Building the Baltic Sea Region through investment and trade, 1989–2009

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PESO Working Papers 2017:1

SÖDERTÖRNS HÖGSKOLA | STOCKHOLM
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Abstract

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. The strategy was a symbolic second milestone with regard to the political endeavours to reintegrate the continent; the first being the 2004 enlargement. 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 in order to further and deepen the integration and reduce the economic gaps within the European Union gives an indication that there is more to be wished for with regard to this region.

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 thus approach the economic underpinnings for the Baltic Sea Region by analysing the developments with regard to investment and trade flows during the last twenty years.

We ask ourselves whether these developments are in congruence with the notion of the building of one integrated region and whether it makes economic sense to talk about a Baltic Sea Region? 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? These are some of the questions that this paper attempts to address based upon a thorough analysis of the existing sources with regard to trade and investment flows.

Keywords: Economic integration, region building, Baltic Sea Region; trade flows, foreign direct investment, European Union Strategy for the Baltic Sea Region, economic transition.

[1] Mansfield, E.D. & Milner, H.V. (1999), 'The New Wave of Regionalism', *International Organization*, 53(3): 589-627 (p. 591).

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I. Introduction

> …I think the co-operation in the Baltic Sea Region […] has helped pave the way for increased regional integration and been instrumental in making [it] one of the most competitive areas in the world when it comes to economic growth.
> Carl Bildt (2006), p. 6.

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).[2] 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. 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 in order to further and deepen the integration and reduce the economic gaps within the European Union (EU) gives an indication that there is 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 was forced 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*"[3], which is a sign that the endeavours toward increased integration and cohesion in the region as of yet have not delivered the desired results. The European Commission in its Communication continued to say that "[t]he region is united

[2] For official documentation on the EUSBSR, cf. the homepage of DG Regional Policy (http://ec.europa.eu/regional_policy/cooperation/baltic/index_en.htm).
[3] COM/2009/248/FINAL (2009), p. 2.

by the sea. But it is also clearly divided between a prosperous, highly innovative North and West and a developing East and South."[4] Such statements stand in some contrast to the very optimistic views heralded in the 1990's. The situation was succinctly summarised by 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.[5]

This also brings us to the focus of our interest in this contribution, namely *the question of Baltic Sea Region integration and the role of trade and investment therein*. It has been suggested that regionalism is defined "as an economic process whereby economic flows grow more rapidly among a given group of states".[6] Thus, as will be discussed further below, much hope has over the years been connected to market forces to help heal the wounds created by the communist division of the region in question. However, have these hopes been fulfilled? Are the east-west divisions diminishing and have the developments with regard to trade and investments over the last decades been in congruence with the notion of the building of one integrated region? Also, does it make economic sense to talk about a Baltic Sea Region?

As our approach in this contribution 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, recognizing 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* then provides a brief overview of what research so far has taught us about trade, investments and regional integration. In what constitutes the empirical main thrust of this contribution, we turn our focus in *Section V* to the developments during the last twenty years with regard to investment and trade flows – with a particular attention to its impact on the countries making up the Baltic Sea Region. *Section VI* concludes with a summary of

[4] COM/2009/248/FINAL (2009), p. 7.
[5] Reinfeldt (2008).
[6] Mansfield & Milner (1999), p. 591.

the findings and a discussion of what can and should be done in order to further our understanding of the role of investment flows in sustainable region building.

To sum up, the overall aim of this contribution is above all to lay the ground for and open up to an *analysis of the role of economic exchange for the transformation and (re)integration of the region*. This we do basically by three means: *(i)* by looking at the trends that have been; *(ii)* by pointing to what economic theory and other studies in the field have taught us; and *(iii)* by discussing what other and complementary venues that research can and should take if we are to better understand the dynamics underpinning a process of regional (economic) integration such as the one that we are currently observing in the Baltic Sea Region (BSR).

II. Building regions?

The waters of what now constitutes the Baltic Sea have been navigated in one way or the other for some 10,000 years.[7] 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.[8]

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

[7] Even though at that time what is now the Baltic Sea was an inland lake cut off from connections to the real sea.
[8] For well-written overviews, cf. Kirby (1995); Gerner & Karlsson (2005).

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'.[9] And, in the absence of a real awareness of what exists there on the 'other side', the chance that one may think of solutions that involve 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.[10]

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, in this interest we are not alone; many a social science scholar has devoted their time to the phenomena of integration. Be they economists, economic historians, political scientists or organizational studies scholars – the process of combining or accumulating resources, entities or processes, that is integration, has had a strong lure. Such processes can be observed in various arenas, but when it comes to the topic of regional and economic integration, top-down and bottom-up integration are often differentiated.[11] Whereas the former often is associated with various elite decisions and concerted efforts and frequently refer to developments of a political nature (political integration), the latter is viewed as a consequence of the decisions and actions by various

[9] See also discussion in Gerner & Karlsson (2002) who point to that from a Swedish perspective the awareness of the other side of the Baltic Sea began to be eroded 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.).

[10] It may be noted that Sweden's current ambassador to the Republic of Poland, Mr. Dag Hartelius, in an interview in June 2009 focusing on what would be needed if the visions underpinning the European Union Strategy for the Baltic Sea Region (EUSBSR) were to become reality, 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). In connection to this it bears remembering that, in the words of Gerner & Karlsson (2009:21), it was not too long ago that "[w]e knew more about the history of Third World countries than that of our Baltic neighbours" [authors' own translation].

[11] Cf. discussion in Jurkynas (2004).

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 of course the year 1989, which marked both the fall of the Iron Curtain that had divided Europe for half a century and the 're-emergence' of many countries as independent states. In this 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.[12] From this standpoint the lure to politicians, sharing the same vision, of an integrated Baltic Sea Region (BSR) was easily comprehendible.[13]

In consequence a number of initiatives were 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 (1999) and indeed at the time not yet a member of the EU – early on took a leading role in these activities.[14] 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. In 2009, during the Swedish Presidency of the EU, the EU Strategy for the Baltic Sea Region was adopted – in itself a sign that the region 'exists' in one way or the other.

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 sig-

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

[13] 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 Landsbergis (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).

[14] Miljan (1999), p. 284. One example is the two so-called Baltic Sea Billions (*Östersjömiljarderna*), aimed to strengthen trade and investment in the 'neighbourhood'. Another is 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.

nificant".[15] Whereas there in the case of the Baltic Sea Region perhaps initially was a leading government (the Swedish one),[16] its counterparts on the other side of the Baltic Sea were "preoccupied with very modern needs like sovereignty, security and state authority over territory".[17] 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 organizations that co-operate…".[18] So, instead of a benevolent leading country, there seems to have come a plethora of organizations at various levels and with various interests that promote the creation of this region in close collaboration with business interests. In some cases these organizations are new creations, but in many cases – as for example with some businesses and universities – their work has been based on either long-standing or revitalized networks and exchanges; to some extent they seem to have been successful. Over the years we have gradually found more and more references to a BSR and there is no doubt some truth to the conclusion by that "[t]he Baltic Sea region has indeed been *talked into existence* and is mentally visible now."[19]

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 'visbility', it is nevertheless useful to open up to 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,

[15] Mattli (1999), p. 42.
[16] It bears remembering that even though Sweden has been 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.
[17] Jurkynas (2004), p. 2.
[18] Bildt (2006), p. 6.
[19] Berg & Sicard Filtenborg (2002), p. 132; emphasis added.

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, and whose history of integration according to Solemn (1977) for long was more one of political paperwork based on a wish for integration than real integration. 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".

Adding to this difficulties of communication due to distance and language barriers as well as a long recent history of division, the countries surrounding the Baltic did not look like your obvious candidates for successful 'region building'. The BSR instead consists of a truly heterogeneous group of countries encompassing some 100 million inhabitants with a great variation in terms of economic structure and development, historical legacies, language and culture. Even so, as noted above, it is increasingly being recognized as a region. How do we explain this?

One explanation clearly lies in the very loose definitions used when talking about regions, which gives us 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."[20]

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 the 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

[20] 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.

we are to be able to analyse whether our observations are in line with the process of region building that is our main focus.[21]

As regards the first and more practical part of our motivation to discuss the characteristics of the region that we aim to analyse, 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 EU Strategy for the Baltic Sea Region. For us, this means that in the presentation below and statistical analysis we include all the eight EU member states that border to the Baltic Sea.[22]

With regards to the other part of our motivation for discussing (i.e. getting acquainted with a 'vision' of what constitutes a region) it should immediately be admitted that, although seemingly an attractive and interesting task, it is beyond the scope and ambition for the present contribution to establish our own definition of what the important qualitative characteristics of a region are. For now, it may rather suffice to say that we by and large agree with 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."[23] This type of a view of the region is also in line with the one referenced above when we talked about the BSR as something that been *talked into existence*.

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[21] Having this type of a 'vision' will be even more important when trying to analyse the information and qualitative data that will be gathered through the case studies that are to be undertaken within the framework of (amongst others) the research project *Markets & Regions: a project on region building and the long term sustainability and potential integrative effects of capital mobility and investment in the Baltic Sea Region*; the project that has funded also this current contribution. The project is a three-year (2010–2012) project funded by exactly The Foundation for Baltic and East European Studies (*Östersjöstiftelsen*) that was being mentioned above.

[22] That is, Finland, Estonia, Latvia, Lithuania, Poland, Germany, Denmark and Sweden. Also, in the analysis' being made below 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.

[23] 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).

A very tangible sign that the region has indeed been 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.[24] Moreover, at the same time as we one level take this region as a given,[25] we still want to put on our academic (i.e. economist's) glasses and explore *(i)* what rationale there is to talk about a 'region'; *(ii)* what characteristics this region possesses; and *(iii)* how these traits have changed over time? Given that a mainstream view among economists is that regional economic integration is underpinned by (increasing) flows,[26] we in this particular presentation choose to approach these issues through an analysis of the developments with regard to trade and foreign direct investments among the countries supposedly making up this region.

Whereas we in this presentation focus on macro-level data for the countries in question, it must nevertheless be mentioned that from our vantage point it is in a longer perspective necessary complement the economist view of regionalism with its inherent focus on flows and factor mobility with a perspective which allows for the incorporation of cognitive aspects of region building like the ones discussed above. Such a more complex and multifaceted view on 'region also fits well with the more long-term aim of our work, i.e. to better understand what particular aspects and/or characteristics of foreign direct investments it is that contributes to a sustainable and long-term process of region building and integration.[27]

[24] 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 more thorough account of above all Polish considerations in supporting and promoting the EUSBSR, see the various contributions in UKIE (2008).

[25] Both as a phenomenon and in terms of the geographic composition that was derived from the EUSBSR we take the Baltic Sea Region as a 'given' entity and do not intend to questions its existence and/or composition.

[26] See also discussion in Section IV below.

[27] In the continued work within the Markets & Regions project a number of case studies will be undertaken. The main aim of these cases is to increase our understanding of what particular characteristics of the investment, investor and/or process of establishment it is that initiates and/or underpins processes of importance for what we here term 'region building' and integration. These case studies will not be limited to include only the 'hard' economic features of the investments in terms of e.g. motives, process, performance, suppliers networks, embeddedness etc. – but will also be used to try to approach the question of whether and how a particular investment adds or not to the perceived sense of community in a broader sense. In this context it will thus be necessary to adopt a more inclusive view of what it is that makes a region – and we are convinced that such

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.[28]

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'.[29] For the existing producers and

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an open view on region building that also includes the 'perceived' will add to the deep interviews that are integral to the case studies that are planned.

[28] 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.

[29] 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,

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.[30]

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.

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).

[30] As an economist with a background in the market economy 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).

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.[31] 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

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

of these very small establishments; in the Polish case with an average foreign investment of a mere 135,000 USD per registered establishment.[32]

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.[33] 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.[34] 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

[32] 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

[33] 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).

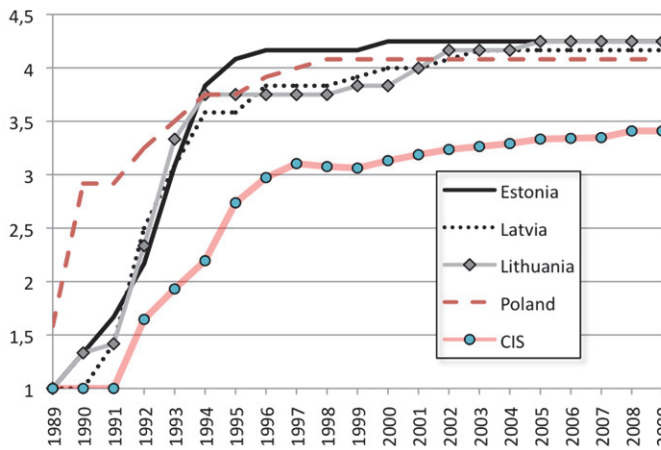
[34] The fact that we do not mention the German Democratic Republic (GDR) is due to the fact that the reforms and other changes in the eastern parts of Germany were to take place under such, in comparison to the other countries, atypical circumstance due to the quick decisions made about reunification 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, p. 286) who concludes that "[t]he gigantic West German transfer to East Germany appears one of the greatest public financial follies of all times."

reforms.[35] 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 hyper-inflation that had built up, which necessitated an ambitious stabilisation programme to be launched.[36] Even so, the general perception of what was *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, but also to some extent underlines the very fast pace of reforms in Estonia.

[35] 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.

[36] 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 respecttively 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 penalizing 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.

Figure 1. Indices of transition for BSE and CIS, 1989–2009



Source: EBRD; own calculations. *Note*: In the above indices of transition we have computed the 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 privatesation, price liberalisation, trade and forex system. For all sub-indices 1 is the minimum (app. a unreformed socialist economy) and 4 or 4+ 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,[37] managerial and commercial expertise as well as international contacts. Given that this combined need for *capital*, *competence* and *contacts* fit well with what one usually associate

[37] 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.

with foreign direct investments,[38] 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.[39] 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 researcher when he after a research visit to Estonia in September 1992 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.[40]

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 sizable foreign capital flows. Dunning (1993), for example, was one of the observers

[38] 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*.
[39] Cf. Sinn & Weichenrieder (1997). In the Baltic States there was some early unease in particular about German investments becoming too dominant, cf. Reardon & Lazda (1993).
[40] Brown (1993), p. 498.

who early on took an optimistic view of the role of FDI in the transforming economies of the east.[41]

IV. Trading and investing a region into existence: the role of trade and FDI in building a Baltic Sea Region

Historically, trade has been a cornerstone and frontrunner for any kind of integration. In this sense, on an analytical level, integration is reflected in trade and factor mobility (including capital mobility). Also, as mentioned above, 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".[42] In this respect, there is no doubt that the last two decades have meant a 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 than is the case for the EU-average (Poland being the exception). In the same manner, the direction of trade relations has also been revamped with all of the eastern BSR countries quickly redirecting their trade relations from the former CMEA-trade towards new trading partners in the developed market economies.[43] It is also well known that market openness and openness to free trade correlates positively with the level of foreign direct investments (FDI), and Dunning (1993) was early to point out that "*more and more, trade and foreign investment are complementing, rather than substituting for, each other*."[44] In addition, there seems to be growing mainstream consensus that there is a positive relationship between trade, FDI and regional integration.[45] So, in short, that there is a relation between these factors seem to be reasonably well documented; thus lending credence also to our ambi-

[41] 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).
[42] Mansfield & Milner (1999), p. 591; emphasis in original.
[43] Dunning (1993), p. 113; for an authoritative overview of the developments within the former eastern block with regard to trade flows, see Broadman (2006).
[44] Cf. Dixit & Norman (1980); Porter (1990); Krugman (1991); Dunning (1998).
[45] Cf. UNCTAD (2006).

tions to better understand Baltic Sea Region dynamics and integration through an enquiry into these particular aspects of economic exchange.

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Bearing this in mind, this section focuses on the empirical developments in the eight countries of Baltic Sea Region over the last two decades. We begin with a brief look at the trade flows. After that, constituting the main part of the section, 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. Then, in a minor subsection we touch upon the question of what kind of investments it is that underpin the gross figures by looking at a small selection of mergers and acquisitions that have taken place in the BSR. Finally, we conclude with an overall analysis of what we know and what we do not know.

Trade relations in the Baltic Sea Region: a brief overview

Regarding trade, one could discern a number of parallel processes, including a significant redirection of trade towards the West and a move away from old product groups that were more a consequence of central planning than market forces. Also, and perhaps most importantly, during the early years of transition after the dissolution of USSR, the *overall trade volume increased quite substantially* in the BSR. On average, the trade increased by 370 per cent between 1992 and 2008.[46] As seen in *Tables 1 to 4*, the general pattern of the BSR trade flows is the relative importance of the Western export markets for the Eastern BSR (BSR-E) EU members, as compared to the situation for the Western BSR (BSR-W) EU members, where their traditional export markets (i.e. the Non-BSR EU countries and the US) still holds the position of being the most important ones. Having said this, we would like to direct the attention to one interesting point, which concerns the exports and imports of the Eastern BSR economies. Despite the dominance of the trade flows originating in the Western BSR area, the total intra-BSR trade volume of the Eastern BSR economies has increased. For example, the share of the Western BSR exports to the Eastern BSR have increased from 1.77 per cent in 1992 to about 4 per cent in 2008, and the imports of the Western BSR countries from the Eastern BSR have increased 1.81 per cent in 1992 to about 3.5 per cent in 2008.

[46] Comparable trade statistics prior to 1992 are not available for the Baltic countries.

Table 1. 1992–1995 average percentage share of total exports (Exporting countries on top row).

Average 1992-1995 **Exporting country**	**Germany**	**Denmark**	**Sweden**	**Finland**	**Estonia**	**Latvia**	**Lithuania**	**Poland**	**EU**	**BSR W**	**BSR E**
Germany		23,16	14,44	13,74	7,69	12,14	15,01	35,86	14,66	3,93	31,51
Denmark	1,86		6,63	3,37	3,27	1,72	3,19	2,95	1,30	2,30	2,92
Sweden	2,26	10,27		11,08	11,74	7,66	3,61	2,46	1,99	3,07	3,30
Finland	0,84	2,26	5,13		21,02	2,38	1,07	1,64	0,83	1,35	2,65
Estonia	0,03	0,09	0,18	1,65		2,01	2,11	0,05	0,06	0,14	0,31
Latvia	0,06	0,10	0,18	0,40	2,56		2,56	0,22	0,06	0,09	1,09
Lithuania	0,09	0,17	0,11	0,22	1,58	4,64		0,57	0,07	0,10	0,93
Poland	1,50	1,37	0,99	1,49	0,32	2,12	5,14		0,91	1,44	0,57
EU	63,68	67,82	59,86	64,91	67,23	51,42	60,87	73,92		63,65	71,37
US	7,40	4,83	8,54	6,93	2,22	1,06	0,83	2,87	6,82	7,31	2,58
BSR W	4,95	35,69	26,20	28,19	43,73	23,90	22,88	42,91	18,79		40,38
BSR E	1,68	1,73	1,46	3,76	12,28	8,77	14,13	0,84	1,09	1,77	

Source: IMF; own calculations.

Table 2. 2004-2008 average percentage share of total exports (Exporting countries on top row).

Average 2004-2008 **Exporting country**	**Germany**	**Denmark**	**Sweden**	**Finland**	**Estonia**	**Latvia**	**Lithuania**	**Poland**	**EU**	**BSR W**	**BSR E**
Germany		17,58	10,26	10,66	5,67	9,12	8,90	26,72	13,10	2,74	22,77
Denmark	1,59		7,14	2,13	2,98	4,57	4,41	2,00	1,31	2,09	2,42
Sweden	2,14	13,99		10,57	13,46	7,21	4,14	3,21	2,04	3,13	4,13
Finland	1,03	2,79	6,14		20,03	2,94	1,15	0,77	0,98	1,61	2,12
Estonia	0,14	0,30	0,73	2,60		12,18	5,82	0,50	0,21	0,34	1,55
Latvia	0,14	0,36	0,34	0,71	9,75		11,40	0,70	0,19	0,21	2,34
Lithuania	0,23	0,49	0,39	0,59	5,24	13,71		1,57	0,25	0,28	2,19
Poland	3,41	2,09	2,16	2,33	1,42	3,55	5,79		2,17	3,14	0,84
EU	64,00	69,93	59,67	56,82	71,48	72,40	63,61	78,64		63,56	76,36
US	8,09	5,94	8,68	6,33	4,53	1,85	3,68	1,76	7,08	7,92	2,13
BSR W	4,77	34,36	23,54	23,37	42,14	23,84	18,59	32,70	17,43		31,44
BSR E	3,92	3,23	3,62	6,23	16,41	29,44	23,02	2,77	2,82	3,97	

Source: IMF; own calculations.

Table 3. 1992–1995 average percentage share of total imports (Importing countries on top row).

Average 1992-1995 **Importing country**	**Germany**	**Denmark**	**Sweden**	**Finland**	**Estonia**	**Latvia**	**Lithuania**	**Poland**	**EU**	**BSR W**	**BSR E**
Germany		22,77	19,74	15,87	10,60	13,89	17,04	26,68	14,96	4,32	24,42
Denmark	1,93		7,17	3,21	2,75	2,49	3,31	2,28	1,28	2,37	2,39
Sweden	2,21	11,49		11,27	9,30	6,83	2,95	2,64	2,19	3,07	3,23
Finland	1,07	2,89	6,46		31,90	7,79	3,24	2,13	1,19	1,69	4,12
Estonia	0,03	0,11	0,23	0,78		3,52	1,71	0,04	0,04	0,09	0,34
Latvia	0,07	0,16	0,41	0,14	2,25		3,77	0,06	0,07	0,11	0,36
Lithuania	0,07	0,20	0,14	0,09	2,69	5,97		0,34	0,07	0,09	0,69
Poland	1,61	1,59	0,91	1,23	0,68	1,62	4,24		0,76	1,52	0,44
EU	61,01	71,11	64,53	61,30	71,54	53,57	53,46	68,48		62,10	66,75
US	7,11	5,03	8,12	6,86	3,43	2,62	2,85	4,11	7,37	7,05	3,90
BSR W	5,21	37,15	33,37	30,36	54,55	31,00	26,53	33,72	19,62		34,17
BSR E	1,77	2,06	1,70	2,23	4,21	11,11	8,77	0,45	0,93	1,81	

Source: IMF; own calculations.

Table 4. 2004–2008 average percentage share of total imports (Importing countries on top row).

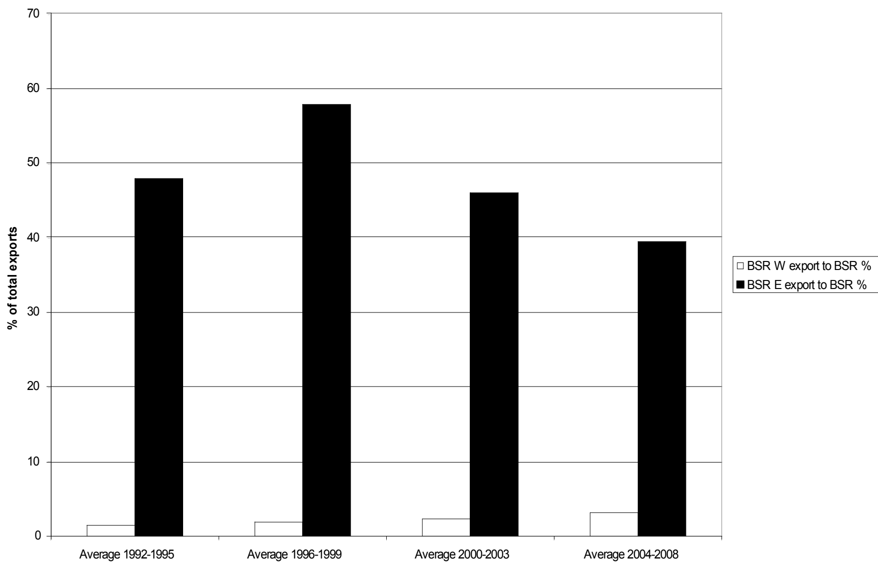
Average 2004-2008 **Importing country**	**Germany**	**Denmark**	**Sweden**	**Finland**	**Estonia**	**Latvia**	**Lithuania**	**Poland**	**EU**	**BSR W**	**BSR E**
Germany		21,33	18,06	15,88	13,14	14,25	14,24	28,37	15,00	4,40	24,82
Denmark	1,59		9,36	4,01	2,32	2,79	2,73	1,47	1,24	2,46	1,76
Sweden	1,76	13,97		13,91	9,74	4,94	3,34	2,57	1,93	3,15	3,31
Finland	1,04	2,20	6,00		17,25	5,25	2,71	1,33	0,98	1,60	2,84
Estonia	0,06	0,30	0,77	2,44		7,55	3,13	0,10	0,14	0,29	0,91
Latvia	0,07	0,36	0,41	0,31	6,69		4,83	0,20	0,13	0,14	1,16
Lithuania	0,14	0,53	0,49	0,20	7,04	14,05		0,61	0,18	0,21	1,85
Poland	3,00	2,30	2,80	1,18	4,08	6,75	9,51		1,73	2,82	1,78
EU	62,75	71,99	70,39	64,42	77,61	75,91	62,08	72,49		64,34	71,89
US	5,21	3,06	3,33	2,47	1,19	1,06	1,84	1,46	4,82	4,69	1,46
BSR W	4,39	37,50	33,42	33,81	42,45	27,24	23,02	33,75	19,15		32,73
BSR E	3,26	3,50	4,47	4,13	17,81	28,36	17,47	0,91	2,18	3,46	

Source: IMF; own calculations.

This pattern can be interpreted in many ways. One is to see this increasing importance of the Eastern BSR economies for their Western neighbours as a reflection of the catching-up transition stage these Eastern BSR EU members find themselves in. Having started from low levels of economic productivity and poor industrial infrastructure, the Eastern EU countries have undergone a rapid development since their independence to their eventual accession to the European Union. By constantly upgrading the industrial, manufacturing and knowledge base, the increase of exports from Estonia, Latvia, Lithuania and Poland is a natural result of their movement upwards along the path leading to a development level comparable with the EU average. This type of rapid economic development is also something that is has been observed in the East Asian economies after WWII. The rapid economic reorientation of the Eastern BSR countries, characterized by this exceptional start in the early years of transition, is also one of the main conclusions of Broadman (2006) in his studies of the former Eastern Bloc countries' transformation into Western economies.

The second way is to interpret this development as a token for the *de facto* economic integration of the Eastern BSR economies into the larger European economy. The abandonment of the planned economy and the following transition and adaptation to the Western system of international trade and investments, have by necessity been a driving force to align their institutional settings accordingly. Thus, by looking at the trade statistics, the trade volume increase after the accession to the EU is just one side of the Eastern BSR countries' reorientation towards the European economic system.

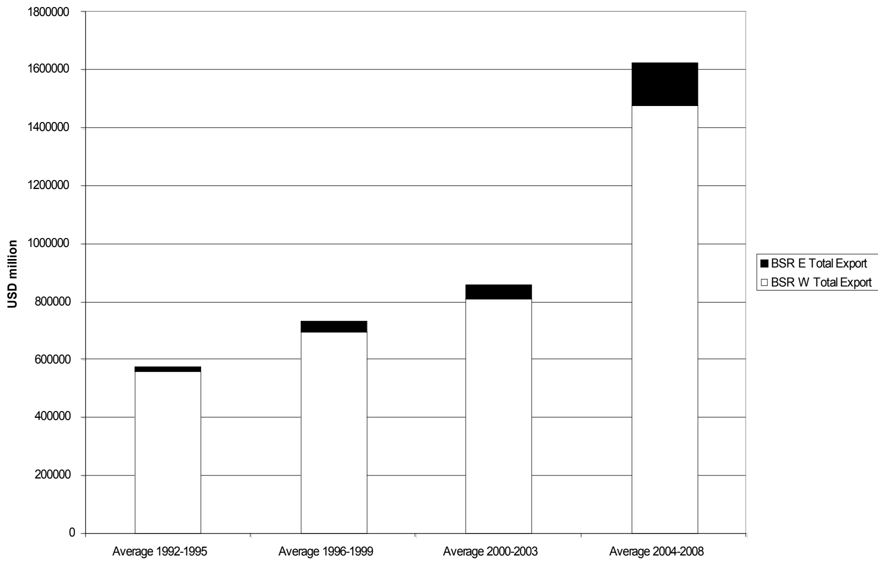
Figure 2. The Eastern and Western BSR countries' exports to the Western and Eastern BSR region respectively as a share of their total world exports (1992–2008, current prices)



Source: IMF; own calculations.

As noted above, the Western BSR markets are very important for the Eastern BSR exporters, while the Western BSR economies rely more on exports to the non-BSR EU countries and the US. This pattern is illustrated in the figure below, where the overwhelming part of the total BSR exports is originating from the Western EU countries Germany, Denmark, Sweden and Finland. Obviously, the causes are easily found in the discrepancy in the size of the economies and industrial structure between Western and Eastern BSR countries. Still, it is noteworthy that the dominance of the Western BSR economies in the BSR world exports is of this scale still six years after the EU enlargement in 2004. This suggests that the EU accession and integration of the Eastern BSR countries' trade into the European common market might have meant less for these countries than the development potential that the EU membership in itself had to in terms of industry and human capital upgrade and income increase as well as infrastructure improvements. The connection between the EU membership and these factors are, however, is not analysed at any depth in this presentation and this discussion will at this stage rest here.

Figure 3. The share of the Eastern and Western BSR world exports (1992–2008, current prices)



Source: IMF; own calculations.

Foreign direct investment in the Baltic Sea Region: the macro view

Having established the significant changes in trade, we will in this section move on to try to highlight the developments that have occurred over the last 15-20 years in the Baltic Sea Region with regard to foreign direct investment (FDI). Focus is on what can be seen from available macro statistics – with all of the well-known limitations that they exhibit – which we nevertheless try to present in a way that help to increase our understanding of the regional developments.[47] The section begins with an overview of the world developments with regard to FDI; we then go on to look at the inflows to the countries in the region; the accumulated stock of FDI; the

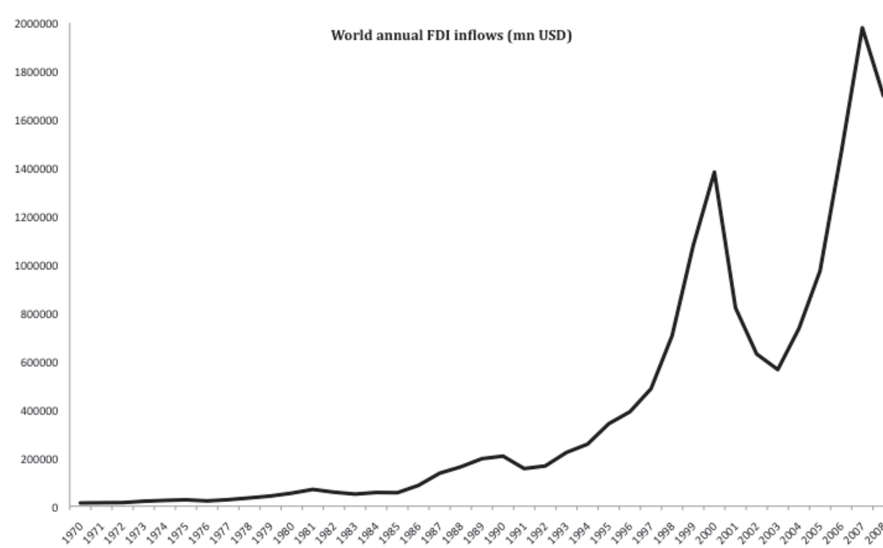
[47] It has since long been acknowledged that there are significant measurement problems regarding inflows of FDI, cf. discussions in UNCTAD (2003) and Rafferty (2003); these are however even more pregnant in some of the new member states where it for various reasons has become habitual to try to hide ownership stakes by using tax havens abroad to channel domestic investments. In Lönnborg 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.

sectoral distribution of the inflows and also the geographical dimension to the inflows.

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 global developments. Looking back in time it is also apparent that FDI inflows for long remained a relatively limited phenomenon. Up until the mid-1980's global annual inflows had yet to exceed 70 billion USD. However, beginning in the late 1980's, a significant growth took hold and the two decades that are at the centre of our attention, i.e. the 1990's and the early 2000's, coincide with two periods of extremely rapid growth of global FDIs (and also one very significant dip in the aftermath of the IT-bubble). These developments are all visible in the figure below which shows the annual world inflows of FDI.

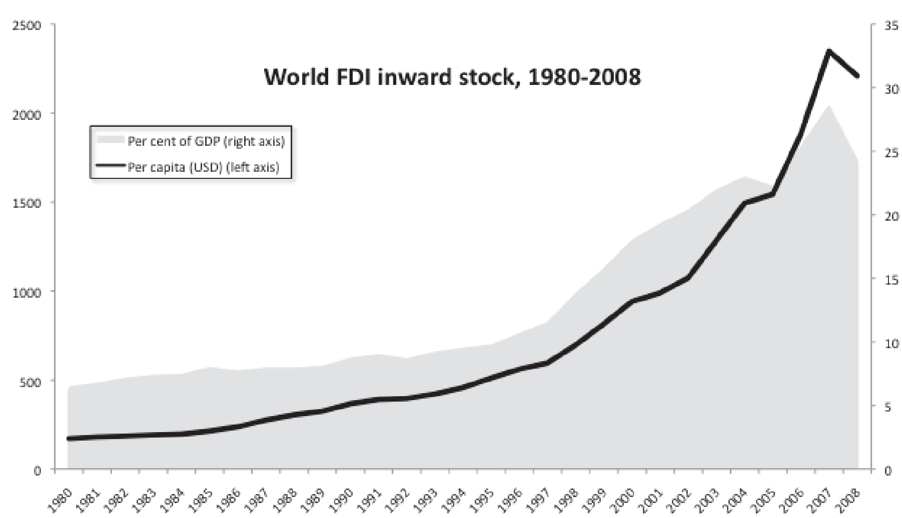
Figure 4. Annual world FDI inflows (mn USD, current prices)



Source: UNCTAD (2009); own calculations.

Equally important to remember is that despite the dip in the early 2000's there has been a continuous growth in accumulated foreign direct investments (i.e. the FDI stock) in the world economy. In *Figure 5* below this is illustrated by means of the per capita dollar value of the outstanding inward stock of FDI over time (left axis) and by the value of the stock relative to world GDP (right axis). As can been seen the per capita values enjoyed a period of uninterrupted steady growth from 171 USD/capita in 1980 up to a remarkable 2,348 USD/capita in 2007 before the most recent global crisis took a toll, reducing the value to 2,209 USD/capita. Looking at how this translates into a relative weight of the world economy (measured as world GDP) a similar story is told with a growth from 6.5 per cent of world GDP in 1980, passing the 10 per cent threshold in 1996 and the 20 per cent threshold in 2002, to a high (so far) of 28.7 per cent of world GDP in 2007 before falling back somewhat in 2008. In the following we will focus on how these world developments have been translated into the setting of the transforming BSR.

Figure 5. World inward FDI stock, 1980–2008; the per capita dollar value of the outstanding inward stock of FDI over time (left axis) and the value of the stock relative to world GDP (right axis) (USD in current prices)



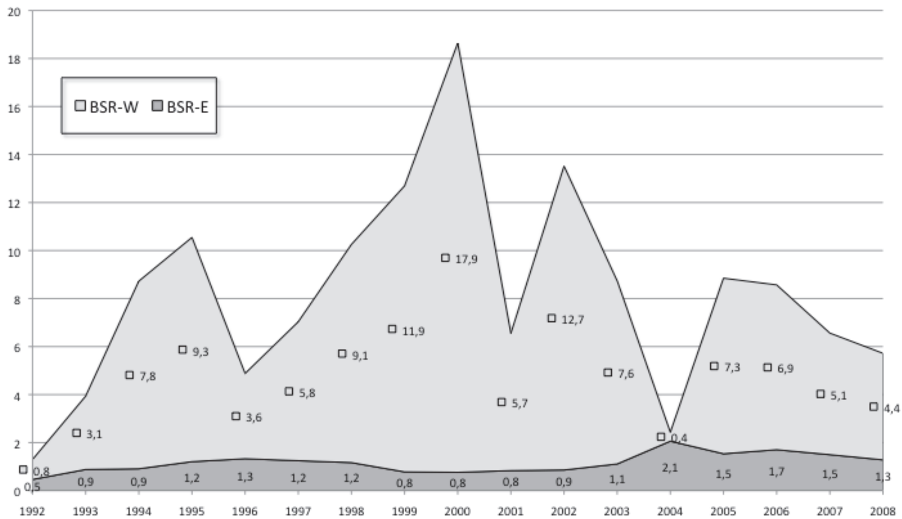
Source: UNCTAD (2009); own calculations.

Of a general interest – not least given the high expectations tied to the role of FDI – is of course the question of how much of these steadily increasing flows that have entered the BSR.[48] This is particularly interesting given that we know that one of the most enduring features of international FDI flows has been the dominance of developed economies as both source and host countries for FDI. Looking at the annual inward FDI into the eastern (BSR-E) and western countries (BSR-W) of the region as a percentage of total world inflows respectively, thus gives an indication of to what extent this capital have changed their ways and found its way to the new Baltic Sea Region. In *Figure 6* below, we see that it is difficult to talk about a general trend towards an increasing share of FDI to the region as a whole; if anything the developments seem haphazardous at least for the western parts of the region (BSR-W).

Indeed, the illustration below points to the fact that the western parts of the region have continued to claim the vast majority of the FDI inflows to the region and at the same time points to that in comparison to the BSR-W, the BSR-E countries have enjoyed a somewhat smoother ride with less volatility. Whereas the volatility in the relative attractiveness of the western BSR markets is quite staggering the eastern BSR markets have managed to maintain and even gradually increased their share of worldwide net FDI inflows. Also, it should of course also be kept in mind that this 'share' is of what so far has looked like an ever-increasing soufflé (cf. Figures 4 and 5).

[48] In Lönnborg et al. (2004) (cf. Table 1, p. 332) it was for example shown that over the period 1991-2001 inflows to all Central and East European countries averaged no more than 2.8 per cent of total global inflows. By comparison the figures shown for the four countries of BSR-E could be taken as a positive sign.

Figure 6. Annual inward FDI, % of total world net inflows (1992–2008)



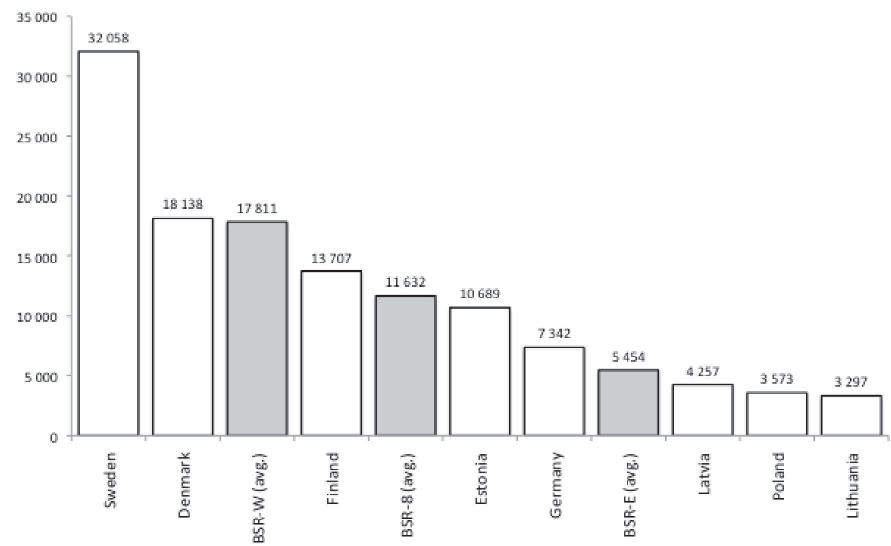
Source: UNCTAD (2009); own calculations. For the underlying figures, see *Table IV* in Appendix.

FDI inflows to the region: the relative impact on the economies

As is apparent from the data on FDI inflows gathered in *Table III* in the Appendix, there are naturally significant differences among the large and small as well as eastern and western countries in the Baltic Sea Region when it comes to the actual nominal level of the inflows that took place. Over the period in question, for which we have somewhat reliable data on all eight countries (1992-2008), the cumulative inflows in Germany by far exceed anything else with in excess of USD 600 billion over the years in question. The second largest country when it comes to cumulative annual inflows is Sweden with USD 287 billion in inflows. A second tier of countries consists of Poland (USD 137 bn), Denmark (USD 97 bn) and Finland (USD 71 bn). By comparison, the three Baltic states are all small players with cumulative inflows (1992-2008) of USD 14.5 (Estonia), 11.3 (Lithuania) and 9.9 (Latvia) billion, respectively.

However, given that the BSR is made up from economies as diverse in terms of size as Germany and Estonia, gross figures in absolute terms on a country basis carry little information. If we instead, for example, look at the cumulative inflows on a per capita basis we immediately get a somewhat more telling picture. In *Figure 7* below we see that Sweden and Denmark stand out as the countries that cumulatively has attracted the most inward flows over the period relative to its population. In fact, it is these two countries that are driving the mean figure for the BSR-W countries in total. We also see that Germany is not significantly more successful in attracting FDI on a per capita basis than the average for the eastern countries of the region (BSR-E), and has attracted more than 3,000 dollars less than Estonia on a per capita basis over the period in question.

Figure 7. Cumulative inward FDI/capita, 1992-2008 (USD, current prices)



Source: UNCTAD (2009); own calculations. For the underlying figures, see *Table IV* in Appendix. *Notes*: The averages reported for the region as such (BSR-8) and the two constituent parts (BSR-W and BSR-E) are unweighted averages.

Even if an approach that means looking at the inflows on a per capita basis takes us a little bit towards a better ground international comparisons the measurement still suffers shortcomings. 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.

If we begin by looking solely at the inward stock per capita on a country basis, we for example immediately see that *Figure 7* above exaggerated and/or distorted the difference between Denmark and Sweden – in fact at end-2008, the inward stock was the same in these two countries at an impressive 27,500 USD worth of foreign direct investment per capita. This figure could be compared to the world average of 2,209 USD per capita. Interesting to note is also that despite the impressive growth for the BSR-E countries, only Estonia manages to exhibit growth of the FDI stock that rivals any of the BSR-W countries (cf. Chg. Rank in *Table 5*); Lithuania is the country that persistently increases the stock the least on a per capita basis and Denmark and Sweden the two that increase the most.

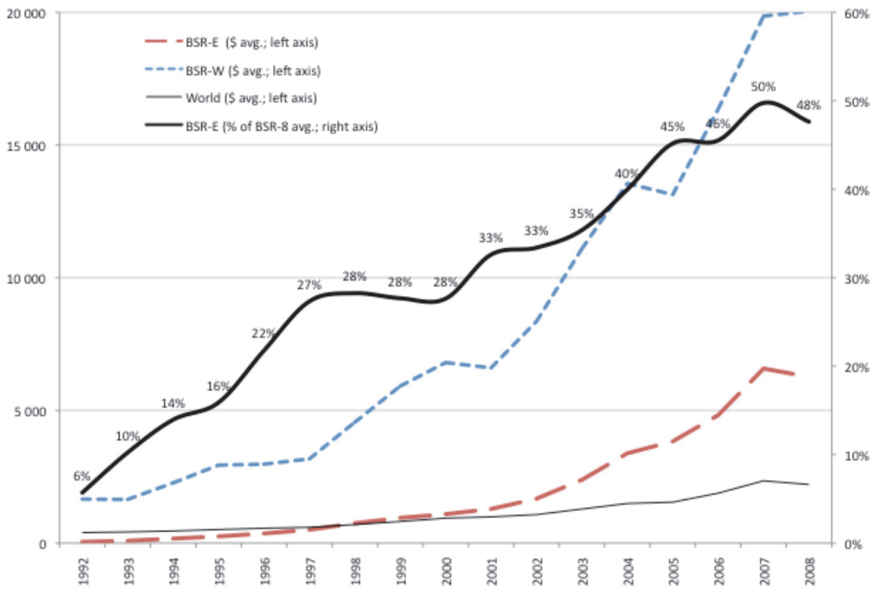
Table 5. FDI inward stock/capita, 1992–2008 (USD, current prices)

	1992		1996			2000			2004			2008				Percentage change		
	USD	Rank	USD	Chg. USD	Chg. Rank	USD	Chg. USD	Chg. Rank	USD	Chg. USD	Chg. Rank	USD	Chg. USD	Chg. Rank	Rank	1996-2008	2000-2008	2004-2008
Denmark	2783	1	4256	1472	2	8606	7134	2	15272	8138	2	27572	19434	1	1	648	320	181
Estonia	63	6	582	519	4	1930	1411	5	7454	6042	4	11900	5857	4	4	2046	617	160
Finland	733	4	1717	984	3	4692	3708	3	10976	7268	3	16563	9295	3	3	965	353	151
Germany	1492	3	1986	494	5	3309	2815	4	6216	3400	5	8515	5115	5	5	429	257	137
Latvia	67	5	380	313	6	878	565	7	1964	1399	7	5068	3668	6	6	1332	577	258
Lithuania	29	8	194	165	8	667	501	8	1858	1357	8	3868	2511	8	8	1991	580	208
Poland	36	7	297	261	7	891	629	6	2266	1636	6	4236	2600	7	7	1427	476	187
Sweden	1620	2	3938	2318	1	10609	8290	1	21752	13461	1	27541	14079	2	2	699	260	127
World	*397*		*561*	*164*		*942*	*777*		*1494*	*717*		*2209*	*1493*			*394*	*235*	*148*
DME's: Europe	*1835*		*2683*	*849*		*4609*	*3 760*		*9534*	*5774*		*13605*	*7 831*			*507*	*295*	*143*

Source: UNCTAD (2009); own calculations. *Notes*: *USD* refers to the value of the inward FDI-stock in current prices; *Rank* (1992 & 1996) is the rank among BSR countries in terms of total stock of FDI; *Chg. USD* (1996, 2000, 2004, 2008) refers to the change in dollar value over the preceding 4-year period; *Percentage change* is the calculated change for the period in question; as *memorandum items* are displayed the average figures for the world and the European developed market economies as a whole, respectively; for definitions, see UNCTAD (2009).

In terms of growth it is also noteworthy that all the eastern BSR countries for all three periods cited in *Table 5* increase their inward stock of FDI at a faster pace than the world as whole and the European developed market economies. Also, it is admirable that all four of the BSR-E countries increase their stock of FDI per capita with more than 1000 per cent over the twelve-year period 1996-2008; Estonia with more than 2000 per cent (sic!). So, in terms of rankings not much may have changed over the years – but in terms of inflows affecting the stock it is the eastern parts of our region that exhibits the most spectacular growth rates – but at the same time we can see that rates of growth gradually become more "normal" the closer to our times that we get. The developments are also summarised in *Figure 8* below, which shows the average stock of inward FDI/capita for the western and eastern part of the BSR, respectively, in the 1992-2008 period. Also, on the right axis is displayed the unweighted mean of the BSR-E figures expressed as a per cent of the average for the region as a whole – a figure which has risen steadily from a mere 6 per cent to roughly 50 per cent. In terms of cohesion this is positive news, but as we repeatedly have pointed to there is still plenty of room for development.

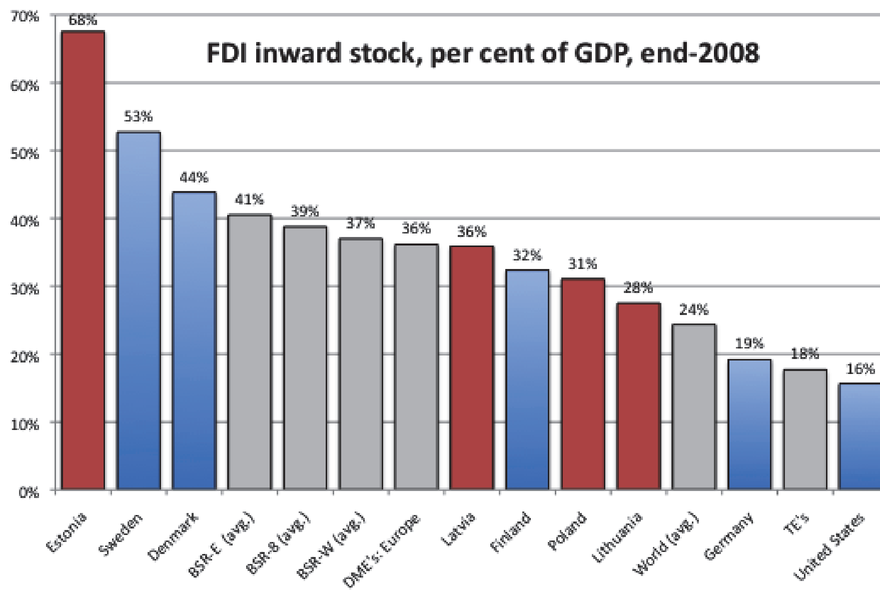
Figure 8. Inward stock of FDI/capita in the eastern and western parts of the Baltic Sea Region, 1992–2008 (USD current prices and % of region total)



Source: UNCTAD (2009); own calculations. *Notes*: please note that the figures represent the unweighted means for the respective group of countries; the percentage figure on the right axis is for the BSR-E as a per cent of the BSR-8 average.

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 as a percentage of the gross domestic product. If all the above measures have been somewhat disappointing for the ones hoping for a fast(er) integration in terms of achieving equality between the eastern and western parts of the region, then the below figure should be somewhat comforting. In *Figure 9*, 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 in the Baltic Sea Region. The inward stock amounted to more than 2/3 of GDP in 2008. Noteworthy is also that the average figure for BSR-E is higher than that for the western countries and more than double that of other transition economies (TE's). *Truly, FDI has grown to be a factor of major importance in the majority of economies in the Baltic Sea Region.*

Figure 9. FDI inward stock, end-2008, per cent of GDP



Source: UNCTAD (2009); own calculations. *Notes*: all average figures are unweighted means for the various groups of countries; for further definitions of inclusions in the groupings Developed Market Economies (DME's) Europe and Transition Economies (TE's), see UNCTAD, 2009.

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Before moving on to the questions of outflows, sectoral and geographical composition, it might 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.[49] Having this in mind, it is easy to understand that

[49] Cf. Lönnborg, Olsson and Rafferty (2004) for a more detailed discussion of the interaction of the privatisation programmes and FDI-attraction to these countries. Also

there were fears that inflows would dry out as soon as the privatisation came to and end. However, as we have seen above, inflows have continued long after privatisation proceeds have come to a halt. Even so, it could also be seen from our data that *growth rates* as of lately have become somewhat subdued – whether this is a sign of a something significant or not is too early to say – and the whole complex question of what constitutes sustainable investment will surely be topical also in the future.

FDI outflows: western dominance

The outflow of FDI from the region follows by and large what is expected from the size of each individual economy. Hence in general terms, Sweden, Germany, Denmark and Finland, are the largest foreign direct investors, while the BSR-E countries do not leave any significant footprints in global FDI statistics. This fact is noticeable also in earlier research, where the studies on FDI address to a larger extent the FDI outflows to areas outside the BSR. Of the cumulative outflows from the Baltic Sea Region as a whole of 1,624 billion USD over the period 1992-2008 the eastern countries accountted for a mere 2 per cent.[50] Noteworthy is also that a significant share of the outward flows from, for example Estonia, is accounted for by financial institutions that in turn are foreign owned (primarily by Swedish interests). To sum up, despite progress in many areas and enormous economic advances among the eastern countries of the region, investment flows to a significant extent remain uni-directional – going from the BSR-W to the BSR-E.

Sectoral distribution of the inward stock of FDI

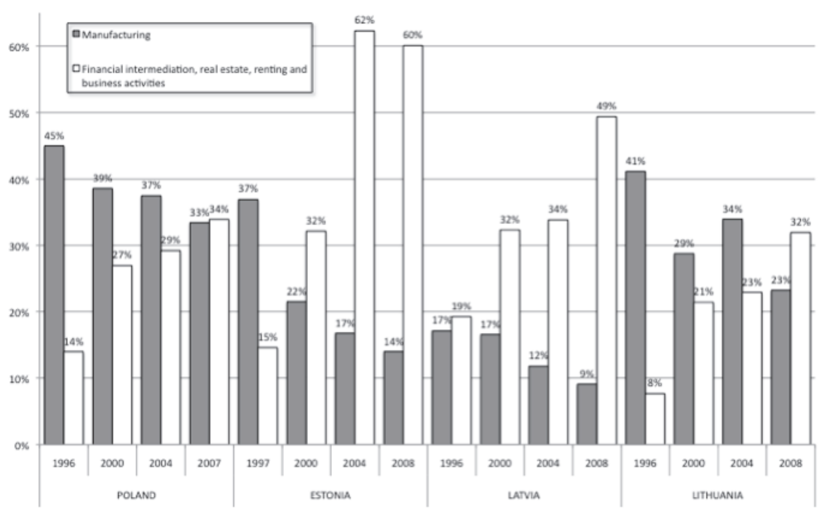
As has been discussed previously, there is a close affinity between the early developments in FDI and the early privatization processes. Thus, it is no surprise to see that manufacturing in general accounted for a large proportion of the stock of inward FDI – being the single largest sector in three out of the four BSR-E countries. The one exception was Latvia where for natural reasons investments in transports and storage early accounted

UNCTAD (2003) point to the privatisation as the main cause for the inflows during the first ten years of economic transformation.

[50] In terms of cumulative outflows from BSR-E, Poland accounted for the largest flows ($22.5 bn) followed by Estonia ($5.7 bn), Lithuania ($2 bn) and Latvia ($1 bn). The corresponding figures for the western countries of the region (BSR-W) were $1065 bn (Germany), $310 bn (Sweden), $124 bn (Denmark) and $95 bn (Finland). Source: UNCTAD (2009); own calculations.

for the lion's share of inward FDI (45% in 1996) and manufacturing was the second largest sector in attracting FDI. Over time, however, the proportion of manufacturing has dwindled in all BSR East countries as inflows have been attracted to other sectors (see *Figure 10* and *Table I* in Appendix). In Poland it had shrunk to one-third by 2007, and in Estonia by more than one half to a mere 14 per cent in 2008. Latvia stands out as the country with the relatively 'smallest' manufacturing sector; with the sector never accounting or more than 17 per cent of the inward stock in FDI.

Figure 10. Inward FDI-stock by activity, 1996–2008 (per cent of total)



Source: WIIW; own calculations.
Note: In the figure above NACE-codes J and K have been combined and are represented by the white bars as financial intermediation, real estate, renting and business activities; the data for manufacturing (D) are unchanged from the source. For detailed figures, see *Table I* in the Appendix.

In place of manufacturing, inward FDI to these economies have above all been attracted to the financial sector, and in all four countries, the industry has close to doubled its share of the inward stock of FDI. Further, if combining with investments into real estate, renting and business activities (NACE K), we see that investments into such "white collar" activities has grown to account from between one-third (Poland and Lithuania) up to in excess of 50 per cent (Estonia and Latvia) of the total inward stock of FDI.

In all cases, these white-collar investments have come to exceed investments into manufacturing.

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 manufacturing sector. In fact, in all countries the stock of FDI in manufacturing has grown somewhere between four and nine times over the period in question (see *Table 6* below) in current prices. In Poland, for example, despite the relative decline of importance, the nominal value of the stock of manufacturing investments *grew* close to ten times – reaching EUR 40 billion at end-2007.

Table 6. Inward FDI-stock in manufacturing (NACE D) (current € mn)

	Estonia		**Latvia**		**Lithuania**		**Poland**	
	1997	2008	1996	2008	1996	2008	1996	2007
Inward FDI (mn Euro)	384	1,629	94	733	232	2,122	4,154	40,042
Period growth (current prices)		424%		783%		914%		964%

Source: WIIW; own calculations.

A more detailed look at what has happened within manufacturing in this group of eastern BSR countries points to a couple of interesting things. Firstly, consumer goods production (food products, beverages and tobacco) was the one sub-sector that in connection to the early economic transformation grew to become the most important attractor of FDI within manufacturing in all four countries. In 1996/1997 it accounted for between 23 and 48 per cent of foreign investments into manufacturing. However, its relative importance has been significantly diminished over time – often cut to about half over the period in question.

One manufacturing sub-sector that has risen to prominence in both Estonia and Latvia is the one relying on the forest for its inputs. In *Table II* in the Appendix, we have combined wood and wood products (NACE DB) with pulp, paper and paper products etc (NACE DC) into one group and in both of these countries it accounted for one quarter of the inward FDI stock in manufacturing. From *Table II* (Appendix) it may also be noted that Poland defends it industrial heritage in the sense that transport equipment remains the most important manufacturing subsector in attracting FDI – accounting for close to one-fifth of the inward stock (2007).

Regional distribution of the inward stock

The other variable used as a yardstick of regional integration is stock of inward FDI divided on source countries. The regional dimension in the pattern of inward FDI is indeed obvious regarding the Baltic States. In particular Sweden and Finland are main contributors, and this is further underpinned considering that investment into Latvia and Lithuania from Estonia in practice is Swedish capital. This explains the high proportion of Estonian FDI in Latvia and Lithuania, while the inward FDI from these countries into Estonia remain limited. The share of FDI from the western BSR countries into the Baltic countries shows a common pattern, a rise in the middle of the 1990's, which continued until 2004 and then dropped in 2007/08. However, the figures about Latvia and Lithuania include the above-mentioned *indirect* investments from Sweden but here defined as Estonian capital. By consequence, the share of FDI from western BSR countries remain relative stable and indeed very important.

Table 7. Inward FDI-stock by home countries, 1996–2008 (% of total)

	Estonia				**Latvia**				**Lithuania**				**Poland**			
	1997	2000	2004	2008	1996	2000	2004	2008	1996	2000	2004	2008	1996	2000	2004	2007
Austria	2.3	0.3	0.15	0.8	2.3	0.5	1	2.6	2.1	0.7	3.1	0.7	2.4	2.8	6.2	5.4
Denmark	4.7	4	2.1	3.7	26.3	10.5	8.7	8.2	5.6	18.2	15.2	8.7	4.9	1.3	2	2.8
Finland	28.8	30	23.8	22.4	2.7	6.2	7.8	5.9	4.7	6	7.8	5.5	0.5	1.1	0.01	1.7
Germany	3	2.5	2.1	2	4.7	11.1	15.3	6.7	13	7.3	11.5	10	24.3	9.8	10.3	17
Netherlands	2.6	2.4	2.6	6.8	1.5	3	7.2	5.8	1.2	1.1	4.3	6.7	25.3	20.6	19.1	10.2
Norway	4.7	4.2	2.8	3.4	4	5.5	4.7	3.5	2.5	4.2	2.8	4	-0.2	0.04	0.9	0.9
Russia	5.7	1.5	2	3.4	13.4	6.1	7	4.7	1.8	1	8.4	5.3	0.1	-0.2	-5.4	-1.5
Sweden	20.7	40	45.4	40	4.9	13.4	12.3	14.2	12	17.3	15	16.8	2.1	6.2	4.9	4.9
UK	3.5	2.5	3	2.3	7.3	0	2	1.8	8.9	6.7	3.4	2	3	1.8	2.6	3.7
US	5.7	4.5	5	1.4	10.9	0	7.5	3.8	28.5	10	6.3	2.6	10.2	3.4	1.1	5
EU-27	*68.2*	*84*	*85.2*	*87.5*	*53.9*	*63.8*	*65.2*	*76.2*	*62*	*75*	*76.3*	*81.2*	*78.4*	*92.6*	*94*	*79.8*
BSR W	*57.2*	*76.3*	*73.4*	*68.1*	*38.6*	*41.2*	*44.1*	*35*	*35.3*	*48.8*	*49.5*	*41*	*31.8*	*18.4*	*17.2*	*26.4*
BSR E	*0.5*	*0.2*	*0.9*	*1.9*	*1.8*	*12*	*9.2*	*20*	*2.4*	*15.2*	*10.5*	*19.7*	*0.01*	*-0.01*	*-0.01*	*0.01*

Source: WIIW (2009); own calculations.

In Latvia the main contributors in 2008 were Sweden (and Swedish capital from Estonia), Denmark, Germany, Finland and Netherlands. Of less relative importance we find Russia, US, Norway, Austria and offshore capital from Cyprus, while around 2 per cent came respectively from Iceland, Ireland, Luxembourg and Malta, and 1 per cent from Switzerland and France. In addition, the pattern in Lithuania is very similar to Latvia.

In Poland we see a completely different structure, and investments from Sweden, Denmark and Finland were limited in 1996. Still, looking on the total FDI, about one third of the capital originated from the BSR-W countries (of which three fourths came from Germany). The changes in the pattern, with major decrease in 2000, stable in 2004 and recovered in 2007, depended mostly on German propensity to invest. In addition, investment from Denmark decreased and FDI from Sweden rose until 2000 and then fell back again. In sum, in 2007 the western BSR countries represented about one fourth of the entire stock of inward FDI in Poland.[51]

In short, like the change in the trade flows in the BSR since the 1990's, the pattern of FDI indicates that some sort of regional integration has occurred. However, whether this in practice has facilitated an actual integration among the Baltic Sea countries is another matter. We know that behind these figures lays a few very large investments, in particular in banks and telecommunication companies. By consequence, this is an important argument for deploying case studies about what kind of impact these FDI actually entailed.

Foreign direct investment: some regional examples

So far, we have given the macro picture of the FDI pattern of the BSR. What about the micro picture? Looking at the UNCTAD compilation of all major merger and acquisition (M&A) deals in the world (UNCTAD 2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009; see also Appendix *Table V* for major BSR M&As), we can immediately conclude that the BSR is not the central scene for the large M&As of the world. Furthermore, the major M&A deals that take place in this part of the world involve companies located in the BSR-W economies.

The M&As described in this section cover only those exceeding USD 1 billion in value, which means that most M&As that take place in e.g. the

[51] In 1996 the largest investment in Poland came from Netherlands and Germany, about one fourth each of total. In difference from the Baltic States major investments came from France (8%), South Korea (4.5%) and Switzerland. Investment also came from countries as Malaysia (although withdrawn in 2000), Belgium (3%), which grew steadily until 2004. Noteworthy is also that in 2000 France was the single largest investor in Poland, with the purchase of the telecommunication company TP SA (Marinova & Marinov, 2003, p. 82). Another difference from the Baltic States was that Spain was substantial investor in Poland, in 2004 they accounted for more than 4 per cent.

three Baltic countries are missed out. The reason for this is simple; not many target companies in Estonia, Latvia and Lithuania have reached a market value that exceeds USD 1 billion. Still, we can observe one single exception to this pattern, namely the 2005 acquisition of the remaining shares of Hansabank by Swedbank (which controlled the bank since 1998), which totalled USD 2.3 billion in value.

Overall, the intra-BSR M&As are characterized by western BSR firms acquiring BSR-E companies. Earlier, we have discussed the dominance of the western BSR economies in the international trade both inside and outside the BSR. The same characteristics can also be said about the large firm M&As taking place in the BSR, but the investments originating from UK and the US are also prominent, where 16 out of 44 large firm M&A cases were involving UK and US firms.

If we turn our attention to *Table 8* below, which compiles some examples of smaller scale FDIs and M&As in the four BSR-E countries, a more nuanced picture of the BSR M&As emerges. *Table 8* being far from representative, the purpose of it is to underline the necessity to study the smaller-scale FDI and M&A cases involving small and medium sized firms (SMEs). As a result of the absence of well-published and well-known mega-M&As of the western BSR type, much less is known about the motives and processes of the M&As in the eastern BSR. As Jansson and Sandberg (2008) have found for Swedish SMEs, not many cross-border FDI are *made by* SMEs due to their lack of funds necessary to establish or acquire foreign firms. The majority of M&A transactions that involve SMEs have larger firms as their acquirers. Therefore, in order to deepen our overall knowledge of FDI and assess their contribution to regional integration, micro-level studies of M&As involving SMEs are important. This is particularly true for research on the BSR economies.

Table 8. Examples of major intra-regional FDIs in each BSR country

Host country	Aquiring firm	Target firm	Industry	Type of M&A	Motive	Investment value (where indicated)	FDI year
Estonia							
	Baltic Beverages Holding (SWE-DAN-FIN)	Saku Õlletehas	Beverages	Acquisition	Market-seeking	EEK 261 mil	1991
	Atlas Nordic Cement Ltd Oy (FIN)	Kunda Nordic Tsement AS	Cement production	Acquisition	Market-seeking	EEK 555.6 mil (USD 2,4 mil)	1998
	TeliaSonera (SWE-FIN)	Eesti Telekom	Telecommunications	Acquisition	Market-seeking	EEK 2,061 mil	2004
	Swedbank (SWE)	Hansapank	Finance	Acquisition	Market-seeking	EEK 3,880 mil	2005
Latvia							
	AKG (GER)		Machinery	Greenfield	Production	EUR 3 mil	2004
	Danish Brewery Group (DAN)	Cido Partikas Grupa	Beverages	Acquisition	Market-seeking	n.a.	2004
	Danish Brewery Group (DAN)	Lacplesis Brewery	Beverages	Acquisition	Market-seeking	n.a.	2004
	SEB (SWE)	Balta Dviziba	Finance	Acquisition	Market-seeking	EUR 40 mil	2006

Table 8. Examples of major intra-regional FDIs in each BSR country (Continued.)

Lithuania							
	Danisco Sugar A/S (DAN)	Sugar factories in Lithuania	Food	Acquisition	Market-seeking	USD 34 mil	1998
	Carlsberg (DAN)	Svyturys	Beverages	Acquisition	Market-seeking	USD 45 mil	1999
	SEB (SWE)	Vilniaus Bankas	Finance	Acquisition	Market-seeking	USD 57 mil	2000
	TeliaSonera (SWE-FIN)	Omnitel	Telecommunications	Acquisition	Market-seeking	USD 66 mil	2003
Poland							
	Tæppeland Holding A/S (DAN)	Topwert Swiat Dywanow	Floor retailing	Acquisition	Market-seeking	n.a.	1995
	NKT Cables A/S (DAN)	Slaska Fabryka Kabli S.A.	Electric equipment	Acquisition	Production	n.a.	1997
	Borg Automotive A/S (DAN)	Fomar Roulunds S.A.	Machinery	Acquisition	Production	n.a.	2004
	Scan AB (SWE)	Kreatina Sp. zo.o.	Food	Acquisition	Production	n.a.	2005

Sources: AKG 2010; Borg Automotive 2010; IFLR 2007; Kreatina 2010; LIAA 2010; NKT Cables 2010; OECD 2000, 2001; Polish Business 2007; Royal Unibrew 2010; Swedish Meats 2005. *Notes*: n.a. = No account.

Trade and FDI in the Baltic Sea Region: summing up

If we put the BSR FDIs into perspective by 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.

As the Eastern BSR economies continue to develop and trade volumes increase, the value of the BSR-E firms will increase. Thus, it is not too bold to say that we can expect an increasing number of M&As involving Baltic and Polish firms that makes into the UNCTAD lists of major M&As.

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 where the share of investments from the group of BSR-W countries had risen to close to 27 per cent by end-2007. 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 similar studies (e.g. Erhlich et al., 2002).

However, this picture seems to depend on the nature and size of the firm conducting FDI. Jansson and Sandberg (2008) concluded that there is no evidence for Swedish SMEs involved in intra-BSR trade as being more active foreign investors due to their trade activities. Having said this, the Lönnborg et al. (2004) study found that large firm FDIs to smaller economies tend to 'crowd out' further FDIs by competing firms, thus implying a lower saturation limit for some countries compared to others. Therefore, the picture here is still inconclusive and suggests that several factors such as investor origin, industry, firm size and the institutional setting of the target country influence the outcome of a specific FDI initiative.

As regards the geographical composition of investment flows it is interesting to note that flows from developing and emerging market economies have increased on global level during the last decade, and also the BSR have seen increased inflows from these countries. E.g. Barauskaite (2009) maps out the Chinese FDIs to the BSR, while pointing out that the influence of these investments are marginal. Nevertheless, they should not be underestimated, since the targets for the Chinese attention are firms that have problems finding willing investors, and the Chinese investors are "entrepreneurial" in the sense that they invest in projects with higher risk (e.g. UNCTAD 2006). We can conclude that it is still too early to determine how much of the economic growth and increase of productivity, which stems from trade and FDI, that can be attributed to the EU enlargement and the Baltic states' accession in 2004. The earlier findings suggest a disparity in FDI motives and behaviour between large and small size firms, which in turn indicate the dynamics of a market-driven BSR integration.

This review does not claim to be comprehensive, but some observations can still be made. It is apparent that the micro level studies, where research on the investors' and/or sellers' motives have been investigated and analyzed, are rare. This lack of micro-level studies is, however, nothing unique to the BSR FDI research, but similar to most international studies on FDI and economic integration. So, the question is how research on individual BSR FDI cases can increase our understanding of regional economic integrations. The answer is that micro-level studies on FDIs, where the mechanisms and motives behind investment actions are analyzed, are important in order to understand also the mechanisms and motives behind regional integrations. This is the agenda for coming research on the BSR.

VI. Concluding remarks and directions of future research

We began this presentation by posing a rhetoric question of whether there is such a thing as a Baltic Sea Region? As with all rhetorical questions an authoritative answer is elusive, so also in our case. In addition, given that this contribution is only the first step in a new research program that seeks to advance our knowledge about regional integration, it would most definitely be premature to try give a definitive answer to that question. At the same time, it should on one level from the above discussions be very clear that we do feel there is good reason to talk about a Baltic Sea Region. The questions rather concern how it has come into being and whether the east-west divisions have diminished.

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 tries 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.[52] 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 in our presentation 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 with above all the Nordic countries having accounted for between one-third to three quarters of the inward stock. The BSR-W dominance is less pregnant for Poland, but still significant. So, summing up, the pattern of FDI inflows to the BSR suggests an actual commitment of private corporations for regional integration.

Even so, and as noted in the beginning of this presentation, in spite that two decades has passed since the fall of the Berlin Wall and more than half a decade after the first eastern enlargement of the EU, we still see comments like: "full advantage of the new opportunities that EU membership provides has not yet been taken and the challenges facing the region have not been

[52] 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).

adequately addressed".[53] This is indeed a token that the movement towards increased integration in the Baltic Sea Region has (as of yet) not delivered the desired results. Truly, as we have seen above, many stakeholders had set their hopes to the role of foreign direct investment as something of a miracle cure to eliminate the legacy of socialism, and even though the inflows of FDI have been significant and the investment promotions agencies have flourished the above characterization holds as late as 2009. To us, as bystanders and observers, it is however not only a token of opportunities not taken – it is equally much a token of a lack of knowledge. Indeed, it seems that despite a vast number of studies of FDI in the BSR and elsewhere we still do not know really what it is that drives and supports regional integration and cohesion.

Part of the answer to this relative lack of knowledge, according to us, may lie with the traditional focus of studies on the macro-level developments. Such studies, focusing on the amount of FDI shows only the *quantity* of capital inflow but says little about what the investment contained and whether these investments contribute to a sustained economic development. The matter of the 'quality' of the FDIs, or put differently, whether FDIs undertaken has supported the domestic economic development, has so far not received less attention than it deserves. Maybe it is better for a country to receive smaller and sustained FDIs than few large and highly moveable investments? In consequence, shedding light on the 'quality' of inward FDI requires other kind of information than highly aggregated data. As noted in passing, a possible way of getting behind the aggregated statistics and say more about the 'quality' of inward FDI, is through case studies and that is the next step in this research program.

Then again, our advocacy for a more extensive use of case studies as a mean of entering the 'black box' of foreign direct investment should not be taken as a sign that we hold this to be an unwritten field. On the contrary, a large number of studies of a case oriented nature (much more than can be mentioned here) have already been undertaken, not least with regard to the Central and East European post-communist countries However, the emphasis are often on the larger countries in the CEE-region and/or specific industries as for instance automotives, textiles and the financial sector.[54]

[53] COM/2009/248/FINAL (2009), p. 2.

[54] One example is the volume by Estrin et al. (1997), that investigated firms from US, UK and Germany entering the three largest CEE-countries, i.e. the Czech Republic, Hungary and Poland. According to the authors the three most important motives behind FDI in the former planned economies were markets, market share and costs. The transition

Naturally though there are also a number of significant case-oriented contributions paying special interest to the developments in the Baltic Sea Region.[55] Even so it seems that our knowledge about the driving factors behind these investment and, above all, their impact on the respective economy remains insufficient. Also, the interesting contributions that have been made to a large extent lack the particular focus on the long-term sustainability of investments and region-building dimensions of the investments, which we are suggesting as central for improving our understanding of the making of the Baltic Sea Region. 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.

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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".[56] 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

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countries were regarded as market with substantial prospects for growth. The low rate of competition also offered an opportunity of creating customer loyalty in growing markets. In addition, the low cost of labour was also considered to be an important driving force behind FDIs. The actual integration of the west and east of Europe has, among others, been highlighted by Petrakos et al. (2000), that shows the major social, economical and political changes that has occurred since the early 1990's. A more recent anthology on the regional development in East Central Europe by Turnock (2005) shows a lot of interesting cases about trade and FDI in transforming the former planned economies. For an attempt to measure the impact of the FDI in Central and Eastern Europe on a macro-level, cf. Lipsey (2006).

[55] One example is the anthology about FDI in the Estonian economy (Varblane, 2001), which contains analyses of different aspect about FDI and trade and their impact on the economy. In addition, the dissertation by Tiia Vissak (2003) focuses explicitly on foreign corporations in Estonia and in particular about their investments in the region. Another example of case studies with regard of investments made by companies from CEE is by Svetlicic and Rojec (2003), where the outward flows of FDI is regarded as an indicator of that a successful transition has already occurred. In Zorska (2005) many different aspects of inward FDI and their impact on the economy in Poland is analysed, which includes the case study of Fiat.

[56] Åslund (2002), p. 434.

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".[57] 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'.

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.

[57] 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.

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