

## ECONOMIC DIVERGENCE IN THE BALTIC SEA REGION — WEALTH GAP DESPITE CATCHING UP<sup>1</sup>

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### *The EU integration of the Baltic Sea Region*

Since 2004 nearly the entire Baltic Sea Region (BSR) is an integrated part of the European Union and the Internal Market. With the rule of the *acquis communautaire* the institutional catching up of the accession countries have been completed from a formal point of view. In the course of the accession process the Baltic States and Poland succeeded with transforming their economies into “functioning market economies” as required by the EU.

However, previous studies have already shown that the Eastern European Baltic Sea countries would not necessarily have their economic integration focus in the BSR. The Polish economy is dominated by the dynamically developing trade with Germany as the main trading partner, whereby it is questionable to regard Germany in its entirety as a BSR country. Moreover, only a fraction of Poland's trade is performed via Baltic Sea shipping and related transport links, while the long land-borders and the crossing infrastructure links invite intense streams of land transport. Overall, the attraction of the markets in Western and Central Europe is much greater than those of the BSR and Poland has not developed special relations with other BSR countries except Germany. For Germany itself as well as for the Nordic countries, the main focus of trade is on all of the EU countries as well as on important overseas markets being in line with the attracting forces of partners' incomes and the retarding effects of distance.

In contrast, for the Baltic States the Baltic Sea relations played a primary role in the course of transformation: trade with Germany and the Nordic countries was much more pronounced than with the non-Baltic Sea countries in the EU. At the same time, the Baltic ports served as transport hubs for the Russian foreign trade, and path dependencies from times of the intra-Soviet division of labor were reflected in disproportionately strong trade with Russia. However, the progressive EU integration rather led to a loss of significance of the Baltic Sea region for the Baltic States. Once again, the large markets in Western and Central Europe as well as overseas also offer attractive development perspectives for the Baltic States.

Even if there is no special integration of Baltic Sea countries within the EU, the neighborhood with highly developed EU countries has visibly promoted the integration process of the Baltic States in particular. Moreover, in the political discussion it is still referred to the medieval city union of the Hanseatic League which by intensive trade and

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<sup>1</sup> The full article “Wirtschaftliche Unterschiede im Ostseeraum — Wohlstandsgefälle trotz Aufholprozess” is available on the CD enclosed with this publication.

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institutional cooperation initiated a long period of economic prosperity in the BSR. Transferred to the age of globalization, a regional co-operation of a similar nature might mobilize critical masses in favor of regional networks and thereby increase international competitiveness and prosperity of the BSR.

Against this backdrop, it is analyzed to what extent economic convergence in the BSR seems to be possible and whether the economic foundations and interfaces for a regional integration perspective within the EU exist. By means of appropriate regional indicators, the economic development of the BSR is examined and their economic potential is outlined. To ensure that the regions included in the analysis are part of the Baltic Rim, only NUTS 2 regions located at the Baltic Sea are selected. The NUTS 2 regions of Denmark, Finland and Sweden are included without exception as well as the entire Baltic States, which due to their small size are not further subdivided according to the NUTS 2 classification. In the case of Germany, the NUTS 2 regions of Mecklenburg-Vorpommern and Schleswig-Holstein are considered, with respect to Poland three voivodships at the Baltic Rim complete the BSR defined at the NUTS 2 level.

#### *The regional economic development and potentials at the Baltic Rim*

The regional analysis of the BSR reveals that despite a catching-up process and the adoption of the EU's internal market rules in the transition countries, economic heterogeneity has been preserved – a convergence of economic conditions is not foreseeable. In particular, in the pre-crisis period the Baltic States had raised hopes for a reduction in the wealth gap with growth rates that were unusually high for European conditions. However, slowing growth momentum in the Baltic and Polish Baltic Rim regions during the post-crisis period, with continuously high growth in the highly developed Nordic metropolitan regions, rather pointed to the limits of economic convergence. As a consequence, until 2016 the income gap between the rich Baltic Sea regions in the north and the poorer regions in the south of the Baltic Rim remained very clear — the Baltic and Polish regions are still at the bottom of this ranking (see figure).

Moreover it can be observed that the German as well as the majority of the Polish Baltic Rim regions exhibit a below-average economic performance even within their own countries. In the Nordic countries the development of rural regions is in a sharp contrast to the booming metropolitan regions. Thus the two-class society in the BSR is not exclusively mirrored in an East West divide, but economic diversity also exists at the Western Rim of the Baltic Sea. Against this backdrop, an economic convergence of the transformation regions with the comparatively poor and less dynamic German Baltic Sea regions or with rural regions of the Nordic countries appears to be realistic. For example, a successful catching-up process of the transformation regions vis-à-vis the German Baltic Sea region of Mecklenburg-Vorpommern is conceivable.

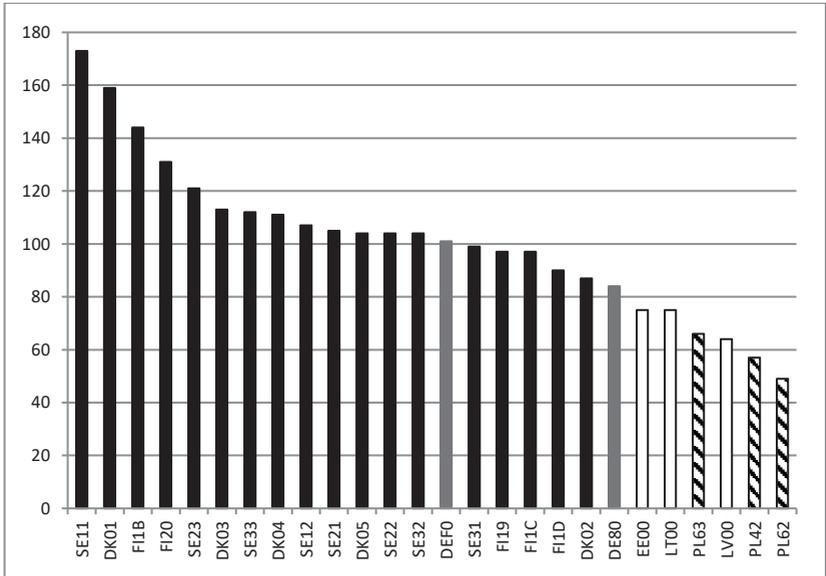


Figure:

Ranking of Relative Per Capita Income of Baltic Sea NUTS 2 Regions 2016<sup>a,b</sup>

<sup>a</sup>GDP at current market prices in purchasing power standard per inhabitant in % of the EU average.

– <sup>b</sup>Values at NUTS 2 level; for the NUTS 2-codes see Table 1 of the full version.

Source: Eurostat (2018a); own illustration.

The still considerable wealth gap in the BSR can be traced back to the diverging economic potential of the Baltic Rim regions. Despite catching up the economic performance of the Baltic and Polish regions has not converged significantly. It is shown that the wealth gap can be explained as a productivity gap by choosing real labor productivity as a performance indicator. Although the Baltic States and Poland could increase their very low labor productivity, at the same time, with the exception of Finland, the labor productivity of the western Baltic Rim countries also increased. The productivity shortcomings in industry, which is of special importance for catching-up countries, are still particularly great.

The productivity gap can be attributed, in large part, to differences in sectoral specialization and in different company structures. It also plays a role how the companies are integrated into global value added chains. While the Northern countries and Germany have specialized in technology- and human-capital-intensive production, in the transition economies raw material- and labor-intensive productions are still disproportionately represented.

The same picture of a two-class society is given by another performance indicator — the innovation capabilities of the Baltic Rim regions. The EU's Innovation Score exhibits a North-West/South-East divide of the BSR: By far the metropolitan regions of Stockholm and Copenhagen are at the top of the ranking, followed by other Nordic regions — all of them classified as “innovation leaders”. Only in the lower half of the ranking the German Baltic Sea regions are positioned while the Baltic and Polish regions are at best “regionally moderate innovators” at the lowest ranks.

### *Conclusions*

Due to the economic heterogeneity and the wealth gap at the BSR, an economic integration of the Baltic Rim regions at eye level appears to be an unrealistic goal. The economic divergence at the Baltic Rim also implies diverging interests: The economic and population centers of the Nordic countries are located around the Baltic Sea while at the Southern rim relatively poor regions are dominating. The Nordic countries rely on the Baltic Sea as the most important device to facilitate transport of passengers and goods. The Baltic Sea is their efficient gateway mainly to markets in Central and Western Europe as well as to overseas markets — they are not primarily interested to integrate economically with their direct Southern neighbors.

Thereby the less developed Baltic Rim regions in Germany, Poland and the Baltic States gain from transport services and benefit from the Nordic countries' efforts to improve the infrastructure links across the Baltic Sea at their own expense. In addition, the poorer regions in the south also benefit from direct investment by Nordic investors. But there is no automatism: They face international competition for productions from non-Baltic Sea locations — especially in the case of workbench productions — because geographical proximity often is not a decisive locational advantage. And overall, the southern Baltic Rim regions are not focused on the BSR as their economic gravity center, since they are also dependent on the integration of their industrial locations in the European and global value added chains as well as on the access to the wealthy markets outside the BSR.

A BSR cooperation in the sense of a medieval Hanseatic League, which primarily trades among each other, is neither reasonable nor conceivable against this background. However, in the era of globalization the function of the Hanseatic League as a door opener and link to more distant markets fits with the economic challenges of present time. Even metropolitan regions may have an interest in increasing their critical mass and benefiting from networking advantages in order to be present on world markets with greater weight. In this respect, in spite of the diversity of the Baltic Rim regions as outlined in the presented analysis, there can be a common interest in an outward-oriented Baltic Sea cooperation.

Even a Baltic Sea cooperation with a limited integration perspective requires adjustment measures and joint action: The poorer Baltic Rim regions have to strive for international competitiveness and gain in attractiveness. This means that the institutional framework and the availability of resources needed for the production of high-quality products and services must be further improved. It also implies that, for example, the regional human

capital should be boosted through joint education and training initiatives to increase the economic interfaces in the BSR. And a joint planning and realization of transport infrastructure projects could further enhance the role of the Baltic Sea as an efficient transport device. This opens up broad fields of cooperation between the Baltic Rim regions, since an improvement of human capital resources and a further development of the transport network is in the interest of all cooperation partners. In this way the huge economic divergence in the BSR might be reduced over time. Then convergence has to be understood as a long-term process of rapprochement which does not necessarily lead to equal living conditions in the BSR.