Chapter 20

Urban Transformation in the Capitals of the Baltic States: Innovation, Culture and Finance

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City governments everywhere are keen to ensure, as far as possible, that their economies replace lost jobs in declining industries as quickly and efficiently as possible. In that quest, new perspectives on the role and function of hitherto relatively passive elements in the urban fabric such as cultural facilities, banks, and universities have been projected. They are now, increasingly, seen as hubs of the microeconomy around which many other activities, all with economic value, coalesce. In what follows, this view will be explored from a number of angles. The main thrust is an analysis of the emergence of fast-growth industries in the three capital cities of the Baltic States which have undergone significant economic restructuring in recent years. In the original research, the Baltic cities were compared quantitatively and qualitatively with three regeneration cities of similar size in peripheral western Europe: Cardiff, Dublin, and Tampere.

The evolution of these cities in three key subeconomies centered upon cultural industries, financial services, and innovative, high-technology industry – all of which show fast employment and turnover growth – is described for the three Baltic capitals of Tallinn in Estonia, Riga in Latvia, and Vilnius in Lithuania. It is shown that the performance of the Baltic cities is highly variable but by no means as lagging as might be anticipated given their relatively recent liberation from state socialist management under the Soviet Union regime. All three show considerable strength in respect of cultural and innovative industry, though as yet relative stagnation in financial services. The empirical accounts are preceded by a review of key literature on fast-growth industries.

Review of Urban Growth Opportunities

Innovation activities

Recent research shows that some 80–90 percent of GDP growth is explained by the innovative activities of firms and other organizations with respect to product, process, and organizational innovation (Freeman 1994). Most of this activity occurs in or near urban settings and depends upon the capacity cities provide for interaction

among diverse innovation actors and organizations within the large firm, between customer firms and suppliers, and among firms, research institutes, and university research laboratories. Writers such as Krugman (1995) have shown, theoretically, how urban concentration helps minimize knowledge imperfections and uncertainties among economic actors, and offers increasing returns to scale for those firms advantageously located in cities, where information intensities are highest. Thus cities and their nearby surroundings offer competitive advantage which, in turn, as Porter (1990) shows, derives fundamentally from spatial clustering of industries and the various support mechanisms, such as related input or output sectors, enterprise support services, and access to know-how, available in city or regional settings.

Competitive industries are, on the whole, innovative and likely to demonstrate a high capability for survival. It is widely believed that innovative firms in high performance or high technology sectors also tend to be associated with higher than average GDP and employment growth. Thus research conducted on employment growth in the world's leading high-technology complex at Silicon Valley in California showed that while total manufacturing employment grew from 131,000 in 1970 to 272,000 in 1985, high-technology employment grew (within those totals) from 52,000 to 215,000 over the same period. In other words, high-tech growth rates, measured in employment, were twice as high as already generally above-average growth in non high-technology sectors which were, nevertheless, secondarily associated with computing, communications, semiconductors, components, instruments, and software firms as input suppliers (Castells and Hall 1994).

The key sources of innovative firms are usually spin-offs from already existing firms and from university research laboratories (Dorfman 1983). The literature on the latter is extensive, that on the former less so. Four key points characterize the main argument regarding what Smilor et al. (1993) call the "entrepreneurial university." At a general level, first, the growth of a "knowledge society" means there is a greater valuation than hitherto of the importance of research results as a source of business opportunity. There is a rapidly growing market for scientific and technological knowledge. Second, universities and individual "academic entrepreneurs" are increasingly at the core of a cluster of local and global linkages through which knowledge is exploited. This ranges from industrial research contracts to consultancy and spin-off company management. Third, there is an accompanying growth in demand for secondary services associated with this process, including the expansion of industrial liaison functions, support for spin-off management training, patenting, and other intellectual property support and "campus company" foundation – the last as a means of managing business generated by academic enterprise (Dill 1995). A fourth, especially important element is the role of *science parks* in facilitating and promoting the formation of new-technology businesses. Modeled on the first successful one at Stanford University, these were supposed to be a key catalytic device for transferring abstract knowledge into commercial innovations. Left to the market, they tend to be relatively unsuccessful, but combined with support services like management training, business networking, and product marketing they have been shown to be highly successful (Jones-Evans and Klofsten 1997).

Culture industries

In a partly comparable way to that in which a long-established and traditional institution like a university may now be seen performing a catalytic economic role in the knowledge society, so there is now a wide recognition that traditional cultural facilities and activities have a catalytic economic role in the urban economy. Taking the three major US cities of New York, Los Angeles, and Chicago, Zukin (1995) showed that between 1980 and 1990 there had been a 34 percent increase in the employment of creative artists from 202,000 in 1980 to 270,000 in 1990, a phenomenon that has continued into the mid- and late 1990s. Among the larger categories of change in terms of creative occupation during that period were actors, directors, photographers, authors, designers, and architects. Of course, these aspects of the "symbolic economy" are responsible for a secondary employment impact upon demand for urban services such as accommodation, restaurants, transportation, and retailing. Given that it is widely accepted that there is a cultural industries multiplier of around 2 (Myerscough 1988), Zukin's estimate of a 68,000 employment increase for just the three major American metropolitan areas, in terms of core cultural industries employment, translates into an overall ascribable ten-year increase of 136,000. A rate of employment increase of over 13,000 per year compares favorably with the 11,000 per year increase in Silicon Valley's high-tech complex during the 1970–85 period.

Thus, culture, arts, and entertainment have come to be looked upon as a "new industry" with enormous growth potential. A study of Cologne showed that between 1985 and 1991 administrative budgets for the arts and culture grew by an average 34 percent while those for science and research declined by exactly the same percentage. This echoes a recognition by urban government of shifts in both latent and expressed demand for expenditure. The scale of urban governmental expenditure on cultural activities was, in 1991, some DM2 billion for cities of 500,000 or more in Germany (Friedrichs 1995). Cologne was by no means at the top of the ranking in terms of expenditure. Hamburg at some DM1,000 per inhabitant led the expenditure table, followed by Frankfurt (DM900), Stuttgart (DM395), Cologne (DM312) and Munich (DM237).

All of this points to the growth capability associated with "creative cities" (Landry et al. 1995). A keynote of this thinking is that "Historically, creativity and innovation have always been the lifeblood of our cities" (1995: 1). Cutbacks in expenditure of the kind suffered by German cities in the early 1990s also mean that artistically creative organizations have had to become more entrepreneurial in seeking to convince private financiers to invest in or sponsor their activities. The creative city is very much compatible with the innovative city, the latter perceived in terms of its incubator function regarding technology-intensive firms.

Financial services

The third growth industry of the 1980s–90s has been financial services. Although the boom of the 1980s has passed, to be followed by significant retrenchment in the early 1990s, there are signs that growing confidence following that recessionary period is, in cyclical terms, boosting the financial sector once again. Within financial services, the one important segment which has been growing despite the

vicissitudes of financial services in general is "producer services." Producer services incorporate financial and other business services which act as inputs for other businesses. Output is frequently customized, nonroutine, and information-intensive and is provided by brokers, financial analysts, investment bankers, legal professionals, accountants, computer scientists, and specialist software analysts (Drennan 1996).

Key characteristics of such areas of the "symbolic economy" (Reich 1990) are that workforces are highly qualified, the industries involved are often creative and innovative, overlapping to some extent with the kind of innovative technology-intensive firms spinning out from universities or other research-based organizations. Employees receive higher than average incomes, a substantial proportion of the discretionary element of which is spent in the cultural economy of the arts, theater, and music and its secondary flotilla of activities in the nighttime economy. There is thus an interesting overlap at both the production and consumption end of the activities of the producer services economy with the spheres of the cultural economy in the creative city and the innovative economy in the "learning city." Like these two flanking economic spheres, the producer services economy-culture is one of highly developed social networks, highly attuned learning propensities, and high spatial clustering, facilitating the moderation of transaction costs by the trustful exchange of tacit knowledge as well as the more normal arm's-length exchange of contract-based market transactions in codified knowledge.

As Drennan makes clear, and is in any case well known, producer services activities are most highly concentrated in the very large global financial centers of London, New York, and Tokyo, though there is a hierarchy of lesser, though still major cities, specializing in particular markets. In each of these cities, producer services activities are key motors of their urban economies. Growth in producer services in London was 300,000 between 1971 and 1989, in New York also 300,000 from 1969 to 1994, while in Tokyo employment increased from 381,000 to 741,000 between 1969 and 1991. On average, therefore, the annual increment in producer services employment in the three key global cities over the decades of the 1970s and 1980s was 16,000 in London, 12,000 in New York, and 16,000 in Tokyo, a tri-city total per annum of 44,000 new jobs.

The Learning Economies: Tallinn, Riga, and Vilnius

It would be surprising if either the sources of information, the economic development processes, or the promotion policies of the urban or national governance bodies in the Baltic cities were to be of the same order as those, relatively sophisticated, action lines pursued in the West. The research approach adopted caused questions such as the ones explored thus far to be broached for the first time in each case. Nevertheless, it is clear that some elements, particularly with respect to cultural industries which bring discretionary tourist expenditure in their train, and the stimulation of innovative industries, are more pronounced than others. Thus, so underdeveloped were the financial services industries in all three countries and cities that there is relatively little of interest to report. However, this is far less the case for the other two sectors and this section will focus on them, with case illustrations, as appropriate.

Tallinn

Tallinn is blessed with a virtually intact medieval, Hanseatic Old Town within which much of its rich cultural infrastructure is located. This is planned to retain higher cultural activities, to evolve as a quiet haven with a revived café culture, art galleries, and residential conversions sympathetic to the historic character of the city. A more modern city center with contemporary arts, leisure, and entertainment centers is planned for the nearby waterfront area outside the medieval walls. All current projects are private ventures, the city government not yet having woken up to the economic dimension of culture. Thus, artists themselves, working through networks, have often been responsible for initiating and realizing projects with funding supplied through foreign foundations. Trade union statistics suggest as many as 5 percent of Tallinn's workforce may be directly and indirectly employed in cultural industries such as the performing arts, media, visual arts, and design, museums and libraries, and festivals. Some 41 percent are in the media sector, 24 percent in performing arts and 16 percent in visual arts and design (Võsa and Kuus 1997). Establishments such as the Estonian Drama Theater, Old Town Studio, State Puppet Theater, Russian Drama Theater and the Tallinn City Theater are among the most important of the city's nine theaters. The national opera theater – Estonia – is also in Tallinn. The City Theater is the subject of a major state investment involving adaptive reuse of medieval buildings. The main private, multicultural theater is Von Krahl, a focus for jazz, rock, dance, and an international music festival.

Tallinn's film production has suffered from the loss of Soviet subsidy. From 1993 to 1995, 6 full-length feature films, 49 documentaries and animated short features, and 36 newsreels were produced compared to 3 feature films, 48 documentaries, and 24 newsreels in 1985 alone under the old regime. Estonian classical music is of high international standard and Tallinn has four major companies, of which the Estonian Concert, the Estonian State Symphony Orchestra, and the Estonian Philharmonic Chamber Choir are examples; seven music festivals are also arranged in Tallinn each year. There is a buoyant press consisting of 17 weekly and 4 daily leading newspapers based in Tallinn out of a total for the city of some 90; books and periodicals are also published in substantial numbers. Estonian TV employs 728 people in Tallinn. There are seven cultural foundations in Tallinn, one, the Open Estonia Foundation funded by George Soros, the international financier and another, the Hereditas Foundation, by a combination of Nordic and American funds.

The Hereditas Foundation has supported one of Tallinn's most interesting cultural initiatives – the Old Town College and the Latin Quarter. This is a scheme to renovate not only the neglected Dominican monastic buildings (hence "Latin" quarter) in the heart of the Old Town, but the craft skills, folklore, music, heritage, and educational infrastructure associated with medieval Tallinn, to make it a lived rather than observed experience. The intention is to make the Latin Quarter a unique cultural tourism experience; the musical college exists, as do the craft workshops specializing in glass, custom-made clothing, ceramics, and leatherware. The key problem for the future is securing funding for further development.

Contrasting with this cultural emphasis upon a neomedieval revivalism aimed at cultural tourists is the emergence of a software industry in Estonia, and particularly in Tallinn. Terk and Võsa (1997) show that turnover was valued at $10 million in

1996 with employment of some 600, a third of the employees engaged in research and development. Practically all of the 120 companies involved are small, the largest employing a maximum of ten people. A handful are overseas owned, the whole industry being represented by the Association of Estonian Computing Companies. Two-thirds of firms operate in customized market niches, the rest as systems integrators and firms involved in standard package adaptation for the Estonian market. A considerable amount of subcontracting is conducted for Scandinavian and Finnish firms. Once again, investment finance is hindering the more rapid growth of the industry by its paucity.

Financial services have been performing well in Tallinn recently. Estonian banks experienced a large rise in profits and share prices in 1997. Hansabank, the largest with a net income of $13.5 million is now selling its banking software and consultancy services within the EU and to eastern Europe. Between them this bank and the next two largest, Union Bank and Savings Bank, contribute to total Estonian bank assets of $1,403 per capita compared with $951 in Latvia and $443 in Lithuania. Hansabank has opened 24 new branches and 90 cashpoints as well as offering telephone and Internet banking services. The sector, in general, sells on the quality of its service, innovation and marketing, but sees the need to restructure organizationally and to intensify its service development. More than a quarter of business is focused upon Tallinn and over half in Estonia. Ukraine and Russia are the main eastern markets.

Riga

Riga is a large city and 85 percent of Latvian industry – mainly still in large, Soviet-style enterprises – is concentrated there. There is a privatization policy in being, but most enterprises are close to bankruptcy. The city government has the political power but not the economic means to stimulate development until its property holdings are sold to raise capital. In terms of cultural industries' development, Karnite and Pocs (1997) point to the current absence of policy but the existence of quite a strong cultural infrastructure and, at national level, two key policy documents on cultural policy which assess future prospects, consider necessary laws, point to the strong state dependence of funding for culture (57% state, 6% private sector, 37% municipal) and the need for more private and associational participation. Like Tallinn, Riga has a fine medieval core and has prospects for developing its emergent tourist industry and enhancing its international potential as a congress and cultural center. The city is a member of the 61-member Baltic Cities network as well as seeking membership of the 72-member Eurocities partnership.

Riga's cultural infrastructure rests upon its 30 "culture houses," which sustain 340 amateur performing troupes, 28 museums with attendances at 722,000 in 1994, 7 theaters with attendances of 630,000, and a film-production industry which, with 5 feature-length films, 31 shorter films and 16 newsreels in 1994, was operating at less than half the capacity of 1980. As in Tallinn, there is a vast range of musical and other performance disciplines with Academies of Music, Arts and Culture which both perform and train artists. Large numbers of books, periodicals, and newspapers are produced, though there is as yet only the single state-run TV station. Virtually all this activity is centered in Riga. Tourist arrivals declined from 100,000 in 1991 to 43,000 in 1994, international arrivals going down from 79,000 to 36,000 over the

period, suggesting the market suffered from an initially very high increase in prices for a relatively poor quality of service.

As in Tallinn, Riga has been developing an indigenous software industry. This is the most developed growth sector in Riga. There is considerable interaction among small and medium enterprises (10–50 employees) and integration with the computer hardware sector. There are 176 firms, of which 40 are pure software firms and the others both hardware and software specialists; all were established after 1991 by computer staff from former state enterprises. The industry is wholly private and receives no subsidies; few firms have foreign contracts or joint-ventures partners. In general, it appears from comparative analyses conducted by the European Union statistical service, Eurostat, that Latvia is one of the more laggard economies in the Central and Eastern European bloc in respect of levels of "economically active" enterprises, largely due to slow privatization and low levels of foreign investment. A possible model for future development of innovative industry lies in the Latvian Technological Centre (LTC) in Riga. This is a partnership between the city, the Latvian Academy of Sciences, the Institute of Physical Energy Studies, and the Association of Science and Technology Societies. It supports some 30 start-up firms in an incubator environment, specializing in IT, biotechnology, and environmental technologies, with support from the EU Copernicus programme.

In Latvia, as noted, the asset base is smaller at $951 per capita, loans, too, at $244 per capita (compared with $769 in Estonia and $238 per capita in Lithuania), and deposits $577 per capita compared to $847 (Estonia) and $318 (Lithuania). GDP is lower in Latvia at $487 per capita than either Lithuania ($550 per capita) or Estonia ($641). Growth in the financial sector stabilized at around 5–7 percent per annum up to 1995 after a 40 percent increase in 1992. Employment in the sector grew from 7,000 in 1990 to 20,000 in 1995 when there was a financial crisis. By 1997 employment was 17,000. Most of this employment is in Riga and its environs. The banking system consists of the Latvian National Bank and at a second level, 12 main commercial banks. Between 1992 and 1997 the number of banks in total reduced from 67 to 34 due to the 1995 banking crisis caused by a weak deposit base and bankruptcies among new banks. Insurance, securities, and other financial services firms in reasonable numbers have also developed in Riga, serving the Latvian markets in the main.

Vilnius

Though a relatively large city Vilnius is not as dominant in Lithuania as the other cities are in their Baltic states. The population of 575,000 constitutes 16 percent of the national total of 3.7 million. The total number of enterprises is rising, there was an increase of 20 percent to 30,000 from 1995 to 1996, of which approximately 10 percent were foreign-owned on both occasions. Far more than Latvia, and perhaps even Tallinn in Estonia, Lithuania has been open to significant inward investment from the likes of KPMG, Price Waterhouse, and Arthur Andersen, management consultants and accountants which have been influential catalysts in the development of local enterprise. Tourism has developed successfully, generating at $150 million, some 4 percent of GDP, 87 percent of the activity associated with which is centered in Vilnius. This is helping stimulate the cultural sector which in Vilnius consists of 5 theaters, 4 concert halls, and 11 museums. In 1994 these

generated 785,000 visits (Ecofin 1996). One of the most important organizations attracting international tourists is the Lithuanian Folk Culture Centre which is a research, educational and festival organizing institution. Like the other Baltic cities, Vilnius has an attractive historical center which houses many of its cultural assets. However, marketing, investment capital, and cultural tourism "know-how" are in need of substantial improvement.

Vilnius is, partly due to its relative openness to foreign investment, host to a number of international business and financial organizations such as the World Bank, European Bank for Reconstruction and Development, and credit lines such as the Lithuanian Development Bank, Vilnius Bank, Baltic American Enterprise Fund, Baltic Investment Fund, US-Baltic Foundation and the Open Society Fund. Seven million ecus were allocated by Phare, the EU development programme for SME business development for the 1993–9 period. By 1996 there were 11 commercial banks, a reduction from 26 in 1993 following a series of bankruptcies in 1995. Overall employment in the Vilnius banking sector is, nevertheless, relatively small at some 4,000 employees in 1995.

Developments in innovative industries in Vilnius and Lithuania more generally are hampered by limited investment finance and the lengthy lead-times for commercialization, but helped by the fact that Lithuania had a highly developed science and technology base under the Soviet system. Nevertheless, reductions in state funding have meant contractions in the R&D labor market since 1991 and this has stimulated entrepreneurship, especially in electronics and IT, and, to a lesser extent, biotechnology. Good links are retained with the university sector but the Soviet market for which Vilnius researchers and technologists were suppliers has, of course, disappeared. In 1994 all 29 Lithuanian research institutes were evaluated to establish their future viability and case for continued funding. The Institute of Semiconductor Physics at Vilnius received the top ranking. Here, considerable joint venturing between the institute and firms takes place, with commercialization of technologies the objective. Companies use institute equipment in return for a share in profits. Emergent SMEs (Small and Medium-sized Enterprises) in IT and other advanced-technology fields face barriers to growth based on capital shortages, inadequate management capability, unsatisfactory premises and lack of information about new markets. Technological capability is not seen as a problem, but rather an asset.

We may conclude this section of this study by judging, fairly straightforwardly, that Tallinn, and Estonia in its train, has perhaps made the greatest progress in terms of its development of fast-growth industries and its acceptance for the next round of enlargement by the EU is testimony to its advance. Vilnius also has perhaps a more broad-based progress to report but there seem to be greater barriers to business expansion and fewer state or associational initiatives under development than in Tallinn. Riga, though the largest city, with considerable cultural and intellectual capital infrastructure, has progressed least in terms of strategic planning or associational or even entrepreneurial practices. This is because of severe financial difficulties, delays in privatization, and relatively unattractive former state enterprises with little obvious, future market attractiveness. Riga has the furthest to progress with, presently, the least fast-growth assets to sustain it.

Concluding Remarks and Policy Implications

An important part of this research involved eliciting assessments from the Baltic cities research teams of the policies being pursued in Western cities from the viewpoint of their possible relevance, suitably adapted, to their own cities of Tallinn, Riga, and Vilnius. Their collective responses give an indication of the kind of support needed, through Phare and other EU programs, the activities of foundations and investors, and the limited resources of the Baltic states themselves. There are four spheres in which there is widespread agreement on the lessons that could be learned from reviewing the experiences of the three research comparator cities of Dublin, Cardiff, and Tampere in dealing with processes of significant economic change and the need for economic regeneration.

Foremost, and plainly, finance is presently inadequate to enable city governments or their states to establish mechanisms for developing strategies or policies to take full advantage of opportunities associated with fast-growth industries. At a macro-level the Irish Industrial Development Authority and Welsh Development Agency were perceived to be crucial instruments for attracting overseas firms and helping build linkages with indigenous industry, but there was not the finance in any of the Baltic states to set up such organizations and staff them with appropriately trained personnel. Contrariwise, though, the ways in which policy networks operated across the public–private sector divide, enabling private risk-taking to be moderated by matching public funding for projects with clear objectives was widely admired. EU, state and city levels of governance could usefully extend matched-funding approaches for projects on which there is a clear consensus about wealth generation.

Second, there is a need for institution-building, learning, and training in urban governance. Presently most initiative comes from private individuals or groups, usually, in the latter case, working on a not-for-profit basis and dependent on limited foundation funds. City governments do not have strategic plans because they do not have clear goals or the means to fulfill them if they had them. Nevertheless actions can be taken in partnership with international, private, and voluntary organizations. However, there is widespread unfamiliarity with this approach to policy formation and only relatively limited capacity to evaluate innovative practices elsewhere. Training in urban leadership, funded through scholarship and study-visits for officials and politicians, is called for.

Third, there was recognition of the value of, first, understanding the economic worth to the city's economy of activities such as those associated with urban culture or university science. Such a perspective has been absent in the past and, while there are small indications of emergent university–industry or foundation–cultural industry relationships in Vilnius and Tallinn, the estimation of the Dublin approach to regenerating Temple Bar as an example for Old Town development with cultural sensitivity is palpable. Similarly, the great success of the Tampere Technology Park, and on a smaller scale, the Cardiff Medipark, in levering value from disinterested science were fully recognized. Once more, there is scope for enhancing emergent efforts with technical and financial support.

Fourth, Baltic city researchers were impressed with the capability of Western cities, firms, development agencies and others to *market* their goods and services,

their image, and reputation. Such skills are in short supply in the Baltic cities, yet they have much in their built fabric, cultural, and scientific infrastructure of which to be proud. The problem, once again, is partly financial as the "quick buck" and poor quality of service experience revealed with the decline in foreign tourists to Riga, though this has not been so pronounced in Vilnius, or especially Tallinn. Being in a position to understand good practice, develop opportunity without killing the "golden goose" and formulate strategic, financial projects are among the most crucial learning processes that policymakers in the Baltic cities and the states to which they belong can usefully experience.

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