Trade and Foreign Direct Investment in the Baltic Sea Region, 1990-2015
Lessons from attempts at regional integration in post-communist Europe

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Abstract
It has been suggested that regionalism is defined “as an economic process whereby economic flows grow more rapidly among a given group of states [in the same region] than between these states and those located elsewhere” [1]. In this paper we approach the economic underpinnings for the Baltic Sea Region by analysing the developments with regard to trade and investment in the quarter of a century that has passed since the fall of the communist regimes that divided the European continent.

The paper offers a novel use and presentation of data on two potentially important factors for regional integration; that is, trade and foreign direct investment. It adds to our understanding by combining national data with insights offered from case studies. The main question asked is whether developments with regard to investments and trade are in congruence with the notion of the building of an integrated region? In short, does it make economic sense to talk about a Baltic Sea Region or is the east-west divide still omnipresent?

The question of what drives integration is pertinent against the backdrop of current discourse where globalization and factor mobility are increasingly being questioned. In the light of this it is of interest to see what lessons can be drawn from this very recent experiment in (re)uniting a once divided continent. For example, to what extent have the developments with regard to foreign direct investments proved sustainable? What sectors are leading the way and which are lagging? What divisions remain to be tackled?

The structure of the paper is such that it starts off with an introduction followed by an overview of the policy initiatives taken to (re)unite this particular part of Europe. In the section to follow, the starting point for potential integration is outlined as we look at the economic reforms that moved the region from Cold War isolation to a process of economic transformation. The main thrust of the paper then comes in a section where developments with regard to trade and foreign direct investment, in turn, are analysed through a novel use of existing sources.

The concluding section summarizes the lessons learned from this episode of (attempted) regional integration. In particular we believe there are important insights with regard to the relevance of existing theories on foreign direct investments. Also, the post-communist developments cast new light on the (side) effects of the much heralded policies with regard to mass privatization.

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I. Introduction

Some twenty years after the fall of the communist dictatorships that divided the European continent the European Union in late 2009 adopted its first ever macroregional strategy – the European Union Strategy for the Baltic Sea Region (often referred to as the EUSBSR). The strategy was a symbolic second milestone with regard to the political endeavours to reintegrate the region and the continent; the first being the 2004 enlargement of the European Union (EU). Having transformed the Baltic Sea from a Mare Dividum to a European Mare Nostrum is indeed also a sign of the success of such integrative political processes. However, at the same time the perceived need for a specific strategy to further and deepen the integration and reduce the economic gaps within the European Union indicated that there was more to be wished for with regard to this region.

Indeed, the mere fact that still in 2009, twenty years after the fall of the Berlin Wall and a little more than half a decade after the first eastern enlargement, EU had to admit that “full advantage of the new opportunities that EU membership provides has not yet been taken and the challenges facing the region have not yet been adequately addressed”, indicated that policies of integration and cohesion had not delivered the desired results. In particular the European Commission pointed to a remaining economic divide between the countries in the north-west (Germany, Denmark, Sweden & Finland) and those in the south-east (Estonia, Latvia, Lithuania and Poland) of the Baltic Sea Region. This stance contrasted the very optimistic views heralded in the 1990’s. The situation was succinctly summarised by then Swedish PM Fredrik Reinfeldt in a 2008 speech where he pointed out that:

> The region is one of the strongest growing regions in the world. But in order to reach the next level, the remaining trade and investment barriers need to be overcome and conditions created for further economic integration.

This also brings us to the focus of our interest in this contribution, namely the economic underpinnings for the Baltic Sea Region in terms of trade and investment. By analysing the developments in these two building blocks of economic integration during the quarter of a
century that has passed since the fall of communism we seek to shed light upon the question of whether regionalism, defined as "an economic process whereby economic flows grow more rapidly among a given group of states", is indeed in the making? As discussed more below, much hope was over the years connected to market forces in healing the wounds created by the communist division of the region. However, were these hopes fulfilled? Are the east-west divisions diminishing and have the developments with regard to trade and investments been in congruence with the notion of the building of one integrated region?

As our approach aims to be broader and more long-term than is commonplace among economists, we begin in Section II to discuss the region as such; its history and how different disciplines tend to approach the question of region building. Certainly, the question of what constitutes a region is central if one is to discuss how certain developments does or does not contribute to its development. Similarly, recognising that a good understanding of the past is of essence, leads us to devote Section III to a brief overview of the Cold War policies and later reform that led to the starting point that reformers had to face up to in the early 1990’s.

Section IV, representing the main empirical thrust of this contribution, focus on the developments with regard to investment and trade flows in the countries making up the Baltic Sea Region. For example we look at the long-term developments of intra-region exports and exports, comparing these flows to the general (rise) of trade; we also look at the regional flows of foreign direct investment (FDI), juxtaposing these towards worldwide developments. With regard to FDI we also ask what extent developments have proved sustainable and what sectors are leading the way and which have been lagging?

Section V concludes with a summary of the findings and also initiates a discussion on how the more recent political and economic developments in Europe and the world as such reflects upon the future of the political ambitions to use instruments such as macroregional strategies to boost territorial cohesion and integration in a soon-to-be post-Brexit European Union. The section also includes a discussion of what can and should be done in order to further our understanding of the role of economic flows in sustainable region building.
II. Building regions: the initial rise of the Baltic Sea Region

The waters of what now constitutes the Baltic Sea have been navigated in one way or another for some 10,000 years. With the Vikings in the very late 700’s began what can be termed economic exchange of a more systematic kind. It is also with the Vikings that we can begin to talk about a region under dominance by one type of actor – in this case the Scandinavians. The Vikings were followed by the Nordic or Baltic Crusades when Christianity conquered the region, an era which in part was paralleled by the development of Hanseatic dominance in and around the Baltic Sea. The Hanseatic era, which more than others came to signify the rise of modern economic exchange, in turn gave way to a period of Swedish dominance in the region that lasted up until 1721 or 1809.

Of interest from our vantage point is that throughout history the normal state of affairs for the Baltic Sea and the countries surrounding it is that the sea in itself has been an enabling one and that the territories and countries more often than not have been subjected to the dominance of one power or the other. Often these powers have also pursued policies of sometimes forced integration in the region. In this sense the Cold War, when the sea developed to a true Mare Dividum with two opposing spheres of interest and all efforts at integration and exchange were cut short, constitute an exception in the history of the Baltic Sea Region; a fact that may be important to bear in mind when looking at more modern day ambitions and visions formulated and put forth by politicians and others.

Even if the Cold War division was an exception it would prove to be one with far reaching consequences with regard to coherence and integration in the region. The perhaps most detrimental of the consequences was that it brought person-to-person contacts to a halt – thereby causing persons, companies and nations from ‘the other side’ to disappear from people’s consciousness despite being ‘neighbours’. And, in the absence of a real awareness of what exists on the ‘other side’, the chance that one may think of solutions involving actors and/or resources from both sides of the sea also diminishes substantially. To think regionally is clearly not so easy if one does not know who and what the region is made up from.

Regional integration and the Baltic Sea Region

The above being said, we may turn towards what make up the focus of curiosity, namely questions pertaining to what it is that creates regional integration and also what is making a
region. And indeed, to economists, economic historians, political scientists and organisational studies scholars alike – the process of combining or accumulating resources, entities or processes, that is integration, has had a strong lure. Such processes can be observed in many arenas, but when it comes to the topic of regional and economic integration, top-down and bottom-up integration are often differentiated.\textsuperscript{10} Whereas the former often is associated with elite decisions and concerted efforts and refer to developments of a political nature (political integration), the latter is viewed as a consequence of the decisions and actions by individuals and/or corporations (often referring to aspects of economic integration).

The starting point for the region building process at the centre of our attention was the year 1989, marking both the fall of the Iron Curtain and the ‘re-emergence’ of many countries as independent states. In this immediate post-Cold War era, with President Clinton at the helm, “enlargement” was to replace “containment” as the main foreign policy objective, and the visions of his predecessor of a Europe “whole and free” was not that far away;\textsuperscript{11} the lure to politicians, sharing the same vision, of an integrated Baltic Sea Region (BSR) was easily comprehensible.\textsuperscript{12}

A number of initiatives were at the time taken to promote knowledge about and exchange with these new neighbours. Somewhat ironically Sweden – part of the group of countries termed “reluctant Europeans” by Miljan (1977) and indeed at the time not yet a member of the EU – early on took a leading role.\textsuperscript{13} But, what started as attempts to increase contacts, get to know and to some extent assist our neighbours developed over time to something much more and very different. An initial culmination of this political drive to support regional integration came in 2009 with the adoption of the EU Strategy for the Baltic Sea Region (EUSBSR) under the auspice of the Swedish Presidency of the EU.

The ‘creation’ of this region has however been far from straightforward. According to some, successful regional integration presupposes at least two key conditions. The first is “the presence of benevolent leading country within the region seeking integration”; the second being that “the potential for economic gains from market exchange within a region must be significant”.\textsuperscript{14} Whereas there in the case of the Baltic Sea Region perhaps initially was a leading government (the Swedish one),\textsuperscript{15} its counterparts on the other side of the Baltic Sea were “preoccupied with very modern needs like sovereignty, security and state authority over
Further, at the outset, the enthusiasm shown by (some) politicians was not matched by an equally convinced business community.

Along the road this was nevertheless to change. Business started to see more and more of the above-mentioned “potential for economic gains”; not least after the prospects of an EU enlargement started to look realistic. This also meant that the dynamics of the process began to change and new actors entered the process. Or, as Carl Bildt put it, “[t]he governments are no longer in the driving seat. It is instead much more business, local authorities, universities and independent organisations that co-operate….”

So, instead of one benevolent leading country, there seems to have come a plethora of organisations at various levels and with various interests that promote the creation of this region in close collaboration with business interests. In some cases these organisations were new creations, but in many cases their work was based on either long-standing or revitalised networks and exchanges. A tangible result of this rejuvenation of cooperation was that over the years more and more references to the Baltic Sea Region (often BSR) were being made; there is thus no doubt some truth to the statement that “[t]he Baltic Sea region has indeed been talked into existence and is mentally visible now.”

**What kind of a region is the Baltic Sea Region?**

Before departing on a discussion of how the business community, through for example trade and investment, may have contributed to this region and its ‘visibility’, it may be useful to open up to a brief discussion of what it is that constitutes this particular region? Indeed, the concept of a region is a problematic one in its own right and there are many competing views on, and definitions of, what constitutes a region. As pointed out by Mansfield & Milner (1999:591) “[b]esides proximity, many scholars insist that members of a common region also share cultural, economic, linguistic, or political ties.”

With this in mind it is not presumptuous to state that countries around the Baltic constituted far from an ideal setting for ‘region-building’. On the ‘north-western shores’ were the ‘Norden’ countries that Miljan (1977:284) concluded to have been not only reluctant Europeans but also reluctant Nordics. Then, on the ‘south-eastern shores’ of the sea were countries with a very recent history of what the EBRD (2003:3) euphemistically termed “misdirected regional and international integration”.

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16 Territory”.
17 “The governments are no longer in the driving seat. It is instead much more business, local authorities, universities and independent organisations that co-operate…”
18 The Baltic Sea region has indeed been talked into existence and is mentally visible now.”
Adding to this difficulties of communication due to distance and language as well as a recent history of division, the countries around the Baltic were not your obvious candidates for successful ‘region building’. The BSR instead consists of a truly heterogeneous group of countries encompassing some 100 million inhabitants with great variation in terms of economic structure and development, historical legacies, language and culture. Even so, as noted above, it is increasingly being recognised as a region. How do we explain this?

One explanation clearly lies in the very loose definitions used when talking about regions, which gives significant degrees of freedom to use the concept as one pleases. As a Finnish geographer pointed out it is true that “[e]ven if region and regional identity have become important in many academic fields during roughly the last 15 years, the meanings of these categories are ambivalent and require further theoretical analysis and interpretation of their significance in various empirical contexts.”

Even though it is not within the realm of this contribution to resolve this confusion, we agree that it is important to discuss the issue. One very practical reason to dwell upon the topic is that we need to know what countries we are talking about when looking at the statistical data available. Another reason is that by discussing what we mean with region and regional identity, we make somewhat clearer what could constitute a desirable goal and/or a direction for the overarching process of regional integration. Getting acquainted with such a ‘vision’ may also be of the essence if we are to be able to analyse whether our observations are in line with the process of region building that is our main focus.

As regards the first and more practical part of our motivation, we have in this contribution chosen to follow the definition of the Baltic Sea Region that has become habitual not least in connection to the adoption of the EUSBSR. For us, this means that in the presentation below and we include all the eight EU member states that border to the Baltic Sea. Also, in the analysis no attempts have been made to divide the territories of these eight countries; rather, in all statistical representations of trade and investments we are talking about the whole of Poland, the whole of Germany, the whole of Sweden etc.

With regards to the other part of a possible motivation for discussing what constitutes a region (i.e. getting acquainted with a ‘vision’ of what constitutes a region) it is in fact beyond the scope and ambition for the present contribution to establish our own definition of
important qualitative characteristics of a region. Rather, suffice to say we support the stance taken by growing number of researchers that implies that an important dimension of a region concerns how it is perceived and made aware. Gerner & Karlsson (2001), for example, describe the region as “first and foremost a mental and cultural construct, a perceived gemeinschaft. As such it may be created, mobilised and used (but also forgotten) by various societal groupings in different eras and for different purposes.”

Such a characterisation is also in line with the development referenced above when we talked about the BSR as having been talked into existence. Further, a tangible sign that the region was indeed talked into existence is the EU Strategy for the Baltic Sea Region, de facto the first macro-regional strategy to be adopted within the European Union. The region covered by this strategy is thus our starting point for the explorations in Section IV below where we despite accepting the existence and definition of the region critically try to explore the economic underpinnings of it. Prior to that we will however in Section III try to paint a picture of the economic starting point for this new era of region-building in the Baltic Sea Region as we believe this to be necessary if one is to be able to correctly interpret the economic data presented in Section IV.
III. From Cold War isolation to economic transformation

If the Cold War in many ways was an era of isolation with regard to general interpersonal contacts among ‘regular’ persons and the free exchange of information that could have contributed to the awareness that many see as essential for region building, there is sadly no indication that things were otherwise with regard to business and more professional contacts. Rather, the enterprise sphere was equally (if not more) isolated from international influences than were the regular citizens.

Communist trade

Indeed, within the framework of the so-called planned economy all types of international relations were monopolised by various centrally controlled structures. In the case of the Soviet Union there was for example a foreign trade monopoly with different sector specific foreign trade organisations that controlled all international contacts. Direct contacts between domestic and foreign enterprises was not on the agenda. In addition to this type of monopoly there was also a central monopoly with regard to the means of payment. In the absence of external convertibility (or internal for that matter) all international financial transactions were handled by the special foreign trade banks established in each of the communist bloc countries; not even communist bloc transactions could be conducted outside the realm of the central monopolies.  

Important to note is that these monopolies were not primarily designed for repression – rather they were a logical consequence of the centrally administered economic system with ‘taut planning’. Under such a system one could not allow for unplanned ‘leakages’ within the system; exports, if unplanned, constitutes such a ‘leakage’.  

For the existing producers and managers this meant that they had no autonomous role to play in the international economic exchange, and consequently they were systematically isolated from external influences and contacts. Further, the international exchange that did take place within the framework of these monopolies were of course also strongly influenced by the internal logic of the centrally administered economic system which saw international exchange as something not totally unlike a ‘necessary evil’. In short, the communist economic system meant that a strait jacket was imposed on international trade flows that as a consequence were far below those of other economies on a similar level of development.
Perhaps it is so that only with a thorough understanding of the communist economic system may one fully appreciate the magnitude of the change that faced these economies and its producers after the fall of communism. Irrespective of that, given that the trading regime among communist states, just like the economy in general, was a political system more than an economic system it was not unexpected that it collapsed when the political regimes which had propped it up fell. Indeed, as of January 1991, from which it had been decided that also socialist trade should be conducted in hard currency, the whole eastern market disintegrated. Industry in these countries thus faced a situation where it had to compete on the international markets from which they had been practically isolated for 40 years.

Joint ventures and embryonic foreign investors
Also with regard to investments, the isolation between the two competing blocs was more or less total. In addition to international embargos and self-proclaimed policies of self-sufficiency the same logic as with trade relations applied also here – one could not under a centrally administered and politicised system allow actors external to the system (e.g. foreign investors) to have an independent role with regard to the workings of the system (e.g. the operation of an enterprise). Even so, during the late 1980’s under the Gorbachev years, many things that previously could not be done all of a sudden were possible. Thus, under this period the Soviet Union (including the three Baltic republics) gradually opened its doors also towards international investments in the form of joint ventures. The so-called Joint Venture Act came into force in 1987 and applied to the whole of Soviet territory.

Even though the three Baltic republics since long had been forerunners in the reformation process, the development was very slow. In Estonia, which was the real experimental ground for economic reform and liberalisation, there were no more than 13 registered joint ventures during the first year. Also in 1988 the number remained equally low and it was not until some relaxations of the law that the number started to grow – resulting in 60 registered joint ventures during 1989. A qualitative step came in 1990 with the adoption of a new joint stock company act, and as a result, the number of foreign owned companies in the Soviet Republic of Estonia exceeded 400 a year later. Even so, it is doubtful to speak about any true impact from foreign interests – at least not until after Estonia and the other two Baltic republics regained their independence in 1991.
Still in hindsight, it is interesting to note that there seems to have been a real regional dimension already with these early day joint establishments. In the case of Estonia, for example, it was Finland and Sweden that dominated with regard to the number of registered units and invested capital, respectively. Also when looking south towards Poland it is clear that geographic proximity seems to have been a factor; West Germany (FRG) was the largest player with 944 registered joint ventures in December 1990 and Sweden was second with 236 registered companies. Even though the scale of investments were a far cry from what we have witnessed in the more recent past it is important to remember that the beginning was made up of many of these very small establishments; in the Polish case with an average foreign investment of a mere 135,000 USD per registered establishment.  

The transition agenda and the role of FDI  
Concerning the economic reform programmes in general it suffices to say that all countries came to rely on the ‘standard recipe’ which invariably involved a liberalisation of markets and prices, privatisation of the means of production and some kind of macroeconomic stabilisation. Even if there were some early discussions concerning these building blocks of transition, there are few that – with the benefit of hindsight— seriously question the wisdom of these policies. The policy differences at the time often evolved around timing and sequencing, and to some extent, the detailed design of these basic reform measures. Methods for privatisation were one recurring theme of discussion that also was to affect the timing and direction of investment inflows. Another type of discussion concerned the extent and pace with which one sought to liberalise the domestic and international economic exchange.  

As regards to the four eastern countries of our interest, one may in a very broad sense point to Estonia as a country that, based on a deep scepticism towards state involvement in the economy, rapidly liberalised economic relations. Remaining obstacles to foreign establishments and cross-border economic activity in general were quickly dismantled. For Latvia, and even more for Lithuania, the general picture is one of somewhat more hesitant reforms. The largest of the new member states in the BSR, Poland, was as a consequence of the Balcerowicz-plan in January 1990 the country that to the general public became synonymous with shock therapy. In reality, much of the 1990's was characterised by a relatively moderate and measured pace of reforms; the so-called shock was more a
consequence of the hyperinflation that had built up, which necessitated an ambitious stabilisation programme to be launched.\textsuperscript{30} Even so, the general perception of what was \textit{thought} being done in Poland, served as a ‘model’ for reforms elsewhere in the region. The pace of economic transformation and liberalisation is illustrated in Figure 1 which above all underlines the very significant difference between the BSR-countries and other CIS-countries (CEE-12), but also to some extent underlines the very fast pace of reforms in Estonia.

\textit{Figure 1. Indices of transition for BSE-4, CIS-12, SEE-6 & CEE-6, 1989-2015}

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\textit{Source:} EBRD; own calculations. \textit{Note:} In the above indices of transition we have computed the unweighted average score for four of the annually published EBRD-indices of transition that directly or indirectly relate to economic liberalisation and the international flows of goods and capital, namely the indices for large-scale privatisation, small-scale privatisation, price liberalisation, trade and forex system. For all sub-indices 1 is the minimum (app. a unreformed socialist economy) and 4.5 is the maximum (app. approaching or having reached the standards of a developed market economy).

In addition to all having been closed economies with a history of forced isolation the countries in the eastern parts of the Baltic Sea Region shared a heritage in that had had an aging economic and industrial structure in dire need of restructuring. Such restructuring, however, would not only require establishing new nominal owners for existing industries (privatisation) but also created a need for investment capital,\textsuperscript{31} managerial and commercial expertise as well as international contacts. Given that this combined need for \textit{capital}, \textit{competence} and \textit{contacts} fit well with what one usually associate with foreign direct investments,\textsuperscript{32} it was no wonder that policy makers as well as managers in the eastern countries of the region developed a yearning for western investors as a possible solution to a significant challenge.
At the same time it bears remembering that there was indeed some initial hesitancy towards foreign investment from both sides. In many of the eastern countries, for example, there was some initial hesitancy towards foreigners taking part in the privatisation process both on the sides of part of the former elites and on among the general public. Further, also on the side of the investors, there were also apparently some early-day fears that the upside of low-cost skilled labour and market access was not enough to compensate for the risks of political and economic instability. So, even though most observers found the notion of foreign direct investments an attractive option for these countries, and that the predictions were that it would help re-integrate these economies into the west and particularly western Europe, it was not a done deal in any way. Indeed, the early day sentiments were well captured by a Brown (1993:498) when after a research visit to Estonia in September 1992 he wrote the following:

“Whether foreign investment will increase is anybody’s guess, but if social problems can be avoided and the kroon remain stable, the highly educated and low-wage work force should prove attractive to someone. However, finding foreign investors interested in buying factories using outdated technology will remain difficult regardless of the wage rate or incentive programs that are offered.”

Even so, the general prediction in the early 1990’s was indeed that the combination of the demand for restructuring in combination with the promises of cheaper production and market access would lead to sizeable foreign capital flows. Dunning (1993), for example, was one of the observers who early on took an optimistic view of the role of FDI in the transforming economies of the east.
“[regionalism is] an economic process whereby economic flows grow more rapidly among a given
group of states [in the same region] than between these states and those located elsewhere”
Mansfield & Milner (1999), p. 591

IV. The economic underpinnings of integration
Recalling the above discussion on economic integration as being underpinned by (increasing)
economic flows, we below approach these issues through an analysis of the developments
with regard to trade and foreign direct investments among the countries in question. We begin
with a brief look at the trade flows which historically has been a cornerstone and frontrunner
for any kind of integration. After that, we look into the overall patterns of FDI flows to and
within the region, paying special attention to the regional and sectoral distribution of flows.
We conclude with an overall analysis of what we know and what we do not know.

Trade in the BSR: intensification and reorientation
On an analytical level what we are looking for is integration being reflected in trade and
factor mobility (including capital mobility). In this respect, there is no doubt that the last
quarter of a century has implied profound change for the BSR. At the same time as world
trade has outpaced world output, many of the ‘eastern’ countries of the region have gone from
the above discussed international isolation to a position where trade accounts for a
significantly larger part of GDP in the eastern part of the region, that is Estonia, Latvia,
Lithuania and Poland (henceforth BSR-E) than is the case for the four western countries
Denmark, Finland, Germany and Sweden (henceforth BSR-W).

Interesting to note, in addition to the very high and early established openness of the Estonian
economy is how Lithuania caught up, positioning itself as the most trade dependent country
in the region. Also noteworthy is Poland’s transformation from relative laggard with foreign
trade accounting for < 40 per cent to a where it accounts for > 80 per cent of GDP.

A similar development can be seen with regard to Germany which changed its economy from
a position in the early 1990’s where it was the least trade oriented of the four western
countries to where its trade accounts for a significantly larger part of economic turnover than
the traditional ”small open economies” of Sweden, Denmark and Finland.
In the same manner, the direction of trade relations has also been revamped with all of the four transforming economies quickly adjusting their trade relations from the former CMEA-trade towards new trading partners in the developed market economies. With regard to direction of trade it is hard not to lose important detail if aggregating across countries; below is thus presented the development and ongoing trade reorientation for each of the eight BSR-countries. In all cases we present the share of merchandise exports and imports which has been destined to/arrived from the other countries in the region (BSR-7) and the neighbouring trading block Commonwealth of Independent States (CIS).

For Estonia, Latvia, Lithuania and Poland we in addition present the development with regard to imports/exports to its western neighbours (BSR-W). For Denmark, Finland, Germany and Sweden the additional graphs presented in represents the share of trade directed involving the "new neighbours" in the eastern part of the region (BSR-E). Each figure is only briefly commented upon below.

As seen in Figure 4 Poland began the 1990’s with a rapid reorientation from the then deteriorating CIS-markets (grey lines) towards its neighbours in the Baltic Sea Region. As illustrated by the short distance between the two solid lines depicting exports to BSR-7 (red) and BSR-W (black) there was initially not much exports to the three Baltic States; this trade regained momentum only towards the latter part of the 1990’s. Noteworthy is also the rather...
significant surpluses that the country ran vis-à-vis its neighbours; up until EU-membership in 2004 when imports from the EU-members surged. As will become clear the Polish experience was not typical for BSR-E but perhaps rather related to the size of the domestic market where Poland (like Germany) for much of the 1990’s had a foreign trade turnover significantly lower than its (smaller) neighbours (see Figure 3 above).

Figure 4. Trade reorientation in Poland, Estonia, Latvia & Lithuania (BSR-E), 1990-2016

Source: IMF (DOTS); own computations.

In Figure 5 we see the most open and trade dependent of all economies in the region, namely Estonia where foreign trade turnover up until 2013 by margin was the highest in the region. Trade reorientation was extremely rapid in this country with exports to the other countries in the region making up for some three-quarters of all exports already in year 2000. Compared to Poland trade with the other countries in the eastern part of the BSR (BSR-E) has throughout been much more important; testified to below by the larger distance between exports to BSR-7 (solid red line) and BSR-W (solid black line). Furthermore, Estonia was the country that saw the most significant reduction in east-bound trade both in exports (solid grey) and imports (staggered grey) from the CIS-countries with exports to this region falling to below 5 per cent of the total around year 2000 before rebounding somewhat to hover around 10 per cent of imports and exports.
Figure 5. Trade reorientation in Estonia, 1993-2016

Source: IMF (DOTS); own computations.

Neighbouring Latvia has a trade dependency somewhat below Estonia and Lithuania, but significantly higher then the BSR-W group of countries or Poland (see Figure 3 above). The country differs from Estonia in that a significantly larger part of its trade (import & exports) is directed towards the BSR-E group of countries; the gap between the red (BSR-7) and black (BSR-W) graphs which represents trade with BSR-E has steadily grown for more than a decade and positions Latvia as the country with the largest part of its trade with Estonia, Lithuania and Poland (see Figure 6).

Figure 6. Trade reorientation in Latvia, 1993-2016

Source: IMF (DOTS); own computations.
The fourth and final BSR-E country is Lithuania and in this case the picture is not so clearcut. By comparison to its neighbours it had initially a slower pace of economic transformation; in trade this is visible in the significantly different pattern with regard to redirection of its foreign trade. Up until the time of the Russian financial crisis the country had a larger share of exports to CIS (grey) than to the BSR-7. Indeed, exports to the western part of the region (BSR-W) has for the better part of period covered Figure 7 been lower than those to the CIS. When interpreting the relative decline of exports to BSR-W to the lowest share among the countries studied it should nevertheless be remembered that Lithuania during the same time has increased its exposure to trade significantly, becoming the most trade oriented country in the BSR-Region in 2015.

*Figure 7. Trade reorientation in Lithuania, 1993-2016*

When turning to the western part of the region (BSR-W) the changes in terms of redirection of trade are for obvious reasons not so rapid; this, however, does not mean that there have been no changes.

In the case of Denmark (Figure 8), a country where foreign trade turnover has increased only mildly during the period in question (from about 45% to 60% of GDP) we still see a clear trend towards increasing trade with BSR-E countries as well as with CIS. Indeed there seems to have been some displacement with regard to trade where the relative increase in trade with new markets in the east are making up for the lowering share of trade with BSR-W (blue...
graphs). To be noted is also that the pace of increase is consistently higher with regard to the BSR-E than with regard to the CIS.

Figure 8. Trade reorientation in Denmark, 1990-2016

Source: IMF (DOTS); own computations.

A very different picture is presented in the case of Finland which in the 1980’s had been highly dependent on trade with the former Soviet Union. As seen in Figure 9 this relative dependency on CIS-trade remained with a slump only in very recent times. Trade with the BSR-W has seen a relative decline up until the slump in trade with Russia. The one long-term trend that is visible is however a steady (albeit slow) increase in trade with BSR-E.

Figure 9. Trade reorientation in Finland, 1993-2016

Source: IMF (DOTS); own computations.
Turning to the very largest country amongst our group of countries, that is Germany, we already above in Figure 2 how its openness to trade increased gradually, steadily and significantly over the last quarter of a century to a position where its merchandise trade make up for some 70% of GDP; significantly more than the traditionally more open small economy of Sweden. Moreover, as can be seen in Figure 10 below this increasing openness has gone hand in hand with a close to five-fold (sic!) increase in the relative importance of the BSR-E (black graphs) countries which is what makes up for the relative decline in trade with the traditional trading partners Denmark, Sweden and Finland (blue graphs); the net results of this is that BSR-7 trade (red graphs) has seen a steady relative increase in importance.

Noteworthy is also how trade with the CIS-countries have increased in importance - albeit not in the same extent as trade with neighbouring Estonia, Latvia, Lithuania and Poland - up until the imposition of sanctions of Russia.

*Figure 10. Trade reorientation in Germany, 1990-2016*

Germany is in the context of region-building particularly interesting in that its actions - based on its economic and political importance - have far reaching consequences for the fate of the Baltic Sea Region. For this region it must be deemed very positive that its establishment has come at a point in time where Germany has stood up not only on a political level but also coincided with Germany developing into a leading world economy which heralds the continuation of economic exchange and free trade.
Turning towards the eight and final country in the region proper, that is Sweden, where the importance of international merchandise trade flattened out and suffered a decline in the aftermath of the most recent global financial crisis; turnover now hovering at around 60 per cent of GDP - down from close to 70 per cent. This relative decline does not take away from the long-term development which is in line with global developments with trade turnover having risen from below 40 per cent of GDP in the early 1990’s. Also in the case of Sweden the direction of trade has been in congruence with our notion of an economic underpinning of regional integration with trade with the former eastern neighbours showing a similar to Germany fivefold increase over the period.

Figure II. Trade reorientation in Sweden, 1990-2016

![Graph showing trade reorientation in Sweden, 1990-2016.](image)

*Source: IMF (DOTS); own computations.*

To sum up we from the above have seen that there has taken place some significant changes in the trading patterns within the region. Almost unanimously the trade between the BSR-W and BSR-E has experienced a relative strengthening in importance. This has in all cases gone hand in hand with significantly growing volumes and an increasing importance of trade per se; a development closely coupled with increasing exports from Estonia, Latvia, Lithuania and Poland as a result of these countries upgrading the industrial, manufacturing and knowledge base and approaching the EU-average in terms of economic development.
Foreign direct investment: general developments in the region

It is well known that market openness and openness to free trade correlates positively with the level of foreign direct investments (FDI), and Dunning (1993:113) was early to point out that “more and more, trade and foreign investment are complementing, rather than substituting for, each other.” In addition, there is a growing mainstream consensus on a positive relationship between trade, FDI and regional integration. These established relationships thus lend credence to our ambitions to continue our investigation into the economic underpinnings of regional integration by turning our attention also to this particular aspect of economic exchange, that is foreign direct investment (FDI).

Focus is on what can be seen from available macro statistics – with all of their well-known limitations – which we nevertheless try to present in a way that help to increase our understanding of the regional developments. The section begins with an overview of the world developments with regard to FDI; we then go on to look at the inflows, stock and relative importance in each of the countries in the region.

In a concluding section we try to create a picture of the sectoral and geographical dimensions of the phenomena through a closer look at the eastern countries. In this contribution we will present no case studies of specific deals (greenfield or brownfield) but rather focus on what the macro statistics can teach us about FDI’s relation to regional integration.

The Baltic Sea Region in the world of FDI

It is important to remember that FDI represents a truly global phenomenon and that the BSR is merely on the fringes of these developments. Looking back in time we see that FDI inflows long remained a relatively limited phenomenon. Up until the mid-1980’s global annual inflows had yet to exceed 70 billion USD (Figure 12; grey line). However, beginning in the late 1980’s, a significant growth took hold and the quarter of a century that are at the centre of our attention, i.e. the 1990’s up until 2015/2016, coincide with two periods of extremely rapid growth of global FDIs (and two significant downturns; in the aftermath of the IT-bubble and the subprime crisis, respectively).

As is seen in Figure 12 annual inflows on a world level experienced a rapid increase in the 1990’s, followed by a rapid downturn and then again an increase which peaked prior to the
subprime crisis when FDI amounted to around 1900 billion (sic!) USD in current prices (grey line; left scale).

As can also be seen the 1990’s was a period when the conventional wisdom of FDI being a phenomena dominated by highly developed economies both as source and recipient of funds still held up; the share of world inflows reaching the BSR-W group of countries (Germany, Sweden, Denmark and Finland) rose to a record high of 20 per cent of world inflows (black line, right scale). At the same time it should be remembered that the relative importance of BSR-W countries rose even more when it came to them as a source for FDI; i.e. outflows from this subregion grew even more (cf Figure 13 below).

Also, the share of these flows reaching the BSR-E group of countries of course remains small in terms of numbers, hovering between 1-2 per cent. Even so, their impact on the respective economy has as will be shown in the sections to follow been profound given that total annual inflows (despite the two dips) has continued to grow throughout the period. In Figure 12 is also detectable the peak in connection to the 2004 accession when BSR-E countries jointly reaped some 2 per cent of world inflows (red line; right scale).

*Figure 12. FDI inflows in the world and the Baltic Sea Region, 1970-2015*

![Graph showing FDI inflows in the world and the Baltic Sea Region, 1970-2015](Source: UNCTAD; own computations)

If turning to look at the period of primary interest we again underline the fact that there is a significant difference between the eastern part (red) of the region and the western part (grey) where the latter for the most of the time is a net exporter of direct investment capital. In Figure 13 we see how above all Germany (black) for all years except for three (2000-2003) is
a net exporter of capital and that it throughout the period is the country that in and by itself are driving the figures for the BSR-W.

At the same time we can from the line of red columns see that the net inflows to the four countries making up the BSR-E group of countries (Estonia, Latvia, Lithuania and Poland) is far from negligible; and, of course, that in general these countries are net recipients of investment capital.

Figure 13. FDI annual net flows (million USD) to/from BSR-W, BSR-E and Germany, 1992-2015

In this context it is important to remember that despite the dip in the early 2000’s, visible both in Figure 12 and Figure 13, there has been a continuous growth of the importance of accumulated foreign direct investments (i.e. the FDI stock). The regional division remains though which is illustrated in Figure 14 where the relative importance of the inward (left pane) and outward stock (right pane), respectively, in BSR-W, BSR-E and CIS is portrayed.
As can be seen in Figure 14 the relative importance of foreign direct investments, measured as the inward stock’s share of GDP has grown to become higher in the BSR-E group of countries with figures for 2015 pointing to that the stock (measured as the unweighted average of the four countries) equals more than 50 per cent of GDP (black line, left pane). Also, as is shown below this is not due to decreasing levels of GDP but rather due to steadily increasing flows.

The right pane of Figure 14 shows what was mentioned before, namely the BSR-W being even more important as a source of capital rather than a recipient with the outward stock (unweighted average) from the four western countries in recent years hovering just below 60 per cent of GDP (red staggered line; right pane) whereas the equivalent with regard to inward stock is 40 per cent of GDP.

A final comment is that the pattern deciphered already in Section III above and even more when discussing trade is that the CIS countries has not kept pace with regard to the reforms and economic development that could underpin an increased importance of FDI. The curves (solid red) for the CIS-group of 12 countries in both the left pane (inward stock) and the right pane (outward stock) never recovered after the subprime dip. A contributing factor of course also being international sanctions against Russia.

Before concluding this very aggregate view of FDI and turning our eyes towards national developments in the BSR-E group of countries a statistical artefact visible in the right pane of
Figure 14 deserves to be commented, that is the quite quick rise of BSR-E as a source of outward FDI visible in the mid-2000’s. This is simply due to the fact that the Scandinavian owned banking industry used Estonian fully owned banks to buy into the banking market in the neighbouring countries. We mention this as a caution to the frailty of aggregate statistics on FDI as they are collected on a national basis.

FDI into the region: the relative impact on the economies
Below we will try to illustrate the generally very high importance that FDI has taken in the group of four eastern countries (BSR-E) but given that there significant variance with regard to individual countries this will be done on a national basis. We will do this by looking first at the actual volume of inflows that has accumulated over the period (Figure 15) and then on the weight that the actually existing stock of FDI carries as measured against the size of the economy (% of GDP) in Figure 16. After this brief introduction to the impact on the various economies we turn to the from a regional integration perspective yet more pressing questions of where the money has come from and into what sectors they have ventured.

In Figure 15 we see clearly how the rather flat line from Figure 12 above which depicted the BSR-E countries share of world inflows translates into a very steep line when "multiplied" by the steady growth of worldwide flows. In the figure we see that in terms of nominal inflows of course Poland (right axis) stand out with in excess of 200 bn of cumulative inflows since 1992. However, given the relative size of the countries the inflow of more than 20 billion worth of FDI in the small country of Estonia with a mere 1.3 million of population (3.4 per cent of Poland’s 38 million) is a very high figure; this is also reflected in the right pane where we see that already at the time of EU accession FDI inward stock had surpassed the equivalent of 80 per cent of GDP - more than double of that of any other BSR-E country.
From the above it should be clear that flow measures carry some significant frailties when used for international comparisons. One is that they say very little about the relative importance of inflows to the economy, that is, one million dollars in a poor economy carries more leverage than it does in a wealthier economy. Also, merely looking at inflows bears the risk of overlooking issues related to the sustainability of investments; inflows one year may be the outflows of the coming year. With that in mind it is obvious that the picture of the flows need complementing by looking at what remains in the country (i.e. the stocks of FDI) and also how this compares to the size of the size of the economy as such.

Then, to conclude this overview of gross flows and stocks it is time to turn to the perhaps most important measure, seen from our perspective, namely how much these stocks amount to in terms of the respective domestic economies; a relevant measure then is the inward stock (end-of-year) as a share (%) of current annual GDP.

In Figure 16, we see that in terms of the relative importance of FDI (as compared to the size of the economy), Estonia is the country that par excellence has the most significant inward stock of FDI. Estonia’s position in this regard (black line) also translates into positioning the country as one of the countries in the world with the highest penetration of FDI; and most definitely the country in the Baltic Sea Region (including the western parts) which has attracted relatively the most FDI.41
Already at the time of EU-accession (2004) the share of inward FDI as a per cent of GDP surpassed 80 per cent. When trying to reconciling the flattening out of the line post-2004 for Estonia in Figure 16 with the continued steep rise in inflows in Figure 15 above it should be borne in mind that growth has been continuous in Estonia. Whether this growth is directly attributable to the FDI-inflows is nevertheless for a different paper.

The same interdependency with growth is also illustrated in the case of Latvia (staggered red line) where the post-2009 relative increase in the importance of FDI depicted in Figure 16 is rather attributable to the domestic financial crisis which was handled with an internal devaluation of the lat and resulted in falling GDP.

Figure 16. FDI inward stock in Estonia, Latvia, Lithuania and Poland, 1992-2015 (% GDP)

Source: UNCTAD; own calculations.

Despite shortcomings with regard to also this aggregate measure Figure 16 still testifies to a tremendous change in a relatively short time with all of the eastern countries not only being open to foreign investments but also managing to attract them to an extent that the relative importance of foreign ownership by now exceeds that of all of its regional western neighbours (BSR-W).

In connection to this it may be worthwhile to ponder a little on what kind of investments that, relative to the size of these economies, make up the quite substantial stocks of FDI described above? It has been shown in other research that a main driver for inflows was the privatisation processes in the countries of the region. A reliance on large privatisation deals
could also to some extent explain the significant annual variation in the inflows to the individual countries.\textsuperscript{42}

Having this in mind, it is easy to understand that there were fears that inflows would dry out as soon as the privatisation came to an end. However, as we have seen above, inflows have continued long after privatisation proceeds have come to a halt.

**Sectoral distribution of the inward stock of FDI**

As just proposed there is a close affinity between the early developments in FDI and the early privatisation processes. Thus, it is no surprise to see that manufacturing in general accounted for a large proportion of the stock of inward FDI – early on (1995-1997 in Figure 20) being the single largest sector in three out of the four BSR-E countries. The one exception was Latvia where manufacturing initially was the second largest sector in attracting FDI.

Over time, however, the proportion of manufacturing (red bars) has dwindled in all four countries as inflows have been attracted to other sectors. In Poland it shrunk to 31 per cent by 2010, and in Estonia to a mere 15 per cent already in 2005. Latvia stands out as the country with the relatively ‘smallest’ foreign interest in manufacturing; with the sector never accounting for more than 18 per cent of the inward stock in FDI (1995).

In place of manufacturing, inward FDI to these economies have above all been attracted to the financial sector. Further, if combining with investments into real estate, renting and business activities (NACE K), we see that investments into such “white collar” activities (black bars in Figure 20) almost doubled its share of (the ever growing cake of) FDI inward stock over the past 20 years. In Poland which has the relatively smallest investments in this for illustrative purposes combined sector it grew from 14 to 27 per cent; whereas in all other three countries it grew to reach or exceed 40 per cent of the inward stock in 2015.

In Estonia such white collar investments more than quadrupled its share between 1997 and 2005 when it peaked at 64 per cent of inward stock of FDI; after this it has shrunk somewhat as ownership in the banking sector was revamped and in 2015 accounted for a still very large 44 per cent of the FDI inward stock.
The third sector of significance charted in Figure 20 is wholesale (grey bars) which is a sector that came to attract significant investments as European wholesalers and retailers bought into existing chains and/or established themselves greenfield in the countries. On average this sector has accounted for some 10-20 per cent of the inward stock. Also, over time its relative importance has either been steady or declined somewhat.

It bears remembering that the cited data are for the relative share of an ever-growing inward stock of FDI and it does not mean that there necessarily has been divestment within the any sector, including the manufacturing sector.

**Geographical distribution of inward FDI: the regional dimension**

The variable used as a yardstick of regional integration in regard to FDI is the stock of inward FDI divided on source countries. Having already established that the western part of the region is primarily a source of FDI than a target of such investments we below turn directly to look for indications of a regional dimension to inward investments into the BSR-E. Figure 21 indeed presents a rather strong case for such a regional dimension in all four countries.

With regard to Estonia, Latvia and Lithuania it is clear that there is a strong Scandinavian and German presence with (from below) Denmark (white bars with black border), Sweden (grey bars), Germany (black bars) and Finland (white bars w. grey border) in 2005 accounting for

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**Figure 20. Inward FDI-stock by activity, 1996-2008 (per cent of total)**

[Graph showing inward FDI stock by sector in BSR-E (NACE 1 & 2), % of total, 1995-2015]
above 40 per cent of the inward stock in Latvia and Lithuania and close to 75 per cent of the inward stock in Estonia. With regard to Poland the regional dimension is less self evident even though the 2005 investments from BSR-W still reached 25 per cent of the inward stock. Even though there is a clear general pattern there are significant differences between countries. As can be seen in Figure 21 the regional dimension is par excellence the most obvious in the case of Estonia where Sweden and Finland alone have accounted for more than half of the inward stock of FDI.

Figure 21. Inward FDI-stock by country of origin, 1996/1997-2015 (per cent of total)

Source: WIIW; own calculations.

In the case of Lithuania and Latvia the Finnish presence is less pronounced but instead the Danish and the German presence in combination with still significant Swedish interests make up for a strong regional dimension. Interesting is also that in both of these countries we see the BSR-E as a region being a player of some impact; investments being both the aforementioned banking investments originating in Sweden but also some sizeable Polish investments (see Table A below).

Poland, finally, is the country where one country alone, that is Germany, accounts for a very sizeable portion of the BSR-W investments and between 13-21 per cent of total inward stock over the time period in question. Germany is complemented by Danish and Finnish investments but only to a very minor part by Swedish investments.
Turning to look at investments into these countries in general, not limiting ourselves to any of the BSR-W countries being the country of origin, we are able to complement the picture somewhat. Table A below includes for each of the four BSR-E countries all investing countries having reached or surpassed a threshold of two (2) per cent of inward FDI stock in any of the years reported for in the table (1996/1997, 2004, 2010 & 2015/2016). In the table is reported all home countries/partner countries that fulfil the criterion of minimum 2 per cent any one year; if the same home country has fulfilled the criterion for country A but not for country B it is indicated by na in the table. Missing data is reported with a dot. Further, as can be seen a more diverse picture is presented, albeit with the main traits discussed above still visible. In the case of Estonia the we see the bold (sic!) figures (indicating that the figure represents the top-three home country stakes the respective year) line up for all reported years for Sweden and Finland whereas the third place initially held by the United States was in the last two reported years (2010 & 2016) taken over by the Netherlands. Also noteworthy is that no other country has such a concentrated investor structure; with only 11 countries having stakes higher than 2 per cent still in 2016 (even though the trend for all countries is for a more diversified investor structure). The share of EU-15 investments for most years hover around 70+ per cent.

Turning to neighbouring Latvia the initially very strong position held by Denmark is visible even though their place as main investing country from 2004 was taken over by Germany and later by Estonia (2010) by virtue of the above discussed (Swedish) banking investments made with the Estonian holdings as a base; partly as a consequence of a later rearrangement of these holdings Sweden in 2016 had risen to first place among investors. Noteworthy about Latvia is also how Russia and Cyprus in 2016 both had risen to the top-three investors; likely as a consequence of the above mentioned stronger emphasis on financial sector investments. The share of EU-15 investments is also significantly lower than in Estonia, hovering around 50 per cent. In terms of concentration there is some more diversity in terms of interest from foreign countries than in Estonia with 13 countries having stakes of 2 per cent or more.
Table A. Inward FDI in BSR-E by partner countries, 1996-2015/16 (per cent of total)

<table>
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<th>Poland</th>
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Source: WIWI; own calculations.

Lithuania is again a country where Swedish interests have been among the dominating ones throughout the period, having increased their share of FDI inward stock from 12 to 19 per cent making them the largest investor in 2016. Noteworthy is also the strong but brief impasse of the United States in the mid-1990’s, then accounting for close to 30 per cent of investments. Finally, as also mentioned above, we see how Poland has taken a strong stake in Lithuania, being the very largest investor in 2010 and still in 2016 on a fourth place among investors. In terms of EU-15 investments the country is somewhat more integrated in the
European sphere than Latvia with an average position closer to 60 per cent than 50 as was the case for Latvia. Regarding concentration Lithuania just like Latvia had 13 partner countries with a stake of 2 per cent or more.

Poland, finally, is again as a large country standing out somewhat from the general picture in that it has a more diverse structure when it comes to partner countries for FDI than any of the three Baltic States; 15 in 2016. Also when it comes to general European interest Poland stands out with EU-15 investments reaching more than 87 per cent in 2016. In terms of individual countries it is here Germany, the Netherlands and France that have been the dominant investors over the period in question.

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To sum up, it seems clear from the above that the pattern of FDI just like the change in trade flows indicates that some regional integration has taken place. In terms of FDI we seem to see a trend towards increasing diversification. Especially in the case of Poland we see how this large country seems to be increasingly integrated in the European sphere. We also know that behind the figures for FDI lays a relatively minor number of very large investments, particularly in banks, telecom and also wholesale.

Juxtaposing the increasing trade flows in the BSR and the number of FDIs in the region, the mechanisms of FDI and export growth in eastward direction becomes clearer. This pattern is theoretically expected considering that the Baltic countries and Poland have to “pay” for their FDI inflows with imports. Still, the volume of FDI and trade is increasing, and so does the Baltic and Polish markets’ importance for the western BSR economies.

Above, we were able to point to a significant regional dimension, with a dominant position for the Scandinavian countries in the three Baltic states – but also an increasing regional dimension in Poland. These results are also in line with what has previously been established. Lönnborg et al. (2004) found that the Scandinavian countries accounted for a significant share of the FDI volume in the BSR, which in turn is consistent with the findings in other earlier studies (e.g. Erhlich et al., 2002).

It is also clear that in terms of FDI flows there is a relative lack of micro level studies with research on the investors’ and/or sellers’ motives. This lack of micro-level studies is, however, nothing unique to the BSR, but similar to most international studies on FDI and
economic integration. So, indeed, micro-level studies on FDI, where the mechanisms and motives behind investment actions are analysed, could be important additions to understand the mechanisms and motives behind regional integrations.
V. Concluding discussion

It should from the above discussion be clear that there is good reason to say that the economic forces were supportive in the rise of the Baltic Sea Region. Also, on an overarching level it is clear that integration in the Baltic Sea Region has been helped to a significant extent by an open, accommodating and supportive policy by the EU; indeed a factor pointed to as a distinguishing one by Anders Åslund (2007) when trying to explain why democracy and the rule of law quickly could take hold in Europe but has been evasive in other parts of the post-communist world.

The European Union Strategy for the Baltic Sea Region can in this regard be seen as yet a step where the political elites through support and fiat tried to underpin the further integration, cohesion and development of this particular region. The precondition posed by Miljan (1987) of a benevolent leading country may also have been said to have been fulfilled, not least the by very active role taken by the Scandinavian countries towards above all the three Baltic states.43

So, all in all, the general preconditions for integration in the BSR were very good in comparison to many other regions. However, our focus has been on the economic forces that need to complement and underpin the political visions and actions, and the empirical focus has been on economic flows in our region. So, for the BSR, have these flows contributed to the creation of an integrated region or not?

As discussed above, after the demise of Soviet dominance in the early 1990’s, there was significant optimism that trade and FDI flows would not only be attracted to the region, but also be a vehicle for a development to integrate the Baltic and East European states to the European economic system. And, indeed, comparing to the relative isolation of the communist era, the changes were tremendous. We have seen, for example, how the cumulative stock of inward FDI in the Baltic States and Poland increased manifold over the period. Also, we have seen that there is regional dimension to the inflows in the three Baltic states as well as in Poland even though the BSR-W dominance is less pregnant for Poland. So, summing up, the pattern of FDI inflows to the BSR suggests an actual commitment of private corporations for regional integration. This is also clearly reflected in the trade flows.
Even so, it now seems that as of lately it has been the political underpinnings that are floundering; the ideas and ideals underpinning European integration have taken a hard turn with the differing standpoints of the countries in the BSR with regard to the Greek crisis and the so-called immigration crisis. Further, the political direction taken in Poland after the last election have not only come to isolate Poland on a general political level but also meant that one of the most ardent political supporters for a Baltic Sea Region has been focusing on different matters.

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An important and overarching question that must also guide future research of course concerns how we should view FDI. Has it been a saviour that not only contributed to growth but also enabled regional integration? If so, through which mechanisms has it worked and how can we get to know more about its features and characteristics? Åslund (2002), for example, quite provocatively stated that “FDI has not assisted the early transition, but it has come as the proof of the success of reform rather than a catalyst of growth”. If he is correct in his assertion, it may be noted that there are some interesting parallels to De Long & Eichengreen (1991) who in their analysis of the Marshall Plan pointed to that its importance rested not so much in the capital it provided, “[r]ather, the Marshall Plan significantly sped Western European growth by altering the environment in which economic policy was made”. In a similar fashion it may be speculated whether or not the connections to foreign markets, actors and networks that FDI brought to the BSR (and the former Eastern Europe in general) were equally important as the capital in itself. In this sense, FDI transactions can perhaps be seen as certificates giving credence to the policies pursued in a country – not unlike membership in international organisations (e.g. EU and NATO). With both being tokens for commitment, political and economic stability, their mere existence, in turn, opens up for ‘more of the same’.

Also, if research on FDI should further our understanding of integration it must be noted that studies to date to a large extent have lacked a focus on the long-term sustainability of. To approach these issues we believe that case studies, with a strong emphasis on the individual firms rather than the industries as such, are of the utmost importance.

To conclude, it is perhaps with a lens similar to this that we should approach the overarching analysis of FDI, or putting it differently, maybe we do not need a formalised picture of each
and every FDI transaction and its economic parameters in order to enhance our understanding of the effect of FDI on the economies and societies where they take place. Rather, what may benefit this understanding more is a thorough analysis of a selected number of cases giving us the possibility to probe deeper into issues relating how they have affected the business climate and other formal and informal institutions in its new ‘home environment’. The rationale underpinning such an approach is then that the effects may be far more indirect than what one can get to through e.g. formalised regression analyses. Again, we must enter the ‘black box’ of foreign direct investment not only to understand why investments take place but equally much to understand what kind of imprints that these investments leave.
References


Brabant, J. M. van (1973), Bilateralism and Structural Bilateralism in intra-CMEA Trade, Rotterdam: Rotterdam University Press.


Åslund, A. (2007), How capitalism was built: the transformation of Central and Eastern Europe, Russia, and Central Asia, Cambridge: Cambridge University Press.
The European Commission pointed out that “[t]he region is united by the sea. But it is also clearly divided between a prosperous, highly innovative North and West and a developing East and South”; see, COM/2009/248/FINAL (2009), p. 7.

Reinfeldt (2008).


At that time what is now the Baltic Sea was an inland lake cut off from connections to the real sea.


See also discussion in Gerner et al. (2002) who point to that from a Swedish perspective awareness of the other side of the Baltic Sea began to erode already from the peace in Nystad (1721) onwards with yet a turning point in 1809 from where the Swedish interest came to be focused on Germany and later England (p. 13 ff.).

It may be noted that Sweden’s former ambassador to the Republic of Poland, Mr. Dag Hartelius, in a 2009 interview on what would be needed to realise the visions underpinning the EUSBSR, expressed a sincere hope that we in a not too distant future more naturally would be prone to thinking regionally – both as a precondition for and a consequence of a deepened regional integration (cf. Olsson 2009a; Olsson 2009b).


Cf. Brinkley (1997). Indeed, according to many it had been realised some 15 years later with the eastern enlargement of the European Union (EU).

It is no surprise that many of the persons who took the early initiatives that would later be result in the EU Strategy for the Baltic Sea Region (EUSBSR) were persons with direct personal memories of the divided Europe and the divided Baltic Sea Region; the Baltic Europe Intergroup in the European Parliament was the group who set the whole process in motion and was constituted by a number of MEPs with an interest in the region and in the group was among other Toomas Ilves (Estonia), Girts Kristovskis (Latvia), Vytautas Landsbergs (Lithuania) and Christopher Beazley (United Kingdom). For a brief review of the group and its work with the EUSBSR, see Olsson (2009b). For an authoritative overview of the various organisations and initiatives that were established in order to promote a Baltic Sea region, see Engelen (2004).

Miljan (1977), p. 284. One example was the two so-called Baltic Sea Billions (Östersjömiljarderna), aimed to strengthen trade and investment in the ‘neighbourhood’. Another was the establishment of The Foundation for Baltic and East European Studies (Östersjöstiftelsen) with the aim to promote research around the Baltic and in Eastern Europe.


It bears remembering that even though Sweden was very active in talking about the Baltic Sea Region Björn Engholm, former Minister-President of Schleswig-Holstein (1988-1993), already prior to the collapse of the Soviet Union launched his ideas of a New Hansa “in an attempt to unite the Northern, Eastern and Southern banks of the Baltic Sea”, see Engelen (2004), p. 19.


Paasi (2009), pp. 121-122; Paasi also adds that in some disciplines, e.g. political economy, researchers tend to abstain from problematising the concept of region, thus adding to the confusion.

Gerner & Karlsson (2001), p. 21 [author’s own translation]. Also see Paasi (1995) and Paasi (2009) for a similar approach to what are important features to ‘build’ a region. Also on the discussions of identity, see the various contributions in Schartau et al. (2007) and also in Lehti & Smith (2003).

For an interesting analysis of the politics and practical steps taken in order to secure a successful adoption of the strategy during the Swedish Presidency, see Ryba (2009). For brief overviews of the strategy and also an outlook on the similar processes in other parts of Europe, see Antola (2009), Antola (2010), Joenniemi (2009). For a thorough account of above all Polish considerations in supporting and promoting the EUSBSR, see the various contributions in UKIE (2008). For more recent appraisals in a comparative and more long-term perspective, cf. Gänzle (2017), Gänzle & Kern (2016) and Turșie (2015).
The local currencies were not convertible even within the communist bloc – for trade within this block one used a currency called the transferable rouble. This was a currency that upon Soviet initiative was created in 1964 as a special foreign trade currency. Also in 1964 was created a bank that specialised in the communist trade and economic cooperation, the International Bank for Economic Cooperation (IBEC). Cf. Olsson (1990) for an overview of the transferable rouble and its functioning; see van Brabant (1989) for an authoritative account of the functioning of socialist economic cooperation, trade and the Council for Mutual Economic Assistance (CMEA) from its inception in 1949.

The one sector where one could not fully ‘plan’ the resources use was the consumer goods sector where individuals with their money actually could choose what to buy (or, at least, could choose to buy or not to buy). Consequently one did ones best to isolate the consumer goods market from the producer goods market in order to avoid any ‘unplanned’ movements of resources; that this policy of isolating the consumer and producer goods market, respectively, did not work is testified to by the work of Hungarian economist Janos Kornai and his famous model where he in a graphic representation shows how leakages between the systems were translated into chronic shortages, cf. Kornai (1979).

For economists and economic historians with training and experience in predominantly a market oriented setting it is difficult to imagine any other trading system than the multilateral, i.e. where one buys and sells the products that one wishes to/from the market/seller/buyer that offers the best price-quality combination and it is sufficient to achieve an overall balance. Within the framework of the eastern economic cooperation (CMEA) there were no such possibilities. The absence of real markets and convertible means of payment meant that bilateral trade where the flows balanced with each and every trading partner was the norm. To some extent one was even forced to rely on what came to be called structural bilateralism, where the exchange had to be balanced not only with every trading partner, but also with regard to different groups of merchandise (often so-called hard and soft goods, respectively). Hard goods can be said to be such goods that had a market – i.e. goods that somebody wanted (perhaps even outside of the communist trading bloc) – whereas soft goods were those that hardly could find a willing buyer even in the communist block. Cf. van Brabant (1973), van Brabant (1980) and van Brabant (1989).

For a more detailed account of the early establishment of foreign investors in Estonia, see Liuhto (1995).

These figures were equivalent to 36 (West Germany) and 9 per cent (Sweden) of the total number of established international direct investments in Poland in December 1990. Looking at the share of invested capital the corresponding figures for the two countries were 31 and 9 per cent, respectively, of the total investments in Poland of 352 million USD (see, Gabrisch & Vale 1993, p. 40) for the Polish data but also for a general analysis of developments in Eastern Europe and the Soviet Union with regard to joint ventures and the early day hindrances for their expansion.

This standard approach to economic transformation (or transition as the language of the time had it) was formalised in for example Blanchard et al. (1991) and Åslund (1993). For an eloquently written overview of these kind of reforms, see Åslund (2007).

The fact that we do not mention the German Democratic Republic (GDR) is due to the fact that the reforms and other changes in the eastern parts of Germany were to take place under such, in comparison to the other countries, atypical circumstance due to the quick decisions made about reunification and the enormous transfers of funds that came as a consequence. For an overview of the policies pursued, see Thompson (2001); for a critical assessment of the consequences of these massive transfers, see Åslund (2007:286) who notes that “[t]he gigantic West German transfer to East Germany appears one of the greatest public financial follies of all times.”

It could also be mentioned that the citizenship issue was a differentiating factor among countries. Whereas this was problematic in Estonia and Latvia – leading to some delays with regard to privatisation – there were no such considerations in Lithuania. However, it may be good to remember that neither Latvia nor Lithuania were initially targeted as so-called first-wave accession countries to the European Union. It was only later on in the process that they were again included in the group of countries that negotiated with their minds set on being in the first group of eastern EU-members.
On the Polish case, cf. Lipton & Sachs (1990a) for the general outline of reform and Lipton & Sachs (1990b) for their take on Polish privatisation. The Balcerowicz-plan, designed in cooperation with international economists, was launched in January 1990 after Solidarity had won all the seats in the Senate and 35% in the lower house respectively in the June 1989 parliamentary elections, and Mazowiecki had formed a government with Polish economist Leszek Balcerowicz as Minister of Finance. The plan, in short, meant a radical cut of the budget deficits, a slashing of state subsidies by more than half and a devaluation of the currency to the prevailing black market rate. At the same time a freeze on wage increases was imposed by means of penalising taxes on wage hikes. Markets were generally liberalised and one also managed to put a halt to the prevailing hyperinflation – even though the government had been ousted before the results were fully visible.

Not least the capital needs were significant at the same time as domestic savings were quite limited; Major (1993) made some early estimates of the value of domestic savings as compared to the value of gross fixed assets (i.e. assets that to a significant extent needed to be privatised), which in the case of Poland was 7 per cent. The message was clear in that privatisation relying solely on domestic investors would be a slow and arduous process. The solutions sought in the countries of the region invariably came to involve either some kind of subsidised privatisation to the general population and/or a opening up the process to include also foreign investors. See Major (1993), pp. 23-37 and Tables 2.1-2.6.

Traditionally one has spoken about investment capital and managerial and commercial expertise as the twin characteristics of FDI; in our case and from the above discussion of the Cold War isolation it should be apparent that a potential foreign investor would very likely bring with it contacts of the kind that these managers and enterprises needed if they were to succeed on the international market they now had to compete on. In this sense it may thus be more appropriate to talk about the ‘three C’s of FDI’, i.e. capital, competence and contacts.

In an early contribution Dunning correctly pointed out that the total inward stock of FDI in Eastern and Central Europe amounted to no more than 0.5 per cent of the world inward stock of FDI – but he was nevertheless very optimistic about the future – pointing to that inflows had increased to around 2 per cent of the world total during 1989 and 1990, see Dunning (1993), pp. 112-113. For more examples of the early optimism, cf. the individual contributions in Hunya (2000).

For an authoritative overview of the developments within the former eastern block with regard to trade flows, see Broadman (2006).

Cf. discussion in Olsson et al. (2017).


It has since long been acknowledged that there are significant measurement problems regarding inflows of FDI, cf. discussions in UNCTAD (2003) and Rafferty (2003); these are however even more pregnant in some of the new member states where it for various reasons has become habitual to try to hide ownership stakes by using tax havens abroad to channel domestic investments. In Lönngbörj et al. (2004) a number of examples are given from the Baltic States. One such is when Latvian telecom operator Lattelekom was sold to a consortium (Tilts Communications) owned by British (Cable & Wireless) and Finnish interests (Telecom Finland), but the investment statistically was accrued to Denmark given that the joint venture consortium happened to be registered there.

For a contribution which more closely looks at the individual transactions that underpinned the early developments, see Olsson et al. (2017).

For a comparison with the western countries of the BSR, cf Olsson et al (2017) which report comparable 2008 figures for Sweden (53%), Denmark (44%), Finland (32%) and Germany (19%).

Cf. Lönngbörj, Olsson and Rafferty (2004) for a more detailed discussion of the interaction of the privatisation programmes and FDI-attraction to these countries. Also UNCTAD (2003) point to the privatisation as the main cause for the inflows during the first ten years of economic transformation.
Åslund (2007), p. 281 for example concluded that “[i]n effect, the West as a whole adopted Central Europe, and Scandinavia adopted the Baltics. Southeast Europe was left in a limbo, and Russia with the rest of the CIS were left out in the cold.” In this context it may also be pointed out that against the backdrop of the early talk by Björn Engholm about the New Hansa, many had expected more engagement from the German side in the BSR as a whole – instead it seems that the German interests were directed more towards the Central European countries, including Poland; for a detailed and informative account of the German policy towards the east, including reunification and the relative presence and acceptance in the countries of the former eastern bloc, see Thompson (2001).


De Long & Eichengreen (1991), p. 3. In the very same paper, written not far after the fall of the Berlin Wall, based on their analysis of the Marshall Plan that “[a]id to Eastern Europe may accelerate growth in the manner of the Marshall Plan if it leads to policies that accelerate the move toward market organization, free trade, and financial stability. Aid might perhaps help as an incentive and as a cushion to make reform possible. But it is not a substitute for reform, or for the process of structural adjustment.” Source: De Long & Eichengreen (1991), p. 5.