to continue to seek common good.

UBC cooperates closely with many BSR organisations, especially the Baltic Development Forum and BaltMet.

A substantial and far-reaching example of UBC-BDF co-operation is the EUSBSR seed money-supported initiative to develop a Baltic Sea Forum for Smart Cities. This work is important in many ways: it addresses a key challenge to find smart, sustainable and quality solutions to the burning issues of cities (energy efficiency, climate change, transport needs, elderly care etc) in an age of economic austerity through co-operation with the private sector, local authorities – and citizens as the end-users. Thus, this PPP initiative also breaks the 'silos' and brings various stakeholders together – another key achievement of the EU Strategy

Euroregion Baltic ERB

In 2014 a lot of effort was made to participate in the programming process within the South Baltic CBC Programme 2014-2020. Supported by its task forces, Euroregion Baltic has contributed to the development of the Programme measures in such a way that good financial support will be available to organisations and institutions in the region willing to co-operate in the future. Euroregion Baltic Board promoted thematic objectives and investment priorities within the South Baltic CBC Programme 2014-2020, based on the Euroregion Baltic 2020 Agenda, recommending thematic priorities related to enhancing the competitiveness of SMEs, protecting the environment and promoting resource efficiency as highly relevant, and priorities related to promoting sustainable transport, promoting employment, and supporting labour mobility as relevant. All these thematic priorities were finally included in the new programme. Euroregion Baltic also actively supported the inclusion of measures in the programme facilitating co-operation with the goal to improve SME internationalisation, innovation and exports. Such co-operation will be possible in the new programme, and Euroregion Baltic will continue its efforts to improve business-to-business links in the area, for example by drawing on the results of the ongoing research of potential business cooperation between small and medium enterprises in South Sweden and North Poland, which should be completed in 2014.

In 2013, Euroregion Baltic also collaborated with Bornholm and other partners from around the Baltic Sea on the establishment of the Baltic Sea Cluster Development Centre (BSCD) whose aim is to co-develop activities and jointly deliver services to clusters in the Baltic Sea Region. BSCD is intended to be a network/knowledge hub on cluster development in the Baltic Sea Region and a business-to-business co-operation between clusters in the region to support the internationalisation of start-up companies and SMEs in clusters. In 2013, the Euroregion Baltic Task Force on Cohesion Policy assisted in Euroregion Baltic's role as one of the actors preparing the South Baltic CBC Programme in 2014 - 2020.

In 2014, the links to the EU Strategy of the Baltic Sea Region were strengthened too. The Euroregion Baltic Task Force on EU Cohesion Policy prepared a roadmap of current and further involvement in the EUSBSR. Euroregion Baltic working structures are already involved in the implementation of the EUSBSR: the Task Force on Labour Cooperation is an observer at the Baltic Sea Labour Forum (EUSBSR flagship), Euroregion Baltic Water Core Group has proposed that the WaterNets project become a EUSBSR flagship, and Business Link Greater Copenhagen (Bornholm) are also in contact with relevant flagship projects regarding the Baltic Sea Cluster Development Centre. In addition, Euroregion Baltic also financed the Youth Board's participation in the EUSBSR Annual Forum in Vilnius, Lithuania on 10-11th November 2013, where a special meeting of the Baltic Sea Youth Forum was held. The goal of this Youth Forum is to unite different organisations and structures that represent youth and exist at different levels in the Baltic Sea Region in order to bundle their opinions and concerns and eventually strengthen their influence.

Continually striving to make Euroregion Baltic an effective tool to tackle common challenges and to deliver benefits to its stakeholders, we held our 4th Annual Forum in Kalmar on 4th September 2014. Themed 'Connecting local actors', the 4th Forum gathered representatives of local and regional authorities, as well as experts and practitioners from the tourism sector and labour mobility networks from the co-operation area. The first part of the Forum informed the participants of new co-operation possibilities within the South Baltic Cross-border Co-operation Programme and facilitated an exchange of project ideas between interested actors. During the debate, the stakeholders also discussed specific ideas and proposals regarding the thematic objectives and investment priorities of the programme for 2014-2020. During the second part, the stakeholders attempted to investigate the potential for blue and green growth in the South Baltic. Showcasing several tourism projects with active involvement of the Euroregion Baltic partners, the Forum also focused on tourism as the third largest socioeconomic activity in the EU with a positive effect on economic growth and employment. The final part of the Forum was devoted to the problem of improving labour mobility. It involved presentations of labour mobility projects currently implemented by the Euroregion Baltic partners and a discussion of specific ideas and interests from the regional and local representatives, as well as other actors involved in the projects or other activities enhancing labour mobility and employment in the Baltic Sea Region.

In 2013, activities in Euroregion Baltic focused on the issues of labour mobility and youth employment. The Task Force on Labour Market Co-operation continued investigating perspectives for the development of the labour market in the South Baltic area. On 14th November in Olsztyn, Euroregion Baltic, Self-Government of Warmińsko-Mazurskie Voivodeship and Regional Labour Office in Olsztyn co-organised a conference entitled: 'Support to youth on the labour market – experiences and future perspectives'. It gathered politicians, labour market experts and youth from the Euroregion Baltic member regions. The objective was to present activities oriented towards supporting the employment of young people entering the labour market. This issue was raised from the perspective of the European Union, regional authorities and non-governmental organisations. The agenda contained addresses regarding the European Commission 'Youth Guarantee Initiative', EURES network activities for labour mobility, activities within the Polish labour offices, and Voluntary Labour Corps. In addition, projects addressing youth, e.g.

SYPERB (Strategic Youth Policy in Euroregion Baltic), and volunteers in European Mobility Programmes were presented. The Euroregion Baltic Task Force on Labour Market Cooperation coordinated Euroregion Baltic collaboration with the Baltic Sea Labour Forum and EURES offices in the Euroregion Baltic area. The Task Force on Labour Market Co-operation proposed facilitating networking in Euroregion Baltic through the establishment of EURES regional teams that would exchange information, do research, perform analysis of the labour market, and support employers and job-seekers. To this end, Euroregion Baltic President, Mr. Per Ole Petersen, sent letters to the national EURES managers in Denmark, Germany, Lithuania, Poland, and Sweden, as well as members of the European Parliament from these countries who deal with issues of employment. Euroregion Baltic Task Force on Labour Market Co-operation also co-operated with the project called 'South Baltic Professionals' and contributed to a specially-designed job portal for the whole South Baltic Region which tackles the structural challenges of the area. Job seekers can now find, in only one portal, job offers from eight South Baltic Regions, including Klaipeda in Lithuania, Kaliningrad in Russia, Kalmar in Sweden and the Tri-city area in Poland.

Within the Euroregion Baltic Task Force on Labour Market Cooperation, a discussion was initiated on a project idea that would contribute to the work that Euroregion Baltic pursues in order to reduce unemployment among young people. A proposal was made to address the problem of dropouts among high performing upper secondary education students, a target group which has not been explored so far, with the majority of projects working with those who drop out because of learning problems, disabilities or unfavourable social conditions. It was agreed that a pre-study will be necessary to investigate this new target group and a partnership to pursue this was formed between the cities of Vaxjo, Klaipeda and Sopot. The application was successfully submitted to the Swedish Institute and the project will be implemented in 2014.

Youth co-operation as such has been a part of our co-operation to which the Euroregion Baltic partners have paid a lot of attention. In 2013, Euroregion Baltic stakeholders supported youth in their participation in projects and events. We drafted and submitted a project called SYPERB (Strategic Youth Policy in Euroregion Baltic) with full support by the Euroregion Baltic Executive Board and formally approved by the Swedish Institute. The purpose of this project is to carry out a Lupp survey and to use it as a tool to improve everyday life for young people in the co-operation area. This will also contribute to the international exchange between youths, civil servants and politicians in the Baltic Sea Region. This co-operation will also target universities.

Baltic Sea Region
Programme 2007-2013

Baltic Sea Region Programme 2007-2013

The EU Baltic Sea Region Programme 2007-2013 (website: eu.baltic.net) is one of the 13 European transnational co-operation programmes. The strategic objective of the Programme is to strengthen the development of a sustainable, competitive and territorially-integrated Baltic Sea Region by connecting potentials over the border. The Programme's decision-making committee includes eight EU Member States as well as Norway, Belarus and the Russian Federation's northwestern territories. The Investitionsbank Schleswig-Holstein, a public development bank in Germany, jointly manages the Programme.

By now, the Programme has committed all its funds to 90 projects involving roughly 1390 partners in eleven countries. Of these, 68 projects have already finalised their activities. The remaining 22 projects will close their activities by mid to end of 2014. To date, more than EUR 143 million out of the total of EUR 215 million committed funds were paid out to the projects comprising EU funds from the European Regional Development Fund (ERDF), and the European Neighbourhood and Partnership Instrument (ENPI) as well as Norwegian national funds.

In addition to regular projects, the Programme has funded three cluster initiatives in 2013: 'Baltic cluster for sustainable, multimodal and green transport corridors', 'Saving the Baltic Sea Waters' and 'Innovation in SMEs'. Cluster members included on-going and finalised Baltic

Sea Region Programme projects. The main objectives have been to exchange knowledge and to accumulate results. Cluster leaders also strengthened links to the stakeholders of the EU Strategy for the Baltic Sea Region (EUSBSR). For instance, the water cluster joined forces with the co-ordinators of the EUSBSR Priority Areas Nutri and Agri. The cluster partners participated in meetings organised by Priority Area Coordinators (PACs) to transmit their recommendations to political decision-makers.

The EU Strategy for the Baltic Sea Region (EUSBSR) continued to play an important role in the Programme implementation in 2013. A total of 49 projects approved by the Programme show a clear link to the EU Strategy. This includes 26 flagship projects, as set out in the EUSBSR Action Plan, and 19 projects that are a part of a larger flagship. Furthermore, two projects that are part of a horizontal action as well as two projects in a strategic action are funded. It means that 63% of the ERDF funds available for projects in the Programme directly support the implementation of the EUSBSR. By their nature, most of the projects contribute to one of the EUSBSR Priority Areas. For instance, the transnational performance of innovation sources (such as higher education organisations and SMEs) was improved and links were built between SMEs and research organisations. These are steps towards establishing a common Baltic Sea Region innovation strategy under the EUSBSR Priority Area Innovation. As an example, the project BSR QUICK established a network of higher education institutions and SMEs' representatives and set up three clusters for dealing with environmental issues, construction technologies, and human resources and organisational development. The project PlasTEP established links between research and business areas through pilot exercises. In concrete terms, the project dealt with technological solutions and facilitated SME involvement in tests of a plasma-based cleaning technology which was developed by research organisations.

The Programme's co-operative character and limited resources do not allow for a contribution to major investments foreseen in the EUSBSR. Projects funded by the Programme are instead preparing or developing supporting actions for larger investments implemented in the frame of EUSBSR.

In early 2013, the EUSBSR Seed Money Facility was launched with funds from the European Parliament. The Investitionsbank Schleswig-Holstein equally manages the Seed Money Facility. Seed money is intended to support the preparation of project applications that contribute to one of the Priority Areas or Horizontal Actions of the EUSBSR. In this framework, institutions receive funding to draft a project plan to be further developed into an application to any of the EU or national funding sources, e.g. the European Structural & Investment Funds programmes 2014-2020.

The preparation of the successor Baltic Sea Region Programme 2014-2020 had already started in 2012 and continues at high pace to date. The strategic focus of the future Programme will address four thematic priorities: 'Capacity for innovation', 'Efficient management of natural resources', 'Sustainable transport', and 'Institutional capacity for macro-regional cooperation'. Support for the EUSBSR will continue to be one of the major focal points. It is intended to promote co-operation projects with organisations from the northwestern territories of the Russian Federation and from Belarus. The geographical coverage of the Programme will remain unchanged, while the Programme budget (ERDF) will increase moderately.

For more information about the state of Programme implementation, a project portfolio, and the state of programming, please visit the Programme website at www.eu.baltic.net.

Bonus

BONUS is the joint Baltic Sea research and development programme, which issues competitive calls on Baltic Sea research and innovation for the scientific community and enterprises, and funds projects of high excellence and relevance. The aim is to produce knowledge, scientific evidence and innovation solutions needed by policy-makers, and to engage end-users and society in the knowledge-based governance of the fragile Baltic Sea.

The BONUS research supports sustainable development and ecosystem-based management of the Baltic Sea Region, the HELCOM Baltic Sea Action Plan and the EU Marine Strategy Framework Directive and other European, regional and national coastal and marine environmental policies and plans. BONUS is funded jointly by the national research funding institutions in the eight EU member states around the Baltic Sea and the European Union's Seventh Programme for research, technological development and demonstration, for a total of EUR 100 million for the years 2011–2017. Russia participates in BONUS through bilateral agreements.

At the core of the BONUS programme is the BONUS strategic research agenda 2011-2017 (www.bonusportal.org/sra) upon which all the BONUS calls are based. The agenda was published in 2011, and thereafter regularly updated in order to ensure that the most critical research needs would be considered at all times. In January 2014, marking the end of the first full year of implementation of BONUS, the 2014 update was published just in time to serve as the basis for the BONUS calls opening in 2014. To date, BONUS has engaged over 800 stakeholders in inception and update activities of the strategic research agenda across the macroregion of the Baltic Sea.

A special Issue of AMBIO: BONUS+ in Support of the Ecosystem Approach to Management in the Baltic Sea was published in February 2014 and showcases the legacy of the BONUS pilot programme BONUS+ that ran in 2009-2011, also in support of our shared goal of the ecosystem-based approach to management in the Baltic Sea. Introduced are the 16 BONUS+ projects that received funding of a total of EUR 22 million (AMBIO Volume 43, Number 1 //link.springer.com/journal/13280/43/1). The HELCOM Baltic Sea Action Plan is used as a case study to illustrate the potentials and challenges in building the science–policymaking interface at the macroregional level. The 16 projects addressed environmental challenges in the Baltic Sea as defined by the Baltic Sea Action Plan, or considered environmental governance and decision-making within the Baltic Sea context in general. Eutrophication, biodiversity, hazardous substances, maritime activities, and environmental governance were addressed, as were crosscutting issues, such as the impact of climate change, maritime spatial planning and the impacts of future development on ecosystem services. At the end of the implementation phase of BONUS+, these projects had contributed to a vast number of relevant policy developments: 37 consultations were carried out at the EU level, 49 modifications were made to policy documents and action plans, 153 suggestions were made for the efficacy of pertinent public policies and governance, and on 570 occasions, scientists working in BONUS+ projects served as members or observers in scientific and stakeholder committees.

A total of EUR 33 million of funding was provided for the 20 successful projects of the BONUS call 2012. All projects funded are now tasked with continuing the BONUS+ legacy and contributing significantly to development and implementation of policies, regulatory documents and management practices as well as to the delivery of specific technological solutions aimed at the sustainable use of the ecosystem's goods and services. This call ran from November 12th, 2012 until the spring of 2013: the research part closed on February 14th and the innovation part, which was organised in collaboration with the EUSBSR programme's flagship project BSR Stars, on March 12th. A year later, seven research projects within the overall theme of 'Viable ecosystem', worth EUR 26 million, that were selected for funding were officially announced in a high profile event held at the European Parliament in Brussels in November 2013. These projects will now be implemented over the next 4 years (2014-2017) with EUR 3.5-4 million of funding for each project. The 13 innovation projects, worth EUR 7 million (max. EUR 0.5 million per project), were invited for negotiations in 2013, now with a view to officially launch the innovation projects on 19/20 May at the European Maritime Day 2014 in Bremen. Further information on the projects is made available, for instance on the BONUS website from that day on. By the summer 2014, the innovation projects will also have commenced their 3 year implementation phase.

The seven 'Viable ecosystem' projects are (www.bonusportal.org/ve):

- **BAMBI** - **Ba**ltic Sea **m**arine **bi**odiversity – addressing the potential of adaptation to climate change

- **BIO-C3 - Bio**diversity changes – investigating causes, consequences and management implications
- **INSPIRE** - Integrating **sp**at**i**al p**r**ocesses into **e**cosystem models for sustainable utilisation of fish resources
- **COCOA** - Nutrient **co**cktail in **coa**stal zones of the Baltic Sea – improving understanding of the transformation and retention of nutrients and organic matter in the coastal zone
- **SOILS2SEA** - Reducing nutrient loadings from agricultural **soils to** the Baltic **Sea** via groundwater and streams
- **BLUEPRINT** - Reducing nutrient loadings from agricultural **soils to** the Baltic **Sea** via groundwater and streams
- **CHANGE -** Changing antifouling practices for leisure boats in the Baltic Sea
- The 'BONUS call 2014: Sustainable ecosystem services' was the next competitive BONUS call opened for proposals, this time targeting research in support of the sustainable ecosystem services of the Baltic Sea. Proposals submitted by the deadline of 16 April 2014 can apply up to EUR 2 or 3 million, depending on which of the six themes addressed (as outlined in the BONUS strategic research agenda), for a maximum of 3 years' implementation per project. In this call, the funding available totals EUR 15 million. By the pre-registration deadline on March 17th, BONUS received in total 60 preregistrations with 382 partners representing all eight BONUS participating states, Russia and nine other countries. The call will close on April 16th and the evaluation will begin with a view for the independent, international evaluators to select the new projects later in the year.

A further call is envisaged to open in the latter part of 2014, and then to cover both research and innovation themes. An entirely new theme planned to open in this call is sustainable aquaculture in the Baltic Sea Region. In addition, some of the themes opened but left unaddressed in the previous calls may well reopen, depending on funding limits.

BONUS values partnerships and looks forward to continuing close collaboration with key partners such as HELCOM, EUSBSR, BDF, CBSS, BSSC, OSPAR, ICES, JPI, VASAB, and many others that share common goals for the knowledge-based governance of the Baltic and other regional seas in Europe and beyond. By launching the BONUS call 2012: Innovation and further themes later in 2014, also dedicated to innovation, BONUS has continued to pioneer the basic idea behind the EU's strategic framework for research and innovation funding, Horizon 2020, and EU's initiative of 'blue growth' in a sustainable way, for instance. BONUS looks forward to also continuing to collaborate with relevant macroregional networks of companies, research actors and financiers that have emerged, in particular around the EU Strategy for the Baltic Sea Region.

BONUS is currently considering its future after the end of 2017, then possibly with the Horizon 2020. As a forward-looking model for other forms of future regional seas research co-operation with common European value, the possibility of broadening of the thematic and/or geographic scope of the BONUS programme is also being examined.

www.bonusportal.org

SI. Swedish Institute.

Swedish Institute SI

The Swedish Institute (SI) is a public agency established in 1945 as an association for cultural exchange aiming to develop international co-operation. In the 1950s and 1960s the institute broadened its scope to include university co-operation and developmental aid. In 1970 the institute took its current name and was transformed into a government-funded foundation.

In the early 1990s, following the fall of the Berlin Wall, SI turned its focus eastwards. Within the fields of education and research, SI created the Visby Programme for knowledge exchange with the Baltic States, Poland and northwestern Russia. This provided grants to some 500 scholars annually. In parallel to this, and particularly from 2000 onwards, public diplomacy and the promotion of Sweden as a country became focal areas for SI.

In 2011, the Swedish Government decided to merge the Baltic Sea arm of the Swedish International Development Cooperation Agency (Sida) with SI. The Sida Baltic Sea Unit had been created in the wake of the 2004 EU enlargement as a vehicle to further promote and develop relations and co-operation between actors in the Baltic Sea Region. This goal was achieved through a combination of seed-funding, advice and promotional activities and the unit gave support to some 580 projects with 250 different lead partners from 2005 to 2011.

From 1 January 2012, national funding lines targeting the wider Baltic Sea Region – including Russia and the Eastern Partnership (EaP) countries – were centralised in one government agency, the Swedish Institute, with the dual mandate to support the implementation of the EU Strategy for the Baltic Sea Region (EUSBSR) and the EaP. The new SI Baltic Sea Unit retains its office in Visby (Gotland) and has a staff of 20, with some people located at the SI main office in Stockholm. Currently (2014) the turnover for the SI Baltic Sea Unit is planned at EUR 6.2 million.

In summary, the SI Baltic Sea Unit (si.se/balticsea) offers a broad range of opportunities for actors in the region – be it in the form of financial project support, leadership programmes, advice, information or networks. The activities in the Baltic Sea Region are thus also an integral and important part of the overarching ambitions of the Swedish Institute to contribute to international co-operation and development through strategic communication and the creation of lasting and active relations with individuals, organisations and businesses in other countries.

FUNDING

An important line of work incorporates funding offers and accounts for close to two-thirds of the SI Baltic Sea Unit budget. The one-year seed financing (project initiation) is a facility where Swedish lead partners can apply for up to EUR 48,500 for regional projects. The aim can either be to develop a new idea, start new collaboration(s) or expand existing ones with partners in Estonia, Latvia, Lithuania, Poland, Russia, Ukraine or Belarus (in some cases also Moldova and Georgia). In 2012-2013, some 70 such projects were granted, involving approximately 200 non-Swedish partners in the wider Baltic Sea Region.

Another type of funding is the three-year thematic partnerships: this is more 'action-oriented' and presupposes an established and multi-sector partnership in the region. In 2012-2013, 22 such partnerships were granted support, receiving EUR 330,000 each. Another facility is the so-called third country component, whereby actors can apply for funding to support the inclusion of non-EU partners in primarily EU-funded projects.

LEADERSHIP PROGRAMMES

Various leadership programmes have also grown to become a core element of the SI offer in the Baltic Sea Region, making up close to 30 per cent of the planned 2014 turnover. A common trait is that these programmes aim to support individuals in their role as 'change agents'. They do so by giving them the tools (knowledge, insight and networks) necessary to strengthen them professionally and the opportunity to develop their ambitions in collaboration with individuals from other countries in the region.

Currently the Baltic Sea Unit supports five such programmes in the region, all with a different focus. The longest-standing programme is the SI Management Programme Northern Europe, which has been operational since 2007 and which targets young managers and decision-makers from the region. The themes for the programme are corporate social responsibility, business development and innovation. A second programme – now in its third year of operation – is the Baltic Leadership Programme (BLP), which focuses on developing the skills and networks of individuals already working directly with one of the prioritised areas within the EUSBSR.

The Balticlab programme, organised since 2012 in co-operation with the Secretariat of the Council of the Baltic Sea States (CBSS), targets young (aged 23-33) creative industry professionals and entrepreneurs. The programme seeks to act as a bridge between the creative sector and those already working with cross-border issues in the Baltic Sea Region. This programme and one of the BLP programmes were both designated as flagship projects under the EUSBSR.

In 2014, two new programmes are being launched. The first is called SI Leadership Programme Resilient Entrepreneurship — targeting Baltic Sea Region entrepreneurs with an interest in resilience issues — organised with the Stockholm Resilience Centre (SRC). The second new programme is one where the Baltic Sea Unit co-operates with Swedish universities to offer a SI Summer Academy for Young Professionals, open to masters level students and junior civil servants from EaP countries.

Box: BSR StarDust project

The flagship programme BSR Stars aims to catalyse internationally-collaborative innovation activities. BSR Stars is based on the challenge-driven and smart specialisation approaches. The challenge-driven approach assumes that 'grand societal challenges' (created by e.g. demographic, urbanisation and environmental trends) also form 'grand opportunities' for future business growth. For the BSR macro region, the smart specialisation approach means forming 'smart' alliances between different research and innovation milieus (involving companies and research actors with specialised knowledge) – creating unique combinations of complementary competencies with good potential to develop new solutions that meet market needs.

In 2013, the StarDust project was finalised – as a first step towards realising the overall long-term goals of BSR Stars. StarDust was initiated in 2010 for testing the strategic policy frames and was led by VINNOVA in Sweden. Within this project, we have managed to test this challenge-driven, macro-regional smart specialisation approach, delivering on ambitious targeted results and proving the potential of such an approach. We have shown the value of a common policy framework – the BSR Stars programme – which has acted as a bridge-builder and catalyser for innovation activities between actors from neighbouring countries. StarDust has focused on testing collaborative methods and policy support for a set of five transnational innovation partnerships called 'pilots'. From 2014 on, the pilots are represented in the portfolio of the BSR programme as transnational innovation partnerships and operate in the following areas:

- Active for Life: New solutions for wellbeing and active ageing
- Clean Water: Partnership for increased business opportunities within the water sector
- Comfort in Living: Kitchen concepts for the elderly
- MarChain: A partnership for maritime collaboration
- Mobile Vikings: A platform for increased innovation capacity and business mobility in mobile telecom

In total, StarDust mobilised 35 partners from the public and semi-public sectors. These partners were supported by 48 associated partners from national, regional and local levels. This set of partners represents all national ministries and innovation agencies in the ten Baltic Sea countries.

More than 800 SMEs have been engaged in the project activities e.g. in match-making events, signal sessions or the user-driven innovation camps. SMEs and other involved companies in various branches (e.g. Electrolux, Telia Sonera and ThyssenKrupp Marine Systems GmbH as well as Germanischer Lloyd SE) have contributed to the development of 32 new product concepts and prototypes across the five pilots. Among them are, for example, new furniture prototypes for the elderly developed by the companies, students and researchers within Comfort in Living, or new personalised mobile guides for the tourism branch, which were developed by students and companies within the DEMOLA platform.

Longer-term collaboration has been developed at different levels: pilot partners' organisations have strengthened their networks and gained knowledge about strong partners, as well as knowledge in other countries. New transnational agreements on innovation and collaboration have been initiated between cluster organisations in different countries. One example is the Business Roaming Agreement between partners in Mobile Vikings, which enables SMEs to use each other's facilities and gain access to each other's network while visiting another country.

The overall aim for the five partnerships was to establish sustainable platforms for continuous development and dynamic smart specialisation. During the implementation of StarDust, all partnerships have been developing individual Strategic Action Plans – where they define their common vision and agenda, and create a "road map" for future operations reaching 2020 and beyond. As part of the BSR Stars portfolio, activities will therefore be continued within the BSR programme during 2014.

EU PROJECTS

Another line of work of the SI Baltic Sea Unit concerns its direct involvement in various EU-related initiatives. With regard to EU-funded projects, the unit has been a partner in a series of projects over the years, most recently Baltic Compass, the 14.3 project, InnoHeat and ONE BSR. The involvement is based upon the vision of sharing expertise and at the same time learning and thus enhancing counselling about EU projects to other parties. This involvement has also enabled the inclusion of non-EU members in these projects.

The SI Baltic Sea Unit has also been engaged as a focal point for the Horizontal Action (HA) Promo and is, as of 2014, engaged as the Horizontal Action Leader for HA Involve. The EU-related engagements have, at a modest cost (approximately 6 per cent of 2014 turnover), allowed SI to be directly connected to the enactment of the policies underpinning the EUSBSR.

STRATEGIC COMMUNICATION

A final line of work of the SI Baltic Sea Unit is strategic communication. The goal of communication and information activities is to increase engagement for co-operation in the region and to boost awareness of relevant policies (for example the EUSBSR) and the opportunities that exist to help their implementation. The organisation and participation in national and international meetings, conferences and workshops is one of the methods; information and promotional materials is another. The SI Baltic Sea Unit also supports the implementation of region-wide platforms for the distribution of information on funding.

OTHER ACTIVITIES

In addition to the activities co-ordinated through the Baltic Sea Unit located in Visby, SI supports a broad range of other activities targeting the Baltic Sea Region in a broad sense. For example, it supports language education in Swedish throughout the region. There is also an extensive and active alumni network with more than 4000 SI alumni in the region (some 1,900 in Russia, 800 in Ukraine, 500 in Belarus and 700 in total in Estonia, Latvia, Lithuania and Poland). SI alumni can seek funding to organise events and networking meetings in their respective home countries. Furthermore, SI continues to offer scholarships for undergraduate, post-graduate and research level scholars in the region through its Visby Programme (studyinsweden.se). There is also a programme whereby foreign journalists may visit Sweden for shorter study visits. More information about the SI Baltic Sea Unit can be found at our webpage (si.se/balticsea).

Box: regional cooperation – the case of Oresund

The Oresund region enjoys a long history of cross-border interaction

Stretching from the metropolitan area around Copenhagen across the sound to southern Sweden with the cities of Malmö, Lund and Helsingborg, the Oresund region enjoys a long history of cross-border interaction and co-operation.

The opening of a bridge between the two countries in 2000 was a reaction to the decline of traditional industries and rising unemployment on both sides that has since been overcome by an improved physical connection and an area branding of the Oresund region. Movement of people and goods across the border was facilitated and the region was becoming more integrated and wealth-generating.

Since the world economic crisis and its resultant changing price differentials have significantly slowed down mobility and integration of the two sides of the sound, the bridge alone is no longer sufficient to ensure and increase collaboration and integration in the Oresund.

A high level of education and innovation characterises the region

While more than two thirds of the region's 3.8 million inhabitants live on the Danish side, efforts to build an 'Oresund identity' in a culturally and linguistically similar but still diversified population stand high on political agendas. Population as well as economic growth and activity are concentrated in the central area of the Oresund, around Copenhagen, Malmö and Lund. The disparities between the centre of the region and its periphery are growing, especially in terms of population density.

In general, the education of the Oresund's inhabitants is very high, although again there is a difference between the urban cores and their surroundings. Overall, the share of the working age population with a higher education degree reaches 35%, compared to the 32% national average of both countries.

The high level of education is closely related to a high level of innovation with strong clusters in the cleantech and life science sectors. According to the Regional Innovation Scoreboard of the EU, the whole area is one of Europe's 'innovation leaders'. R&D expenditures of 4.9% of the GDP in the region outperform national expenditures of 3.4% and 3.1% respectively for Sweden and Denmark in 2010, which still exceed the 3% Barcelona target set by the EU to develop knowledge-based economies.

The integration of the region is facing challenges

Despite good prerequisites, the Oresund is facing several challenges concerning the labour market, integration and economic development of the region.

The delocalisation and job cuts of key multinationals such as Astra Zeneca, partly due to strong global cluster competition in the life sciences, have had an impact on the job market in the past years. Specialisation in high-tech industries on the one hand creates jobs and improves the region's attractiveness to multinationals, but on the other hand leads to a dependence on few large companies, and their strategic decisions have significant economic impacts on the region.

Nevertheless, both sides of the sound show an increased demand for high-skilled workers, with labour shortages already existing in the welfare and health sector, education and ICT. The common labour shortages are exacerbated by an ageing population, and lead to increased competition for new talent between the two sides.

The integration of the two sides of the sound into one Oresund region has declined since the world economic crisis. The termination of significant cross-border initiatives such as the Oresund University and the Oresund Science Region are representative of a lack of long-term commitment and stress the need to resume improvement of this integration. The lack of integration can be attributed to two main aspects. First, regulatory, tax and other policy obstacles impede cross-border mobility and labour market integration. In this context, the influx of students (traditionally more so from Sweden to Denmark) is hampered by differences in university rules and tuition fee structures.

Second, there is a lack of political commitment from both sides. Considered in their respective national contexts, the Danish side of the Oresund is a more important economic region (representing 49% of the national GDP) than the Swedish side (Skåne representing 11% of the national GDP), and although both regions would benefit from increased co-operation, the perceived value is higher on the Swedish side of the sound. Furthermore, the development of stronger relationships for the Danish Capital Region with southern Sweden is often perceived as competition with the development of Jutland. This perception, coupled with growing regional imbalances between the core and the periphery of the Oresund region, act as a deterrent for national authorities to devote more attention and efforts to the building of the Oresund. In general, there seems to be relatively weak national interest and support for cross-border co-operation from both sides. Private actors, citizens and NGOs are also only weakly involved in governance and strategic issues of the Oresund, which leaves public sector representatives to drive the development

Better integration is the key to the region's competitiveness in a global context

In order to overcome its relative peripherality globally and improve its competitiveness with other regions, the Oresund should create a larger metropolitan area with an integrated labour market. In this way, it could establish a critical mass and become more attractive to both companies and workers. If the two sides of the sound were more closely connected, existing as well as new firms could take advantage of complementary knowledge assets. Synergies, such as could be developed by merging cleantech cluster organisations, could have a very positive effect on the overall situation of the region.

A main focus of the integration efforts should lie on increasing innovation in several areas. The work of business incubators, science parks and start-up support initiatives should be further extended to foster more cross-border businesses. Still, not only private business, but also the public and the healthcare sector should work towards more innovativeness. The healthcare sector is an important example of how the region could turn its challenges into a competitive advantage. The ageing population places high demands on the separate healthcare systems on both sides of the sound, and the flexibility of this sector is generally tightly bound to strict national regulations. Removing barriers towards patient mobility and integrating health care system could provide a significant competitive edge for the region. In this case, however, not only regional, but especially national support is needed in order to adjust regulations and barriers accordingly.

The public sector has the opportunity of engaging in joint innovative public procurement and open data strategies to fuel the development of the Oresund. In order to keep better track of progress and to identify strengths and weaknesses, coverage of the Oresund Database and Orestat's work should be extended. More availability of information does not only improve precision of efforts, but also gives more visibility and credibility to a range of projects.

The governance of the Oresund is institutionalised through the Oresund Committee, which, established in 1993, gathers local and regional authorities. It is a political interest organisation representing the Oresund's interest before the national parliaments of Sweden and Denmark. In 2010, the committee adopted ORUS, its regional development strategy focusing on a long-term vision for four main themes: knowledge and innovation, culture and events, a diverse, yet cohesive labour market, and accessibility and mobility. While there exists no doubt that these topics need to be worked on, the lack of prioritisation complicates implementation. In comparison with other regional strategies, it is very positive that innovation forms a part of the Oresund's strategy. However, so far there are no joint strategies targeting economic development and innovation.

Unfortunately, there is, broadly speaking, a stronger interest in the integration and joint development of the region from Skåne than from Denmark's Capital Region. At the national level, interest in both countries is quite low. Apart from stronger political support, engaging universities, private organisations and the population more closely could contribute a significant improvement to the region's integration. Projects should not stop after the initial public funding period, but continue in order to avoid quality and sustainability issues.[2]

The presented article provides a summary of the case study 'The case of Oresund (Denmark-Sweden)' that was part of the OECD project *Regions and Innovation: Collaborating* Across borders. It was drafted by Claire Nauwelaers and Karen Maguire with support from Giulia Ajmone Marsan, who based it on a background report prepared by the Oresund team. The entire report, as well as detailed information on sources can be found in the Regional Development Working Papers (2013/21) section of the OECD iLibrary.

The OECD's Regional Development Policy Division publishes working papers on a regular basis. These working papers cover a wide range of topics, including regional statistics and analysis as well as rural, urban and multi-level governance and economics. The covered topics can be very specific and deal with innovation, networks or determinants of regional growth.

In the context of the Baltic Sea Region States, several interesting Regional Development Working Papers were published in 2013. The topics covered include not only the case of Oresund, but also the cases of Helsinki-Tallinn, the Bothnian Arc and Hedmark-Dalarna. Comprehensive information can be found in the OECD iLibrary.[3]

2 Nauwelaers, Maguire & Ajmone Marsan (2013): The case of Oresund (Denmark-Sweden) – Regions and Innovation: Collaborating Across Borders. OECD Regional Development Working Papers, 2013/21, OECD Publishing. http://dx.doi.org/10.1787/5k3xv0l8knn-en

3 OECD Regional Development Working Papers. OECD, 2013. http://www.oecd-ilibrary.org/governance/oecd-regional-development-working-papers_20737009

Non-governmental and public-private organisations

ScanBalt

About ScanBalt BioRegion

ScanBalt BioRegion is the brand name for health- and bioeconomy in Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, Poland, Sweden, northern Germany, northern Netherlands, and the northwestern part of Russia. ScanBalt BioRegion is denominated as a EUSBSR flagship within health economy (ScanBalt HealthRegion) and is thereby an integrated part of EU strategies for the Baltic Sea Region.

About ScanBalt® fmba

ScanBalt® fmba (www.scanbalt.org) promotes the development of the ScanBalt BioRegion as a globally competitive health- and bioeconomy. ScanBalt is a not-for-profit member-driven association of clusters, networks, companies, research institutions, hospitals, public authorities and other organisations. ScanBalt promotes coordinated investments between Horizon2020, structural funds, other trans-national funding mechanisms, national and regional public-private financing. The members have a ROI on their membership of approximately 15:1 on average.

Member Services:

The following core services are available for the members:

- Promotion of regional competencies, events and activities
- Promotion of talent attraction and talent retention

- Establishment of thematic public-private transnational project consortia
- Attraction of resources and funding
- Co-ordination of projects and activities
- Strategic partnerships with other regions
- Advancing policy issues and opinions

ScanBalt acts according to a strategy for the ScanBalt BioRegion setting priority areas and action lines.

ScanBalt Business Club

ScanBalt Business Club (www.scanbaltbusiness.com) is a new umbrella for activities and services supporting SMEs and industries such as:

- Awareness for companies, products and services
- Bridging of academia and SMEs
- Trans-national match-making
- The formation of a trans-national business accelerator
- Establishment of a BSR trans-national investment fund
- Training for professionals and entrepreneurship training
- Facilitating the trans-national access of SMEs to procurements
- ScanBalt BioRegion as a global hot spot for investments, talents and industries

It is **free of charge** to insert a company portrait at scanbaltbusiness.com. The portraits are distributed by a variety of channels. CEO interviews, industry opinions and news on products and services are brought in the quarterly ScanBalt News and on www.scanbalt.org. Companies are invited to present at ScanBalt Press Study Tours for selected groups of journalists.

Other major initiatives and results 2013-2014

BSR Health Economy: Innovation agenda 'Driving cross-sectoral innovation in health and life sciences' and new analysis

An innovation agenda 'Driving cross-sectoral innovation in health and life sciences' was launched Nov 2013 with both policy-oriented recommendations and concrete suggestions for actions to be implemented in the coming years. The objectives of the innovation agenda are to

- Promote and increase the development and implementation of innovative products, technologies and services for health and life sciences;
- Accelerate market access for innovative products, technologies or services;
- Set up a framework for a sustainable innovation ecosystem in the BSR;
- Promote more efficient BSR health care systems through innovation;
- Promote collaborative BSR efforts to combat challenges to health and well-being;
- Spur macro-regional development and the creation of new jobs and businesses.

It is possible to establish the Baltic Sea Region health sector not only as a cost-generating healthcare system, but also as an interdisciplinary sector registering above-average growth and offering great potential opportunities. This is a key conclusion from an analysis performed by Nord/LB in collaboration with the BSHR Health-Port project.

Tools established for supporting early and mature innovations in ScanBalt BioRegion.

BSR idea competitions were followed by tailor-made business support actions in order to bring products and services to the market.

In the 1st Innovation Competition four business cases were selected as winners and they received support for early business development such as POC, business plan preparation, team building, clarifying market opportunity and meeting with potential customers.

In the 2nd Innovation Competition the prize was targeted to more mature innovations that could benefit from support actions, such as attracting private equity and venture capital financing, and negotiation support with financiers. The 2nd prize was shared between two winners.

The concept is to be an integrated part and module of ScanBalt BioRegion Business Club.

ScanBalt BioRegion tops the world in clinical medicine research, but we do not see enough startup proposals. Therefore, a financing instrument is on the drawing board to support these efforts and attract mainly private financing.

The preparation of innovation tools was part of the BSHR HealthPort project co-financed by the Baltic Sea Region programme 2007-2013.

BSR Bioeconomy

ScanBalt is an active partner in the discussions of a BSR Bioeconomy initiative led by the Nordic Council of Ministers.

There are optimistic views on all three cornerstones of the Bioeconomy: Bio-refinery feed stock availability, value chain potentials and process/product development. This opens the possibility for the bioeconomy to take off, hereby providing basis for the generation of jobs, increased resource efficiency, and regional and rural development.

ScanBalt is consortium partner in a Horizon2020 application, which shall promote and assist the development the Baltic Sea Region as a model macro region for bio economy.

In addition, ScanBalt has been instrumental in transforming the EU project 'Submariner' into a flagship in the EUSBSR.

Join ScanBalt BioRegion project consortia or propose new topics

ScanBalt is working intensively to establish a number of new project consortia directed towards Horizon2020, the Baltic Sea Region programme and other funds. ScanBalt promotes co-ordinated investments between Horizon2020, structural funds, regional and national public-private financing.

The focus is on MedTech, Health and Bioeconomy, together with horizontal issues such as innovation, cluster development, internationalisation, communication and talents.

MedTech is inserted into an EU pre-seed project process PATHOS, which aims for a shared Baltic Sea Region MedTech innovation platform.

ScanBalt Forum 2014 Active and Healthy Ageing, 8th - 10th Oct (Groningen)

The 2014 ScanBalt Forum focuses on the ageing society. Industry and research institutions are brought together in a stimulating environment to exchange ideas, make new contacts and to initiate international collaboration. The 2014 ScanBalt Forum is organised by the Healthy Ageing Network Northern Netherlands (HANNN) and the University Medical Center Groningen in close collaboration with the three Northern provinces: Groningen, Fryslân and Drenthe.

A ScanBalt Business Club Event takes place during ScanBalt Forum 'Healthy Ageing Campus Match Making'. The match-making event will promote partnerships and collaboration for those sharing an interest in the opportunities resulting from the challenges of the ageing society.

Stay updated at www.scanbalt.org

Contact: General Secretary Peter Frank, pf@scanbalt.org, tel + 45 27141078 or one of the regional liaison offices; see www.scanbalt.org for contact details.

sustainable growth innovation competitiveness Baltic Development Forum

Baltic Development Forum BDF

Baltic Development Forum (BDF; www.bdforum.org) is a leading think-tank and network for high-level decision-makers from business, politics, academia and media in the Baltic Sea Region. Baltic Development Forum is a non-profit, independent organisation. Its mission is to position the Baltic Sea Region in the EU and on the global map by advancing its growth and competitive potential through partnership between businesses, governments and academia.

BDF has a wide range of partners including major cities, large companies, institutional investors and business associations in the Baltic Sea Region. BDF's many different partners and multiple funding sources ensure that BDF's independence is safeguarded.

Baltic Development Forum is chaired by Lene Espersen, former Minister for Foreign Affairs of Denmark. The Baltic Development Forum Honorary and Advisory Boards consist of high-level political dignitaries and prominent business executives representing the entire Baltic Sea Region.

BDF provides platforms that bring together actors from diverse sectors and from across the Baltic Sea Region, ensuring better cooperation, coordination and coherence. The annual BDF Summits highlight the potential and the challenges of the Baltic Sea Region as an integrated, prosperous and globally competitive growth region, and provides a forum for increased regional collaboration, policy formulation and business opportunities. Through conferences, seminars and round table discussions on specialized issues, BDF builds regional capacity on current matters throughout the year, and brings relevant stakeholders together to formulate joint approaches. The aim is to get a close and private exchange of views on important developments and to play an agenda-setting role.

The development of the EUSBSR is the most important and concrete development for the Baltic Sea Region. BDF works together with the main regional partners to provide substantial input into the EUSBSR strategy, and it is crucial to engage regional organisations and stakeholders to support the European Commission and the EU in defining the contents of a strategy for the Region. Various regional actors (governments, regional organisations and business representatives) must all be able to present their view on the priorities for the future in order to develop the region further.

The joint 16th Baltic Development Forum Summit and 5th Annual Forum of the EUSBSR, themed 'Growing together – for a prosperous, inclusive and connected Baltic Sea Region', will take place in Turku on June 3-4, 2014 (www.bsr2014.eu). The aim of this year's event will be to explore how co-operation can help strengthen economic growth, contribute to sustainable development, and create a strong and integrated Baltic Sea Region. Key areas to be addressed include outlooks on governance, the digital economy, regional co-operation, smart urban solutions, blue growth, innovation and competitiveness.

At the Summit, the State of the Region Report will be presented alongside its sister-report, the Political State of the Region Report, which will assess the co-operation climate of the different neighbourhoods in the Region. This report also represents a wide network of researchers who are engaged in different aspects of the Region's development (www.thinktankdeepwater.org).

The event is organised by Baltic Development Forum and the European Commission, DG Regio, and is hosted in partnership with the Finnish Presidency of the Council of the Baltic Sea States, and the City of Turku. Many other activities will take place during the Baltic Sea Days in Turku, proving that the Region is able to co-ordinate and work efficiently together.

Apart from being one of the leading organisers of the Summit, BDF is engaged in several projects that cover different priority areas, such as ICT, investment promotion, Blue Growth, innovation, energy efficiency, water resource management, and news exchange.

In recent years, BDF has been active in the field of ICT and growth, organising conferences and seminars in all parts of the Region. With support from Microsoft, BDF is engaged in launching an ambitious regional ICT think-tank 'Top of Digital Europe: ICT think-tank for the Baltic Sea Region' in order to further enhance focus on this potential high-growth sector in all parts of the Region. BDF has received support for the proposal from several important actors, including several governments, as well as key political figures. BDF will build on previous policy recommendations within e-procurement, public sector information and open data, roaming, as well as online intermediaries and big data. A new report 'Searching for the Micro Multinationals' that focuses on barriers and drivers for ICT companies to grow into new multinational companies, similar to e.g. Nokia, will be launched at the BDF Summit in Turku.

BDF is engaged in the ONE BSR, a flagship project within the EU Strategy for the Baltic Sea Region. The project aims to identify and produce elements for the Baltic Sea Region's image and identity. BDF is responsible for two major components of this project - Baltic Sea Region Investment Promotion Agencies (BSR IPAs) and NewsWave. In order to strengthen the perception of the Baltic Sea Region as a coherent and attractive destination to foreign investors, BDF is leading the BSR IPAs initiative, which strives to attract more in- vestments to the Region as a whole through joint efforts. With this approach, BDF takes action to develop co-operation structures that can lead to higher competitiveness and prosperity in the Region.

The BSR IPAs initiative has proven to be fruitful, and a strong interest in finding common interests and grounds for co-operation has been observed. In order to ensure the sustainability of the initiative, BDF will present a Business Plan, which will be presented at the BSR IPAs Forum in June in Helsinki. The initiative has received much attention from regional and European stakeholders. BDF will assess the possibilities of directing other projects on investment promotion after the end of the project in 2014.

BDF is editor-in-chief of a news website 'NewsWave' (www.newswave.eu), which presents independent journalistic news to all: to the citizens, policy-makers, businesses, stakeholders, experts and the creative community of the Region. The overall objective of the website is to improve information exchange and cross-border communication between the countries of the Region. Information and communication has been identified as a critical aspect in the effort towards establishing a distinct regional identity. The news website is politically neutral, balanced, informative, open-minded, and based on the tradition of independent public service journalism.

In 2013, BDF published a new report on regional identity called 'Facets of Identity – the Bal- tic Sea Region and beyond' as part of its formal role as Horizontal Action Leader of the EUSBSR. The report is an attempt to add new aspects to the debate on a common regional identity. The report discusses different approaches to identity-building including ethnology, philosophy, psychology, and history in order to find common traits while acknowledging that the Baltic Sea Region consists of several sub-regions, i.e. the Nordic and the Baltic regions. An instrument for identity- building is region branding, whose purpose it is to turn the region's great diversity into a competitive advantage.

The ONE BSR project also seeks to establish co-operation links with partners outside the EU, especially with St. Petersburg and the Northwestern Federal District of Russia.

BDF maintains and develops close links to Russian partners in the Baltic Sea Region. For almost three years now, BDF has been managing an energy efficiency project in Kaliningrad and Northwestern Russia called RENSOL (www.rensol.eu). Through the project, BDF strives to provide a better basis for dialogue with Russian partners and thereby see more cross-border projects in the Baltic Sea Region. Within RENSOL, BDF is primarily focusing on financing mechanisms and modelling. Finding good financing tools, practices and models is an extremely interesting issue, since rapidly expanding residential areas have a huge untapped potential for improvements in energy saving and energy efficiency. BDF has, therefore, produced a 'Guide to Financing Energy Efficiency in Russia – RENSOL Experience', which aims to identify best global financing practices for energy efficiency projects.

In 2014, two high-level meetings took place in connection with the RENSOL results multiplication activities, which enable their adaption in Northwestern Russia. The closing conference will take place during the BDF Summit in Turku. The Russian actions in Crimea have certainly caused a new situation that influences the regional co-operation climate. Not only are the Baltic States, who have large Russian speaking-minorities, worried. The efforts to harmonise the EU's regional co-operation priorities within the EU strategy for the Baltic Sea Region, and the Russian Federation's priorities connected to that, have been put on hold. To BDF, it is always important to maintain an open dialogue and to discuss all relevant issues.

In 2014, BDF intends to follow up on the Baltic Sea Conference on Blue Growth, Sustainability and Water Industries with regional and European partners in order to exploit ways that environmental challenges can be turned into opportunities. Financing and innovation are key issues to be addressed in this regard. BDF is also engaged in a range of activities related to maritime transport and the transition towards clean shipping in the Baltic Sea Region.

Baltic Development Forum is also engaged in the process of upcoming projects. In partnership with City of Turku, Union of Baltic Cities and Tartu Smart City Lab, BDF is developing a concept for a 'Baltic Sea Region Forum for Smart Cities', which will stimulate knowledge exchange, build region-wide capacity and facilitate public-private dialogue on smart city solutions and governance.

Encouraged by many of BDF's co-operation partners, BDF has extended its role into the Fehmarnbelt Region through acting as the umbrella secretariat for the Fehmarnbelt Days 2014 event, which is organised by STRING, Fehmarnbelt Business Council, Fehmarnbelt Committee, Danish Ministry for Housing, Urban and Rural Affairs, and Femern A/S. All partners strive towards developing cross-border co-operation in this part of the Baltic Sea area.

The opening of the Fehmarnbelt Fixed Link, anticipated for 2021, will create opportunities for collaboration and for an exchange of ideas and increased growth. The link will unite nine million inhabitants in an area stretching from Northern Germany, over Denmark, to Southern Sweden. The link also promises closer co-operation within the area and a strengthened connection to the wider Baltic Sea Region.

For three days, the Fehmarnbelt Days 2014 will provide a platform for stakeholders to exchange ideas and experiences, discuss key issues and cross-border collaboration and work out growth opportunities. Key areas to be discussed during the Fehmarnbelt Days 2014 are infrastructure, tourism, business, the labour market, transport and logistics, and education and research. Moreover, a variety of social and cultural events will take place in the heart of Copenhagen. More information on the event is available under www.fehmarnbeltdays.com.

BDF does not only engage in projects that promote the BSR, but it also honours individuals or organisations that have made an extraordinary contribution to the Baltic Sea co-operation and development. Thus, it established its Baltic Sea Award in 2007. A few of the previous winners of the Baltic Sea Award are Mr Carl Bildt, Foreign Minister of Sweden, and Mr Radoslaw Sikorski, Foreign Minister of Poland. Last year's winners were announced at the BDF Summit Gala Dinner in Riga on 29 May 2013.

Suomen Itämeri-instituutti
The Baltic Institute of Finland

Baltic Institute of Finland

The Baltic Institute of Finland (BIF; www.baltic.org) is a leading collaborative body for the Baltic Sea Region in Finland, and is among leading project development organisations in Baltic Sea co-operation networks. Since its launch in 1994, the institute has promoted co-operation in the Baltic Sea Region and contributed actively to the international network of collaborators in the region. BIF promotes collaboration projects in the Baltic Sea Region and facilitates the participation of Finnish organisations. The Baltic Institute of Finland is a network-based organisation, and its principal focus is on planning and co-ordinating tangible collaborative projects and maintaining an extensive network of collaborators in the Baltic Sea Region.

When measured by the scale and impact of activities, 2013 was the best year in the BIF's history. The BIF 2013 projects and events contributed, among other things, to the promotion of clean shipping, development of smart specialisation strategies, building Demola open innovation platforms, promotion of biolifescience cluster collaboration with Russia, air accessibility, active and healthy ageing, and music sector collaboration in the Baltic Sea Region.

In 2013, BIF was involved in as many as 20 collaborative projects in the Baltic Sea Region – in 10 of them as the lead partner, and in 10 as a partner. BIF organised 37 major events in the Baltic Sea Region and in Brussels. The main events were the 100+ participant BSR InnoShip final seminar, 'Solutions for low-emission shipping in the Baltic Sea region', in Brussels on September 9-10, 2013, the INNOVAge-JADE European project meeting on active ageing in Helsinki on June 10-12, 2013, and the Nordic-Russian IPR project final seminar in Helsinki on November 15th, 2013. In 2013, BIF also organised as many as 13 major events in Russia on biolifescience cluster co-operation. As in previous years, BIF focused on innovation and economic co-operation in its projects. As much as 85% of the projects' financing came from EU programmes.

BIF has been involved in the EU Baltic Sea Region strategy process since 2005. BIF is strongly involved in the implementation of the strategy and its flagship projects. In 2013, BIF was leading one flagship project (BSR InnoShip), and involved in three innovation and SME development-related flagships: BSR Stars, BSR QUICK and Baltic Supply. The EUSBSR flagship projects have provided a stronger policy framework, better EU-level dissemination channels, and better co-ordination between different actions and stakeholders.

A BIF-lead BSR InnoShip (2011-2013), a Flagship project under the Priority Area on Clean Shipping (PA Ship) in the EU Strategy for the Baltic Sea Region, was successfully finalided at the end of 2013. BSR InnoShip provided decision-makers, authorities and key marine stakeholders with up-to-date knowledge and best practices on emission effects and risks, as well as on the economic implications of their reduction, in order to enhance voluntary measures, innovative integrated efforts and policy-making.

BSR InnoShip was a transnational co-operation project involving 20 partners from nine Baltic Sea Region countries (Finland, Estonia, Latvia, Lithuania, Sweden, Norway, Denmark, Poland and Germany). The 3.6 million Euro project was co-financed by the EU Baltic Sea Region Programme 2007–2013.

These best practices and solutions for low-emission shipping in the Baltic Sea Region were presented in the BSR InnoShip final seminar in Brussels on September 9-10, 2013. Furthermore, various BSR InnoShip outputs were presented, including e.g. feasibility studies and economic analyses of different clean shipping solutions, emission maps ready for integration into HELCOM services to facilitate future decision-making, as well as the launch of the Baltic Sea Clean Maritime (BSCM) Award. The award ceremony was held in connection with the 4th Annual Forum on the EUSBSR in Vilnius on November 11-12, 2013

The project results and final seminar discussions emphasise the importance of LNG infrastructure development as the most crucial prerequisite for low-emission shipping in the Baltic Sea Region. Financing arrangements for investments – loans, guarantees, state aid – are needed. So far, there are still very little operational experience with any of clean shipping solutions, and virtually no LNG infrastructure in place, nor in the pipeline. Continued guidance and advice, including technology selection and slow steaming operations, are needed. According to studies made in BSR InnoShip, the economic impact of MARPOL Annex VI (sulphur in ship fuels) will lead to direct additional costs of 3.8 billion Euros in 2015.

In the EUSBSR PA Ship, in 2012-2013 BIF was also in charge of a European Commission-funded project 'Strengthening stakeholder engagement, dissemination and coordination of joint activities in the EU Strategy for the Baltic Sea Region Priority Area 4.' The idea was to support the ongoing actions in the Priority Area 4 in their common goal to make the Baltic Sea Region a model area for clean shipping. As the main event of the project in 2013, a joint Baltic Development Forum, the European Commission (DG-Mare) and PA Ship (TA project) conference 'Baltic Sea Conference 2013 – Blue Growth, Sustainability and Water Industries' was held in Copenhagen on 3 October 2013, in connection with Helcom ministerial meeting. The 'Baltic Sea Conference 2013 – Blue Growth, Sustainability and Water Industries' brought together more than 300 high-level participants from the European Commission and Danish government, and actors from throughout the Baltic Sea Region – from different sectors and levels of decision-making – in order to chart the way forward for an environmentally sound and prosperous Baltic Sea Region.

Furthermore, various stakeholder and EUSBSR promotion events were organised in this PA Ship project in 2013. They included exhibition stands and presentations of the EUSBSR PA Ship at the European Maritime Day 2013 in Valletta, Malta on May 21-22, 2013, at the Baltic Development Forum Summit in Riga, Latvia on May 29-30, 2013, and at the EUSBSR Annual Forum in Vilnius on November 11-12, 2013.

BIF contributes to European-wide promotion of the EUSBSR and dissemination of BSR good practices on innovation policies and instruments by collaborating in three EU INTERREG IVC programme projects. The INNOVAge project (2012-2014), led by Marche Regional Authority, Italy, aims to help older people to live independently for longer in their own homes by increasing their autonomy and by organising new 'technological supply chains' associated with new developments, like independent living and eco-innovation, with a valuable contribution to minimise the environmental impact of elderly daily life activities.

The project 'TRES - Towards Regional spEcialisation for Smart growth spirit' is led by Fundación TECNALIA Research & Innovation, Spain. TRES aims to mobilise the innovation potential and capacity of regions towards smart growth. TRES will also foster a clearer understanding of the role regions have to play in EU2020 to better face new opportunities, inter-creating together and pushing clusters for change. TRES brings together a good representation of the EU's diverse innovation geography and multiple ways of addressing innovation challenges and paradigms.

The third project, 'SMART EUROPE - Smart strategies to create innovation-based jobs in regions of Europe', is led by the Province of Flevoland, Netherlands. In SMART EUROPE, project partners from 11 European countries will exchange policies and instruments for identifying and supporting the main regional economic actors that can generate job opportunities in the innovation-based sectors of their economy. Both 36-month projects will be implemented in 2012-2014.

The BALTIC BIRD project (2012-2014) promoting air accessibility in the Baltic Sea Region is lead by Ministry of Economics and European Affairs of the Region Brandenburg. In this project, BIF is responsible for work package 3 ('Passenger Potential Analysis'). In 2013, in-depth analyses of the region's potential and even the potential of the individual new or specified routes were carried out. The results of these analyses were presented at the BALTIC BIRD conference in Tallinn on October 15-17, 2013.

In 2014, BIF focuses on the initiation and planning of new projects for the EU programme period 2014-2020, by also utilising the EUSBSR Seed Money Facility. The BIF-lead INNOPLATFORMS project was approved by the EUSBSR Seed Money Facility on January 22nd, 2014. INNOPLATFORMS is one of three seed money projects approved in the EUSBSR Priority Area Innovation (PA Inno).

INNOPLATFORMS focuses on the development and implementation of new kind of innovation policy approach to promote transnational co-operation, based on lessons learned from already-implemented open innovation platforms and related innovation policy tools, in co-operation with leading innovation regions in the BSR. The project contributes particularly to the further development of the EUSBSR flagship project BSR Stars' strategy by leveraging the experiences of implementations of open innovation platforms in the BSR. The major outcome will be an operational open innovation platform network in the BSR that is able to attract the public sector, companies and universities in concrete co-creation activities.

New kinds of open innovation platforms, like New Factory (Demola and Protomo) in the Tampere Region in Finland, have proven to be able to efficiently generate new business and jobs by providing an inspiring environment for co-creation. The Demola platform is targeted especially at students that want to get valuable teamwork and work-life experience by developing business ideas for company needs, and has already been adopted by eight European regions (Lund, Norrköping, Vilnius, Riga, Tampere, Oulu, Budapest, Maribor). In the INNOPLATFORMS project, experiences from Demola Network development and innovation platform activities from several BSR regions are utilised.

pan-european institute

Pan-European Institute PEI

The Pan-European Institute (PEI), founded in 1987, is an academic research centre at Turku School of Economics, University of Turku in Finland. PEI analyses the economic developments in the Baltic Sea Region countries, the Arctic region and Eastern Europe, with a particular focus on Russia, Belarus and Ukraine.

PEI's research activities have recently concentrated on issues such as the maritime cluster, FDI, regional development, innovation, and energy in the Baltic Sea Region. The PEI staff has frequently acted as experts for both Finnish and foreign institutions, such as several Finnish ministries, the Parliament of Finland, the European Commission, the European Parliament, and the United Nations.

As an example of recent research activities, in 2012–2013 PEI was involved in a large international research project called SmartComp (Smart Competitiveness for the Central Baltic Region). The project was funded by the EU Interreg IV A Programme. The aim of the project was to support smart, environmentally sustainable development, growth, competition and co-operation between maritime clusters, cities and universities in the Central Baltic region. PEI was the leader of the project's research work package, in which the researchers analysed the maritime sector's networks, as well as future challenges and opportunities, in close contact with business representatives. For more information about the project, please visit the project website at www.cb-smartcomp.eu.

PEI also organises seminars and other events related to developments in the Baltic Sea Region, and contributes to the academic discussion, as well as publishes reports on related issues. Since 2004, PEI has published the Baltic Rim Economies (BRE) review, which focuses on the economic development of the Baltic Sea Region. Over 1000 leading experts, including EU commissioners, ministers, members of parliament, CEOs of leading corporations, academics, and researchers, have contributed articles to the review. For more information about BRE and the reviews published in it, please visit www.utu.fi/pei.

PEI also provides some half a dozen courses in English at Turku School of Economics under the subject heading of International Business. The courses are particularly related to the Baltic Sea Region and Russia, such as 'Business in the Baltic Sea Region', 'The Development of EU-Russian Economic Relations', 'Investment Opportunities in Eastern Europe' and 'Business Prospects in the Arctic'.

CENTRUM BALTICUM

Centrum Balticum

Centrum Balticum is a prominent voice for the whole Baltic Sea Region. It is an independent expert that mediates between research and decision-making, and Finland's leading centre on Baltic Sea Region affairs. It acts as an information unit and co-ordinates a network of researchers and experts. In co-operation with cities and universities, Centrum Balticum generates new ideas for policy-making, facilitates best practice sharing and sets public debate in motion.

Centrum Balticum maintains a web portal and databank called Domus Baltica in order to promote the dissemination of information related to Baltic Sea Region in Finland and abroad. It also publishes a Baltic Sea Region Policy Briefing series for international experts to discuss developments and future trends from the Baltic Sea Region viewpoint, as well as a weekly column called Pulloposti, in Finnish. Currently, several thousand Finns interested in Baltic Sea Region affairs receive this weekly column, which is written by the top Finnish professionals in their fields.

Centrum Balticum participates in international projects as a co-ordinator, a disseminator of information and an event organiser. For instance, Centrum Balticum currently co-ordinates the Baltic Sea Challenge initiative, which is a collaborative environmental effort between the cities of Turku and Helsinki. The Protection Fund for the Archipelago Sea acts as a part of the Centrum Balticum Foundation and finances concrete water conservation projects in the Finnish Archipelago Sea and its catchment area. Centrum Balticum also promotes practical co-operation across the Baltic Sea Region with an innovative, bottom-up collaboration concept called the Turku process.

Centrum Balticum organises the annual Baltic Sea Forum, which gathers hundreds of Finland's leading experts to Turku to discuss topical issues related to the Baltic Sea Region. In 2014, the Forum focused on regional strategies: the EU Strategy for the Baltic Sea Region, the Arctic and the northwestern Russian strategies. The aim of the forum is to promote effective dialogue between the neighbouring regions. In November Centrum Balticum will host, for the second time, a Forum for Finnish researchers of the Baltic Sea Region. In addition to these events, Centrum Balticum organises a variety of smaller events, such as luncheon seminars with the ambassadors of the Baltic Sea Region states.

Centrum Balticum was established in 2007 by the City of Turku, together with four other Finnish cities, three universities based in Turku, and the Regional Council of Southwest Finland.

www.centrumbalticum.org/en

2 International Financial organisations in the Baltic Sea Region

The European Investment Bank

EIB´s lending activities in the Baltic Sea Region

The European Investment Bank's lending volumes in the Baltic Sea Region increased significantly in 2008-2009 as the EIB responded to the financial crisis. In 2010 and in 2011 this lending volume fell relative to its pre-crisis level. In 2012, lending was back at the same level as it was before the crisis, and in 2013, the lending volume started to grow again. The aggregate lending volume in the region over the past five years (2009-2013) amounts to EUR 51.5 billion. The total volume of signed loans in 2013 to the BSR was EUR 11.9 billion (EUR 7.7 billion in 2012).

The single largest share of this lending goes to Poland, which received almost 50% of the EIB loans granted in the Baltic Sea Region in this period, followed by Sweden at 14% and the concerned Bundesländer in Germany, at 12%.

The most significant sector in Poland in terms of volume is the transport sector, which received more than half of the EIB loans to Poland. The remaining part was evenly distributed among other sectors. In the other Baltic Sea Region countries, i.e. in the three Nordic countries Denmark, Finland and Sweden, the most dominant sector is industry. The EIB's lending objectives support the activities in the region, in line with the three objectives of the EU Strategy for the Baltic Sea Region:

- To save the sea
- To connect the region
- To increase prosperity

Most of the EIB-financed projects in the region support the EU Strategy for the BSR, with many projects being classified as flagship projects or projects directly supporting the EU's key objectives of the Strategy.

EIB supporting Co-Financing with EU Structural Funds

An important part of the EUSBSR is the reorientation of existing EU-funded programmes in the region to make them support the EU Strategy for the Baltic Sea Region. The EIB co-financing of EU-funded programmes has been a vehicle for

EIB lending in the region, 2009-2013 (million EUR)					
Signatures	2009	2010	2011	2012	2013
EU					
Denmark	421.7	387.0	155.0	224.2	649.6
Estonia	841.5	75.0	183.0	122.4	148.6
Finland	1 145.0	1 000.8	1 403.2	544.2	919.2
Germany[1]	1 615.0	1 249.0	745.6	967.7	1 494.8
Latvia	285.0	100.0	36.0	100.0	35.0
Lithuania	1 169.0	71.0	10.5	3.2	232.0
Poland	4 778.9	5 565.3	5 279.1	4 440.4	5 698.6
Sweden	1 135.0	2 607.8	707.6	1 131.6	1 571.5
EFTA					
Iceland	170.0	0.0	70.0	0.0	0
Norway	0.0	50.0	100.0	204.2	100.0
Eastern Europe					
Russia	132.5	250.0	100.0	0.0	1 046.7
Total	**11 699.9**	**11 356.3**	**8 790.0**	**7 737.8**	**11 896.0**

[1]In the German Bundesländer included in the Baltic Sea Region (Berlin, Brandenburg, Hamburg, Mecklenburg-Western Pomerania and Schleswig-Holstein).

promoting a number of important investments in this fast-growing region. The EIB has approved a number of projects or programmes that are fully or partly co-financed with EU Structural Funds. For the 2007-2013 programming period, EIB has to date approved 15 Structural Programme Loans (SPLs) with a total amount of EUR 5.7 billion in the BSR. As the EIB on finances on average 13% of the total project cost in the case of SPL, the EIB financing supports a total investment cost of EUR 44 billion in the region, which is a major contribution to growth and employment in the BSR. Public investments included in these programmes have been essential to counteract the economic and financial crises. In a period with a weakened private sector, the investments in public infrastructure have created new employment and spurred competitiveness in the region.

In the 2007-2013 programming period, the key objectives of the European Fund for

Regional Development (ERDF), the European Social Fund (ESF) and the Cohesion Fund are to contribute to (1) convergence, (2) regional competitiveness and employment, and (3) European regional co-operation in the EU.

The rationale of the convergence objective is to promote growth-enhancing conditions and factors leading to real convergence for the least developed Member States and regions. Those regions eligible for such support are, in EU terminology, referred to as 'convergence regions'. In the Baltic Sea Region, Estonia, Latvia, Lithuania, Poland and two German Bundesländer (Mecklenburg-Western Pomerania and Brandenburg-Nordost) are defined as convergence regions.

Outside the convergence regions, the regional competitiveness and employment objective aims to strengthen competitiveness, attract investment and boost employment. Development programmes help regions to anticipate and encourage economic change through innovation, and promote the knowledge society, entrepreneurship, environmental protection and improved accessibility. More and better jobs are being sup-

Table. EU Funds co-financing in the Baltic Sea Region and EIB support

2007-2013 programming period

Country	Name of operation	Project cost (million EUR)	Approved EIB loans (million EUR)	Signed (million EUR)	EIB loan's share of total project cost (%)
	Approved programmes				
Estonia	EU Funds Co-Financing 2007-2013 (EST)	4 331	550	550	13%
Latvia	EU Funds Co-Financing 2007-2013 (LV)	5834	750	750	13%
Lithuania	EU Funds Co-Financing 2007-2013 (LT)	9564	1132	1132	12%
Poland	EU Funds Co-Financing 2007-2013 (PL)	20855	2130	2000	10%
Poland	Kraków Urban Infrastructure*	214	96	29	45%
Poland	Lodz Regional Infrastructure*	323	106	106	33%
Poland	Lodz Municipal Roads*	240	71	70	30%
Poland	Lublin Municipal Infrastructure*	386	126	126	33%
Poland	Malopolska Regional Infrastructure*	318	38	38	12%
Poland	Rzeszow Municipal Infrastructure*	231	69	69	30%
Poland	Szczecin Municipal Infrastructure III*	185	75	75	41%
Poland	Szczecin Municipal Infrastructure IV*	126	58	58	46%
Poland	Toruń Municipal Infrastructure*	189	67	19	35%
Poland	Zachodiopomorske Regional Framework*	284	84	84	30%
Poland	EU Funds Co-Financing 2007-2013 (PL)	19 305	2 000	2,000	10%
Poland	National Environmental Protection Fund	300	150	121	50%
Poland	Mazovia Regional Infrastructure*	400	180	88	45%
Poland	Poznan Municipal Infrastructure*	209	81	81	39%
Poland	Poznan Municipal Infrastructure III*	333	145	145	44%
Poland	Gdansk Municipal Infrastructure II*	368	145	64	39%
	Total approved projects	**42 380**	**5 667**	**5 378**	**13%**

* Partly co-financed with the Structural Funds regional and municipal investment framework operation.

ported by adapting the workforce and by investing in human resources.

In the EU Member States of the Baltic Sea Region, the EIB also provides financing to small and medium-sized enterprises (SMEs) through credit lines extended to local financial intermediaries. The EIB funds are on-lent by these intermediaries to eligible SMEs to help cover their capital expenditure and working capital requirements.

of EIB structural programme lending in the 2014-2020 programming period has started and it is expected that the three Baltic States: Estonia, Latvia and Lithuania are expected to have new Structural Programme Loan facilities approved in 2014 for co-financing with EU Structural and Investment Funds. Similar preparation work has started in Poland.

Supporting Environment and Infrastructure Investment and Green Growth

In a communication from the European Commission in 2012, the new overall objectives of the EU Strategy for the Baltic Sea Region have been reformulated; each objective is now accompanied by indicators and targets:

- to save the sea;
- to connect the region; and
- to increase prosperity.

These three objectives closely match most of the priorities given to the EIB by the 27 EU Member States. As the Bank's mandate is to support EU policy, the EIB has a special responsibility to contribute to the success of the EU Strategy for the Baltic Sea Region. It does so by supporting the implementation of the Baltic Sea Strategy in various ways, such as by financing wastewater treatment plants in places that were classified by the Helsinki Commission as hot spots – that is, point sources of massive pollution. Within the framework of the Northern Dimension Environmental Partnership, the Bank has co-financed several high-priority projects to clean up pollution in the St. Petersburg region.

The EIB has likewise financed infrastructure to integrate parts of the Nordic-Baltic area into a larger Baltic Sea Region. EIB loans have gone to bridges, tunnels, port facilities and railway links. Improved and safer energy production and energy transmission lines have also been high on the agenda.

The EIB has also supported a large number of research, development and innovation projects in the Baltic Sea Region. In some countries of the region, RDI has become one of the most important sectors for EIB financing.

All these factors, brought together, pave the way for a green growth in the region. The Bank´s firm objective – while contributing to the implementation of the EU Strategy for the region – is to remain the single most active multilateral financing institution in the area and one of the leading lenders to flagship projects.

EIB as provider of financial services

A number of special initiatives are of particular relevance in the context of the Baltic Sea Strategy. These are the JASPERS (Joint Assistance to Support Projects in European Regions) programme, the JESSICA (Joint European Support for Sustainable Investment in City Areas) initiative, the JEREMIE (Joint European Resources for Small and Medium-sized Enterprises) initiative, and the activities of EPEC (the European PPP Expertise Centre). The European Investment Fund, EIF, the risk-financing arm of the EIB Group, is active in the Baltic Sea Region by providing equity instruments, SME guarantees and financial engineering products for SMEs.

JASPERS

JASPERS (Joint Assistance to Support Projects in European Regions) is a partnership between the European Commission (DG Regional Policy), the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD) and KfW Bankengruppe (KfW). JASPERS supports the implementation of cohesion policy in the programming period 2007-2013 by providing the twelve countries that joined the EU between 2004 and 2007 with specialist expertise for the preparation of projects to be submitted for grant financing from the Structural and Cohesion Funds. Approximately EUR 354 billion was available in grants for the budgetary period 2007-2013.

JASPERS activities in the Baltic Sea Region concern the three Baltic States and Poland. Under the Baltic Sea Strategy, JASPERS is willing to provide support in preparing flagship projects to be co-financed with EU funds, at the request of a Member State and if agreed to by DG Regio. JASPERS has over 25 staff members in the EIB Office in Warsaw working in the Baltic Sea Region's new Member States, in addition to those working in the Vienna and Bucharest external offices and at headquarters in Luxembourg, for a total of over 100 staff members.

JESSICA

JESSICA is an initiative developed by the European Commission and the European Investment Bank, in collaboration with the Council of Europe Development Bank (CEB). Member States are given the option of using some of their EU grant funding, their so-called Structural Funds for the 2007-2013 operational programmes, to make repayable investments in projects forming part of an integrated plan for sustainable urban development.

With JESSICA, the EIB has two roles in the Baltic Sea Region. First, it assists Member States and national authorities upon request through evaluation studies with assessing the potential for loans, guarantees and equity for urban development and preparing the framework for the implementation of JESSICA. Secondly, it acts as the JESSICA Holding Fund to channel Structural Funds into Urban Development Funds (UDFs) on behalf of national authorities in support of urban projects. Currently in the Baltic Sea Region, the EIB is acting as the JESSICA Holding Fund in Lithuania, as well as for 5 Holding Funds in Poland. To date, UDFs operating under the above EIB Holding Funds had signed agreements with close to 100 projects supporting sustainable urban transformation in the Baltic Sea Region. This has so far included energy efficiency improvements as well as the creation and redevelopment of public spaces, and the support of transport, tourism, leisure, business incubation, offices, educational, medical and cultural facilities.

JEREMIE

The JEREMIE initiative offers EU Member States, through their national or regional Managing Authorities, the opportunity to use part of their EU Structural Funds allocations to finance small and medium-sized enterprises by means of equity, loans or guarantees, through revolving Holding Funds, which act as an umbrella fund. This initiative was developed by the European Commission and the European Investment Fund, which is part of the EIB Group. The European Investment Fund (EIF) has successfully implemented JEREMIE activities in both Latvia and Lithuania, which has involved investing over EUR 250 million into SME financing through selected financial intermediaries. In addition, EIF has launched a EUR 100 million Fund of Funds programme under the name of the 'Baltic Innovation Fund' in full partnership with the national agencies of LGA (Latvia), INVEGA (Lithuania) and KredEx (Estonia). These two types of investment initiative have contributed to a significant improvement in the private equity and venture capital market development process across the Baltic States. In addition, as a result of regional and national Evaluation Studies conducted by the EIF in Poland, the local authorities are proceeding to implement six different JEREMIE Holding Funds, at present without further EIF involvement.

EPEC

EPEC, the European PPP Expertise Centre, is a joint initiative of the European Investment Bank, the European Commission and European Union Member States and Candidate Countries. It works to strengthen the capacity of its public sector members to enter into public-private partnership (PPP) transactions. It offers a platform for PPP task forces in EU member and candidate countries to share experience and expertise, analysis and best practice relating to PPP transactions. Public authorities in Denmark, Finland, Latvia, Lithuania, Poland and Germany are EPEC members. They actively support EPEC activities and their interest focuses on the following areas of the EPEC work programme: PPP investment planning and project preparation, combining EU funds and PPPs, the accounting and statistical treatment of PPPs, and PPPs for trans-European networks and energy efficiency.

ELENA

ELENA – European Local ENergy Assistance – is part of the EIB's broader effort to support the EU's climate and energy policy objectives. This joint EIB-European Commission initiative helps local and regional authorities to prepare energy efficiency or renewable energy projects by providing funds for technical assistance. In the Baltic Sea Region, two projects have been signed to date for a total amount of EUR 5.5 million. One contract has been signed with City of Malmö concerning new tramway lines in Malmö, Helsingborg and Lund, supporting a total investment of EUR 421 million. The second contract has been signed with Region Zealand in Denmark concerning investments in energy efficiency and renewable energy, supporting total investment cost of EUR 62 million.

NER300

NER300 is so called because it is funded from the sale of 300 million emission allowances from the New Entrants Reserve (NER) set up for the third phase of the EU Emissions Trading System (ETS). The funds from the sales are to be distributed to projects selected through two rounds of calls for proposals, covering 200 and 100 million allowances respectively. NER300 is one of the world's largest funding programmes for innovative low-carbon energy demonstration projects. The programme acts as a catalyst for the demonstration of environmentally safe carbon capture and storage (CCS) and innovative renewable energy sources (RES) technologies on a commercial scale within the European Union. The sale of emission allowances is administered by the European Investment Bank. In the Baltic Sea Region, the Commission has proposed five schemes for awards to date, three in Sweden, one in Finland and one in Poland, for a total amount of EUR 225 million.

RSFF

RSFF – Risk Sharing Finance Facility, is an innovative investment-based facility established by the Commission and the EIB that creates additional financing capacity in support of eligible RDI activities. In the period 2010 to 2013, EIB has contributed close to EUR 1 billion for more than 12 projects under RSFF in the Baltic Sea region.

Project Examples, loans recently approved by the EIB

Support for RDI investment in catalytic technologies, RDI investments in Denmark

In 2013, the EIB supported the RDI activities of catalysis company Haldor Topsøe with a DKK 560 million (EUR 75 million) loan. RDI investments backed by the EIB loan focused on the development of catalysts and new catalytic technologies for different industry sectors, such as refineries and chemicals, with the aim of increasing the energy efficiency of industrial manufacturing processes. In addition, environmental applications targeting the reduction of pollutant emissions from automotive and various industrial activities (refineries, power plants, etc.) were also developed within the framework of this RDI project. The RDI activities will be carried out over the period 2013-2016 at the company's central facilities in Lyngby, 15 km north of Copenhagen. The project will accelerate the accumulation and diffusion of knowledge within European industry, through Haldor Topsøe's co-operation with clients, universities, research institutes and scientific facilities in collaborative projects, thus helping to underpin the market leadership and competitiveness of industrial technology in Europe. As the EIB strongly promotes projects supporting job creation, RDI investments have thus helped to safeguard and create skilled employment opportunities in Europe. Up to 85 additional RDI jobs are expected to be created by this project, which represents a 30% increase in the company's RDI workforce.

Development of the Stockholm metro, Sweden

The EIB granted a SEK 3.5 billion (about EUR 400 million) loan for the development of the Red metro line in Stockholm. Modern trains will be purchased and the existing signalling system will be replaced with communications-based train control. In addition, a new underground depot in Norsborg will be constructed, and the existing Nyboda depot upgraded for the servicing of the new rolling stock. The Red metro line development project will not only improve the level of service, but also cater to the future increase in demand from Stockholm's growing population. The EIB targets environmentally friendly subway transport services, and the new metro trains are designed to minimise energy consumption and noise. The modernised metro system will encourage a modal shift from private to public transport, thus contributing to a reduction in emissions from private vehicle use. Moreover, the project will create jobs as the increased service level of the upgraded metro line requires more train operators.

© Stockholm County Council - Fotograf Jan Danielsson, Marcus Kurn

Urban Infrastructure Development, Tallinn City, Estonia

In 2012, the EIB supported the upgrade of Tallinn's infrastructure with a EUR 67 million loan. The EIB funds, provided on favourable terms, will help to increase the quality of life in Tallinn. The project concerns the rehabilitation of the city's infrastructure, particularly roads, transport, public open spaces, education and sport facilities, social and health infrastructure, social housing, and cultural heritage sites. High-quality urban road infrastructure will underpin the long-term economic and social development of Tallinn by reducing generalised transport costs. Moreover, the renovation of streets and roads will contribute to improved driving conditions and thus reduce vehicle operating costs and energy consumption, resulting in a positive environmental impact. This loan is a follow-up to the successful co-operation between the EIB and the Municipality of Tallinn.

© Kadarik, Tüür, Arhitektid

Energy-efficient power plant in Acone, Latvia

The Latvian energy company Latvenergo received a loan from the EIB for the construction of a combined heat and power unit on the site of the TEC-2 in Acone, on the outskirts of Riga. The new combined heat and power plant was inaugurated in December 2013. This project replaced the old inefficient generating units and increased the plant's capacity to protect Latvia from a possible electricity supply shortfall, reduce its dependence on imported energy and improve the security of

© Latvenergo

supply in Latvia. The new co-generation plant uses state-of-the-art technologies and comprises one combined cycle unit with a gas turbine, heat recovery steam generator and steam turbine, with a projected electricity capacity of 400 MWe and a heat capacity of 270 MWth for district heating. Thanks to the EIB co-financing, this investment will meet electricity and heat demand in Latvia at a competitive cost.

Securing Energy Supply, the construction of an LNG terminal in Klaipeda, Lithuania

Last year, the EIB lent EUR 87 million to Klaipedos Nafta for the construction and operation of a new LNG import facility located in the port of Klaipeda. The LNG terminal comprises a floating storage and regasification vessel (leased by Klaipedos Nafta), an offshore jetty including gas handling facilities and an 18 km pipeline connection to the Lithuanian gas grid, which are all being financed by the EIB loan. The project is scheduled to be completed by the end of 2014. The EIB strongly promotes the security and diversification of the energy supply. Accordingly, the project will ensure the sustained supply of a key source of energy and will increase competition in Lithuania.

© Hoegh LNG

Modernisation of Polish railways, Poland

The EIB lent EUR 190 million to the Polish railway operator PKP Intercity for the renewal and expansion of its existing fleet by 2015:

- acquisition of 20 Electrical Multiple Unit trains (EMU) with a maximum operating speed of 160 km/h;
- modernisation of 218 passenger coaches;
- purchase of 25 passenger coaches with a maximum operating speed of more than 160 km/h;
- acquisition of 10 diesel mainline locomotives with a maximum speed of 140 km/h;
- modernisation of 20 diesel shunting locomotives with a maximum speed of at least 90 km/h. The new and modernised rolling stock will run at faster speeds and thereby reduce journey times. It will also ensure higher levels of passenger safety and comfort as well as easier access, particularly for people with reduced mobility.

© PKP IC/Bartłomiej Banaszak

Support for research and development of cleaner and low-emission marine engines and power plants, RDI, Finland

The EIB provided a EUR 150 million loan for the continuation of Wärtsilä's research, development and innovation (RDI) activities in Finland, Italy, Switzerland and several other European countries. The project will involve the development of engines and power plants that are cleaner, more efficient and more reliable with higher levels of automation, lower lifecycle costs and an improved environmental performance. New maritime emissions requirements are expected

to increase the demand for clean engines, and a similar trend is evident in land-based power plants. The company conducts its RDI both internally and in close co-operation with European universities and research institutes, enabling such institutions to carry out advanced applied research and also creating and spreading technological know-how.

The Nordic Investment Bank

The Nordic Investment Bank (NIB) is a regional multilateral financial institution in the Baltic Sea Region with eight member countries: Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden. The main part of NIB's lending is targeted at the bank's member countries, as well as at the neighbouring area, with annual commitments in support of investments in the Region on the level of EUR 1.8-2.4 billion over the last four years.

Approved	2010	2011	2012	2013
Denmark	137	271	229	401
Estonia	39	0	65	156
Finland	658	460	271	651
Latvia	21	14	20	0
Lithuania	20	21	87	136
Poland	74	130	0	0
Sweden	642	283	1109	497
Iceland	0	51	0	0
Norway	120	545	553	406
Russia	150	68	110	50
TOTAL	1861	1843	2444	2297

NIB provides long-term complementary financing, based on sound banking principles, to projects that strengthen competitiveness and enhance the environment. All project proposals are evaluated against the mandate outlined in the bank's strategy. Only those that obtain a high enough mandate rating are accepted for further consideration.

NIB takes an active role in regional co-operation in the Baltic Sea Region with a view to supporting the implementation of priority projects. The key issue from the financing perspective is to be able to identify bankable investments. While NIB only provides financing for specific projects, the Bank also engages, as appropriate, in the policy discussion on how to develop the regulatory framework necessary to secure the best possible environment for investments to materialise.

The Baltic Sea Region is distinguished by an intense level of co-operation across a multitude of different forums. Various programs have been developed to promote cross-regional development in areas ranging from culture and science to energy and transport, not forgetting the environment. As important as good relations and dialogue are, it is, however, the concrete results that matter in the long run. Reaching this, again, in many fields requires investments. But as experience shows, the process from the strategy and program level to concrete implementation is complicated. At best, strategies and policies provide clear guidance and help to set priorities, which in turn create a good basis for investment decisions and resource mobilisation, but this requires a targeted effort.

The EU Strategy for the Baltic Sea Region has established a framework for regional co-operation, laying down priority areas and identifying flagship projects. The revised priorities set out by the strategy, with its strong emphasis on the fields of environment, energy and transport, correlate well with the aims of NIB, and the Bank is supporting the implementation of the strategy in close co-operation with other actors, such as the European Investment Bank.

In the wider regional context, the Northern Dimension, based on an equal partnership between the European Union, Iceland, Norway and Russia, creates a platform for co-operation. In particular, the partnerships established under the Northern Dimension provide a framework for concrete activities.

Good governance, efficient administration, a supportive business climate, etc. are, as experience shows, criteria distinguishing successful regions from less successful ones. Furthermore, there is a large need for infrastructure investment across the Baltic Sea Region. This encompasses transport and logistics, energy, renewable energy and energy saving. At the same time, public sector finances are increasingly tight in many countries. And the new regulatory framework for banks (Basel III) will make it more difficult for the financial sector to provide long-term capital. This creates a need for innovative financial solutions. Different models will be needed, involving good co-operation with international and national financial institutions, as well as public authorities. Well-structured public-private partnerships can provide an effective mechanism for harnessing private sector competence and funding capacity in supporting investments. Effective use of domestic budgetary resources and EU funds is another issue in which a partnership with long-term financial institutions can be very useful, due to the financial assessment and safeguard procedures applied in the credit process.

International Financial Institutions can also assist local project owners, in particular in the public sector, by providing technical assistance (consultants) for project preparation and implementation through trust funds under IFI administration. In this way, individual projects will be executed according to best practices and they will, ideally, function as role models, spreading such practices more widely.

NIB is working mainly in four sectors that contribute to the fulfilment of its environmental and competitiveness mandate: Environment, Energy, Transport, Logistics and Communications, and Innovation. Environmental projects are found across the sectors with investments in renewable energy, sustainable transport, R&D related to eco-efficiency, resource-saving manufacturing and environmental services.

NIB has developed its internal methodology for assessing the competitiveness impacts. This assessment seeks to capture direct effects of an investment upgrading or expanding a company's capital base, for example by installing or replacing production equipment; wider direct effects improvements in infrastructure, for example by construction of new highways, railroads and ports; and indirect effects , for example by applying global best practice technologies

Over time the largest sector of activity for NIB is energy, whereas in 2013 the largest area was financing of investments in Industries and services. Lending in this sector was primarily directed at financing the innovation process, namely R&D projects related to technology development, which are essential for maintaining the competitiveness of enterprises in NIB's member countries in today's knowledge-based economies. Lending within this business area represented 45 % of all loans agreed upon during 2013.

NIB provides financing to small- and medium-sized enterprises in co-operation with local financial institutions that act as intermediaries. In addition, by financing investment projects in which modern technology is used, the demand side is supported. In accordance with NIB's sustainability policy, the Bank requires that best available technology is used.

- During 2013, NIB started developing a special initiative to broaden its outreach to the SME sector in the member countries, in co-operation with local banks. This is intended to supplement the current NIB loan programmes to intermediary banks. The goal is to enhance the Bank's offering of longer-term financing to smaller businesses to support investment and help them to expand their activities.

In the energy field in the Baltic Sea Region, security of supply and environmental sustainability are key challenges. The investment needs of the Region will be large in the coming decades. Enhanced integration of regional energy transmission in electricity and gas is a necessity, not least to enable a further increase of the share of renewable energy, and substantial long-term investments are needed in interconnectors and distribution systems. NIB is participating in the preparation of a number of priority projects, among others in the context of the Baltic Energy Market Interconnection Plan.

In spite of the high needs, investments in new generation capacity are currently few in number, in part due to uncertainties regarding the price development. Investments in transmission and distribution are continuing on a relatively high level. The projects recently financed by the Bank in this field primarily have related to investments in renewable energy, hydropower and wind power generation. In addition, loans have been provided for investments in upgrading electricity transmission and distribution systems and for new bio-power plant investments. In the pollution abatement field, loans have been provided for rehabilitation and renovation of water and waste facilities.

In the field of infrastructure, transportation and telecom NIB supports projects that improve the efficiency of transport, logistics and communications. Recent projects have included investments in railway infrastructure and rolling stock, road construction and ports. Another area of importance has been investments in infrastructure for education and healthcare.

In the field of climate change, NIB in the years 2008-2012 implemented a special lending program, the Climate Change, Energy Efficiency and Renewable Energy facility (CLEERE), providing loans for projects directed at climate change mitigation and adaptation, primarily in the energy sector but also in industry and transports. Originally established with an envelope of EUR 1 billion, the facility was increased due to strong demand, eventually to EUR 4 billion. NIB continues to finance such projects as part of its ordinary activities.

NIB supports the work of HELCOM to implement the Baltic Sea Action Plan (BSAP). The aim of the plan is to restore the good ecological status of the Baltic marine environment by 2021. NIB has set aside EUR 500 million in a special Baltic Sea Environment Financing Facility (BASE) to provide loans supplementing existing financing through national budgets and EU structural and cohesion funds, in order to finance measures that reduce pollution. Some EUR 330 million have been allocated under the facility. Loans under the facility are made in the ordinary course of lending activities.

To support the preparation of BSAP related projects, NIB and the Nordic Environment Finance Corporation (NEFCO) took the initiative to establish a special trust fund, the 'BSAP Fund', which was set up in 2009 with donor contributions, initially from Sweden and Finland, amounting to some EUR 11 million. The purpose of the fund, managed jointly by NIB and NEFCO, is to assist, through grants for technical assistance, the development of bankable projects that support the implementation of the BSAP. This first phase of the fund has been fully committed and several projects are currently in implementation.

NIB continued to participate actively in the Northern Dimension Environmental Partnership. NDEP aims to co-ordinate the financing of environmental projects with cross-border effects in the Baltic Sea Region, the Barents region and northwestern Russia. Projects prioritised by NDEP may receive grants from the NDEP support fund, which are combined with loans. Until recently, all projects were located in Russia, but today Belarus is also a country of operations for the NDEP. NIB is acting as lead bank for a number of the projects, collaborating with, among others, EBRD, EIB and NEFCO.

Photo: Dong Energy A/S

Anholt, Denmark's largest offshore wind farm, is co-financed by NIB. The farm was inaugurated on 4 September 2013.

Photo: Soile Laaksonen, VR Group

NIB and SEB Leasing Oy signed a EUR 70 million loan agreement in September 2013 to finance the acquisition of new railway trailers and coaches to be leased to the Finnish state-owned railway operator VR Group. The loan has a 15-year maturity.

The most recent partnership is the Northern Dimension Partnership on Transport and Logistics (NDPTL). The purpose is to facilitate co-operation on and implementation of regionally important transport infrastructure and logistics projects, with a focus on removing bottlenecks from relevant corridors. Implementation of such projects is expected to benefit from close collaboration with the IFIs, including in relation to PPPs that can provide an effective mechanism for harnessing private sector competence and funding capacity in support investments. The Partnership has developed positively. The NDPTL secretariat is hosted by NIB. The NDPTL support fund initiated its activities, approving the first grants for preparation of projects in Finland, Russia and Poland.

Tangible results and better implementation needed

A key feature of the Baltic Sea macro-regional strategy is to move from an idea of stronger co-operation to concrete work through investments and new initiatives. In this Section, the activity reports of twenty organisations and umbrella projects show well-established continuity and a high number of projects supporting Baltic Sea strategies. However, the average size of a project remains very small, adding to the fragmentation and the difficulty of reporting visible results. A wide range of projects has continued for so many years that it is time to expect tangible results and more focus on priorities. Stronger political strategic leadership and follow-up need to be put in place. There is still the gap between ministerial declarations and deliveries on ground. In addition, the private sector and the civil society capacity are still underutilised.

This is the first time the report of The Baltic Sea Parliamentary Conference has been included in this Section. The close co-operation of the region's national parliaments plays an increasingly important role when working on priority-setting, transparency and better coherence in the region. The European Parliament has an enhanced role in regional, environmental, energy, transport and research policies, as well as in allocation of EU resources, so its links to the Baltic Sea parliaments have become even more important.

Another additional contribution comes from the BONUS program, which issues competitive calls on Baltic Sea research and innovation for the scientific community and business. BONUS is funded jointly from national research sources in the eight EU member states around the Baltic Sea and the EU's Seventh Program for research by a total of 100 million euro for the years 2011-2017. Russia participates in BONUS through bilateral agreements. This program, together with many other Baltic Sea programs and projects, faces the challenge of finding a competitive way to benefit from the EU 2014-2020 funding, for example via the Horizon 2020 program.

The European Investment Bank (EIB) and the Nordic Investment Bank (NIB) contribute in a very tangible way to the financing projects, supporting priorities in environment, transport and energy policies. The average project size is in most cases significant. The projects improve the infrastructure, networks and living environment, enhancing the competitiveness in the region. Many projects financed by the EIB and the NIB offer a high value-added by linking governments, EU and private business together. Both financial institutions have been able to maintain high levels of financing, despite the financial crises and slow economic growth. They also contribute to professional preparations of major infrastructure projects, as well as corporate governance.

In practice, all of the organisations reported in this Section are adapting to the new governance structure of the EU macro-regional strategies and/or to the EU policy instruments for the years 2014-2020. The changes could, at their best, give extra momentum for new programs and better implementation. The EU is asking for more concrete political leadership, firm ownership and clearer responsibility for the Strategies by countries and regions. However, the European Commission continues facilitations in partnership with countries, regions and macro-regional organisations, ensuring a co-ordinated approach at the EU level.

The EUSBSR was the EU's first macro-regional strategy and has already shown convincing results in many priority policies. Where the results do not meet expectations, a re-evaluation is needed (sunset clause).

In the coming years, there are four similar EU macro-regional strategies competing for political attention and resources, but at the same time learning from each other. Sound competition will benefit all actors when clearer focus, major projects and visible results are needed.

Final observations

As leaders from across the Baltic Sea Region meet in Turku in early June 2014, they see a Region affected by the political reminders of the past and the economic trends of the future.

Politically, the crisis in the Ukraine feels to many like the return of a Cold War that we had hoped was far behind us. Not only are Russia's actions towards the Ukraine deeply worrying. It is also the question whether Russia sees itself as part of the community of 'Western' societies or decides to stay outside. This is a decision for Russia and Russians to take, but it is a decision that has fundamental implications for the entire Baltic Sea Region and what collaboration across the Region will look like. We are and will remain neighbours, and have a common stake in making this neighbourhood work. Good neighbourhood requires a commonly accepted set of rules and principles, and this is what is currently in question.

Economically, there are signs that the Region is entering a 'new normal' of permanently lower growth rates. The Region remains the 'Top of Europe' and registers both prosperity growth and internal catch-up rates that outperform the rest of the EU. But growth has decelerated, and seems now insufficient to close the gap with leading economies elsewhere in the world. The most recent GDP forecasts see headline growth picking up, in the Region as well as elsewhere in Europe (see Helge Pedersen's analysis in this Report). But this uptick in growth is modest, especially given the phase of the post-crisis recovery we are in. It is difficult to see where powerful new growth drivers should come from: labour mobilisation will be hard to increase significantly, and labour productivity rates, too, are unlikely to pick up quickly (see Anders Sorensen's analysis of the Danish situation). Monetary policy is already highly lenient, while fiscal policy cannot add much stimulus without leaving the path of sustainability. And global trade seems unlikely to return to pre-crisis growth rates anytime soon.

While the short-term macroeconomic trends are characterised by this sobering 'new normal', the Region's long-term prospects continue to benefit from very solid underlying competitiveness fundamentals. These support current level of prosperity well, and the high ranking of many countries in the Region on the relevant indicators is a key reason for why the Region is outperforming the rest of Europe. Competitiveness matters.

Despite the Region's impressive overall competitiveness, there are issues to address at the national and regional levels to further enhance competitiveness. An overall issue is the impact of the modest overall size of the Region and its individual countries. More integration is important, in markets as well as in innovation systems, and transport and energy networks. More attraction of outside talent needs to happen as well. But neither happens automatically. In many countries of the Region there are individual pieces of government regulation that could be streamlined at little cost; the recent World Bank study on Sweden highlighted in this Report gives an interesting perspective. While action on these will be largely national, it could benefit from collaboration across the Region.

What are some of the big trends that are going to affect the Region's competitiveness in the coming years? The next phase of globalisation will be one. Three different trends are likely to characterise this new phase: first, the weight of global economic activity will be shifting further towards Asia. Second, global trade will benefit less from falling trade barriers and transportation costs than it did in the past, and could enter a period of significantly lower growth. Third, the reorganisation of global value chains will continue, leading to more specialisation of locations around specific activities and functions. For the Baltic Sea Region, one of the prime beneficiaries of globalisation so far, these new trends pose a more complex set of challenges to address.

The continued shift towards a knowledge-driven economy will remain another key trend. The returns to skills will increase further. And the changes in the innovation processes itself will require that firms, academic institutions, and innovation policies adjust. The Baltic Sea Region remains an important node in the global innovation landscape and has lots to gain from the continued trend towards knowledge as a key production factor. But its innovation systems need to continue to adjust, and the Region needs to find its particular position relative to other innovation hubs around the globe.

Environmental sustainability and climate change will be the third factor, with profound economic implications. Changes in relative prices for energy and emissions will continue. Economies and companies will have to continue to invest significantly in changing energy systems, technologies, and value chains. New markets will continue to emerge for providing solutions to these environmental needs. The Baltic Sea Region sees itself as a global leader in this area, as well as a place to leverage the economic opportunities that the transition to a more environmentally sustainable economic system will generate. But the changes required are complex and costly, and the competition for these new markets is intense. The Region will need a clear strategy to succeed.

Collaboration across the Baltic Sea Region will be an important asset to deal with these multiple trends. The Region continues to benefit from an exceptionally strong network of projects and institutions that are the envy of macro-regional efforts elsewhere in Europe. The EU Strategy for the Baltic Sea Region (EUSBSR) has been a critical element in enhancing co-ordination among the many efforts under way, and in orienting them towards a clear set of objectives relevant for the Region. But by now, the strategy has also become part of normality. If the Region aims to achieve more, it will need to take active steps to leverage the framework of the strategy in a new way. A well-functioning governance approach will play a critical role in this context; the Commission will soon publish its recommendations in an official communication. Ultimately, however, it will fall upon the leaders in the Baltic Sea Region to chart the course ahead. The European institutions provide critical instruments that help a region to do more than it could do on its own. But they are not a substitute for regional leadership and strategy.

The European Union is asking for more regional ownership, stronger political strategic leadership, commitment and follow-up. Not only governments and their line ministries, but also national parliaments, with active links to the European Parliament, have an enhanced role to play.

When it started in 2009, the EUSBSR was the first and only EU-level macroregional strategy. Now the EU is developing four similar strategies. In addition, the Nordic Dimension and the Arctic Policies are complementary to the Baltic Sea Region strategy and demanding their own political attention and public funding. The increased competition means the need to show tangible results, visible projects, regional value-added and professional implementation at all levels.

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About BDF

Baltic Development Forum is the leading think-tank and network for high level decision-makers from business, politics, academia, and media in the Baltic Sea Region.

Our vision is to make the Baltic Sea Region the most dynamic, innovative, and economic growth centre in the world. Our mission is to position the Baltic Sea Region in the EU and on the global map by advancing the growth and competitive potential through partnership between business, government, and academia.

Baltic Development Forum is chaired by Lene Espersen, former Foreign Minister of Denmark. The Baltic Development Forum Honorary and Advisory Board consist of high-level political dignitaries and prominent business executives representing the entire Baltic Sea Region.

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