

INSTITUTIONAL DIVERGENCE IN THE BALTIC SEA REGION – A VIEW FROM INTERNATIONAL RANKINGS¹

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1. Introduction and methodological aspects

100 years of the Republic of Estonia in 2018 – Happy Birthday to You! Estonia’s geographical location on the Baltic Rim, its small size, and its maritime attitude suggest to write a birthday serenade in the context of the entire Baltic Sea Region (BSR).

In the political arena the BSR is sometimes regarded as a natural integration area with a stress on mutual internal relationships.³ This may be true with regard to the “liquid motorway” transportation function of the Baltic Sea, linking efficiently all the countries on its rim. In fact, the Baltic Sea has been, is, and will be heavily utilized in the past, the present age and the future.⁴ At the same time, the Baltic Sea can nearly be regarded as an inland see of the European Union (EU): eight of its immediate rim countries (with the exception of the Russian Federation) are EU members, and the indirect member Norway is linked to the EU by the membership in the European Economic Area (EEA). Thus, the common legal body of EU-rules – the *acquis communautaire* – is valid nearly all over the Baltic Rim.

However, a closer inspection of the BSR reveals divergences between at least five subgroups of countries, not only from a mere economic, but also from an institutional perspective. Economically one has to discern (i) the Nordic countries Norway, Denmark, Sweden and Finland with their high per-capita incomes but limited market sizes, (ii) the three small Baltic countries Estonia, Latvia and Lithuania as new EU-members of 2004 showing still substantial gaps in per-capita incomes vis-à-vis the core EU, (iii) Russia as the largest country in the world, but with only Kaliningrad and Leningrad oblasts and the City of Saint Petersburg being Baltic Rim provinces, (iv) the larger 2004 new EU member Poland, where only the wojewodships Zachodniopomorskie, Pomorskie and partly Warminsko-Mazurskie are located on the Baltic shore, and (v) Germany as EU member from the beginning, where also only two *Länder*, Schleswig-Holstein and Mecklenburg-Vorpommern are true Baltic Rim regions. Also in institutional perspective divergences between these countries are discernable, because even if rules begin to converge, different ways and qualities of enforcement between the individual countries may exist.

¹ The full article “Institutionelle Unterschiede im Ostseeraum – eine heterogene Region im Spiegel internationaler Rankings” is available on the CD enclosed with this publication.

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³ See, e.g., the forewords to the study of Stiller und Wedemeier (2011: 5-7).

⁴ See Böhme et al. (1998) for the intense transportation function of the Baltic Sea.

These differences in institutions are the topic of this paper. They will not be addressed by “counting laws and regulations”, but by making recourse to various international rankings which assess the operation of institutional frameworks in many countries worldwide. This is done in section 2 while in section 3 a synoptic view on the institutional divergences in the BSR will be given.

2. The Baltic Sea Region in the assessment of international rankings

Several universities, supranational organizations as well as non-governmental organizations (NGOs) publish regularly international rankings which assess the relative position of the quality of institutions in the reporting countries by virtue of a great number of sub-indicators. Five of these rankings have been chosen for this analysis: (i) the KOF Globalization Index of the Technical University of Zurich, (ii) the international Corruption Perceptions Index by Transparency International, (iii) the Ease of Doing Business Index of the World Bank, (iv) the Global Competitiveness Report of the Davos World Economic Forum, and (v) the Hausmann-Hidalgo-Complexity-Index (ECI) by Ricardo Hausmann (Harvard University) und Cesar A. Hidalgo (Massachusetts Institute of Technology). How do the Baltic Rim countries perform according to these rankings?⁵

2.1 KOF Globalization Index

In spite of current protectionist tendencies globalization is still a device to improve a country's wealth. The **KOF Globalization Index** measures the intensity of the links of a country to the other countries worldwide by assessing (i) economic, (ii) social and (iii) political relationships. It does so by collecting data for a variety of these relationships, since 2018 both for *de facto* and *de jure*, whereby *de facto* means how a country is really interconnected with the world, and *de jure* means how the rules and regulations which govern these connections are configured.⁶ The partial as well as the overall indices are shown on a “0” (= not integrated at all) to “100” (=fully integrated) scale. KOF der ETH (2018) provides data for 2015 for 185 countries.

The *overall KOF globalization index* exhibits a clear Northwest-Southeast falling decent: The Nordic countries are among the Top10 worldwide: Sweden No. 3, Denmark No. 6, Finland No. 9 and Norway No. 10; in-between Germany ranks on No. 8 – all with indicator values between 88 and 85. The Baltic Countries follow with a certain gap in-between, whereby Estonia reaches No. 20 with still more than 80 points. Lithuania and Poland are Nos. 30 and 31, Latvia No. 40, and the Russian Federation is least globalized on rank No. 55. The *de facto*-ranking is similar, but shows Estonia nearer to Norway, and Latvia ranges behind the Russian federation. The *de jure*-ranking shows Finland on worldwide rank No. 2, and Estonia again as the best on the Eastern shore.

⁵ The pertinent tables are to be found in the long version (in German) on the CD-ROM.

⁶ Economic criteria are among others the intensity of border crossing trade, investment and income streams in p.c. of GDP as well as trade and investment barriers. Social globalization is measured by, e.g., border crossing personal, informational and cultural contacts. Political criteria comprise for instance the number of foreign embassies, international treaties and membership in international organizations. See KOF der ETH (2018) and Gygli, Haelg and Sturm (2018).

For the three subindices the rankings differ substantially. In *economic* terms Estonia is the only BSR country among the Top10, both *overall* and *de facto* while the Nordic countries and “export champion” Germany follow behind. Only *de jure* Estonia is a little bit behind the Nordics – but still before Germany – while Finland is on No.8 among the Top10. Here a “small country effect” (countries with limited domestic markets maintain a lot of contacts abroad) is clearly discernable for the Baltic and the Nordic Countries.

In *social* terms the Nordic Countries are clearly leading before Germany and Estonia as again the best among the Eastern rim countries. *De jure* it even reaches rank No. 6. That Poland and the Russian Federation are clearly lagging behind may be the result of their size with more inward-looking communication. Regarding *political globalization* the KOF index shows the opposite result of the economic one: advantages for the large countries Germany, and in parts also Poland and the Russian Federation.

2.2 International Corruption Perceptions Index

If institutions, i.e. rules and regulations, are assessed, it is not sufficient to look at the mere letters in the code of law. Instead, enforcement and efficiency of the legal system as well as (potential) shortcomings have to be taken into account. A particular infringement worldwide is corruption. Information on how independent experts perceive corruption in a country is provided by the **International Corruption Perceptions Index** of the NGO Transparency International. It documents on a scale from “0” (= completely corrupt) to “100” (= impeccable) how the experts from policy, economy and society feel how corrupt officeholders and politicians in the countries under inspection are. The 2017 report covers 180 countries (Transparency International 2018).

Compared to a depressing result for the world on average at least half of the BSR performs well in terms of corruption. The Nordic Countries are all among the Top10 worldwide and nearly “clean” with indicator values above 82, Denmark even on rank No. 2. After Germany on rank No. 12 a gap emerges. Among the countries with lower per-capita-incomes again Estonia takes the front rank No. 21 of the Eastern Rim group. Poland, Lithuania and Latvia are in the late 30ies while the Russian Federation belongs to a different league on rank No. 142. Thus the corruption perceptions also follow a Northwest-Southeast scheme, or from “rich” to “poor”.

2.3 Ease of Doing Business Index of the World Bank

In how far the institutional framework promotes – or hampers – economic activity is reported by the **Ease of Doing Business Index of the World Bank**. For a great variety of indicators the “distance to frontier”, i.e. the gap to the indicator-specific best practice (= 100), is assessed. This index is a yardstick for the implications of the regulatory framework, its application, and its shortcomings (The World Bank 2017; 2018b). The most recent report for 2018 with data as of June 2017 contains 11 categories of indicators in the context of starting, running and keeping a business in 190 countries of the world.

The picture for the BSR shows, in general, the already known good ranking of the Nordic countries, which receive ranks No. 3 (Denmark), No 8 (Norway), and No. 10 (Sweden) among the Top10, albeit with some surprises for other countries. Finland follows as

No. 13, but is outperformed in this case by Estonia on No. 12. This means that the framework in Estonia for running a business is nearly as favorable as in the Nordic countries. Lithuania and Latvia are following on ranks No. 16 and 19. The transformation process after the re-gained independency in 1991 apparently has created rather good business conditions in all Baltic States.

A surprise, but only at first glance, is the fact that Germany does not perform better but only on rank No. 21. Here the traditional high and bureaucratic regulation in Germany has left marks. Poland and the Russian Federation follow on ranks No. 27 and 35, whereby Russia performs better in terms of this index compared to the other rankings. In sum the Ease of Doing Business shows a North-South-scheme with some surprises, or: a “small beats large”-pattern.

2.4 Global Competitiveness Index of the World Economic Forum in Davos

A related, albeit more far-reaching ranking is the **Global Competitiveness Index**, provided by the World Economic Forum in Davos. It describes the global competitiveness of the countries under observation on a scale from 1 (= bad) to 7 (= excellent) and incorporates not only institutions proper but also performance indicators which highlight the results of these institutions. In sum 12 categories of criteria which sketch the institutions, policy approaches and locational factors governing the productivity of the economy and the future wealth potential of a country are surveyed, in the most recent edition 2017-18 for 137 countries (World Economic Forum 2018).

Although the general pattern of the BSR countries according to the Global Competitiveness Index again shows the already known descent from the Northwest to the Southeast, the internal ranking within the “rich” and the “less wealthy” group is different. Germany ranks in this case worldwide on No. 5 before the Nordic countries Sweden (No. 7), Finland (No. 10), Norway (No. 11) and Denmark (No. 12). The gap between the Northwestern and the Southeastern rim countries appears to be larger than according to the other rankings. On the Southeastern rim the internal ranking is different, too, although Estonia again is the best on this side of the Baltic Sea on No. 29. The next on No. 38, however, is the Russian Federation, where infrastructure aspects, low government debt, and a high percentage of secondary education participants seem to matter. Hence, Russia outperforms Poland, Lithuania and Latvia. According to the Global Competitiveness Index there exists at least a dividing line between the competitiveness of the rich and the less wealthy Baltic Rim countries.

2.5 Economic Complexity Index (ECI) by Hausmann and Hidalgo

The last ranking deployed in this contribution focusses even more on the implications of the prevailing institutions in a country than the other four, because it assesses the quality and variety of the production potential in a country. It is the **Economic Complexity Index (ECI)** by the Economists Ricardo Hausmann (Harvard) and Cesar E. Hidalgo (MIT). According to their *complexity theory* manufacturing still serves as the pivotal device for R&D, innovation and economic growth. Both authors emphasize that economic complexity—meaning the stock and great variety of knowledge, skills and

capabilities available in a country—is directly embodied in manufacturing activities in the course of producing individual commodities.⁷ Based on their theory Hausmann and Hidalgo build the complexity index of a country—the more diverse the picture of the various productive capabilities is, the higher is the country’s index number—, rate this index for all countries, and afterwards present a ranking of the countries in the world with respect to this variety of the embodied productive knowledge. In some sense a country’s complexity index is a kind of a deeply disaggregated production possibility curve and, thus, a measure for its production potential, its future productivity gains and its growth prospects.⁸

The most recent version of the ECI ranking uses data for the year 2016 for 128 countries worldwide (Hausmann and Hidalgo 2018). Among the BSR countries Germany receives rank No. 4 in the Top10 (aft of Japan, Switzerland, and South Korea), meaning that here the stock of knowledge and skills to produce nearly everything is rather high. Sweden and Finland follow suit on No. 8 and 9. The next on rank No. 20 is Poland which is intensely integrated into many international value added chains. Denmark on rank No. 23 and even more so Norway on No. 39 show a somewhat less favorable performance – the concentration on food industries in Denmark and on oil production in Norway may be the reason. In contrast, Estonia succeeds to receive rank No. 26 shortly aft of Denmark, and even Lithuania’s production potential on rank No. 34 appears to be more attractive than the Norwegian one. Only Latvia is lagging behind again on No. 41, whereas the Russian Federation on No. 48 clearly exhibits the consequences of its concentration of energy exports.

In sum, the ECI ranking shows a more complex picture of the BSR than the other ones. Not all Nordic countries succeed to gain good rankings, the Baltic States show still existing structural weaknesses, and the Russian Federation has neglected structural change from energy exports to manufacturing products. Germany appears to be the leader in this context. However, one can doubt that this reasoning comes true for its two rather poor Baltic Rim *Länder* Schleswig-Holstein and Mecklenburg-Vorpommern.

3. Concluding remarks

The analysis across the five rankings and their indicator systems supports the hypothesis that the BSR is still a rather heterogeneous region – not only in economic terms between rich and less wealthy rim countries but also in institutional terms, the latter in spite of the nearly universal validity of the EU *acquis communautaire*. With respect to the institutional divergence in the BSR a North(-West) – South(-East) descent emerges more or less as result of all rankings, albeit with partially different internal rankings. The poorer countries on the Eastern and Southern Rim have not yet succeeded in catching-up institutionally despite nearly one and a half decade of EU membership of most of

⁷ Cf. Hidalgo and Hausmann (2009), Hausmann and Hidalgo (2011; 2012) und Hausmann, Hidalgo et al. (2011) for a detailed elaboration of their theory.

⁸ Technically, this index is based on two sub-measures: (i) diversity of a single country’s (export) product pattern, i.e. the number of commodities exported by this country, and (ii) ubiquity of the product which measures the number of countries which are actually producing a particular commodity.

them. A somewhat positive exception is Estonia which appears to perform a breakaway at least there where the institutions proper are assessed. Lithuania and Latvia are lagging behind. Also Poland does not acquire good rankings on average, the non-EU-member Russian Federation is still lagging further behind, while Germany receives better grades in most rankings.

However, in the case of the last mentioned three large Baltic Rim countries one should take into account that only (very) small parts of them are true members of the Baltic Rim. As long as the institutional framework does not diverge regionally the rankings sketch an unbiased picture. If interregional divergences exist it would be preferable to use regionalized data. Unfortunately these are not available for most of the rankings, with the exception of the Ease of Doing Business Index of the World Bank, where some elder but incomplete reports exist for Poland and the Russian Federation. For Poland the Baltic Rim Wojewodships perform either pretty good, on average or bad, and for Russia the Baltic Rim oblasts are to be found in the inferior half of the sample. For Germany no such (internationally comparable) data exist, although the good performance can be questioned in economic terms for the less industrialized Baltic Rim *Länder* Schleswig-Holstein und Mecklenburg-Vorpommern.

In sum the BSR exhibits in institutional terms a distinct North(-West) – South(-East) descent. In combination with economic criteria this changes into a North-South descent. The BSR is still everything else but a homogeneous economic space.