

Preconditions for Sustainable Growth in the South-Eastern Baltic Sea Region

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Agenda

- Sustainability
- Economic growth defined
- The importance of economic growth
- The factors behind economic growth
- The triggers of economic growth
- The location of economic growth
- The preconditions for growth in the south-eastern Baltic Sea region

Sustainability according to the Brundtland report

- Sustainability = development by which societies today meet their needs without compromising the ability of future generations also to meet their own needs.

Critique of the Brundtland definition of sustainability

- Too often, people interpret the Brundtland definition exclusively in biophysical terms, and thus concentrate on conservation of physical resources, the protection of human health, the maintenance of stable ecosystems, and so on.

A broader definition of sustainability

- Achieving sustainability entails balancing the environment, the economy and social equality.
- To endure on a sustained basis, a society needs fair access to good jobs and economic resources, and it must factor into its economic accounting the consumption and destruction of environmental resources – especially those that are irreplaceable.

Economic growth defined

- An increase in a nation's or a region's production capacity, i.e. in its capacity to create value added.
- Economic growth can be measured in terms of the change over time in the potential gross domestic product (GDP) and the potential gross regional product (GRP), respectively.

A framework for growth

- A well-developed institutional framework:
 - constitutions, laws and regulations
- Well-defined and enforceable property rights
 - ownership rights, possession rights, rights to receive, rights to use, rights to enjoy the fruits of one's work, creativity, knowledge, and the value of one's ideas
- Low transaction costs
 - information, negotiation, monitoring and enforcement costs

Why is economic growth important?

- Economic growth is the only means human societies dispose to increase real incomes, and hence the standard of living
- Economic growth is necessary to combat environmental damages and decay, to increase the provision of public services, such as health care, elderly care, and education.

The factors behind economic growth

- Economic growth can be achieved by
 - An increase in the availability of, i.e. investments in production factors and/or
 - An increase in the efficiency in the use of available production factors, i.e. in the productivity
- In the long run can sustainable growth only be achieved through increased productivity

Which are the production factors?

- Real capital
 - Machines, buildings, transport equipment
 - Infrastructure
- Labour
 - Labour force
 - Human capital
- Knowledge

The special role of knowledge in the economic growth process

- Conventional factors of production are both rivalrous and excludable
- Much knowledge has the character of a pure public good that is both non-rivalrous and non-excludable
- Investments in knowledge, i.e. in R&D, benefit many producers and forms the basis for an endogenous economic growth

Productivity can be improved through

- The introduction of more efficient production methods:
 - Embodied technological change (= more advanced machines)
 - Disembodied technological change (= better organised production)
 - Learning-by-doing (increased efficiency in current work practices)
- Structural change (= introduction of more efficient production units and/or elimination of inefficient production units)
- The introduction of more valuable products

Which are the triggers of economic growth?

- Demand-led growth
 - Domestic demand
 - Export demand
- Supply-led growth
 - Innovation-led growth
 - Import-led growth

The location of economic growth

- Economic growth is a spatial phenomena
 - It is localised to certain regions
 - Not all regions can or will play the same role in the economic growth process
 - Hence, it is in particularly necessary to study economic growth at the regional level.

The importance of internal scale economies

- In principle, all types of economic production is characterised by internal scale economies, due to the existence of fixed production costs
- The existence of internal scale economies makes the size of the regional market potential crucial for the possibilities of different firms to operate with positive profits

The importance of geographical transaction costs

- Some products (goods and services) have high transaction costs which means that they will only be transacted intra-regionally
- Some products have low transactions costs which means that they can be transacted also inter-regionally and in many cases exported to any place of the globe

Internal scale economies and high transaction costs combined

- Products with internal scale economies and high transaction costs are strongly dependent upon the intra-regional market potential
- They will only be produced in regions that have a high enough market potential
- This means that larger regions will host many more different industries than smaller regions, and thus offer a more differentiated supply of goods and services.

Regional economic growth as a cumulative process (1)

- Since many products are characterised by internal economies of scale and high geographical transaction costs they will prefer to locate in regions with a large intra-regional market potential
- Since many firms prefer to locate in regions with a large market potential these regions tend to grow increasing their market potential still more.
- A larger market potential will attract more scale dependent firms to locate there, and so on.

External economies of scale of two kinds:

- Localisation economies = benefits accruing to firms producing the same or similar products locating to the same region
- Urbanisation economies = benefits accruing to firms locating in large urban regions

Localisation economies

- Shared information about markets, technologies, inputs, etc
- A shared labour pool with skills pertinent to the industry in question
- The localisation of specialised input suppliers

Urbanisation economies

- A large diversified and highly qualified labour pool
- A large and diverse supply of firms offering specialised business services and specialised material inputs.
- Good access to research universities and R&D institutes

Regional economic growth as a cumulative process (2)

- Regions offering localisation or urbanisation economies attract firms dependent upon such economies
- The localisation of more firms, i.e. the formation of clusters, increases the localisation (urbanisation) economies in these regions and make them more attractive for firms dependent upon external scale economies, and so on.

Regional economic growth as a cumulative process (3)

- Due to the existence of internal economies of scale every manufacturer will prefer to locate in one single location
- In order to keep transport costs low, the manufacturer will prefer a location with a large regional demand
- However, the regional demand will be large precisely where the majority of manufacturers choose to locate

An alternative explanation to the clustering of firms

- The potential to benefit from knowledge spill-overs from other firms producing similar products can be a major inducement for firms to locate in a given region.
- When more firms locate in a given region the probability of knowledge spillovers increases and makes the region more attractive as a location, and so on.

What is a region?

- With a region we understand a functional region, which consists of one urban centre surrounded by a hinterland (some regions have two or more centres).
- A functional region is most easily defined as a commuting region with a commuting time limit of 50-60 minutes single trip
- In most cases a functional region is made up of several administrative units (e.g. municipalities)

What is a functional region?

- A functional region is
 - A regional labour market
 - A regional market for household services
 - A regional market for business services
 - A home market for many firms (in particular, those producing products with high geographical transaction costs).

The market potential of a functional region is critical for its growth potential.

- How can we increase the market potential of functional regions?
 - By stimulating more firms and people to move to the region
 - By extending the borders of the functional region through investments in infrastructure and improvements of public transport that reduces commuting times
 - By improving the income level in the region through higher education and by stimulating firms with a high productivity to establish in the region

Preconditions for sustainable growth in the south-eastern Baltic Sea region:

- Strengths
- Weaknesses
- Opportunities
- Threats

Strengths of the south-eastern Baltic Sea region

- A labour force with a good basic education
- Closeness to high-income markets in North and West Europe
- A strong willingness to catch-up
- A coming integration in the EU
- A low wage level

Weaknesses of the south-eastern Baltic Sea region

- Too many and too small functional regions
- An underdeveloped intra- and inter-regional infrastructure
- Too few people with a western style higher education
- Not necessarily a low cost level
- A lack of high-quality export products

Opportunities for the south-eastern Baltic Sea region

- The region could become
 - the Taiwan of Europe or the Ireland of Eastern Europe
 - the labour pool of aging economies in Western Europe
 - the shopping, entertainment and service centre of Europe, or
 - perhaps all three things at the same time

Threats to the south-eastern Baltic Sea region

- No entrepreneurial tradition
- A too low savings ratio in the region and in the rest of Europe
- Low economic growth within EU-15
- An unwillingness in the current EU countries to open up labour markets for people from the south-eastern Baltic Sea region
- A continuation of terror acts decreasing the willingness to travel

Policies for sustainable growth in the south-eastern Baltic Sea region (1)

- There is a strong need
 - To increase higher education in technical and economic sciences
 - To improve intra-regional transport infrastructure and public transport to improve the functioning of regional labour markets
 - To improve the road infrastructure in strategic transport corridors giving access to markets in EU-15

Policies for sustainable growth in the south-eastern Baltic Sea region (2)

- There is a strong need
 - To encourage import and use of new advanced products, which can stimulate the development of new export products via imitation
 - To extend and improve language training to make jobs in EU-15 accessible for educated labour in the region and to facilitate exports, imports and the development of the tourism industry

Policies for sustainable growth in the south-eastern Baltic Sea region (3)

- There is a strong need
 - To develop the tourism industry in the region in terms of hotels, restaurants, shopping facilities, entertainment, museums, sights, monuments, beaches, and so on.
 - To facilitate structural change within and between sectors with labour retraining programs and subsidies for inter-regional labour mobility

Policies for sustainable growth in the south-eastern Baltic Sea region (4)

- There is a strong need
 - To develop a comprehensive regional planning in all functional regions in the region to secure that there is a coordination between investments in housing, in industrial estates and in intra-regional transport infrastructure. This planning must consider the preservation of urban, cultural and natural assets. The development of urban centres must be given special priority to promote both tourism and the willingness of qualified labour to stay in the different functional regions.

Policies for sustainable growth in the south-eastern Baltic Sea region (5)

- There is a strong need
 - To stimulate the formation of industrial clusters to achieve localisation and urbanisation economies
 - To accept a concentration of population in growing functional regions
 - To allocate enough funds for investments in housing and intra-regional infrastructure in growing functional regions