



## To our readers

The Institute for Economies in Transition at the Bank of Finland (BOFIT) conducted its final monitoring report on the Baltic States (*Baltic Economies – Bimonthly Review*) and Poland (*Polish Economic Review*) at the end of the year 2003. The Pan European Institute (PEI) decided to carry on this monitoring activity since the Baltic Sea Rim has been one of the Institute's core research areas for several years. Though the PEI generally follows the monitoring tradition set up by the BOFIT, slight changes concerning the emphasis of these reports will be incorporated.

We concentrate our monitoring reports on economic and particularly upon business development in the Baltic Rim. The *Baltic Rim Economies – Bimonthly Review* consists of concise information on recent macroeconomic development, reasons behind important movements and expectations concerning the near future. In addition, we inform our readers of interesting news concerning the business climate, legislation, corporate acquisitions and major foreign direct investments in the three Baltic States and Poland. Each bimonthly report includes an expert article on a current topic.

The Bimonthly Review will be published regularly on the last weekday in every even month. The report is freely available on the Internet, in pdf-format, in the following site: <http://www.tukkk.fi/pei/bre>. We will also inform our readers by email when the new review comes out. You can subscribe into our mailing list using the same address. We do not publish a paper version of the report.

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## Estonia

### GDP growth accelerated in the third quarter

Estonian GDP grew 4.6% y-o-y in the third quarter of 2003 and 4.4% during the first nine months of 2003 compared to same period in 2002. Growth rose from the previous quarter when the equivalent rate was 3.5%. According to preliminary estimates, GDP growth in 2003 will be close to 4.5%, thus a bit slower than expected in early 2003. However the growth is predicted to accelerate in 2004 due to an improved foreign economic situation. The growth forecasts for 2004 vary from 5.1 to 5.8%. In comparison the economic growth in Euro area is estimated to be around 2% in 2004.

Domestic demand remained strong and increased over 6% y-o-y in the third quarter. Both private and public consumption increased around 5% y-o-y. The growth of gross fixed capital formation increased from 4% in second quarter, up to 9%. Exports grew by 4% and imports 10% in the third quarter. The import of goods increased 14% y-o-y while imports of services declined simultaneously by 5%. Regarding economic activities, the value added increased most in mining and quarrying (10%), construction (9%) and manufacturing (7%).

Inflation has remained slow since April 2003. The annual inflation (CPI) in January 2004 was 0.5%. Health care prices rose 7% whilst the prices of transportation declined nearly 3% y-o-y.

According to a labour force survey, the employment rate increased slightly in the fourth quarter (y-o-y). The unemployment rate declined by two units, from 11.3 to 9.3% y-o-y, and was also a bit lower than in the previous quarter of 2003. The average gross wage grew 9.4% y-o-y, the gross monthly wage grew fastest in construction, up 22%.

### Exports and imports grew in 2003, the current account deficit remained at high level

According to preliminary trade statistics at the end of December, foreign trade deficit increased 21% y-o-y up to 1.7 billion euros in 2003. Exports grew 10% while imports grew 13% during the same period. During the first eleven months of 2003, the share of EU-15 trade was 69% in exports and 54% in imports. The structure, by countries, remained quite stable compared to 2002. Finland is still the most important trade partner both in exports (26%) and in imports (16%). The share of exports and imports to/from Russia decreased during 2003.

Estonia's current account deficit remained at a high level in the third quarter, 13.2% of GDP, and during the first nine months the deficit was 14.6% of GDP. According to the Bank of Estonia, the Estonian economy faces serious problems due to its substantial current account deficit. Export volumes have to increase and the underlying principal contributor to the growth of imports - internal demand - has to decline. Otherwise this will cause the substantial decline of economic growth in the following years.

Net inflow of FDI financed 43% of the deficit in the third quarter. As of 30<sup>th</sup> September, the volume of FDI was, in total

5.2 billion euros. Estonia expects over 10 billion in FDIs in this year. At the end of third quarter, Estonia's net foreign debt was around 15% and public debt 3% of GDP.

Bank loans to individuals continued to increase; the loan stock was 48% larger at the end of 2003 compared to the end of 2002. However the growth rate slowed down in December.

### Net sales of enterprises up 10%

In the third quarter of 2003, the net sales of enterprises increased 10% y-o-y. The net sales increased in all activities except the primary sector. The growth was highest in health and social work (41%), transport, storage and communication (23%), and education. The contribution of micro enterprises was 21% of totals. The growth of net sales has continued since the second quarter of 1999.

### Government aims rapid incorporation to eurozone

The government of Estonia decided on the 16<sup>th</sup> January that Estonia's aims towards joining the ERM2 exchange rate mechanism as soon as possible after 1<sup>st</sup> May, and being ready to launch the euro in the middle of 2006. Estonia's objective is to be among the first new members, and Estonia has good prospects for meet the criteria. The rapid incorporation should not be the aim itself, merely a consequence of a stable currency as well as macroeconomic stability. On the other hand, this rapid incorporation asks for cooperation with the government, the Bank of Estonia and the private sector.

Estonia's hope that the forthcoming EU membership would remove Russian's double customs seems to be dashed. Russia announced it could bring in hard requirements for Estonian imports. Estonia's (and the EU's) diplomatic efforts face a great challenge in order to remove the barrier.

### Some business highlights

- Banks' profits increased in 2003. Eesti Ühispank Group reported its net profit increased up to EEK 542.7 million, the annual growth was 43%. Hansapank Group's net profit went up 9% up to EEK 130.9 million.
- Estonian Air carried 46% more passengers in January 2004 compared to the previous January, and in 2003 31% more than in 2002, whilst the Tallinn-Helsinki ferry line lost 0.4 million passengers in 2003, down to 5.7 million.
- Estonian transit trade companies are enjoying a boom in business due to the mild winter and Russian transitions.
- Estonia auctions the fourth UMTS licence. Deadline is 23<sup>rd</sup> April, and the starting price is 4.5 million euros.
- ICT company Vihmapuu won a large medical software contract in California.
- Estonian Cell, a subsidiary of Norwegian Larvik Cell, plans to build a new pulp plant in Kunda, in North Estonia. The investment will be around EUR 165 billion.
- Elcoteq plans to double the size of its assembly plant in Tallinn.
- Kesko's food sales grew 31% in 2003 up to EEK 3.3 billion. Kesko and Swedish ICA are planning a joint venture in the Baltic States.
- Media advertising markets grew 12% in 2003 up to EEK 908 million.
- Swedish textile manufacturer Borås Wäfveri plans to transfer its whole production to Estonia; an Irish paper maker, Victor Stationary, plans to hire 150 Estonians for its new plant.

Estonia - main economic indicators	1997	1998	1999	2000	2001	2002	2003	2004	as of
GDP (y-o-y %-growth, constant prices)	9,8	4,6	-0,6	7,3	6,5	6,0	4,4		1-9/2003
Industrial production (y-o-y %-growth)	14,6	4,1	-3,4	14,6	8,9	7,4	9,7		1-12/2003
Inflation (CPI, end of period, y-o-y %-change)	12,5	6,5	3,9	5,0	4,2	2,7	1,1	0,5	01/2004
General government budget balance (% of GDP)	2,2	-0,3	-4,7	-0,7	0,4	1,2	2,5		1-9/2003
Gross wage (period average, EUR)	227	262	284	314	352	393	455		Q4/2003
Unemployment (% end of period, LFS data)	9,8	10,2	12,9	13,9	11,9	11,3	9,3		Q4/2003
Exports* (EUR million, current prices)	1 891	2 252	2 239	3 445	3 698	3 641	3 995		1-12/2003
Imports* (EUR million, current prices)	3 127	3 529	3 224	4 615	4 798	5 079	5 734		1-12/2003
Current account (% of GDP)	-12,1	-9,2	-4,7	-5,8	-6,0	-12,3	-14,6		1-9/2003

Source: Statistical Office of Estonia, Bank of Estonia, own calculations

\*special trade system

## Latvia

### Strong economic growth continues

Latvia's rapid economic growth continued in the third quarter of 2003. GDP growth in the nine months 7.3% y-o-y, and 7.4% during the third quarter compared to the analogues period of the previous year. The growth accelerated from the second quarter, when the y-o-y rate was 6.2%. The annual growth rate for 2003 is predicted to be 7.0-7.2%. Recent forecasts estimate the growth for the year 2004 to be from 6.3 to 7.0% while the estimated rate for acceding countries is notably lower, around 4%.

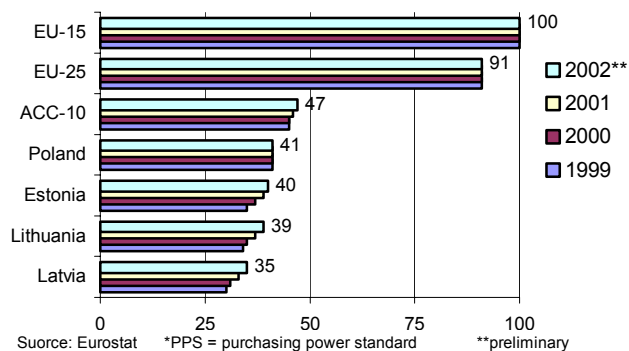
In the first nine months of 2003, the increase was mainly based on the growth in trade (11%), manufacturing (9%), transport and communications (8%), and construction (16%). These activities constituted nearly 60% of total GDP. In manufacturing, the production of food products and beverages grew 8% in the third quarter. Also, the manufacture of fabricated metal products increased 21%, the manufacture of wood products grew 18%, and machinery and equipment 15% y-o-y. The most remarkable decline exists in the manufacture of chemical and chemical products, -15% y-o-y.

The growth of construction is notable. New construction production rose 24% and repair and reconstruction 18% in the third quarter y-o-y.

According to recent data of from 2003, retail trade increased strongly in 2003, as in previous years, 13% y-o-y in constant prices. Growth increased most in the trading of clothes, footwear and textiles. Industrial output increased 6.5% y-o-y in constant prices, and 4.2% during the fourth quarter. The growth was largest in manufacturing (10%) and in mining and quarrying (5%).

Inflation has remained rather high. Consumer prices rose 3.9% y-o-y in January 2004. Compared to December, the prices rose 1.2%, which is the sharpest month-on-month rise since January 1999. That was mainly due to changes in living costs. Producer prices also increased sharply 4.9% y-o-y in January.

### Per capita volume indices of GDP in PPS\*



Eurostat has recently published regional GDP per capita values in EU and acceding countries in 2001. According to their results, the lowest regional GDP values, calculated by purchasing power standard, in the ten acceding countries were found in some six Polish counties (29-31%), and the next weakest was Latvia as a whole. The GDP (PPS) in Latvia was 33% while the highest value was 135%, in Prague.

### The value of exports and imports grew side by side

Latvian exports increased in the unit value by 7.9% y-o-y in 2003, and the unit value of imports increased 6.9%. At current prices, exports grew 17.2% while imports grew still faster by 19.7%. The trade balance gap became broader when imports exceeded exports by 81%. In exports, wood and wood articles constituted the largest part, 35% of total exports. Export grew in almost all the commodity groups, though growth was sharpest in exports of machinery, mechanical appliances and electrical equipment (28%), and by the total value in exports of wood and wood articles (109 mln lats, up 23%). Correspondingly in imports, machinery etc. constituted the greatest share of total imports, as its share was 21% (up 19% y-o-y). Imports of base metals and articles of base metals grew by 2%, and transport vehicles 28%. Great Britain (16%) overtook Germany as a most important export country, but in the import sector, Germany's share (16%) is still clearly the greatest.

The continuous burden of the Latvian economy, the current account deficit, has remained at a high level. In the third quarter of 2003 the deficit was 10.3% of GDP and in the nine months 8.9% y-o-y. As of nine months, direct investments covered 35% of the current account deficit.

### The number of foreign travellers rose in 2003

According to CSB's survey of travellers in 2003, the amount of foreign travellers in Latvia was the highest in a decade, 2.47 million, up to 0.2 million from previous year. Also, the amount exceeded the value of Latvian travellers returning from abroad. The average visitor spent 1.9 nights in Latvia, and used 27 lats per day. Majority came from neighbouring countries, from Lithuania (31%) and Estonia (26%).

### Latvia's view of the introduction of the euro

In December 2003, Latvia complied with the Maastricht criteria, except their exchange rate stability. According to current projections, the peg of lats to the euro could be implemented as of January 2005 alongside with joining the ERM2. Adoption of the euro could take place on January 1<sup>st</sup>, 2008.

### Some business highlights

- Passenger turnover in the regular flights of the Latvian Airlines rose 31% in the first nine months, freight turnover by train 31%, and cargo turnover 16%. The volume of transported oil products decreased 13%.
- Five leading supermarket chains, VP Market, Rimi Latvija, Mego, Nelda and Kesko Food, increased their sales 49% in 2003.
- Neste Latvija and Latvija Statoil may sue the Latvian government for a claim. A dispute concerns companies' oil quay contracts in Riga Free Port.
- A settlement between the Latvian government and TeliaSonera could delay due to a government crisis, but it is still one of priorities in their telecommunication policy. TeliaSonera has announced its readiness to begin the negotiations.
- Latvian banks made a record aggregate profit in 2003, LVL 71.7 million (56 million in 2002); loans for private persons grew 77% in 2003.
- French construction giant Bouygues expressed its readiness to build and operate the Riga Icehockey Hall. Multihalle is responsible for the construction, and the deadline for completion of the hall is September 2005.
- Forecast: The Latvian advertising market grew 10% in 2003 to LVL 45 million.
- Vitol Group is interested in a 38.6% share of Ventspils Nafta.
- Retail trade companies Elvi Grupa and Iepirkumu Grupa are negotiating a possible merger; Lidl plans to enter Latvia in 2005.
- Latvia is to auction a third mobile operator licence by the end of this year.

Latvia - main economic indicators	1997	1998	1999	2000	2001	2002	2003	2004	as of
GDP (y-o-y %-growth, constant prices)	8,4	4,8	2,8	6,8	7,9	6,1	7,4		1-9/2003
Industrial production (y-o-y %-growth)	6,1	2,0	-8,8	3,2	6,9	5,8	6,5		1-12/2003
Inflation (CPI, end of period, y-o-y %-change)	7,0	2,8	3,2	1,8	3,2	1,4	3,6	3,9	1/2004
General government budget balance (% of GDP)		0,1	-4,0	-2,8	-2,1	-2,5	-1,8		estimate
Gross wage (period average, EUR)	183	202	225	268	282	297	302		Q3/2003
Unemployment (% end of period, LFS data)	14,1	13,7	13,2	13,3	12,9	11,6	10,7		Q3/2003
Exports* (EUR million, current prices, average exch. rate)			1 613	2 020	2 232	2 416	2 559		1-12/2003
Imports* (EUR million, current prices, average exch. rate)			2 758	3 453	3 910	4 284	4 634		1-12/2003
Current account (% of GDP)		-10,6	-9,8	-6,9	-9,6	-7,8	-8,9		1-9/2003

Source: Central Statistical Bureau of Latvia, Bank of Latvia, Ministry of Economy; own calculations

\*special trade system

## Lithuania

### GPD growth estimate 8.9% in 2003

According to preliminary estimates, GDP growth in 2003 went up by 8.9% and exceeded all forecasts. The growth was generated in almost every area of activities. The increase was largest in industry, construction, and the wholesale and retail trade. At the same time the GDP per capita value rose 9.6% y-o-y (at constant prices), up to 4599 euros. According to preliminary calculations, the growth in the fourth quarter of 2003 was 10.6% y-o-y while the corresponding rate in the second quarter was 8.1%. The growth was mainly based on the same activities as throughout the whole of 2003.

In the first nine months of 2003, GDP growth was 8.3% y-o-y. Electricity, gas and water supply grew 25% in the third quarter, construction 21% (of which new construction numbers 38%), mining and quarrying 14% and trade 12%. In the manufacturing sector, growth was 15%, of which the largest lay in the manufacture of rubber and plastic products (41%), refined petroleum products (36%) and furniture (26%).

Respectively, domestic demand grew fast in the third quarter. Households' consumption increased nearly 12% and public consumption by 5%. Gross fixed formation increased 18% y-o-y. Exports grew 7% while imports grew simultaneously rapidly by 12% y-o-y.

According to preliminary results, the turnover of retail trade companies increased over 14% in 2003 compared to previous year. Growth was sharpest in the sales and repairs of motor vehicles, and in the sales of household consumables. Construction enterprises performed their own account 16% more than during the year 2002.

Economic forecasts for the year 2004 are highly optimistic, the estimates range between 6 and 7%. Public consumption is projected to grow notably in 2004 and 2005, partly due to forthcoming EU co-financed projects.

### Prices went down in 2003

The consumer price index was at the end of January 2004 1.3% lower than in the corresponding period for 2003. Prices went down most in communications, -15%. Compared to the previous month, the CPI rate in January 2004 was zero.

### Enterprise sector in 2001

	Estonia	Latvia	Lithuania	Poland*
Total number (1000)	29	36	58	1417
of which (%)				
Micro	78,5	76,9	81,5	96,5
Small	17,8	18,9	14,9	2,4
Medium	3,3	3,7	3,2	0,9
Large	0,5	0,5	0,4	0,2
Turnover (EUR billion)	18	18	22	409
Value added (EUR billion)	3	6	4	147
Employment (1000)	356	496	699	7022

Source: Eurostat \* data as of 2000

### Moody's and S&P raised Lithuanian credit ratings

International rating firms, Moody's and Standard&Poor's, upgraded Lithuania's foreign and domestic currency ratings for the very first time from the previous Baa1 to A3, and BBB+ to A-. The upgrade is based on the positive economic progress and the success of the structural reforms pursued.

The Heritage Foundation's "2004 Index of Economic

Freedom" ranked Lithuania at 22<sup>nd</sup> place. In comparison, Estonia was ranked on 6<sup>th</sup> and Latvia at 29<sup>th</sup> place.

### Exports grew faster than imports in 2003

According to preliminary data, Lithuania's exports increased by 8.7% y-o-y in 2003 while imports increased only 4.9% during the same period. The trade deficit decreased nearly 5%, down to EUR 2.3 billion. Exports to current EU countries declined sharply from 48% to 42%. However, the share of acceding countries increased 9% y-o-y up to 19%. The most important trading partners were Switzerland (12%), Russia (19%) and Germany (10%). Exports to Great Britain declined by 50% whilst exports to Switzerland grew nearly eightfold due to Lithuanian oil refinery Mazeikiu Nafta's exports through Switzerland. In imports, the EU's share grew slightly, up to 45%, and the acceding countries share to 12%. Russia's (22%) and Germany's (16%) share is still dominant in Lithuania's imports.

In exports, the share of mineral fuel grew by 14% y-o-y up to 19.5%. The next largest share was of vehicles etc. (15%) and textiles and textile articles (13%). Machinery and mineral fuel were the largest import articles in 2003.

Lithuania's public debt declined in 2003 due to the decrease of government guaranteed loans and exchange rate fluctuations. At the end of 2003, their debt was about 24% of the estimated GDP. Foreign direct investment stock increased 1% within the first nine months of 2003. The stock per capita was EUR 1116. Denmark, Sweden and Germany remained in their position as the key investor countries.

According to the recent quarterly data of Lithuanian balance of payments, the current account widened in the third quarter of 2003 compared to the analogous period in 2002. The deficit in the first nine months amounted to 5.8% of GDP.

### Sharp decrease in foreign visitors

The number of foreign visitors decreased in 2003 by over 9% from the previous year. The decrease was based on the decline of visitors from neighbouring countries; the number of Russians dropped 24% and Belarussians 21%. On the other hand, the number of visitors from Western European countries grew notably in 2003.

### Some business highlights

- Lithuanian banks' aggregate profit of LTL 235.5 million in 2003. Hansabanka's profit grew 21.6% up to LTL 61 million in 2003; Vilniaus Bank's profit grew 4.6% to LTL 133 million; Snoras Bank's profit went down to LTL 8.3 million.
- Spanish garment retailer Zara has chosen Lithuanian Apranga as partner in establishing its Baltic chain.
- Klaipeda harbour handled a record-high cargo tonnage in 2003 to 21.1 mln. tons.
- Construction products trader Senukai's sales grew 31% in 2003 to LTL 679 mln.
- Construction company Penevezius Statybos Trestas' turnover grew 46% in 2003; YIT Kausta informed that its turnover dropped 15% in 2003.
- Two investors left a bid for the 86% share of KHES, builder of the Kruonis pumped storage power plant.
- Vakaru Nafta plans to produce disposable tableware and packaging in Klaipeda free economic zone. Production would commence in 2005.
- OMHEX announced its interest in privatisation of the National Stock Exchange.
- Lithuania and EU have allocated nearly LTL 1 billion for road building in 2004.
- Vilnius airport served 13.4% more passengers in 2003 compared to 2002.
- Kaunas city plans a new technology park, partly financed by PHARE.

Lithuania - main economic indicators	1997	1998	1999	2000	2001	2002	2003	2004	as of
GDP (y-o-y %-growth, constant prices)	7,0	7,3	-1,8	4,0	6,5	6,8	8,9		estimate
Industrial production in sales (y-o-y %-growth)	3,3	8,2	-9,9	2,2	16,0	3,1	20,1		Q3/2003
Inflation (CPI, end of period, y-o-y %-change)	8,4	2,4	0,3	1,4	2,0	-1,0	-1,3	-1,3	1/2004
General government budget balance (% of GDP)				-2,3	-1,9	-1,4	-1,5		estimate
Gross wage (period average, EUR)	173	208	231	264	296	332	340		Q3/2003
Unemployment (% end of period, LFS data)	14,1	12,6	15,3	16,1	17,5	13,0	11,6		Q3/2003
Exports* (EUR million, current prices, average exch. rate)			2 583	3 841	4 778	5 526	6 135		1-12/2003
Imports* (EUR million, current prices, average exch. rate)			4 340	5 650	6 767	7 943	8 441		1-12/2003
Current account (% of GDP)	-10,2	-12,1	-11,2	-6,0	-4,8	-5,3	-5,8		1-9/2003

Source: Statistics Lithuania, Bank of Lithuania, own calculations

\*special trade system

## Poland

### GDP growth accelerated in the last quarter

According to preliminary estimates, Poland's GDP grew in the fourth quarter faster than expected, by 4.7% y-o-y, and up 3.7% on the whole of 2003. The growth was based on growth of investments and exports combined with low import demand. During the first nine months of 2003, GDP grew 3.3% y-o-y, and within the third quarter by 4.0% (revised data). According to forecasts, GDP growth in 2004 is expected to be around 4.3-4.8%.

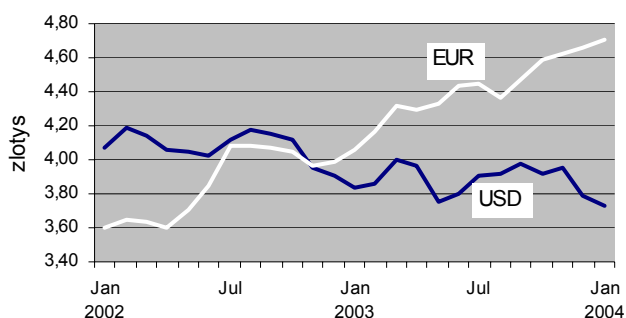
Examining the whole of 2003, industry grew 7.6% y-o-y, services 4.1%, and household consumption 3.1%. Respectively, construction decreased by 5.1% y-o-y and gross fixed capital formation 0.9%. Domestic demand grew stably throughout every quarter, and increased by 2.4% y-o-y. During the fourth quarter of 2003, industry grew nearly 10% and household consumption by 4%.

The growth of industrial output remained strong in 2003. The sold production of industry grew 8.7% compared to previous year, and in manufacturing the growth rate was 10.4%. Growth was largest in the manufacture of motor vehicles etc. (31%), the manufacture of machinery and equipment (23%), the manufacture of furniture, and the manufacture of rubber and plastic products (both 20%). The sales of new car sales grew by over 16% in 2003, up to 358 000. However, planned changes in VAT legislation may cause a sharp decrease for 2004. Output growth continued in January 2004, and leapt above expected growth, up 14.3% y-o-y.

Within the first eleven months of 2003, Poland's exports grew nearly 22% y-o-y (at current prices, in zlotys) whilst exports grew 16%. Due to significant currency fluctuations, the value in euros grew in exports by 6.8%, and in imports by 1.6%. The foreign trade structure, by nations, remained very stable; Germany's share remained around one third in exports and one fourth in imports.

Inflation has remained at a low level since mid-2002. In January 2004, the consumer price index was 1.7% higher than a year before. Inflation seems not to be a notable risk in 2004 whilst a weakening zloty increases import prices.

### Zloty's exchange rate



Depreciation of zloty against the euro continues, and according to analysts, the euro could soon cost 5 zlotys. From January 2003 to January 2004, the zloty's external value decreased by 16%. During the same period, the value against the dollar increased 2.6% due to zloty's appreciation during recent months. Rising value of the euro is a main threat to Polish economy, engaged with the increasing public

debt, and a very high unemployment rate.

Poland's public debt at the end of 2003 is estimated to be close to 50% of GDP whilst the debt at the end of 2002 was 46%. According to the state budget for 2004, the debt may increase to close to 55% in 2004.

### Hausner's austerity plan would create savings of close to 50 billion zlotys in 2004-2007

Poland's deputy Prime Minister Hausner expects aggregate savings from the government's austerity plan to be around PLN 50 billion during the forthcoming years. The government has previously adopted the plan to cut public spending PLN by 31 billion. According to PM Miller, early general election will be held if the Sejm will not support the plan.

The IMF has announced its support for the Hausner plan. The austerity plan could ease Poland's debt incurrence, which is necessary in order to meet the Maastricht criteria. Poland aims at joining the eurozone at the earliest in 2007. According to many experts, though, 2009 seems to be more realistic aim.

### Poland will get over 50 billion euros in 2007-2013

The European Commission proposed, in its "Third Report on Economic and Social Cohesion", for a total of EUR 140 billion aid for the acceding countries in 2007-2013. Based on mechanical calculations, Poland's share would be over 70 bln.

On the other hand, Jean-Charles Leygues, director of DG for Regional Policy of the European Commission, refused to confirm the amount. According to Leygues, Poland will get over EUR 50 billion from the EU's structural and cohesion funds. However, the director stated, if a large portion of aid for forthcoming years (some EUR 11 billion) is not used, it could be difficult to table a reason for larger funding. The final budget decision for the years 2007-2013 will be made in 2005.

### Some business highlights

- The Warsaw Stock Exchange's main index WIG reached a record-high value in February and exceeded the level of 23 000 for the very first time.
- According to a survey on corporate governance, institutional investors choose the most transparent companies listed on the Warsaw Stock Exchange.
- Norwegian Statoil and PGNiG, the Polish gas monopoly, may sign a contract on supplies to Poland of 2 billion cubic metres of natural gas annually. At present, Poland buys some 0.5 billion. Parties signed a memorandum of cooperation.
- Some Polish firms may get Iraq contracts, to equip Iraq's new armed forces. The NOUR consortium, which won the tender against Polish arms and engineering giant Bumar, includes two Polish companies. Bumar has filed a formal protest against the result of a choice.
- Hyundai/KIA plans to establish a new car factory in Poland or Slovakia. Investment would be the biggest foreign direct investment in Poland. Hyundai plans to produce over 300 000 cars annually, and employ 3500-4000 workers.
- Concern 3M will move the production of immobilising materials from France, USA and Japan to its Polish plant in Wroclaw.
- Decisions on the privatisation of the so-called G-8 group, eight energy distribution companies, might be made soon.
- Polish aircraft producer PZL Mielec signed a contract with Russian RSK for the production of MIG AT training planes.
- The significance of Belarus and Ukraine as Poland's partners in economic relations is increasing, measured by Polish FDI abroad.
- According to the Polish Food Producers' Foundation, Poland is the 6<sup>th</sup> largest producer of food and beverages in the EU.

Poland - main economic indicators	1997	1998	1999	2000	2001	2002	2003	2004	as of
GDP (y-o-y %-growth, constant prices)	6,8	4,8	4,1	4,0	1,0	1,4	3,3		1-9/2003
Industrial production (y-o-y %-growth)	11,5	3,5	3,6	6,7	0,6	1,4	8,7		1-12/2003
Inflation (CPI, end of period, y-o-y %-change)	13,2	8,6	9,8	8,5	3,6	0,8	1,7	1,7	1/2004
General government budget balance (% of GDP)	-1,2	-2,4	-2,0	-2,2	-4,3	-5,1	-5,7		1-9/2003
Gross wage (period average, EUR)	288	314	401	472	557	544	492		Q4/2003
Unemployment (% last survey in the year, LFS data)	10,2	10,6	15,3	16,0	18,5	19,7	19,4		Q3/2003
Exports* (EUR billion, current prices, average exch. rate)		25,1	25,7	34,4	40,4	43,4	42,5		1-11/2003
Imports* (EUR billion, current prices, average exch. rate)		41,5	43,2	53,1	56,2	58,3	54,1		1-11/2003
Current account (% of GDP)	-3,0	-4,3	-7,4	-6,3	-4,1	-3,6	-2,7		Q2/2003

Source: Polish Official Statistics, National Bank of Poland, own calculations

\*special trade system

## The EU accession of the Baltic States and Poland creates an integrating bridge between the East and the West

by Kari Liulto

On the 1st of May, four Baltic Rim economies – Estonia, Latvia, Lithuania, and Poland – join the European Union, and with their integration into the Union the borderline between the EU and Russia almost doubles. Their EU accession creates a rather peculiar situation in EU-Russian relations, as the Russian-Estonian and the Russian-Latvian borders have not yet been ratified by the Russian parliament. The Russian relations of Lithuania and Poland becomes emphasised especially due to Kaliningrad, a small Russian enclave (half the size of Belgium) located between them.

After the next enlargement, eight out of nine countries surrounding the Baltic Sea belong within the European Union. Hence, the Baltic Sea becomes almost the inner sea of the EU, excluding only the regions of the Russian Federation i.e. the City of St. Petersburg and the Leningrad Oblast surrounding it, and the Kaliningrad Oblast. The inner sea status of the Baltic Sea and the EU-Russian energy dialogue aid in tackling logistical and environmental challenges concerning Russia's rapidly growing oil shipments via this northern water way, which is covered by thick ice for several months a year.

The political significance of the Baltic Rim within the EU may increase. Nevertheless, it remains to be seen whether four old and four new EU members around this sea share common objectives. Should all the Baltic Rim countries stand united, they have a better chance in shifting the Union's policy focus from the Mediterranean Sea towards the Baltic Sea.

Along with the EU accession of four new Baltic members, regional attractiveness improves in the eyes of foreign investors since this region provides high economic growth, stability, wealth, and a sea access to Russia's vast natural resources. According to the UNCTAD World Investment Report, the foreign direct investment stock of the countries surrounding the Baltic Sea has almost tripled since 1995. Then, the FDI stock of these nine countries was \$ 270 billion, whereas seven years later it already reached \$ 750 billion. The increase around the Baltic Sea region was higher than in the rest of the world, indicating improved investment possibilities in the northern part of Europe. The investment inflow probably accelerates after the next enlargement, which is only two months away.

The European Union's next enlargement only moves the dividing Iron Curtain towards the East unless the new

member states undertake an integrating role between the enlarged EU and its new eastern neighbours – especially Belarus and Ukraine. Besides, the new members, the Baltic States and Poland in particular, have an important task in further integrating the Russian economy closer towards the EU.

Although the EU covers almost 40 per cent of Russia's foreign trade, Russia is a relatively small trade partner for the Union. Even if Russia accounts for less than five per cent of the external trade of the EU15, she is, due to her oil and natural gas deliveries, a strategic partner for the Union. In the future, Russia's strategic importance as an energy supplier grows; roughly a half of the EU25's gas imports and a quarter of its oil imports will arrive from Russia.

Along with enlargement, the importance of the Russian economy ascends as the new EU members have much more intensive trade relations with Russia than the majority of old ones. Russia is an important trade partner for Estonia, Latvia, Lithuania, accounting for 3-10 per cent of their exports and 8-22 per cent of imports. In addition to Russia, the rest of the Baltic Sea region is of strategic importance. The whole Baltic Rim covers clearly over half of the foreign trade of the Baltic States. The respective figure for Poland is some 40 per cent, which is close to that of Finland.

Though the Baltic States and Poland have not invested so much in Russia, nonetheless, Russian firms have landed there. Russia accounts for 1-5 per cent of the total FDI stock in these four aforementioned countries, her proportion being smallest in Estonia and highest in Latvia and Lithuania. Just as an example, the Russia's share of the Finnish inward FDI stock is one per cent.

Currently, the Baltic States and Poland create a bridge for Russian companies towards the EU rather than a foothold for Western companies to the East. However, along with the improvement of their Russian relations, these countries may become a two-way bridge between Old Europe and Russia, i.e. they may become an important gateway to the vast Russian market, and perhaps, an integrating zone for Belarus and Ukraine. Hence, one can argue that the Baltic States and Poland play a much more strategic role in the EU than the pure economic indicators would reveal.

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### Exports and imports by groups of countries

January-November 2003	Exports to (share %)				Imports from (share %)			
	Estonia	Latvia	Lithuania	Poland*	Estonia	Latvia	Lithuania	Poland*
<b>EU-15</b>	<b>68,6</b>	<b>62,3</b>	<b>42,2</b>	<b>68,7</b>	<b>53,7</b>	<b>50,8</b>	<b>44,8</b>	<b>61,4</b>
<b>EU-25</b>	<b>82,5</b>	<b>79,6</b>	<b>61,5</b>	<b>80,5</b>	<b>64,9</b>	<b>75,2</b>	<b>56,7</b>	<b>69,1</b>
<b>Baltic Rim (9)</b>	<b>70,9</b>	<b>55,9</b>	<b>47,7</b>	<b>45,4</b>	<b>55,4</b>	<b>63,4</b>	<b>55,5</b>	<b>38,7</b>
Estonia	***	6,5	4,3	0,3	***	6,5	1,4	0,1
Latvia	7,0	***	9,6	0,7	2,4	***	1,6	0,1
Lithuania	3,8	8,1	***	2,4	3,5	9,7	***	0,4
Poland	1,1	1,5	3,4	***	2,8	5,1	5,2	***
Finland	26,0	2,7	1,5	0,7	16,1	7,4	2,4	1,5
Sweden	15,2	10,6	4,0	3,7	8,8	6,3	3,5	2,6
Denmark	4,0	6,0	4,7	2,5	2,2	3,4	2,9	1,5
Germany	9,8	15,2	10,0	32,3	11,2	16,0	16,2	24,5
Russia	4,0	5,3	10,2	2,8	8,4	9,0	22,3	8,0
Ukraine	1,9	2,0	2,3	2,8	4,4	1,7	1,4	1,1
Belarus	0,1	1,4	3,1	0,7	1,2	3,7	1,4	0,6

Source: Statistical authorities in Estonia, Latvia, Lithuania and Poland

\*data by individual countries 1-9/2003