Building closer connections

The Three Seas region as an economic area
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Key findings

→ The Three Seas Initiative is made up of twelve EU member states in Central Europe: Austria, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. Now that Britain has left the EU, they cover 29 per cent of the EU’s territory, have 25 per cent of its inhabitants and produce 19 per cent of its GDP. The initiative is the result of consistent work by Polish analytical circles backed by Polish politicians and US diplomacy. The Three Seas was originally inspired by a joint report by two think tanks: Central Europe Energy Partners in Poland and the Atlantic Council in the US.

→ Despite many differences, the Three Seas countries are united by their geographical location and the resulting geopolitical consequences. This may be the source of the region’s relatively strong attachment to transatlantic cooperation (compared to Western Europe) and its sensitivity to security topics. Most of the Three Seas countries are also part of a certain community of conservative values.

→ Over the past 15 years, the Three Seas countries have been among the most rapidly-developing regions in the EU. In 2004-2018, their share in generating EU GDP increased by almost 4 percentage points, to 19 per cent. The leaders were Poland (5.3 per cent), Slovakia (4.8 per cent) and Romania (4.7 per cent). All the countries in the region (except Croatia) grew at least three times faster than the EU average.

→ The Three Seas countries already constitute an important industrial centre in the EU, especially for the automotive sector. In these countries, the average share of value added generated by industrial production in GDP is 16.7 per cent, compared to 13 per cent in the rest of the EU, that is almost one-quarter lower.

→ Almost all the Three Seas countries face the spectre of the demographic trap. Their societies risk growing old before they get rich. Despite strong economic growth, almost all the countries in Central Europe have experienced waves of emigration and a low birth rate.

→ For decades, infrastructural investments in the Three Seas region focused on linking it to industrial centres in Western Europe, while neglecting development along the north-south axis. This is one of the reasons why trade within the region has been relatively stagnant, compared to trade with the rest of the EU. In almost all Central Europe, transport, logistics, energy and digital infrastructure is relatively underdeveloped, both within countries and between them. Catching up with the most developed countries in Western Europe in this dimension is a fundamental condition for the Three Seas’ further development, as well as the creation of a regional network of connections driving economic growth.

→ The Three Seas region is gradually becoming a significant hub for maritime and rail trade between Europe and Asia. The region is investing heavily in transport infrastructure, which fosters the development of logistics and transport. This opens the way to increasing regional connectivity and obtaining the benefits of the development of intra-industry trade, using comparative advantages and regional production.
specialisations. This requires further investment in cross-border infrastructure and integration of the regional logistics market.

→ Energy cooperation as part of the Three Seas region seems to be a model for cooperation in the region in other areas. Early on, the states recognised that the limited infrastructural connections between them in this area weaken their security and competitiveness.

→ The economic consequences of the COVID-19 pandemic and the reduction in EU funds for the Three Seas countries expected in 2021-2027 means that a new source of external capital needs to be found to finance the region’s further integration. The increased engagement of non-European development institutions – from the US, Japan or China, among others – in Central Europe could be a significant new source of funding for the development of infrastructure. Using new instruments to mobilise private capital is key, including through guarantees and limiting investment risk modelled on the new instruments for financing development in the EU (including the Juncker Plan).

The Three Seas Initiative could help create a new model for Central Europe's development. On the one hand, countries in the region could be hit by the consequences of the crisis in the automotive sector, which will suffer significant losses due to the COVID-19 pandemic. On the other hand, serious shifts in supply chains, and perhaps also the return of some industrial production from Asia to Europe, will become a source of new investments in the Three Seas countries.
## The report in numbers

<table>
<thead>
<tr>
<th>Statistic</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>5.3 per cent</td>
<td>the average growth rate in Poland, the fastest-growing economy in the Three Seas region in 2004-2019</td>
</tr>
<tr>
<td>15 per cent</td>
<td>of EU GDP was generated by the Three Seas region in 2004</td>
</tr>
<tr>
<td>19 per cent</td>
<td>of EU GDP was generated by the Three Seas region in 2018</td>
</tr>
<tr>
<td>243 per cent</td>
<td>increase in trade turnover in Three Seas countries in 2004-2018</td>
</tr>
<tr>
<td>EUR 347 billion</td>
<td>total capitalisation of the Three Seas stock exchanges in 2018</td>
</tr>
<tr>
<td>EUR 80 billion</td>
<td>value of transport, energy and digital projects funded by the EU in Three Seas countries in 2014-2020</td>
</tr>
<tr>
<td>5 out of 9 corridors</td>
<td>in the Trans-European Transport Network (TEN-T) pass through the Three Seas region</td>
</tr>
</tbody>
</table>
1. The Three Seas – motives, genesis, institutions

The Three Seas Initiative is a political platform coordinated at the presidential level launched in 2015 on the initiative of Polish President Andrzej Duda and Croatian President Kolinda Grabar-Kitarović. It brings together twelve EU member states in Central and Eastern Europe: Austria, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia. Now that Britain has left the EU, the twelve Three Seas countries cover 29 per cent of the EU’s territory (1,210,000 km²), are home to 25 per cent of its inhabitants (112 million) and produce 19 per cent of its GDP (based on purchasing power parity).

The idea of building stronger connections between countries in Central Europe is not entirely new. Ideas for managing the region, where conflicts between the two powers were often played out, emerged over the past 150 years. In the 19th Century, Prince Adam Czartoryski was already trying to create, with the West’s support, a political community of Poles, Czechs, Slovaks, Hungarians, Romanians and Southern Slavs. German politician Friedrich Naumann proposed the idea of Mitteleuropa (covering a similar area to the Three Seas region) as a community of states linked by strong economic ties allied with Germany, forming a counterweight to Russia and Britain. Today’s Three Seas Initiative is much more focused on economic matters. Above all, it aims to strengthen economic integration in the region, which – as the movement of goods and services between east and west increases – could become the largest beneficiary of mediating these flows and, through its infrastructural coherence, diversify energy supplies.

The idea of increasing connectivity in the Baltic, Adriatic and Black Sea region proposed as part of the Three Seas Initiative expresses a new way of thinking about development policy, which is increasingly widespread in the EU, the US and China. It aims for synergy in the development of various types of infrastructure (transport, energy, digital) and focuses in its long-term effects: stimulating transport and logistics connections, creating new supply chains, closer integration of economies and societies and, as a result, creating a community of interests when it comes to politics and security.

There are many differences between the Three Seas countries in terms of historical traditions. Austria, Poland and Bulgaria’s experiences have been completely different. Not all the countries belong to all the Western institutions: Austria is not in NATO; just Austria, Estonia, Lithuania, Latvia and Slovakia are members of the Eurozone, and Bulgaria, Romania and Croatia have not yet received permission to join the Schengen Area. The countries are strongly connected by geography and the resulting geopolitical conditions. They are all located in the east of the EU and secure most of the EU or Schengen land boarder (almost 80 per cent). This means that they create a kind of antemurale, as the first barrier ensuring the EU’s security in the east. In recent years, this

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1 For stylistic reasons, the Three Seas initiative countries will also be referred to as Central Europe.
1. The Three Seas – motives, genesis, institutions

Three Seas milestones

→ 2014 – the seeds of this idea were jointly presented in 2014 by the American Atlantic Council and Polish think-tank Central Europe Energy Partners in the report Completing Europe: From the North-South Corridor to Energy, Transportation, and Telecommunications Union (CEEP 2014) financed by Polish energy companies.

→ 2016 – the Three Seas Initiative’s first summit was held in Dubrovnik on the initiative of Polish President Andrzej Duda and Croatian President Kolinda Grabar-Kitarović. A declaration on tightening economic cooperation by developing transport, energy and digital infrastructure was signed.

→ 2017 – at the second Three Seas summit in Warsaw, with US President Donald Trump as the guest of honour, the Three Seas Initiative Business Forum was established.

→ 2018 – at the third Three Seas summit in Bucharest, attended by Germany’s Minister of Foreign Affairs Heiko Maas and US Secretary of Energy Rick Perry, a network of member countries’ chambers of commerce was created, a list of priority projects in transport, energy and telecommunications linking the region was approved, and a letter of intent on establishing a Three Seas Initiative Investment Fund was signed.

→ 2019 – on Poland and Romania’s initiative, with the involvement of Latvia, the Czech Republic and others, the Three Seas Initiative Investment Fund was established with EUR 500 million in initial capital and the aim of raising EUR 3-5 billion.

→ 2020 – US Secretary of State Mike Pompeo pledged USD 1 billion in support for investment in the Three Seas countries, especially in the energy sector.

had a very concrete dimension, as protection of the EU border against waves of migration or efforts to stabilise the EU’s eastern neighbours in the face of Russia’s aggressive policy focused on the Three Seas countries. Although there are differences in the Three Seas countries’ foreign policies (Ukielski, 2016, p. 7), their geographical location means that they are mostly attached to transatlantic cooperation. A survey by Pew Research Center (Wike et al., 2020, p. 34) shows that of the five EU countries2 with the most positive attitude to the US, four are in the Three Seas region. They are Poland, where 79 per cent of respondents expressed a positive opinion about the US, Lithuania (70 per cent), Hungary (66 per cent) and

2 The survey only covered some of the Three Seas countries: Bulgaria, the Czech Republic, Hungary Lithuania, Poland and Slovakia. The other EU countries surveyed were Britain, France, Greece, Italy, Spain, the Netherlands and Sweden.
Bulgaria (57 per cent). Opponents of this positive attitude to the US do not outnumber its supporters in any of the Three Seas countries analysed, unlike in Germany (39 per cent of respondents have a positive attitude towards the US and 57 per cent a negative one), Sweden (45 per cent vs. 51 per cent) and the Netherlands (46 per cent vs. 52 per cent). In France, these attitudes are balanced (both 48 per cent).

The potential for cooperation in the Three Seas Initiative is greatest when it comes to the economy. It is in the countries’ joint interest to continue rapid conversion with the level of economic development in countries in Western Europe. The exception is Austria, which has long been among the most developed countries in the EU. However, because of its strong links to Central Europe, supporting the region’s convergence is in its interest, too.

The Three Seas countries that are not yet among the richest countries have made significant progress in recent years, but it seems that further improvement will be more difficult. In the decade or so after they joined the EU, simple reserves and lower labour costs were enough to narrow the economic gap. Now increasing competitiveness increasingly requires building an innovative economy, which involves building a comprehensive system for generating innovation. This will be fostered by a greater range of connections between companies in countries with a similar level of development, which share the ambition of moving to a higher level in the value chain. It is usually much more difficult to build balanced relationship through cooperation between SMEs from countries at a medium level of development and strong corporations from highly-developed countries. The condition for deepening economic cooperation between the Three Seas countries is significant improvement in the infrastructural connections in the region, not just in the energy sector, where the most progress has been made, but also in transport, logistics and digital connections.

VIA CARPATIA – THE RESULT OF THREE SEAS COOPERATION

The first declaration on the construction of the Via Carpatia was signed in 2006 in Łańcut, Poland, by the ministers of transport of Poland, Lithuania, Slovakia and Hungary. Work on building the new north-south road connection accelerated with the establishment of the Three Seas Initiative.

In 2018, the ministers of transport of Poland, Bulgaria, Lithuania, Romania, Slovakia and Hungary signed a request asking the European Commission to incorporate the Via Carpatia route into the TEN-T core network during the review of the trans-European transport network plan.

In 2019, the European Parliament supported the amendment of the regulation that allowed the Via Carpatia route to be included in the list of priority projects of the Connecting Europe Fund, which will make it easier to finance the cross-border sections of the route.

According to governments’ declarations, the national stretches of the route should be ready by 2022 in Hungary, 2023 in Slovakia and 2025 in Poland. The process could be made easier by the Via Carpatia’s incorporation into the TEN-T Trans-European network, which could happen during its revision in 2021.

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3 The other country is Italy, which is not part of the Three Seas Initiative (62 per cent).
2. The Three Seas’ economic potential

Over the past 15 years, the Three Seas countries have been among the most-rapidly developing regions in the EU. In all of them, except Croatia, the growth rate was significantly above the EU average (not counting Britain). Poland (5.3 per cent), Slovakia (4.8 per cent) and Romania (4.7 per cent) did especially well, growing at least three times as fast as the EU average.

▶ Chart 1. Average annual growth in 2004-2019 (per cent)

<table>
<thead>
<tr>
<th>Country</th>
<th>Growth Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland</td>
<td>5.3</td>
</tr>
<tr>
<td>Slovakia</td>
<td>4.8</td>
</tr>
<tr>
<td>Romania</td>
<td>3.9</td>
</tr>
<tr>
<td>Lithuania</td>
<td>3.4</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>3.8</td>
</tr>
<tr>
<td>Estonia</td>
<td>3.1</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>3.0</td>
</tr>
<tr>
<td>Latvia</td>
<td>2.3</td>
</tr>
<tr>
<td>Slovenia</td>
<td>2.3</td>
</tr>
<tr>
<td>Hungary</td>
<td>1.7</td>
</tr>
<tr>
<td>Austria</td>
<td>1.5</td>
</tr>
<tr>
<td>EU-27 average</td>
<td>1.3</td>
</tr>
<tr>
<td>Croatia</td>
<td>1.3</td>
</tr>
</tbody>
</table>

Source: prepared by PIE based on: Eurostat (2020).

▶ Chart 2. Three Seas countries’ share in EU GDP (without Britain) in 2004-2018 (purchasing power parity, per cent)

Source: prepared by PIE based on: Eurostat (2020).
The Three Seas countries’ good economic results systematically improved their position in the EU. In 2004, when the EU was enlarged, countries in the Three Seas region generated just 15.2 per cent of the EU’s GDP (not counting Britain). By 2018, this had increased to 19.1 per cent. Interestingly, this tendency was almost continuous, despite the global financial crisis of 2008-2009, which seemed to be an especially difficult time for emerging economies. The Three Seas countries showed then that their macroeconomic foundations are so strong that, after the short recession of 2009, they are capable of returning to the path of rapid economic growth. The situation was completely different in other EU countries, where problems with macroeconomic imbalances threatened to break up the Eurozone.

Chart 3. Average annual growth in 2004-2019 (per cent)

An important source of macroeconomic stability in the Three Seas countries was the concentration on industrial production, as presented in Chart 3. Of the ten EU countries with the highest share of value added generated by industry in GDP, eight are in the Three Seas region. In those countries, the average share is 16.7 per cent. In other EU countries, it is almost one quarter lower (13 per cent). The Three Seas countries have managed to resist the deindustrialisation trend common in many-highly developed countries. Thanks to that since joining the EU, they have become one of EU major industrial centres.
Building significant industrial potential in the Three Seas region probably would not be possible without intensive trade connections with the EU’s largest economies. Chart 4 shows that trade with the Three Seas countries accounts for 19.8 per cent of Germany’s trade, 12.4 per cent of Italy’s, 10.8 per cent of Russia’s, 7.4 per cent of France’s, 5.4 per cent of Britain’s and just 1.5 per cent of the United States’.

The importance of trade with the region for the German economy is especially striking. To a significant extent, it results from major investment links in the automotive sector. Many German car companies and their suppliers have factories in Three Seas countries, where parts and cheaper car models are usually produced. A German-Central European supply chain cluster was formed, largely thanks to German automotive companies’ investment in southwestern Poland, the Czech Republic, Slovakia, Hungary and western Romania (MFW 2013).

A similar strategy is being pursued by Italian and French companies, though to a more limited extent. The Three Seas region’s fairly large share in Russia’s trade results from Central Europe’s dependence on energy supplies from Russia. At the same time, the Three Seas countries have relatively weak trade connections with more distant countries and those with a lower share of industrial production in GDP. On the one hand, this results from the lower engagement of investors from these countries in Central Europe. On the other hand, it stems from the Three Seas countries’ insufficient ability to offer attractive products on the highly-competitive US and British market, which not only requires innovativeness, but also significant organisational and logistics capacities. For this reason, the Three Seas countries export many more production parts to distant markets (than the statistics indicate), but in the form of low-margin parts for end products of French, German or Italian companies.

The high level of industrialisation in the Three Seas countries does not mean that they

Source: prepared by PIE based on: https://globaledge.msu.edu [accessed: 15.03.2020].
are neglecting other areas of economic activity. As Chart 5 shows, quite a high share of value added in GDP is generated by the ICT services sector. At 3.8 per cent, it is slightly above that in other EU countries (3.7 per cent). Nevertheless, there are considerable differences between the Three Seas countries. Bulgaria, Estonia, Latvia, Hungary, the Czech Republic and Croatia are among the countries with the highest share of value added from ICT services in GDP. In contrast, in countries such as Austria, Lithuania, Poland and Romania, the share is below the EU average.

![Chart 5](chart.png)  
**Chart 5.** ICT services sector’s share in generating value added to GDP in 2017 (per cent)

Source: Eurostat (2020).
The ICT services sector’s major role is not the only indicator of the Three Seas countries’ potential in this area. Central Europe has many talented IT specialists. In the HackerRank (2020)\(^4\), which tested the skills of 300,000 programmers in different countries, three countries in the Three Seas region were in the top ten: Poland (3\(^{rd}\)), Hungary (5\(^{th}\)) and the Czech Republic (9\(^{th}\)). There were only two from among the EU’s other member states: France (8\(^{th}\)) and Italy (10\(^{th}\)). The Poles came third, after the Chinese and the Russians, with especially high results in the following areas or software languages: Java (1\(^{st}\) place), Python (2\(^{nd}\)), algorithms (2\(^{nd}\)), creating tutorials (4\(^{th}\)), Shell (4\(^{th}\)) and Ruby (5\(^{th}\)). A study by Pentablog, a platform that supports the recruitment of IT talent, produced similar results. Of the top ten countries with the best programmers, the first four are Slovakia, the Czech Republic, Hungary and Poland (Pentalog, 2020). The high number of skilled programmers, combined with very good industrial competencies, will result in the potential to create solutions for Industry 4.0, an area where the EU could achieve a strong position in the next decade, in the future.

\(^4\) HackerRank tools are used by Apple and Google, among others, to recruit employees.
3. Demographic and cultural potential

The high economic growth in most Three Seas countries has made them more prosperous, but has not guaranteed full social stability. Almost all of them have experienced high emigration and low demographic growth. As a result, the Three Seas countries’ population has declined by 3 per cent since 2004, while of the other EU countries’ has grown by 5.5 per cent. Despite these unfavourable tendencies, the relatively young working-age population and high motivation to work remain important advantages for Central Europe. The challenge for the Three Seas countries will be to build an economic model that increases the standard of living to at least the EU average, while ensuring that they emerge from the demographic crisis. Otherwise, the region could fall into a demographic trap, in which society grows old before it gets rich.

The Three Seas countries for a certain community of values, which is especially visible when compared to other EU member states. Although they vary when it comes to religion\(^5\), they share similar beliefs. Analysing the results of surveys regularly conducted by the Pew Research Center in eleven Three Seas countries (without Slovenia) shows that, compared to other EU countries, they are conservative when it comes to national and religious identity, as well as attitudes to the family. The following countries are especially close when it comes to values: Croatia, Lithuania, Poland, Romania and Latvia (considering how, for a country that is so religiously diverse as Latvia, religion cannot be the source of a strong national identity). The Czech Republic, Estonia and, to some extent, Austria deviate from the rest of the Three Seas region, though even in these cases there are similarities with the rest.

Belief in God is above the EU average in nine of the eleven Three Seas countries surveyed. Of the EU countries where belief in God is the highest, seven out of ten are in the Three Seas region: Romania, Croatia, Poland, Bulgaria, Lithuania, Latvia, Slovakia and Austria. The exceptions are Hungary, Estonia and the Czech Republic, which has the lowest percentage of people who believe in God in the whole EU.

In most Three Seas countries, people have a different understanding of national identity compared to Western Europe. They are much more likely to emphasise the importance of religion in national identity. This conviction dominates in Orthodox Romania and Bulgaria, as

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\(^5\) According to Eurobarometer study (2015) majority of people in Austria (67 per cent), Croatia (84 per cent), Lithuania (88 per cent), Poland (91 per cent), Slovakia (73 per cent), Slovenia (67 per cent) and Hungary (37 per cent) declare as Roman Catholic, while in Bulgaria (83 per cent) and Romania (90 per cent) as Eastern Orthodox. Higher religious complexity is observed in Estonia (23 per cent of Eastern Orthodox, 24 per cent of Protestants and 39 per cent of non-believers), Latvia (26 per cent of Roman Catholic, 24 per cent of Eastern Orthodox and 17 per cent of Protestants) and Czechia (27 per cent of Roman Catholic, 64 per cent of non-believers).
### 3. Demographic and cultural potential

#### Table 1. Number of respondents with a given view in each country (per cent)

<table>
<thead>
<tr>
<th>Country</th>
<th>Belief in God</th>
<th>Religion as an important part of national identity</th>
<th>Being born in a given country as an important part of national identity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Romania</td>
<td>95</td>
<td>74</td>
<td>88</td>
</tr>
<tr>
<td>Croatia</td>
<td>86</td>
<td>58</td>
<td>62</td>
</tr>
<tr>
<td>Poland</td>
<td>86</td>
<td>64</td>
<td>82</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>77</td>
<td>66</td>
<td>86</td>
</tr>
<tr>
<td>Lithuania</td>
<td>76</td>
<td>56</td>
<td>71</td>
</tr>
<tr>
<td>Latvia</td>
<td>71</td>
<td>11</td>
<td>71</td>
</tr>
<tr>
<td>Slovakia</td>
<td>69</td>
<td>35</td>
<td>56</td>
</tr>
<tr>
<td>Austria</td>
<td>67</td>
<td>39</td>
<td>53</td>
</tr>
<tr>
<td>Hungary</td>
<td>59</td>
<td>43</td>
<td>83</td>
</tr>
<tr>
<td>Estonia</td>
<td>44</td>
<td>16</td>
<td>62</td>
</tr>
<tr>
<td>The Czech Republic</td>
<td>29</td>
<td>21</td>
<td>78</td>
</tr>
<tr>
<td>Portugal</td>
<td>83</td>
<td>62</td>
<td>81</td>
</tr>
<tr>
<td>Italy</td>
<td>73</td>
<td>53</td>
<td>68</td>
</tr>
<tr>
<td>Ireland</td>
<td>69</td>
<td>48</td>
<td>59</td>
</tr>
<tr>
<td>Spain</td>
<td>64</td>
<td>38</td>
<td>66</td>
</tr>
<tr>
<td>Germany</td>
<td>60</td>
<td>34</td>
<td>48</td>
</tr>
<tr>
<td>Finland</td>
<td>58</td>
<td>32</td>
<td>51</td>
</tr>
<tr>
<td>France</td>
<td>56</td>
<td>32</td>
<td>48</td>
</tr>
<tr>
<td>Denmark</td>
<td>51</td>
<td>19</td>
<td>36</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>44</td>
<td>22</td>
<td>41</td>
</tr>
<tr>
<td>Belgium</td>
<td>42</td>
<td>19</td>
<td>49</td>
</tr>
<tr>
<td>Sweden</td>
<td>36</td>
<td>15</td>
<td>22</td>
</tr>
<tr>
<td>Slovenia</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Three Seas region (average)</td>
<td>69.0</td>
<td>43.9</td>
<td>72.0</td>
</tr>
<tr>
<td>Rest of EU (average)</td>
<td>57.8</td>
<td>34.0</td>
<td>51.7</td>
</tr>
</tbody>
</table>

Note: percentages above the EU average are highlighted in green.

well as Catholic Poland, Lithuania and Croatia. In Austria and Hungary, most of society does not consider religion key to national identity, but the level is still high compared to the rest of the EU. People in the Three Seas countries are also more likely to consider being born in a given country an important part of national identity. Most respondents in all eleven countries held this view. Interestingly, even the Czechs – whose answers to the other questions differed from those in the other Three Seas countries – agreed.

These conservative values are not limited to declarations, but also translate into concrete decisions. Although there are significant differences within the region, the number of marriages in most of the Three Seas countries is relatively high. The average marriage rate in the region is 5.3 per 1000 people, compared to 4.3 in the rest of the EU. Women in the Three Seas countries have their first pregnancy at the age of 27.8 on average, two years earlier than women in the rest of the EU. The divorce rate in the Three Seas countries and the rest of the EU is similar.
Juxtaposing the conservative values held by people with fertility rates in the EU gives surprising results. All the Three Seas countries are below the average diversity indicator for the result of the EU. In Central Europe, the fertility rate oscillates around 1.51 children per woman of childbearing age (when generational replacement is guaranteed from a rate of at least 2.1). In the rest of the EU, the rate is 1.64. Firstly, this is partly a result of the relatively high fertility rate in Western Europe, especially among women from migrant backgrounds. Secondly, an insufficient standard of living, and sometimes the lack of stable employment (due to the use
of flexible forms of employment), makes young people in the Three Seas countries put off the decision to have children or discourages them from having them. These trends can be illustrated by data from Britain’s Office for National Statistics, which shows that while British women give birth to 1.8 children on average, this is 2.2 among women from migrant backgrounds (ONS, 2020). With a fertility rate of 2.2, women who moved to Britain from the EU’s new member states have more children than British women and significantly more than women in their home country.

**Chart 7. Share of a country’s population living in other EU countries (per cent)**

In addition to many economic benefits for the new member states, the EU enlargements of 2004 and 2007 had a social cost, in the form of an increased wave of emigration. Many inhabitants of the Three Seas countries used their freedom of movement to emigrate to a country with a higher standard of living. In many countries in Central Europe, they left the country en masse. As a result, almost one in ten citizens of the Three Seas countries now lives in a different EU country. In the rest of the EU countries, this is the case for just one in 20 citizens. Of the 13 EU countries with the most citizens living in other EU countries, ten are in the Three Seas region. The following countries are especially affected: Romania (18 per cent of citizens living in a different EU country), Lithuania (16 per cent), Croatia (14 per cent), Bulgaria (13 per cent) and Latvia (11 per cent). Outside the Three Seas region, this applies to EU countries affected by the Eurozone crisis – that is, Greece and Portugal – as well as Ireland, due to its close links with Britain.

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6 Austria with its high quality of life and significant immigrant population is an exception.
As a result of these unfavourable demographic and migratory trends, the Three Seas countries’ population has decreased by almost 3 per cent since 2004. Nevertheless, the countries’ demographic potential remains high as their population is still relatively young. The old-age-dependency ratio (the ratio between number of people of post-working age, i.e. over 64, and the number of people aged between 15 and 64) in the Three Seas countries is 29.5 per cent on average, compared to 31 per cent in the rest of the EU. There are considerable differences within the Three Seas region. The ratio is lowest in Slovakia (23.5 per cent), Poland (26.4 per cent), Romania (28.1 per cent), Austria (28.2 per cent) and Hungary (29.3 per cent). The situation is much worse in Lithuania (30.4 per cent), the Czech Republic (30.4 per cent), Slovenia (30.5 per cent), Estonia (31 per cent), Croatia (31.6 per cent) and Latvia (31.7 per cent).

Chart 8. Average number of hours worked per year by an employee in 2018.

Note: no data for countries that are not part of the OECD: Bulgaria, Croatia and Romania. The data collected by the OECD on the number of hours worked in the domestic economy are not fully comparable, but they can serve as a starting point for comparing employees’ involvement at work.

Source: prepared by PIE based on: OECD (2020).
The Three Seas countries not only have a favourable demographic structure – their inhabitants are hardworking, too. According to OECD data, employees in the Three Seas countries work 6.7 per cent more (almost two weeks) on average in a year than those in the rest of the EU (1689 vs. 1583 hours). However, there are significant differences within the region. The number of hours worked was relatively high in the Czech Republic (1792), Estonia (1748), Poland (1792) and Hungary (1741). Austria is at the opposite end of the spectrum (1511). This indicator can be interpreted in two ways. On the one hand, the high number of hours worked in the Three Seas countries may reflect employees work ethic and engagement. On the other hand, it may be a sign of low productivity, with fewer high-performance machines and devices. Moreover, the high number of hours worked can have social consequences, in the form of a lower fertility rate among women.

To summarise: despite unfavourable demographic and migratory trends, most Three Seas countries still have the advantage of relatively young and highly-motivated human capital. A major challenge will be to find a new economic model that will enable the countries to emerge from the demographic trap. Otherwise, the fertility rate in the Three Seas countries will not increase and rapidly-aging countries in Western Europe will seek to attract further waves of migrants from Central Europe.
4. Development of connectivity in the Three Seas countries

The Three Seas Initiative’s fundamental aim is to develop connectivity in the Baltic, Adriatic and Black Sea region. The idea of connectivity expresses a new way of thinking about development policy, which is being implemented in the EU, the US and China. It aims for synergy in the development of various types of infrastructure (transport, energy, digital) and focuses in its long-term effects: stimulating transport and logistics connections, creating new supply chains, closer integration of economies and societies and, as a result, creating a community of interests when it comes to politics and security.

The development of connectivity in the Three Seas region is based on the development of infrastructure in three pillars:
- energy (interconnectors, transmission infrastructure),
- transport (road, rail, intermodal),
- digital (fiber optic and wireless networks).

Hard infrastructure needs to be accompanied by connections enabling it to be used effectively to stimulate local growth: building a mutually-connected network of logistics hubs, stimulating contact between business and academic communities, integrating of capital markets, creating common digital platforms and so on. The key is to develop cross-border connections that have network effects across the region.

Chart 9. Trade within the Three Seas region compared to trade with the EU in 2004-2018 (bln EUR)

Source: Eurostat (2020).
For the Three Seas countries, the development of regional connectivity is needed to remain on the path of high economic growth and, as a result, maintain the pace of real convergence with the EU. Improving connections within the region opens the way to the benefits of the development of intra-industry regional trade: the use of comparative advantages or regional production specialisation. Diversified infrastructure guarantees continuity of production, not only when it comes to energy or digital communication, but also the movement of goods – as the coronavirus pandemic in 2020 has shown.

As Chart 9 shows, trade among the Three Seas countries – a significant indicator of the development of connections within the region – rose from EUR 66 billion in 2004 to almost EUR 227 billion in 2018. After the first wave of the stimulation of trade in 2004-2008 associated with EU enlargement, economic contact within the region entered a period of relative stagnation. Since 2012, the Three Seas markets’ share in the region’s exports, compared to exports to the whole EU, has remained at 35 per cent. Exports to the “old EU” therefore grew at a relatively faster rate than trade within the Three Seas region. More broadly, the Three Seas region’s integration with Western Europe proceeded faster than that within the region. This is linked to its position as a production location in Western European companies’ supply chains.

Chart 10. Three Seas region’s share in individual countries’ total trade (changes in 2004-2018, per cent)

Since 2004, when most of the Three Seas countries joined the EU, the region’s share in total trade in each of the countries has increased (Chart 10). The relatively small economies of Slovakia, Croatia and Latvia are the most economically integrated with the region; there, the share is over 30 per cent. The share increased the most in Bulgaria, Romania, Hungary and Latvia (by 9 p.p.) and Croatia (by 10 p.p.). The region’s three largest economies made the least progress in terms of integration with the region: Poland (+3 p.p.), Austria (+4 p.p.) and the Czech Republic (+3 p.p.). These countries could potentially play the role of integrators of regional economies.

The relative stagnation of trade within the Three Seas region is caused by structural barriers that limit the development of deep connections between the region’s economies. In almost the entire Three Seas region, transport, logistics,
energy and digital infrastructure is relatively poorly developed – both within countries and between them. Catching up with the most developed economies in Western Europe in this respect is the fundamental condition of the region’s further development, as is creating a regional network of connections that will drive economic growth. Without this, countries in Western Europe will benefit the most from the Three Seas countries’ dynamic development.

ENERGY

Energy cooperation as part of the Three Seas is a model for cooperation in the region in other areas. Early on, the countries recognised that the limited energy infrastructure connections between them reduce their security and competitiveness. Excessive dependence on a single gas supplier, Russia, threatens the continuity of supply of this key commodity. Today, region is gets closer to diversifying its energy supply, new goals are appearing on the horizon: integrating markets to a level similar to that in Western Europe to lower gas prices.

The gas crisis of 2009, and then Russia’s attack on Ukraine in 2014, proved to many countries in Central Europe that being dependent on a single supplier of gas can be risky and prompted work to develop gas infrastructure along a north-south axis.

Map 1. EU countries’ dependence on gas supplies from Russia

Who is dependent on Russian gas?
Fourteen Countries get more than 50 per cent of their gas from Russia

Source: Buttler, Wilkes, Shiryaevskaya (2020).
Map 1 shows that the Three Seas countries are among the EU countries most dependent on gas supplies from Russia. In Western Europe, Russian gas usually accounts for less than half of gas supplies. In Central Europe, this tends to be well over 50 per cent.

**Chart 11.** Gas prices in EU countries for non-household entities (excluding taxes) in the first half of 2019 (in EUR/kWh)

Dependence on Russia is not only a threat to the continuity of gas supplies, but also affects prices. In eight of the twelve Three Seas countries, gas prices for non-household entities are above the EU average. This lowers the competitiveness of companies that use gas to produce end products (especially in the chemical industry).

The limited energy integration in the region generates specific costs. The insufficient infrastructure capacity connecting the western and eastern EU countries prevents the benefits of the single gas market from being used. In the western member states, integration activities almost harmonise gas prices; in the east, this process is much less advanced (Musiałek, 2020). As a result of these differences, countries in the east of the EU face higher gas prices than those in the west, although price differences are narrowing due to the gradual integration of gas markets. This problem has been noticed by the European Commission, which supports the Three Seas countries’ efforts to increase the integration of their gas markets. This is demonstrated by how, in 2017, the Commission supported the gas connector project between Poland and Slovakia with the highest amount granted to the Connecting Europe Fund that year, EUR 107 million. The investment in the LNG terminal in Croatia received slightly less support (EUR 102 million). When it comes to gas connections, the Three Seas’ goals also coincide with those of the EU. The establishment of gas hubs is supposed to be a pillar shaping market
Development of connectivity in the Three Seas countries

conditions for gas trade, replacing existing bilateral contracts, which usually sanction Central European countries’ dependence on suppliers. The EU does not want to limit itself to supporting gas connections. On 24.10.2014, the European Council deemed achieving a cross-border energy transmission potential of 10 per cent by 2020 and 15 per cent by 2030 a target on the road to establishing a single electricity market (European Council 2014).

Thanks to the initiative, the Three Seas countries can more easily coordinate cross-border energy projects and obtain funds for the infrastructure needed to integrate the energy market, especially from the Connecting Europe Facility. The Central European countries’ efforts are having real effects; for example, the likely completion this year of an investment enabling the reverse flow of gas from Romania to Hungary, which will enable the latter to obtain gas that is not Russian for the first time. Similarly, thanks to the gas interconnector with Poland, Slovakia can import gas from suppliers other than Russia. The Three Seas Initiative enables north-south energy integration in Central Europe to proceed even faster. The summits so far have been an excellent forum to agreement on important energy infrastructure construction projects, such as:

→ gas interconnectors between Poland and Lithuania, between Austria, Bulgaria, Romania and Hungary, and between Slovakia, Hungary and Romania, among others;
→ the LNG terminals in Świnoujście, Poland, and the island of Krk, Croatia;
→ the synchronisation of the Baltic States’ electrical networks with the other EU countries’ ones.

Money from EU funds will not be enough to complete energy investments. Over the next decade, as part of financing energy infrastructure, the Three Seas countries should allocate EUR 21 billion for transmission lines, EUR 51 billion for electricity distribution and EUR 16 billion for gas networks; of this, EUR 28 billion will go towards cross-border connections (Spotdata 2019). It is hard to expect that the EU will be able to finance the integration of energy markets in Central Europe as part of the reduced, post-Brexit Multiannual Financial Framework.

TRANSPORT AND LOGISTICS

Despite progress in the expansion of the transport network over the past decade, the investing in infrastructure, developing intermodal transport (connecting different means of transport) and developing cross-border connections in north-south corridors remains a fundamental challenge for the Three Seas countries. The region’s logistics competitiveness, measured using the Logistics Performance Index (LPI), is successively rising. Using the full economic potential generated by the development of transport infrastructure will require further investment by the logistics sector, including in ports and intermodal terminals, as well as the sector’s closer integration as part of the region.

The framework for the development of cross-border transport infrastructure as part of the Three Seas region is set by the Trans-European Transport Network (TEN-T), the programme for the development of railway, road, air, maritime and inland waterway transport in the EU. By 2030, it aims to establish a common European transport space, based on competitive and environmentally friendly solutions (railways and inland waterway transport), and to connect ports and airports appropriately with the railway network.
4. Development of connectivity in the Three Seas countries

Map 2. TEN-T corridors passing through the Three Seas region

Five of the nine TEN-T corridors pass through the Three Seas region (Map 2), including the key ones: Baltic Sea-Adriatic Sea (connecting Polish ports with the Port of Koper in Slovenia), the Rhine-Danube (integrating the region’s south) and the North Sea-Baltic Sea (connecting Poland with the Baltic States) corridors. Moreover, the Via Carpatia could be included in the network. In 2018, the TEN-T network was extended to the Three Seas countries’ neighbours in the Balkans and the Eastern Partnership countries.

**Chart 12. Level of implementation of TEN-T Core Network for railway transport in 2016 (per cent)**

<table>
<thead>
<tr>
<th>Country</th>
<th>Level of Implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rest of EU</td>
<td>78</td>
</tr>
<tr>
<td>Austria</td>
<td>72</td>
</tr>
<tr>
<td>The Czech Republic</td>
<td>63</td>
</tr>
<tr>
<td>Poland</td>
<td>23</td>
</tr>
<tr>
<td>Slovakia</td>
<td>20</td>
</tr>
<tr>
<td>Lithuania</td>
<td>12</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>11</td>
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<tr>
<td>Hungary</td>
<td>8</td>
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<tr>
<td>Slovenia</td>
<td>6</td>
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<tr>
<td>Croatia</td>
<td>5</td>
</tr>
<tr>
<td>Romania</td>
<td>4</td>
</tr>
<tr>
<td>Estonia</td>
<td>3</td>
</tr>
<tr>
<td>Latvia</td>
<td>7</td>
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</tbody>
</table>


**Chart 13. Level of implementation of TEN-T Core Network for road transport in 2016 (per cent)**

<table>
<thead>
<tr>
<th>Country</th>
<th>Level of Implementation</th>
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</thead>
<tbody>
<tr>
<td>Slovenia</td>
<td>100</td>
</tr>
<tr>
<td>Latvia</td>
<td>100</td>
</tr>
<tr>
<td>Austria</td>
<td>97</td>
</tr>
<tr>
<td>Hungary</td>
<td>81</td>
</tr>
<tr>
<td>Rest of EU</td>
<td>81</td>
</tr>
<tr>
<td>Poland</td>
<td>62</td>
</tr>
<tr>
<td>Croatia</td>
<td>60</td>
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<tr>
<td>The Czech Republic</td>
<td>55</td>
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<tr>
<td>Bulgaria</td>
<td>45</td>
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<tr>
<td>Romania</td>
<td>45</td>
</tr>
<tr>
<td>Slovakia</td>
<td>39</td>
</tr>
<tr>
<td>Estonia</td>
<td>34</td>
</tr>
<tr>
<td>Lithuania</td>
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</table>

The level of implementation of the TEN-T network in the Three Seas countries stands out clearly from the EU average, especially when it comes to railway transport (Chart 12). The period after they joined the EU was primarily used to make up for shortcomings in road infrastructure, but only minor progress was made when it comes to railway infrastructure. However, the latter determines transport’s competitiveness – the ability to build close economic links between companies. Achieving the TEN-T’s aims will require at least another decade of intensive and coordinated investment in infrastructure by governments, involving EU funds and launching additional sources of funding, including in dialogue with foreign partners (the US, Japan, China) and by attracting private capital focused on long-term investment in infrastructure. Given the global excess of capital and the slowing growth of the world economy, infrastructural investments offering stable rates of return could attract institutional investors, especially if they are combined with guarantees from public funds.

Reducing the gap in the level of transport infrastructure in the Three Seas region is accompanied by the broadening of the region’s offer when it comes to logistics (Chart 4). The development of international logistics is the key factor for maintaining the Three Seas region’s competitiveness and stimulating advanced production models. In the Logistics Performance Index (LPI) published by the World Bank, the Three Seas countries average score rose from 3.05 to 3.26 in 2007-2018 (on a scale of 1 to 5). However, it remains below the average for the rest of the EU (3.68) and for Germany, which has the highest score in the world (4.2).

Chart 14. Cumulative change in LPI logistic indicators for the Three Seas countries in 2007-2018

Source: prepared by PIE based on data from the World Bank (2020).
Within the Three Seas region, there are significant differences in the general level of logistics competitiveness, as well as the dynamics and direction of changes (Map 3). Austria has by far the highest LPI result, in all categories; it ranks a very high fourth globally. However, in 2007-2018, its result decreased slightly (by around 1 per cent). Over that period, it grew the most in Poland and the Czech Republic, increasing to 3.68 (from 3.13) and 3.54 (to 3.04), approaching the average result for the result of the EU. These were the only countries to increase the level of logistics competences significantly and broadened the availability of competitively-priced international transport. The overall result was also increased significantly by Croatia and Estonia. The result of the region recorded moderate growth, too, except Latvia, where the LPI result fell by as much as 7 per cent.

Map 3. LPI in the Three Seas countries

In the Three Seas region, a division is drawn between the relatively logisticsly competitive “centre” (Austria, the Czech Republic, Poland and Hungary, with Slovakia’s clearly weaker result) and the peripheral regions in the Balkans and the Baltic States, which remain less competitive. This results from differences in the level of infrastructure, but also from technological and organisational factors: disproportions in logistics competences, the ability to post competitively-priced international deliveries or track cargo. The development of deep economic connections as part of the Three Seas region, as well as obtaining network effects when developing infrastructure, therefore requires spending capital on logistics, raising human capital, technology transfer and good business practices.

The Three Seas Initiative can play an important role in shortening delivery times between member states, mainly by stimulating the development of infrastructure, supporting contacts in transport and logistics circles and promoting infrastructural projects among private investors. The technological and organisational gap points to the major potential to increase productivity in the transport and logistics sector in the Three Seas region and the high profitability of this type of investment.
DIGITAL INFRASTRUCTURE

Digital infrastructure is especially important for developing connectivity in the Three Seas region. As the economy’s "nervous system", infrastructure for communications and data transfer not only conditions the development of modern digital services, but also influences the productivity of industry and other services (including transport and logistics), as well as the efficiency of the production and transfer of energy. Digital infrastructure not only supplements, but also becomes the condition for the creation of modern transport connections, especially since experiments involving autonomous vehicles are at an increasingly advanced stage.

Source: prepared by PIE based on: Schwab (2019).

The level of ICT adaptation, calculated as part of the Global Competitiveness Report, in the Three Seas region is close to the European average in terms of digital infrastructure (Chart 15). This indicator aggregates the penetration of the cellular network and mobile Internet, access to the fibre optic network and the number of people in the population who use the Internet, among other things (Schwab, 2019). On a scale of 1 to 100, the region scored 71 points in 2019 on average, close to the level in Germany (70) and France (73.7). However, there is a clear geographical divide within the region. The Baltic States are among the best in the world (79-82 points), with the relatively developed Bulgaria and Romania behind them. Unlike when it comes to transport and logistics infrastructure, the region’s industrial "centre" – Poland, Hungary, Austria and the Czech Republic – is less developed in terms of digital infrastructure. These differences create the potential to establish a regional division of labour, in which, for example, the Baltic States could specialise in providing ICT services for the region’s industrial centres. Obtaining network effects in the Three Seas region will therefore require investment in digital infrastructure, both by public entities and private business.
5. Financing regional connectivity

With the region’s rapid economic growth and macroeconomic stability, the large gaps in connections between the Three Seas countries when it comes to energy, transport, logistics and the digital economy constitute major potential for highly-profitable investments. Countries in Central Europe are increasingly interested in carrying out these kinds of projects using funds from their own budgets, as they place them increasingly high on their national interest agenda. As noted earlier, high-quality infrastructural connections are a condition for guaranteeing energy supplies and supply chain continuity, but also for new connections that can increase competitiveness by speeding up the circulation of goods, services, capital, people and ideas. However, the insufficient accumulation of capital means that, for investments in infrastructure, the region still has to rely on external financing.

Fundamentally, three sources of external capital can be used to finance connectivity in the Three Seas region:

→ **grants and loans from the EU** so far have played a dominant role in supporting investment in increasing the region’s integration in every area of connectivity. However, their importance could decline in coming years due to Brexit and the higher level of income in Central Europe, which limits the availability of funds for reducing disproportions in the EU’s development;

→ **loans from multilateral organisations and the development banks of countries outside the Three Seas region** (including EU funds) are usually spent on investment projects that are also important in terms of the interests of actors from outside the region or serve to implement a certain global political agenda (such as climate policy or the Belt and Road Initiative);

→ **private investments**, which aim to carry out high-return projects on a commercial basis. They are financed from regional capital markets, among other places, and mainly focus on projects linked to the effective use of infrastructure, such as building sea and land reloading terminals, warehouses and purchasing of rolling stock.

These sources of capital are not separable and can be applied in hybrid form. Both the Three Seas countries and external development banks offer instruments for mobilising private capital, including through loan guarantees, preferential loans, taking up shares in projects and organising investment funds open to the participation of private capital. They aim to demonstrate a certain political will and lower the risk of the investment to attract private capital to integrate the region’s infrastructure.

EU FUNDS AND THE THREE SEAS’ INSTRUMENTS

In the Three Seas region, the main sources of official funding for energy, transport and digital infrastructure are individual countries’ budgets and, when it comes to international sources, EU funds:

→ **The Cohesion Fund** supports the development of transport, energy and digital infrastructure in countries with income below 90 per cent of the EU average. Its priorities include building a trans-
European transport network and developing environmentally-friendly sources of energy and means of transport. It consists of non-returnable subsidies. In 2014-2020, the Three Seas countries received EUR 35.6 billion in grants in these areas (European Commission, 2020).

→ The Connecting Europe Facility (CEF), a funding programme launched in 2014 as part of the Cohesion Fund, directly focused on developing connectivity in three main pillars: transport, energy and the digital economy. So far, the Three Seas countries have obtained EUR 13.5 billion in total (European Commission, 2019).

→ The European Regional Development Fund (ERDF) aims to strengthen the EU’s economic and social cohesion. Unlike the Cohesion Fund, it involves reducing disproportions between regions (European Commission, 2020). However, this does not rule out using the ERDF to integrate Central Europe by carrying out investments that can also create value added at the international level. Its priorities include supporting R&D, the digital agenda, SMEs and the low-carbon economy. In transport, energy and digitisation, funding for the Three Seas countries amounted to EUR 28 billion in 2014-2020.

→ The European Fund for Strategic Investments (EFSI) established in 2016 as part of the European Investment Bank (EIB) focuses on supporting private and public investment in priority areas through budget guarantees for higher-risk projects. Transport, energy and digital projects in the Three Seas countries received support of EUR 2.9 billion in total (European Investment Bank, 2020).

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7 As of February 2020. EU grants value refers to real absorption (funded projects) from national envelopes, as well as CEF and EFSI.
The total value of transport, energy and digital projects with the EU funds signed by the Three Seas countries in 2014-2020 was almost EUR 80 billion. The vast majority of funds were obtained as part of grants from the Cohesion Fund (including the Connecting Europe Facility) and the European Fund for Regional Development. However, the absorption of funds was uneven – Poland used almost 46 per cent of them, with absorption per capita of EUR 961. Romania was second, with almost EUR 11 billion (14 per cent), but absorption per capita of just EUR 559. Absorption was lowest in Bulgaria, with EUR 287 per capita, more than three times less than Latvia (EUR 1100), which came first in this respect. Austria has been omitted, as its income level means that it does not have access to cohesion and regional development funds. The reasons for these big differences are complex. Important factors include effectiveness when negotiating the level of EU funds, countries’ ability to absorb funds, and their ability to obtain financing from the funds available for the whole EU (EFSI, CEF). As a result, though, the southern Three Seas countries, with the lowest level of infrastructure, receive the least resources for developing it, in relative terms.

The instruments for financing the development of infrastructure as part of the Three Seas Initiative supplement EU instruments; they also have similar goals. The three foundations of the development of connectivity in the Three Seas region – transport, energy and digitisation – fit the objectives of the CEF. In 2019, on the initiative of Poland (Bank Gospodarstwa Krajowego) and Romania (Exim Bank), with the participation of Latvia and the Czech Republic, among others, a Three Seas Investment Fund was established. The initial capital contributed by regional development banks was EUR 500 million. Ultimately, it is also supposed to receive capital from other sources, including other development banks in the region, as well as institutional and private investors – EUR 3-5 billion in total.

Registered in Luxembourg, the Three Seas Fund operates on a commercial basis and
is managed by an independent entity, Fuchs Asset Management (Puls Biznesu, 2019), which is supposed to search for commercially viable ventures, including based on project proposals submitted by Three Seas countries. As a tool for mobilising private funds, the fund has considerable potential when it comes to searching for commercial projects that create synergies with spending on infrastructure, including when expanding logistics hubs in the Three Seas region.

EXTERNAL PARTNERS – THE US, CHINA, JAPAN

Central Europe located on the route of transport corridors between Europe and Asia, which makes it attractive in business terms. It is becoming an area of increasing geopolitical competition between big players, including the US, China and large EU countries. The competition between powers in the region is becoming a potential source of new opportunities for financing the development of connectivity in the region.

A new, potentially attractive mechanism for developing transport, energy and digital connectivity in the region is using the new development instruments prepared by the US. In response to the changing geopolitical context, around the end of 2019 and the start of 2020, the US carried out a deep reform of its existing development institutions (including USAID and OPIC), transforming them into one – the U.S. International Development Finance Corporation (US DFC, 2020). The institution combines the tasks of a development bank (issuing loans for development projects and bank guarantees, among other things) and an investment fund (with shares in projects). In parallel, the US is developing the Blue Dot Network (BDN), which aims to mobilise private capital through a system of certifying projects in terms of quality and the promotion of sustainable development, issued by a consortium of development banks in the US and other developed countries, including in Europe and East Asia. The new architecture of American development financing is geared towards developing countries, but could also potentially encompass all or some of the Three Seas region, especially for projects that the US considers priorities or significant for security reasons. Washington’s current priority in the Three Seas region is energy, as emphasised by Secretary of State Mike Pompeo’s declaration in 2019 that it will invest USD 1 billion in this area.

In parallel to the US and EU’s actions, China is making its presence felt in Central and Eastern Europe, defined more broadly than the Three Seas region. The first meeting in the 17+1 format was held in Warsaw in 2012. It was also attended by countries in the Western Balkans that are not members of the EU and, since 2019, Greece (Austria is just an observer). The very broad area of 17+1 cooperation includes energy (with an emphasis on coal and nuclear energy-generation technologies) and, since the summit in Riga in 2015, one of the priorities is transport and logistics. These areas are especially important for China due to the Belt and Road Initiative’s transport dimension and the rapidly-growing railway connections between China and the EU, in which Central and Eastern Europe plays the key role of a “gateway to the EU” and an important logistics centre.

Although building transport and logistics connectivity in the region in one of Beijing’s priorities, China’s role as a source of development financing for the Three Seas countries remains small. The terms of the Chinese Exim Bank’s credit line, geared towards the
development of transport and energy infrastructure, remains financially unattractive for the countries in the region and incompatible with EU legislation (including procurement law). As a result, in the eight years since the format was established, the only contract within the Three Seas Initiative region signed according to this model is a Chinese-Hungarian-Serbian railway line project linking Belgrade and Budapest worth USD 2.9 billion. However, due to a conflict with the European Commission on the Hungarian side it is not being implemented. Unlike EU funds, Chinese projects are carried out in the form of export loans, rather than grants.

In addition, there are two private equity funds operating in the region (China-CEE Fund I and II). Founded by the Chinese and Hungarian Exim Banks, they invest in regional enterprises in the energy, transport and education sector. A third Chinese fund with a similar profile, the SINO-CEE Fund, was established in 2016 by Chinese state-owned bank ICBC and a group of state-owned insurers. Originally, it was supposed to be funded by regional banks in the region, but ultimately the unattractive conditions of cooperation (limited opportunities to obtain the status of general partner) meant that only Hungarian Exim Bank joined it (EUR 100 million).

In addition to China, Japan is present in the Three Seas region. In terms of foreign direct investment, Japanese (and South Korean) companies are significantly more important in Central and Eastern Europe than Chinese entities. In 2018, Japanese Prime Minister Shinzō Abe visited five Three Seas countries (Lithuania, Latvia, Estonia, Bulgaria and Romania) and, in April 2019, he met with the leaders of Poland, Slovakia, the Czech Republic and Hungary as part of the V4 format in Bratislava. The summit took place on the day of the Belt and Road Forum in Beijing, which showed Japan’s ambition to compete with Chinese when it comes to increasing connectivity in Central and Eastern Europe. The institutional and financial framework of potential Japanese engagement is prepared as part of the EU-Japan Partnership on Sustainable Connectivity established in 2019 during a conference in Brussels, with both parties pledging to cooperate on the development of transport, energy and digital infrastructure in Eurasia (The Partnership on Sustainable..., 2019).

PRIVATE INVESTMENT AND CAPITAL MARKETS

The mobilisation of private investment by the state, including in cooperation with external partners, should be treated as a way of further increasing the investment rate in the Three Seas countries. In 2004-2008, the share of investment in the Three Seas countries’ GDP amounted to as much as 27 per cent, almost 5 percentage points above the average in the rest of the EU. This created a strong foundation for accelerating real convergence. However, the financial crisis of 2008, and then the Eurozone crisis, lowered the investment rate in almost all the countries in the region – in 2014-2018, the average rate was just 21.7 per cent (only 1.9 points more than in the rest of the EU). The largest drop was recorded in Latvia (11 points), Estonia (9.4 points), Slovenia (9.1 points), Bulgaria (8.5 points) and Romania (5.9 points). The smallest decrease occurred in the region’s economic “centre” – Poland, Hungary and the Czech Republic. Austria was the only country in the region where there was a slight increase (0.1 points).
The drop in the investment rate in the Three Seas countries is directly related to the decline in the influx of foreign capital in 2008-2012 (Chart 17). After the region’s accession to the EU began, it experienced a significant current account deficit. In 2007, the average for all the Three Seas countries was 5.7 per cent, including a record 25.7 per cent in Bulgaria and 21 per cent in Latvia. In 2014-2018, the region generally recorded a relatively balanced current account turnover, maintaining its balance in the range of between -2 per cent and +2.5 per cent (except for Romania, which had a high deficit, and Slovenia, which recorded large surpluses). These processes had a stabilising effect on the Three Seas countries’ economies, but led to the end of the post-accession investment boom fuelled by external capital.

Alongside efforts to increase the influx of foreign capital, a fundamental way of increasing
investment rate in the Three Seas region remains increasing domestic savings and creating effective mechanisms for allocating capital – including developed capital markets. In terms of stock market capitalisation (Chart 19), the Warsaw Stock Exchange (EUR 140 billion) is the leader in the region, followed by the stock exchanges in Vienna (EUR 102 billion), Budapest (EUR 25 billion) and Prague (EUR 23 billion). The total capitalisation of the stock exchanges in the Three Seas countries in 2018 was EUR 347 billion, around 19 per cent of the region’s GDP. For comparison, that year the capitalisation of German stock exchanges corresponded to around 44 per cent of GDP\(^8\), which indicates that there is potential for the Three Seas region’s capital markets to grow.

\[\text{Chart 19. Stock market capitalisation at exchanges in the Three Seas region in 2018 (billions of EUR)}\]

- Ljubljana SE
- Zagreb SE
- Warsaw SE
- CEESEG – Vienna SE
- CEESEG – Prague SE
- Bulgarian SE
- Budapest SE
- Bucharest SE


According to research by the CFA Institute, the region is still struggling with limitations in this area, including ones linked to the low number of listed entities and the low demand among retail investors and, in the case of certain markets (Hungary, Slovenia), institutional investors, too (Silvestri, 2019). These limitations could potentially be overcome through closer regional cooperation in this area. One example of this is the initiative announced in 2019 to create a joint Three Seas region index, the CEEPlus, including the stock exchanges in Poland, the Czech Republic, Hungary and Slovakia, as well as Croatia, Romania and Slovenia (GPW, 2019). The index is supposed to feature around 100 of the most liquid companies and be accompanied by passive funds geared towards retail investors.

\(^8\) Prepared by PIE based on World Bank data.

1. Consequences of the COVID-19 pandemic for the Three Seas countries’ economies. For the Three Seas countries, the biggest challenge since at least the socio-economic transition after 1989 will be coping with the economic consequences of the COVID-19 pandemic. It is likely that the consequences of the freezing of the economy will affect individual countries in different ways. The economic losses caused by the pandemic could result in the bankruptcy of many western companies, which will create space for the expansion of certain companies from the Three Seas region and an opportunity to occupy a higher position in supply chains.

2. The threat of certain global companies going bankrupt could mean a decrease in orders for many suppliers in Central Europe. The role of the state in many economies will certainly increase, at least temporarily. For the Three Seas countries, the crisis caused by the COVID-19 pandemic could turn out to be an opportunity to redefine their economic model, decrease their dependence on foreign capital, and seek regional synergies and the optimal pattern of the division of labour in the region. On the one hand, maintaining considerable resources when it comes to industrial production could become one of Central Europe’s advantages. On the other hand, the region should perhaps seek new opportunities to use their advantages, especially since the automotive sector, which has a strong presence there, could be one of the largest victims of the COVID-19 pandemic.

3. New Europe-Asia trade flows. The start of the 21st Century brought significant changes in the structure of trade between Europe and Asia, linked to the opening of overland railway connections over the Eurasian land mass and the rapid development of ports in the Three Seas region. The region, which previously traded with the rest of the world through seaports and airports in Western Europe, is starting to play the role of an important European logistics hub. The rapid development of the port in Gdansk, which is increasing serving the northern part of the Three Seas region, has led to the separation of the world’s most important maritime route between Europe and Asia into two branches – the North Sea and the Baltic Sea. The port in Koper, Slovenia, which ensures access to the southern part of the Three Seas region and to southern Germany, it is part of the increased importance of Mediterranean ports in trade with Asia. This is combined with the completely new flow of trade by rail from China, which accounts for around 5 per cent of the value of trade between the EU and China, which reaches the EU transport network through the EU’s eastern border in Poland. The new transport connections and freight streams in the Three Seas area are an opportunity to develop the logistics sector, including the network of regional hubs, as well as a factor increasing the region’s industrial competitiveness.
4. **Backshoring, nearshoring and reshuffles in supply chains.** The growing international uncertainty that results from the unforeseeable consequences of the US-China trade war, the coronavirus pandemic and the intensifying situation in the Middle East, among other things, are reducing investors’ appetite for risk and could lead to the shortening of supply chains. These processes will foster backshoring (the return of production to the domestic market) and nearshoring (the return of investments to neighbouring countries) from production bases in Asia to Europe, which is currently supported by a series of economic and political factors. The so-called fourth industrial revolution, which relates to 3D printing and robotisation, among other developments, is changing the calculation when choosing where to produce and making countries in Asia, including China, where the main competitive advantage of the cheap labour costs, has been less attractive. This is juxtaposed with a series of political processes, including the American strategy of decoupling the Chinese economy from global supply chains and China’s growing protectionism, which is deterring some European producers. Add to that the impact of the coronavirus pandemic in 2020 – which is still difficult to measure – which will lead to at least some of the most strategic production returning to the EU. The Three Seas region could benefit from this process significantly; it not only offers labour costs that are still relatively competitive, but also a high level of human capital and, with the appropriate state policy, transport and infrastructure connectivity that increases the region’s overall competitiveness.

5. **The European Green Deal.** Another challenge for the years ahead is the need to introduce low-carbon technologies in EU countries. An example of these ambitions is how the European Investment Bank has been entrusted with supporting the energy transformation towards a low-carbon economy in EU member states, and banned from financing gas power plants, which are considered relatively low-carbon (especially compared to coal-powered ones). Meeting stringent climate goals requires building a single European energy market with much greater potential for transmitting the energy generated between individual countries. From the Three Seas countries’ perspective, the higher costs of building traditional infrastructure (especially roads) could constitute a threat when it comes to implementing climate goals, although railway investments will be appreciated. A relevant question is how sectors traditionally present in the Three Seas countries, such as the automotive, chemical and construction sectors, will adapt to the Green New Deal, and how this will affect their presence in the region. So far, even German automotive companies, which enjoy a strong position globally, are struggling to master the technology to produce electric cars in a profitable way. From 2020, the EU will require that a certain share of the cars produced by manufacturers be electric; otherwise, they will face large fines.
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