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Economic and Political Perspectives on Integration in the Baltic Sea Region

Abstract:

The purpose of this paper is to address the influence of the changes in the European economic landscape in the aftermath of the break up of the iron curtain and the new dynamics of the process of European integration in the since 1989.

The main focus is on the interaction between political and economic aspects of transition and reintegration in the Baltic Sea Region (BSR). In the first section a concept of spatial integration is sketched based on political and economic concepts of integration. The second part provides a brief record of political and economic integration and reintegration in the Baltic Sea Region. The central hypothesis is that the region has embarked on a path toward a coherent economic and political region with regard to political and economic affiliation. We have seen a consolidation of the old market economies within one trading block, and the former state trade economies will join the EU within two years. The old division of the Nordic countries into two different blocks concerning security policy seems also to diminish. In the same period, the cleavages between East and West with regard to security policy and economic system have disappeared.

The paper aims to provide a comprehensive assessment of this process at the end of the first phase of transition at the threshold of the creation of a unified economic space in the Baltic Sea Region. The empirical section will contain information on economic flows as well as an assessment of the institutional changes within the BSR and the emerging new system of production and division of labor in the area.

The final section will, based on the concept of spatial integration discuss, whether or not the BSR constitutes a functional region within the European regional system.

Keywords: European economic integration - Transition and transformation in the BSR - The BSR in the European regional system – Trade and Production in the BSR

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Introduction

Location and integration as well as adaptation and cooperation are the key-issues to be addressed in an assessment of the future position of the Baltic Rim in the European system. The purpose of this chapter is to address the influence of the changes in the European economic landscape in the aftermath of the break up of the iron curtain, and the new dynamics of the process of European integration in the since 1989. Integration is probably the single most important social force in the process of transition of the Baltic Sea Region (BSR). The success of the various aspects of the process of integration will have decisive influence of the regional networking system within the region and between the Baltic Rim area and the European and global system.

Regional integration has altered the spatial dimensions of regional activities, and this chapter will discuss regional integration frameworks' impact on the regional development and potentials of the Baltic Rim Region.

Spatial integration - a comprehensive concept for the study of regional transition?

Regional integration has been an important factor in the political development of Europe since the Second World War, and has altered the spatial dimensions of regional activities. After the break up of the iron curtain the process of integration changed in scope and intensity, in particular in the Baltic Sea region, and became a major force in the process of transition of the former command economies and the reintegration into the western market based economic system.

This section provides a tentative outline of concepts based on regional integration for the analysis of the process of reintegration of the Baltic Rim region into the main stream economic and political system in Europe, the European Union and the market based economies of the world as a whole.

The theoretical fundament of the processes of regional integration can be found in economic and political theory of integration, but as stated above, this is in particular the case in this process which has to be seen in a spatial perspective as well. Theoretically, the first two approaches are distinctly based in economics, in particular concept from the field of international economics and trade theory, and various branches of political science. The economic concepts of regional integration where originally introduced by Jacob Viner (1950) in his analysis of Customs Unions, but the concepts have been expanded in scope and depth to cover most aspects of regional economic cooperation.

There are several reasons to extent the analysis beyond the traditional economic and political aspects of integration, when dealing with processes of transition and reintegration simultaneously. The relationship between macroeconomic integration and the necessity of providing instruments to cover specific areas or sectors from significant adverse effects of this process is obvious. In particular the political approaches to integration are useful when focusing on the needs for restructuring of the existing EU-policies to meet the challenges of the enlargements with former CMEA-countries.

Theories of Political Integration

Traditionally, four approaches to political integration are distinguished: the federalism, the transaction or pluralistic approach, and the functionalism and the neofunctionalism, the 'theory of Western European integration'. The different schools indicate that no common consensus with regard to a definition exists. Some are focusing on the process of forming a regional body, whereas others emphasize the stage of integration. In a review of the state of the art of political integration theory after the first 'honey-moon' of political integration and the first major draw-backs in real world integration as well as theory-building, Charles Pentland (1973) made the attempt to formulate what he called a common denominator of political integration:

> "All it seems possible to say is that international political integration is a process whereby a group of people, organized initially in two or more independent nation-states, come to constitute a political whole which can in some sense be described as a community" (Pentland 1973, p. 21)

Based on Lindberg & Scheingold's models of system change (1970 pp. 134 - 139), and the challenges to political integration theory in general (Chryssochoou 1997, p. 1) the following preliminary conclusions seem possible:

> "-The virtuous circle in this process can result in a system transformation but with a possible outcome which at the best will be reinforced by forward linkage (or in a Haas' terminology, spill over) mechanisms. The alternative after the system transformation is 'out-put failure' if the EU not is able to follow up on the fundamental transformation initiated by the reintegration of the East and Central European Countries.
>
> - The experiences of the first years of the transition process indicate that the risk of negative outcomes (output failure or spill back) is real. Particulary, in the fields of economic restructuring (within the EU, as well as in the accession countries) and external (with regard to economic assistance and the implementation of preferential treatment in the area of trade and other forms of economic exchange) the risk is evident.
>
> - In the field of political integration, the record at present seems to be less ambiguous. The decisive test will come when East West negotiations will change character from more or less traditional intergovernmental frameworks (led by the presidential country of the EU) to become an integrated part of the EU decision making with majority voting etc. This will stress the still unsolved institutional issues only superficially dealt with in the Intergovernmental Conference (IGC) of Amsterdam, and is another reminder of one of the crucial shortcomings of the concepts of regional integration, and the lack of an operational approach towards integration." (Cornett 1999, pp.258f.).

The result is that it seems useful to distinguish between several forms of international cooperation and integration depending on scope (range of cooperation) and institutional capacity (procedures and intensity of mutual decision-making) of the framework under consideration. The distinction was originally introduced by Lindberg & Scheingold (1970, p. 99f.). Recently, a similar argument has been forwarded in a textbook on European Economic Integration by Jacques Pelkmans (2001, p. 23):

> "The European Community has developed in essentially three ways:
>
> - deepening of its economic liberalisation, common regulation and politics and of the commitments and prohibitions of the Memberstates);
> - widening (of the scope of its economic and other powers);
> - enlargement (of membership)" .

With regard to the reintegration issue, the main conclusion is that the ambivalence between the scope and institutional capacity dimension of integration will resist, also after a geographical enlargement. Additionally, the problem of regional imbalance within the European system will become more topical, not only from an economic, but also from a political point of view. The importance of the latter becomes manifest in the final stage of the enlargement process with the East and Central European countries both internally in the EU, here in particular in the EU summit in Nice 2000 (the Economist 2000), and with regard to the new member-states in the final negotiations at the Copenhagen summit last December (Der Spiegel 2002, 51).

The two classical problem areas stipulated in 1970 will persist. Whether the history of internal structural problems will repeat itself or not, only time will prove. The reaction in the 1970s was to extend scope at the price of serious shortcomings in decision-making and institutional capacities. This will not necessarily be supranational in a neofunctionalistic sense, but rather of intergovernmental or confederal (Sæter 1971) style, combined with the institutional structures developed in the EU-system[1]. The crucial argument with respect to the choice between a federalistic and a confederalistic approach to cooperation is that the national government still has the control over the most important areas of politics, and that unanimity still is required if joint policy has to be made[2].

In an enlargement perspective the most important impact is, that for every enlargement the decision-making structure becomes more complicated and the risk of being unable to produce necessary decisions increases (spill-back or output-failure in Lindberg and Scheingolds terminology).

The role of Greece with regard to the EU's policy toward Turkey, and to some extent Cyprus, illuminates this point. Enlargement with new members without institutional reforms, becomes a risky business, if the general principle of equal treatment and equal rights on obligations for all members is maintained. In policy areas governed by the principle of veto according to the 1966 Luxembourg accord means that the EU will be unable to act if issues are at stake considered to be of national interest. In particular latent ethnical cleavages in East and Central Europe can become a major challenge to the EU's political and economic ability to act.

Economic Integration

At the first glance problems look less complicated with regard to economic issues and economic integration. Traditionally, regional economic integration takes place between relatively similar countries regarding economic development or political traditions and institutional frameworks. As long as we are dealing with economic integration between competing countries we are in the mainstream of economic integration, which is usually considered to be the area where the change for economic gains is highest. Since the main benefits come from economies of scale, specialization and economies of scope, the classical

1. For a graphical illustration of two variants of the sketched transnational political system see figure 2 p. 535 in Chryssochoou (1997).
2. "Applied to the present Union, the term 'confederal' refers to the structure of the larger management system, suggesting that not only has the role of the member nation-states remained effective, but also that their government have found ways of strengthening their position domestically, regionally and internationally". (Chryssochoou 1997, p.524). This is still a central issue in the ongoing work for draft of a European constitution in the European Convent.

trade related advantages (trade creation) comes on the lower level of integration according to table 1below.

The taxonomy of economic integration in table x1 coincides with the institutional commitment or capacity concept discussed in the previous section. The tighter economic cooperation, the more important a joint system of policy making is[3].

Economic integration in the Baltic Rim has in many respects been a complicated task due to the fact that we are dealing with an area few years ago covered by three major - and two fundamentally different - trade blocks. The regional arrangements were very different, the ambitious EU framework, the more limited scope of the European Free Trade Area (EFTA), and the fundamental different state-trade framework of the Council of Mutual Economic Assistance (CMEA)

Table 1 Stages of Economic integration

Stage	**Definition**	**Comments**
Free Trade Area	No tariffs and quotas within group	Only negative integration, removal of barriers Framework according to GATT/WTO art. 24.
Customs Union	Common tariffs (and quotas) Suppressing discrimination for CU-members in product markets	Only negative integration, removal of barriers Framework according to GATT/WTO art. 24.
Common Market	No restrictions on factor movements No invisible barriers for trade	No positive integration
Common Market (extended)	Service sector included, all invisible barriers removed (i.e. harmonization of technical standards)	EU internal market program Elements of positive integration in specific sector policies
Economic and Monetary Union	A Common Market with some degree of harmonization of economic poicy Common Currency and Monetary system	Euro / European Central Bank Convergence criteria (i.e. inflation and budget targets) Elements of positive integration
Complete economic integration	Unification of monetary, fiscal, social and coutercyclical policies 'Supranational authority where decisions are binding for the member-states	Centralized Economic policy making, supranational institutions with joint decision making

Source: here ased on Pelkman 2001,p.8, Robson (1987) and Hansen et all. (1992, p. 4). Originally the typology was elaborated by B.Balassa in the early 1960's.

The records of the three are mixed, but not necessarily with the EU as the best performing unit according to the aims originally set up in the various agreements. Brada & Mendez (1985) compared various types of economic integration systems, including the three mentioned. In their study, based on the examination of their ability to promote inter-member

3. The concept of an economic and monetary union and the European Political Union were originally considered to be two pillars of the Maastricht Treaty of the European Union.

trade, one result was that the environmental factor inter-member distance was the most important individual factor, an important finding in a regional network perspective. Regarding the effectiveness of their integration policy, the study showed a relatively poor record for the highly institutionalized EC. The latter can partly be explained by the period of investigation, the early seventies, were most trade effects from the implementation of the Customs Union where achieved. Regarding their comparison of the CMEA with the western approaches the most interesting conclusion is:

> "Thus the combined effect of central planning and of integration policy in CMEA causes that integration grouping to under fulfill its potential by about the same amount as the EEC. Consequently it does not seem that CMEA integration policies or the system of central planning appear to be significant greater barriers to promoting inter-member trade than do politics adopted among integrating market economies." (Brada & Mendez, 1985, p. 555)

The first crucial issues regarding these roads to integration are how the structural shortcomings are solved and the process of transition can avoid serious social and political conflicts without huge transfer payments. This requires an appropriate set-up both in the accession-countries and in the EU. The problems with the reforms of the Common Agricultural Policy and the Structural funds illuminate this problem both in an EU enlargement perspective and an internal accession perspective.

A central issue in the discussions of the role of regional economic integration with regard to the formation of an international trade regime is whether regionalization has to be considered competitive or complementary to global solutions. This issue is also relevant in a reintegration perspective since close agreements with or membership of the EU, requires acceptance of the 'acquis communautaire', the total of legal rules and customs developed through 40 years of cooperation, in the accession process represented by the so-called 31 chapters. In particular with respect to competition and trade policy the direct economic impacts will be significant from the beginning in the East and Central European countries. In a longer perspective of integration similar effects will arise in the field of environmental policy, industrial policy and labor market regulations, when adaptation to the Common market level of integration takes place.

Table 1 does not only indicate an increasing level of economic integration, but also a growing need for policy coordination. In particular, the intermediate steps of integration are unstable in an economic sense, since traditional instruments of economic policy are not available on the national scene, and a joint policy-making system with supranational power is not established on Community level.

Spatial Integration

Usually, there is a strong correlation between geographic adjacency and strong economic ties. In economic theory this has not always been a part of mainstream economic thinking and analysis (Tichy, 1998).

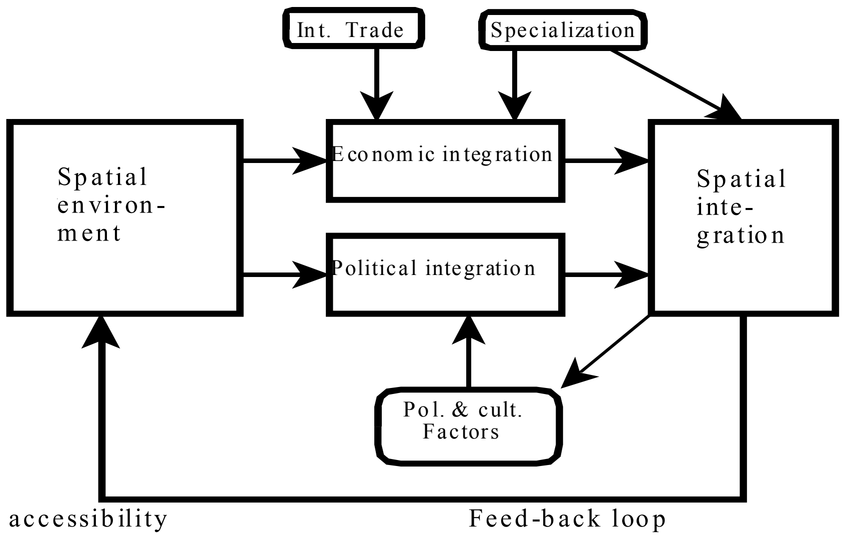
Regional integration is in many respects an ambivalent notion, varying from a very general concept that describes cooperation between nations or regions, to very specific social theories of human or organizational behavior.

Spatial integration is not a common used phrase, but rather a kind of summarizing description of a comprehensive notion dealing with an overall assessment of regional changes. Spatial integration includes features like:

- The development of specific geographical defined systems of production, such as industrial district, cluster of industries, or systems of innovation,
- A system of urban networks defined according to specific functional links,
- The availability of a relevant regional infrastructure linking the analyzed area together,
- Last but not least, the intensity of intra regional flows relative to the outside flows can be considered to be the 'conditio sine non quo' whether we talk about a spatial integrated area.

In particular the last condition is restrictive. In this notion the concept of spatial integration has to be understood as the most far reaching concept of integration. The spatial concept is not merely a consequence of the physical environment, but also the result of economic and political integration.

Figure 1 A revised concept of integration



Source: Cornett 2002a

In a continental or regional perspective we have strong evidence that political and economic integration is 'powered' by spatial proximity and adjacency, but at the same time, political and economic integration reinforce the other aspect of spatial integration, accessibility.

Figure 1 provides a brief summary of this approach focusing on the main factors leading toward spatial integration and the impact of this process on the future development through a feed -back mechanism reinforcing accessibility. The final result could be a kind of ‘network based’ (spatial) theory of integration (Gidlund 1990, p145ff). The next section will address the role of integration in the process of transition of the former state-trade-economies in the BSR.

A Framework for Transition?

Regarding the reintegration of the former state trade economies into the western dominated market economic system, the nature of the issue of complementarity and competitiveness is more complex. Historically, most of the countries are familiar with the principles of the market, and at least some of the mechanisms used in the CMEA were similar to western concepts of integration. The traditional principles of integration in the former CMEA were at least to some extend based on the exploitation of scale economies in competitive sectors of the involved countries, according to common plans within the framework of the socialistic division of labor (see Robson, 1987, 215-232).

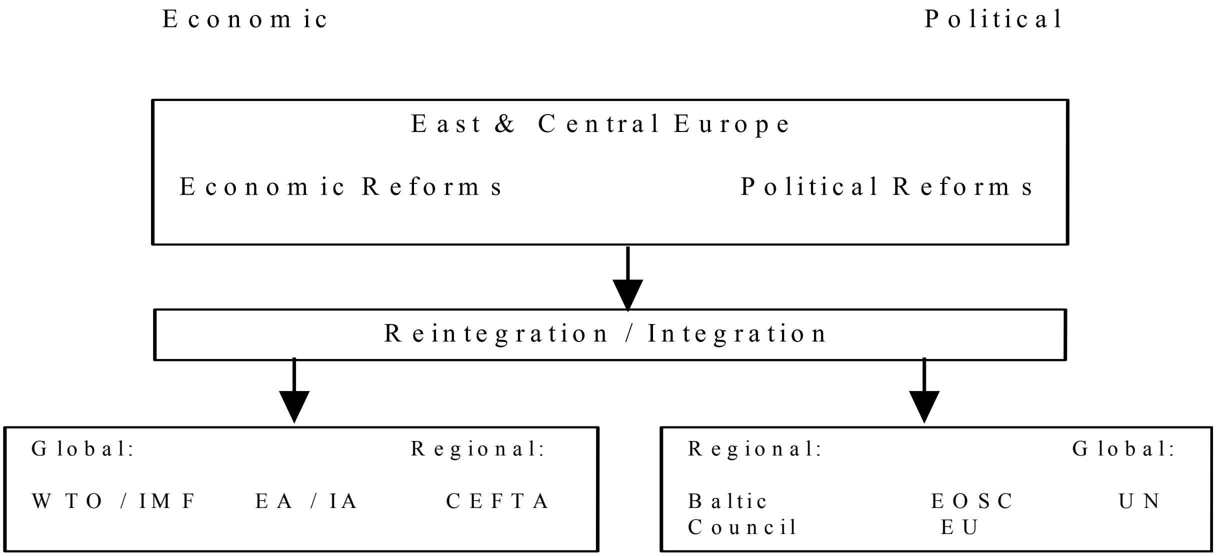
The crucial issues for the emerging market economies are that strategies reasonable in developed capitalistic countries in the sixties and in a slightly modified version when launching the Single European Market Program in the middle of the eighties are not necessarily feasible for countries undergoing a process of total societal restructuring. First of all, strategies based on multilateral trade liberalization will not work in an environment, of huge differences in economic performance and structure. The increasing competition from the established market economies will require protection of infant industries with potential harmful effects of developing a 'substandard' industrial base[4] to guarantee the development of a healthy industrial base. Experiences with the economic agreements between the EU and East and Central Europe in the first years of the accession process, proved the reluctance of the EU to grant preferential agreements in sectors within which the East European countries are potentially competitive, such as like textile, steel and agriculture (see European Economy 1994).

From a principle and a conceptional point of view, the result of our discussions so far seems to be clear. In real world politics obstacles persist. With regard to practical policy making, it can be questioned whether regional integration is an appropriate framework at all for countries which for a considerable period will rely on exports from sectors with relatively limited potential for scale economies, rather than on sectors with large potential for scale and scope economies.

The lessons of the ‘ups’ and ‘downs’ of West European integration are unambiguous. It seems unavoidable that economic and political integration has to go hand in hand, and the political part still seem to be the easiest to fulfill, i.e. “the stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities” (here quoted from EBRD 2001, p.27) of the Copenhagen principles from 1993. Only a coordinated policy in these two branches of international cooperation - both on the regional and global level - can lead to a successful and lasting result. The central brinks of these processes applied to the reintegration of East and Central Europe are summarized in figure 2.

4. Third world experiences with regional economic associations as a means of economic development have at least been mixed. (Robson 1987, pp. 194ff) See also Brada & Mendez, 1985).

Figure 2 Political and economic aspects of integration and transition



Source: Adapted from Cornett & Iversen 1993

Transition and transformation in the BSR

12 years of transition and reintegration in the BSR has resulted in huge changes in the economies of the countries, some expected some unexpected at the beginning of the 1990s. Reviewing reports on transition and transformation (see EBRD 1995 ff. or European Economy, 2001-C4) no unequivocal pattern for all transition economies emerges. Also, the BSR countries follow only to some extent the same pattern and timing. In particular in the first years Poland and a little later Estonia were front-runners. Nowadays, the three Baltic States in particular seems to be almost on the same level, at least according to the EU pre-accession evaluations, and the division into first 6 and second 6 group of accession countries has disappeared.

Analyzing the process toward reintegration has at least two aspects, the internal of domestic transformation and the external relationship toward the regional and global economic system. In practice these are closely interrelated. The focus of this chapter is mainly on the external aspects, but the institutional regime[5] for the economies is of crucial importance for economic growth and the size of income and production. They are important determinants for foreign economic relations, and are the crucial parameters for the estimation of future economic performance and the linkages to foreign markets. In the analysis of external linkages and the evaluation of the state of the reintegration process trade and foreign

5. For an overview, see the country assessments in the Transition report 2001, EBRD 2001.

direct investment figures play an important role[6]. After the break-up of the iron curtain, FDI became an obvious means in the process of reintegration and the emerging new division of labor and specialization in the region. From a structural point of view, the region consists of countries with the gravity point of economic activities within the region like the Baltic States and three of the four Nordic countries. The three largest countries of the BSR have only a minor part of their population and economic activity located in the region. For obvious reasons trade in the Baltic Rim region is dominated by Germany. The small open market economies in the Baltic Rim account for the largest per capita trade in the region. The transition economies in the Baltic Rim contribute only with a relatively small share of trade in the area. Before embarking on an economic assessment of the transition process and the regional impacts a brief assessment of the institutional impacts of the process is presented in the next section.

Institutional change and realignment

The components of the process of transformation and institutional realignment in the BSR transition economies is almost finalized, at least on the international scene, see figure 2 above. All four Central and East European Countries (CEEC's) will become members of the EU in 2004, and the three Baltic States were among the 7 new members of NATO, approved on the Prague? summit in November 2002 (Spiegel-online 2002). Economic and institutional adaptation to the EU system is on track, and the last controversial (economic) issues were solved at the Copenhagen summit in December 2002.

This does not necessarily mean that all problems are solved with regard to institutional change and realignment. According to the EBRD comprehensive index for liberalization and institutional performance and the functioning of democracy and institutional development the four CEEC's are among the best-performing countries, but huge differences persist with regard to specific indicators[7].

The Baltic States and Poland are democracies based on parliamentarism Since 1989/1991, all countries have proved that democracy is real through various changes in government. In most countries we have seen alterations between former communist parties or other left-wing groups and more traditional conservative parties. The Baltic States have a Chamber system similar to the Nordic countries; Poland is ruled by a two-chamber system. In all four countries, the prime minister is elected by the parliament. A prime minister is politically more important than a president, who has mainly honorable responsibilities. Since

6 . Usually, trade is the first step in a process of building up economic relations between distinct markets. In this perspective, FDI can be considered a process toward closer integration. In some cases, the opposite may take place, i.e. the investment of the automobile industry in Latin America in the sixties due to trade protectionism. Similar mechanisms were at work in the 70s and 80s when joint ventures between CMEA countries and western market economies became popular. In this case shortages of foreign exchange of the state trade economies and the perceived market potential of the western industry powered this process. See also Cornett 2001.

7. For details see EBRD 2001 p.17ff. Generally the early starting countries perform best. This can also explain the rather modest score of Russia, in particular on the democracy-index. In any case, these type of combined index' have to be taken only as very rough indications in a comparative perspective. A survey of each country with regard to the reform process and specific issues like financial institutions, social and enterprise reforms or privatization can be found in the country-section of the annual published transition report of the European Bank Reconstruction and Development (EBRD).

1993, Russia also has a two- chamber system, ruled by democratic principles. The main difference between Russia and the four other countries is that Russia has a very strong presidency with a direct elected president and that Russia is a federation of Russia, 21other republics and 11 autonomous regions[8].

Economic transition and linkages in the BSR

The process of catching up on the income level in the EU requires not only political and economic reforms, but also excessive economic growth to reduce the gap[9].

Table 2 shows that Poland has been ahead of the other transition economies in the BSR in the mid-nineties. With regard to the Baltic States the picture is mixed, but the most recent numbers (and forecasts) indicate a relative high growth performance. A comparison with the old market makes the saliency of the catch-up problem evident, since the excess growth compared to the traditional market economies in the region seems to be rather modest.

As mentioned above, trade is usually the first type of link between independent economic units, and therefore it is also often the most sensitive indicator of changes in the economic environment. The redirection of foreign trade was also a first and most significant change after the dissolution of the CMEA in 1991. Historically, trade flows in the Baltic Rim have suffered from the artificial economic borders between economies in the area. This does not mean that the region historically - at least not for the last hundred years - has constituted a functional internal coherent region. In the seventies and eighties the region belonged to three different economic associations, the market based EU, EFTA, and the CMEA, the latter being based on non-market principles. The economic border between the two former did not have major importance on trade flows for most groups of commodities.

Table 2 Economic Growth in the Baltic States and Poland

Annual change in GDP at constant prices								
	1995	1996	1997	1998	1999	2000	2001E	2002F
Estonia	2,9	3,9	10,6	4,7	-1,1	6,9	5,3	4,7
Latvia	-0,8	3,3	8,6	3,9	0,1	6,6	7,9	4,5
Lithuania	3,0	4,7	7,3	5,1	-4,1	3,9	4,5	3,5
Poland	6,9	6,1	6,9	4,8	4,1	4,0	1,5	1,9
CEEC-10	5,2	3,9	3,5	2,3	2.2	3,7	3,1	3,1

Note: E: estimates, F: forecast

CEEC-10: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia & Slovenia

Source: 1995: European Economy 1998 C-2 1996-1999: European Economy C-4, 2000- : European Economy 2001-2) For CEEC-10 1997 & 1998 European Economy 1999-C4

8. Information based on Spiegel Almanach 2000 and Spiegel Jahrbuch 2002 (www.spiegel.de).
9. For detailed analysis of this problem, see Agenda 2000 'Reinforcing the Pre-Accession Strategy' and the specific country-studies in European Commission 1997b.

Table 3 Share of intra regional trade as pct. of total trade of Baltic Rim Countries since 1992

	1988	1992	1996	2000
Denmark	39,8	48,7	42,5	40,9
Estonia	…	92,0	68,8	55,1
Finland	51,3	41,7	35,2	49,3
Germany (FRG)	13,5	8,6	9,3	9,6
GDR	24,6	…	…	…
Latvia	…	61,8	48,8	45,9
Lithuania	…	57,8	46,1	33,3
Norway	35,2	35,9	36,9	65,6
Poland	46,7	47,4	48,2	29,7
Russia	34,1	18,9	21,5	75,2
Sweden	37,5	35,5	32,2	39,4
Baltic Rim	26,5	17,9	18,9	19,9

Note: Figures based on exports to Baltic Rim countries as pct. of total exports. All figures are based on reported imports from receiving countries. Danish exports to Sweden 1992 are based on Danish exports. For 1992 some figures are missing for former state trade countries. 1998 figures based on export to GDR and SU. Figures for GDR trade with Germany and SU 1988 are based on German sources and converted to US-$ based on annual average exchange rate at Frankfurt (ultimo 1987 and 1988).
Source: IMF 1995, 1998 & 2001. Statistisches Bundesamt 1991.

The division between market and non-market based trading frameworks was much more important, and the redirection of trade flows took mainly place with regard to trade between the countries belonging to the former East block, the Nordic countries, and Germany. Table 3 above illuminates this process based on intra-regional trade-flows for the BSR. The most important trend is that the Baltic Rim region is the dominant foreign trade partner for the smaller economies only. Considering the nature and the size of the German economy, the importance of the Baltic Rim as a geographical region diminishes further. With regard to future trends of trade, the three Baltic States will probably move toward a trade pattern more similar to the Nordic countries, and find their historical place in the regional trading system (Laaser & Schrader 1992). The reorientation of trade, visible in table 3, has to be interpreted carefully due to the significant decrease of the foreign trade volume immediately after the break-up of the CMEA. With regard to Poland, a broader European orientation seems likely. In an integrative perspective, the development of linkages beyond trade is of special interest as an indicator of a stable and lasting relation.

Table 4 Foreign Direct Investment (net inflow in millions of US-$)

Year	Poland	Estonia	Latvia	Lithuania	Russia
1992	284	80	n.a.	n.a	n.a.
1995	1.134	199	245	72	1.663
1996	2.741	111	379	152	1.665
1997	3.041	130	515	328	4.036
1998	4.966	574	303	921	1.734
1999	6.348	222	331	478	746
2000(E)	9.299	324	398	375	-346
2001(P)	7.000	350	300	450	2.000
Cumulative inflow 1989-2000	29.052	2.008	2.498	2.387	9.998
Cumulative inflow 1989-2000 per capita US-$	751	1.400	1.056	646	69
In pct. Of GDP 2000	5,9	6,4	5,6	3,3	-0,1

Note: Net inflows as recorded in balance of payments. Gross inflows of FDI are in some cases considerably higher than net inflows on account of increasing intra-regional investment flows.
Source: IBRD 2001, Table A.3.9

Foreign direct investment can be the result of barriers to trade (i.e. the case of the automobile industries investments in Brazil or Mexico in the sixties or many joint ventures with state trade countries before 1990), or they can be the result of an integrative process beginning with trade and ending up in the creation of an integrated system of production. Since the BSR is in a process of fast removal of trading barriers foreign direct investment is used as an indicator of more formalized international integration of the economic systems[10]. Table 3 summarizes the FDI inflow to the transition economies in the BSR. In particular Estonia has received a considerable amount compared to the size of the population. Also Latvia has received over 1000 US-$ per capita. The figures for Poland and Lithuania are significant lower per capita, but not measured by absolute figures. In particular net inflow to Lithuania has increased in the late 1990s. Poland and Russia, the two transition economies not fully being a part of the BSR, are of course the largest net receivers of FDI, with Poland as the largest target.

Considering internal flows of FDI the pattern is similar to trade, but the figures must be used very carefully due to lack of data, the methodological problems involved in the process of data collection, and the period of the flows. Nevertheless, the Baltic Rim economies' importance for FDI in the three Baltic States is evident. This can be considered to be at least a weak indication of increased participation in the regional system of divisions of production, due to the fact that most trade barriers has been removed or are in the process of becoming obsolete. In particular with regard to the regional dimension FDI seems to reinforce

10 . For an assessment of firm-behavior concerning intra-regional FDI, see Snickars & Bourennane (2000)

spatial concentration at least in the Baltic States.[11] Overall it's only possible to evaluate FDI patterns in a regional context based on national statistics for the smaller states in the region. I.e. the strong position of the German economy, and in particular of the non Baltic Rim part, has to be taken into account. Based on GDP, the Baltic Rim part of Germany counts only for 8,3 % of the German GDP in 19912[1]. Similar problems can be found with regard to Poland and Russia.

Regional convergence and transition in the BSR

All countries have regional and economic disparities, and its not always the absolute level of differences which matter politically. In a European perspective, perceived disparities have been effected by real economic differences (i.e. differences in economic growth), statistical measures and of course the increasing number of countries in the EU. The last factor has been a decisive issue in the enlargement negotiations up to the Copenhagen summit together with in particular the future of the Common Agricultural Policy. Without any doubt, one of the single most important factors affecting the statistical level of convergence - or the growth of regional disparities - has been the consecutive enlargement of the EU, see table 5 below. Regional disparities and regional coherence are complex concepts, and empirical measurements often depend on the indicators chosen. Nevertheless a slight trend toward convergence has been reported in several studies based on income per capita figures[13].

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11. A study by Snickars & Bourenname (2000) of investment behavior of Nordic companies in the Baltic state and Skt. Petersburg showed a heavy concentration in the four major cities.
12. Another figure can illuminate the point. In 1996, export as percentage of total turnover in the German manufacturing sector was 29,7 %. In the three Baltic Rim states the figure were in Hamburg: 11,9%, in Schleswig-Holstein 26,0 and in Mecklenburg-Vorpommern 10,6 %. (IdDW 1997, Table 4).
13. "The next approach is to check whether there has indeed been a reduction of disparities. In other words,to what extent regional wealth levels (measured as income per capita) have converged. There has recently been a revival of interest in the issue of convergence, ... All these studies find a long-term convergence of regional income levels, although they differ in their conclusions as to the speed of the process and the causal factors. In recent years the trends towards convergence, that is lower disparities, has leveled off (Molle et al. 1980, Molle and Boeckhout 1995; CIC 1996). However, the aggregate figures hide important developments for individual countries. Particularly interesting is the case of Ireland. The growth of this country has been so substantial that it is no longer eligible for objective 1 status (it's GDP/head is now higher than 75 % of the EU average). (Molle 1999, p.154).

Table 5 Variations in GDP per capita, current prices, lowest, and highest country score (EU=100)

		1961	1973	1986	1995	'2000+'
EU-6	'highest'	152 (117)	142 (120)	125 (113)	173 (117)	184 (108)
	'lowest'	69	66	84	69	85
EU-9	'highest'		152(135)	132 (135)	182 (145)	178 (136)
	'lowest'		54	64	72	85
EU-12	'highest'			147 (149)	197 (152)	192 (1479
	'lowest'			32	48	50
EU-15	'highest'				195 (150)	190 (145)
	'lowest'				48	50
EU-27	'highest'					233 (178)
	'lowest'					7

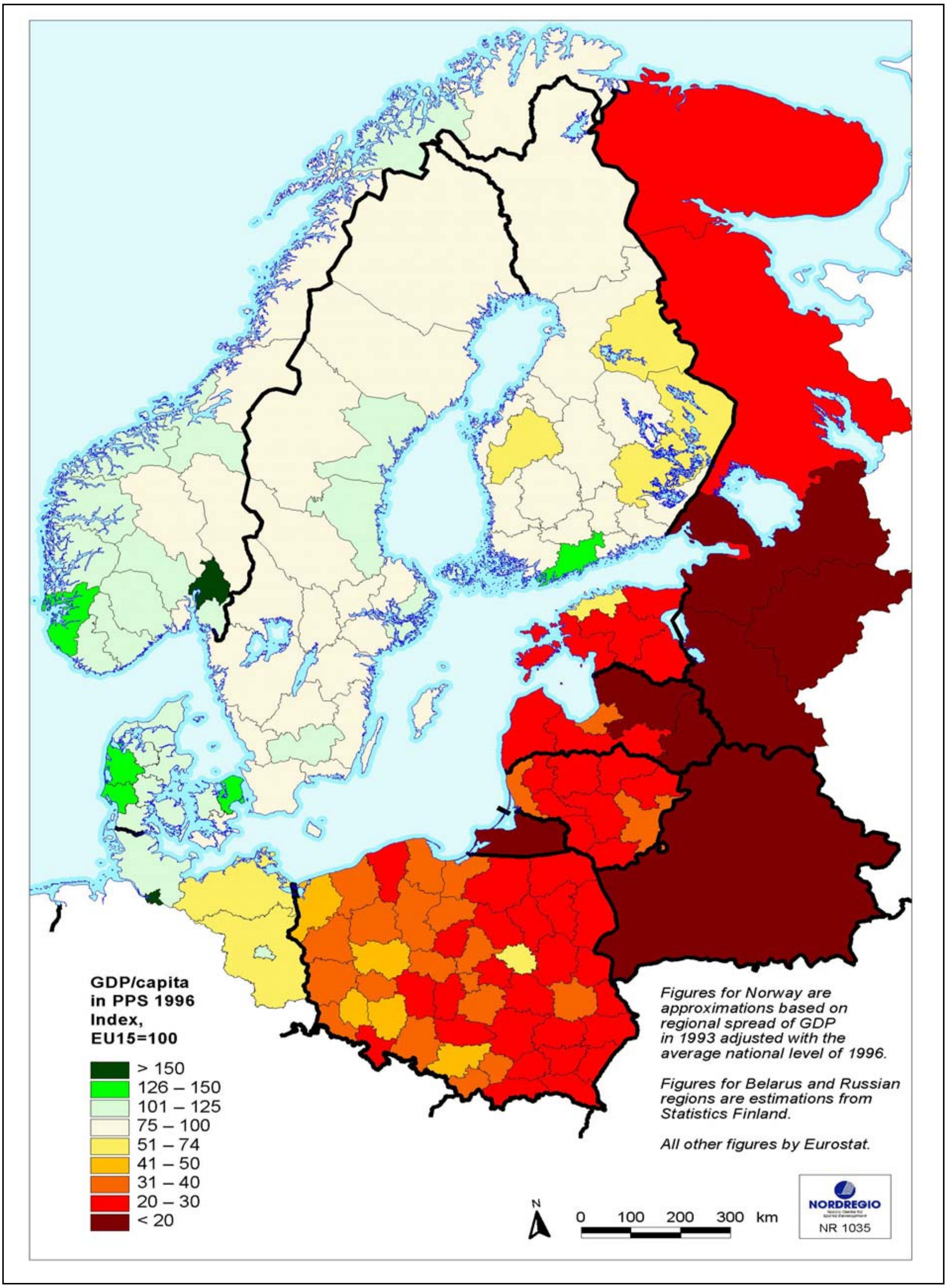
Note: ( ) Figures without Luxembourg, 1986 without Denmark '2000+': Calculation based on 1998 figures. Tentative estimations converted from national currencies according to average annual exchange rates for EURO/ECU. Figures for non EU-members converted from US-$.
Source: here quoted from Cornett (2002b).

Long-run changes in the geographical distribution of economic activity are unavoidable in dynamic societies, and in particular in regions of regional economic integration. Some regions will gain, others will loose economic activity and employment. The purpose of this section is briefly to address the issue of regional diversion in a BSR context.

The figures of table 5 prove a tendency toward reduced disparities between the countries that have been members of the EU since the beginning or have entered the Community early (the 1973 enlargement). Reading table 5 horizontal, the level of disparities measured over time can be found for each group of EU-member-states. If Luxembourg is omitted from the analysis, the gap in 1998 (2000+ scenario) is reduced to less than 25% of the average for the original 6 EU members. Nevertheless, reduced disparities - measured by GDP per capita - on the national level do not necessarily mean a more equal development if the analysis is made on a more disaggregated level[14], but is still a useful indicator for the overall development.

14. See e.g. Dunford (1994), Molle (1999), Armstrong (1995)

Figur 3 Regional disparities in the BSR



Source: Nordregio (www.nordregio.see)

Table 6 Regional disparities in BSR countries 2000 (GDP per cap. PPS)

	National average		Richest BSR region		Poorest BSR region	
	EU-15 100	EU-25 100	Name	Index EU-15		Index EU-15
Germany	106,4	117,3	Hamburg	181,5	MVP	69,4
Denmark	118,6	130,7	…	…	…	…
Finland	104,0	114,6	Uusimaa	143,2	Väli-Soumi	74,5
Sweden	106,6	117,5	Stockholm	147,0	Norra Mellan	91,0
Poland	38,9	42,8	Pomorskie	39,1	Wamin-sko Maz.	29,0
Lithuania	35,7 (29)	39,3	Vilnius	(35)	Taurage	(22)
Latvia	30,9 (26)	34,0	Riga	(37)	Latgale	(16)
Estonia	40,1	44,2	Közép-Mag.	75,6	Észak-Alföld	31,5
Russia	…	…	…	…	…	…

Note: Germany: Schleswig Holstein, Hamburg, Meklenburg Vorpommern (MVP). Poland: Pomorskie Waminsko Maz. Kujawsko-Pomorskie Figures for Lithuania and Latvia: (1996).
Source: European Commission 2003, Table 12. Nordregio 2000

A careful inspection of the regional map of the BSR (see figure x3) paints a more realistic, but less unequivocal picture. In a BSR perspective, the main income disparity problem coincides with the old East-West division. From a structural perspective, we nevertheless also face huge regional problems in a geographic North–South perspective due to huge depopulation problems in Northern Scandinavia and Finland (Hanell 2000).
Within the former state trade economies we also find huge regional differences – of course on a much lower level than in the western part of the BSR. A report from Nordregio (2000) stresses in particular the huge differences between the capital and metropolitan regions and the countryside in the Baltic States. Similar patterns are found in Poland and the BSR part of Russia.

In table 6 the intra-regional differences are summarized by comparing the richest and poorest regions in the BSR countries based on NUTS II regions of the EU regional classification were applicable or national data similar to EU NUTS III level. Within all BSR countries huge regional disparities exist, but due to differences in the regional system and the principle of delimitation this can only be taken as a rough indication of the problem. The most interesting measure is probably to compare the poorest region with the national average rather than with the best performing area, often a rather narrow defined metropolitan region heavily depending on commuting from suburbs outside the city-limits. No unambiguous pattern is visible. The lowest score is found in Germany and Latvia (65 vs. 61), the highest in Sweden

(85) and Estonia (78). It seems that the explanation has to be found in patterns of urbanization and regional division rather than transition and development.

The BSR in the European Regional System

More then ten years after the start of the process of transition in the Baltic Rim and Europe as whole, huge changes has taken place, both internally in the transition economies and in the political and economic relations between the countries. Economically, the former CMEA has disappeared: The EU is now the unchallenged hub in the economic system of the BSR. Poland Lithuania, Latvia and Estonia will become members of the EU 2004, and also Russia has developed closer ties to the EU, in particular since Putin became president. For the BSR as a whole regional consolidation is almost finished. Finland and Sweden are now members of the EU, and Norway is closely linked to the internal market through the European Economic Area agreement. For the transition countries this process has not been without obstacles and drawbacks. No paved road leads from an isolated non-market based economic system to a position as full-fledged member of the western market based economic system. The purpose of this article is to assess the development in the BSR, to identify some of the trends of the past thirteen years. Main trends identified in the last decade are:

- Overall, the analysis of the pattern of trade – and to some extent also the changes in the composition of the traded commodities confirm the tendency toward an adaptation of the patterns found in the EU as a whole or the between the old market economies in the western part of the Baltic Rim.
- One important tendency we have seen, is that trade patterns and economic links in the BSR is undergoing a significant change, and for the transition economies converting toward the West European patterns.
- The second result is that this conversion takes place with a slower pace and at a lower level than expected in the early nineties. A closer look on the nature of this trade proves that huge differences persist, but that there are signs of leveling the disparities.
- For the transition economies in the BSR (i.e. Latvia, Estonia, Lithuania and Poland) the analysis of intra-industry trade indicates that they have embarked on a catch-up process with regard to an adaptation to the European market based system of production. They are still far behind the old market economies with regard to volume and intensity of participation in the international division of production (Cornett 2002c).

It is still not possible to sketch a comprehensive picture of the development in the BSR since 1989. Too different has the path of development has been followed in the transition economies. In particular the speed and timing of transformation has been different. Nevertheless the direction seems to be the same, and with regard to adaptation to the EU chapters also the previously slower countries have catched up. Out of the 31 chapters in the accession process, the Baltic countries and Poland had fulfilled between 19 (Estonia) and 16 (Latvia) at the end of 2001 (EBRD 2001, p. 27). With regard to the economic development in the BSR and in particular the transition economies, important features are that the potentials for trade often were overestimated in the first years of transition. Intra-industry trade analysis of the transition economies in general and the BSR region in particular supported these findings with regard to an emerging new system of specialization, at least in some sectors. A tendency toward adaptation and integration of the transition economies since the early nineties is identified, but the latest figures point toward a slow down in the speed of the process, and the level of intra industry trade is still much lower than between the old BSR market economies or the EU as a whole (see Cornett 2002b).

Overall, this means that an analysis of a subsystem based on a concept of integration seems to be fruitful and can contribute to the understanding of the problems and potentials of the Baltic Sea region system. With regard to the question whether regional specialization can be a substitute for global specialization the answer is ambitious.

A tentative conclusion is that the processes are complementary rather than mutual exclusive. Further research of the linkages and pattern of cooperation between sectors of the economy and countries are needed, as well as in depth investigations of the impacts on the emerging new systems of production on the regional and firm level.

The review in this paper indicates a potential for regional solutions in the BSR, despite of the fact that the region not constitute a distinct functional region in the traditional sense. Almost all countries have stronger links to the outside world then to partners within the area. Nevertheless the BSR is a separate region within the European spatial system.

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