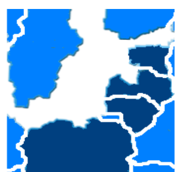


Baltic Rim Economies

Estonia – Latvia – Lithuania – Poland

27.8.2004 Turku School of Economics and Business Administration

Bimonthly Review 4▪2004

Estonia

GDP expected to grow nearly 6% in 2004

According to a recent estimate by the Ministry of Finance, Estonia's economy will expand by 5.6% y-o-y in 2004. Thus the estimate is 0.3% higher than ministry's previous forecast last spring, and in the line with recent forecasts by the Estonian Central Bank, IMF, EIU and European Commission.

Generally, the Ministry of Finance does not see any remarkable spectres in the forthcoming economic development. According to the ministry, the Estonian economy will benefit from the structural reforms and enlargement of the common market in the EU. Moreover, the beneficial tax system and flexible labour market are reinforcing the competitiveness of Estonian enterprises, and fostering growth of foreign investments in Estonia. The ministry expects that the growth of domestic demand will accelerate, but to be slower than GDP growth.

The current account deficit, the main concern of the Estonian economy, is expected to decrease, down to 10.8% of GDP. In the first quarter of 2004, the current account deficit recorded 10.9% of GDP.

Industry and trade are growing stably

Estonia's industrial production grew by 7% y-o-y in the first seven months of this year. In July, rapid annual growth was observed in the manufacture of chemicals and related products and in the manufacture of textiles. The output from mining decreased nearly 30% y-o-y.

In the first half of 2004, the retail trade volume index increased by 15% compared to the corresponding period in 2003.

Tax burden and statutory tax rates

	Total taxes as of GDP (%) 2002	Top statutory personal income tax rate (%) 2004	Effective top statutory corporate income tax rate (%) 2004
EU-25	40,4	41,7	27,4
EU-15	40,5	46,2	31,4
Estonia	35,2	26,0	26,0
Latvia	31,3	25,0	15,0
Lithuania	28,8	33,0	15,0
Poland	39,1	40,0	19,0

Source: Eurostat 2004

Estonia defends its tax system

The income tax systems of the new member states have been under keen debate during recent weeks. Especially Germany and France have demanded the bringing of new members' low tax rates into line with the old member states.

The Estonian government defends its tax policy against critics. Estonian key ministers emphasise that all decisions on corporate income tax will be made in Estonia – not by the EU. According to an agreement with the EU Commission, Estonia took the obligation to abolish income tax on dividends by January 1, 2009. The problem is that Estonia's present dividend distribution system is in contradiction with the EU's parent-subsidiary directive. The ministers are hesitant to assess whether Estonia would be ready to attempt its zero tax rate on reinvested profits after the current deadline. If the current tax benefits are abolished without offering anything else, then both foreign and Estonian manufactures could start shifting their production outside Estonia.

Imports are still growing faster

In May, Estonia's foreign trade balance stabilised to the "normal" rate, after its rapid widening in April. According to preliminary data (due to changes in methodology), exports (in current prices) grew in January-May by 16%, and imports a bit faster by 19% y-o-y. Machinery and appliances covered 27%-share both in exports and imports. In the first five months of 2004, the trade deficit was EUR 870 mln, while in January-May 2003 it was EUR 690 mln. Therefore the expected narrowing of the trade deficit was not realised in the first five months.

Estonia's foreign trade with non-EU countries increased rapidly in June. Exports grew by 48% and imports by 9% compared to June 2003. In June, imports from Russia covered more than one third of Estonia's non-EU imports, and exports to Russia over one fourth of total non-EU exports.

Fitch Ratings upgraded Baltic currencies' ratings

In early July, the international rating agency, Fitch Ratings, upgraded the long-term foreign currency ratings of Estonia, Latvia, Lithuania and Slovenia for credible euro convergence. Fitch upgraded the long-term foreign currency rating of Estonia to A from A-, and Latvia and Lithuania to A- from BBB+.

According to Fitch's expectations, Estonia and Lithuania (and Slovenia) will be the first of new EU states to adopt the euro in early 2007, and in Latvian case in early 2008.

Some business highlights

- A merger of Estonian AS Lohmus, Haavel & Viisemann (LHV) and Lithuanian Hermis Finansai creates the Baltic's biggest investment bank with offices in Tallinn, Riga and Vilnius. LHV acquired 100 percent of shares in Hermis Finansai.
- Merko Ehitus will build a new production plant for textile producer Wender, which will invest EEK 100 mln in Pärnu in the new plant and equipment. The plant will create 150 new jobs.
- Estonian timber company Hapa Group starts production in Sri Lanka. The company has hired 100 persons and hopes to employ 300 persons. The company will produce children's furniture and toys for the US and Japanese market.
- Estonian tax officials raided three restaurants in Tallinn Old Town. The tax authorities claim that the restaurants paid undeclared salaries to about 40 employees.
- Estonian Air will open a new route Tallinn-Dublin on October 14. The route will be operated twice a week, and is expected to serve mainly leisure-oriented travellers. The route to Gothenburg will be opened in Aug. 30 and to Brussels on Sept. 7.
- Estonia's largest bank, the Hansapank Group, increased its net profit by 34% y-o-y in the first half of 2004. Sampo Bank's profit increased by 10% y-o-y and Ühispank's profit increased by 10% y-o-y in the same period.
- Port of Tallinn increased its profit by 307% y-o-y up to EUR 19.1 mln in the first half of 2004. The port handled 9.1% more cargo than in the first half of 2003.
- Elcoteq Tallinn, Estonia's largest exporter, has hired around 800 employees within the past six months.
- Estonian construction material producer Maxit plans to invest around EEK 125 mln in a new plant close to Riga.

Estonia - main economic indicators	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**as of**
GDP (y-o-y %-growth, constant prices)	10,5	5,2	-0,1	7,8	6,4	7,2	5,1	6,8	Q1/2004
Industrial production (y-o-y %-growth)	14,6	4,1	-3,4	14,6	8,9	8,2	9,8	7,0	1-7/2004
Inflation (CPI, end of period, y-o-y %-change)	12,5	6,5	3,9	5,0	4,2	2,7	1,1	4,1	7/2004
General government budget balance (% of GDP)	2,1	-0,3	-4,2	-0,9	0,6	1,1	2,4		1-12/2003
Gross wage (period average, EUR)	227	262	284	314	352	393	430	474	Q2/2004
Unemployment (% end of period, LFS data)	9,8	10,2	12,9	13,9	11,9	11,3	9,3	10,0	Q2/2004
Exports* (EUR million, current prices)	1 891	2 252	2 239	3 445	3 698	3 642	3 996	1 833	1-5/2004
Imports* (EUR million, current prices)	3 127	3 529	3 224	4 615	4 798	5 079	5 734	2 699	1-5/2004
Current account (% of GDP)	-11,4	-8,6	-4,4	-5,5	-5,6	-10,2	-13,2	-10,9	Q1/2004

Source: Statistical Office of Estonia, Bank of Estonia, author's calculations *special trade system

Latvia

Robust economic growth continues

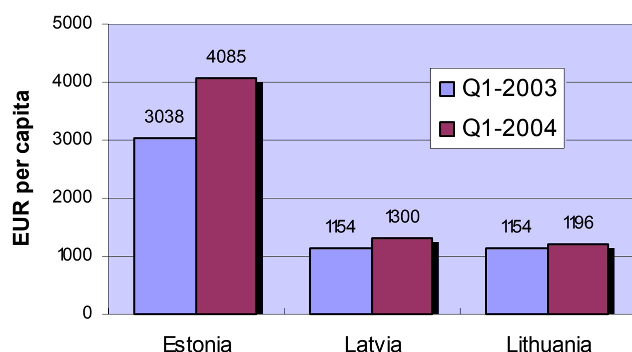
Latvia's economy has grown very strongly over the past five years, and the growth seems to be continuing at a high rate in the second quarter of 2004. The Bank of Latvia forecasts that Latvia's GDP will grow 7.5% y-o-y in 2004. According to EIU's forecast, the Latvian economy will expand a bit slower by 6.8%. The growth is still based on almost all sectors of the economy.

During the first six months of this year, industrial production grew nearly 8% from the analogous period for 2003. However, within the second quarter of 2004, the growth rate declined from the previous period down to 6.4% y-o-y. In June, the most rapid expansion was observed in the manufacture of chemicals and related products, up by 49% y-o-y.

The growth of construction output continued in the second quarter at the same rate as in the first quarter. The half-year increase was more than 12% y-o-y. The construction of new buildings (e.g. hotels) grew nearly 32%, whilst the repair construction decreased slightly year-on-year.

Among the other sectors, Latvian retail trade companies' turnover increased in the first half of 2004. The aggregate rate was 14% higher y-o-y. The retailing of textiles and clothing grew by 36% y-o-y and the retailing of food and beverages by 25%.

Foreign direct investment stock, end of period



In the first quarter of 2004, inflow of FDI increased slightly from the previous period. However the quarterly amount remained stable year-on-year. Since the first quarter of 2003, the stock of FDI has increased by EUR 324 mln, more than in Lithuania but much less than in Estonia. In the first quarter of 2004, the Baltics' FDI inflow was largest in Lithuania.

Inflation the third largest in EU-25

In July, Latvia's annual inflation rate recorded the highest annual rate since December 1997. Consumer prices went up 6.7% from July 2003, and 0.2% from the previous month, fuelled mainly by foodstuff, rising by 1.2% m-o-m. Production prices have been growing even faster. In July, production prices were 9.3% higher than a year ago.

The IMF, in its report on Latvian development, warned Latvia that the current inflation and significant rise in debt could increase risks involving external factors. The IMF also expressed its concern related to the government's plan to boost spending.

Latvia's Financial Minister calms the Latvians. According to him, Latvia will be able to rein in inflation in order to meet Maastrich criteria and adapt to the euro. He explained that a steep price-rise has arisen due to irrational EU-related fears and the growing prices of electricity and fuels.

Foreign trade is growing extremely fast

During the first half of 2004, Latvia's exports and imports have grown enormously. Exports grew nearly 24%, and imports nearly 25% compared to the first six months of 2003. In the March-April period, there was a sharp peak in imports, but the growth stabilised near to the "normal" rate in May.

In June, exports to CIS countries expanded rapidly from May. Also, compared to June 2003, exports to CIS countries almost doubled, and constituted 14% of Latvian exports. Correspondingly the share of EU-exports dropped. The structure of imports by countries remained stable.

Latvia's government set a long term strategy

According to the government's new strategy paper, Latvia must attain the living standard of highly developed countries in 20 to 30 year's time. In order to meet the target, Latvia's GDP should grow at least 7% in 2004, 10% y-o-y until 2010, and 5% y-o-y until 2030. Also, the unemployment-decline target was set.

According to the strategy, Latvia has to change from a low-lost subcontractor to a high-tech manufacturer, increase spending on R&D and change from a labour intensive economy to a knowledge based economy. The programme defines over 50 indicators that are important in reaching the goals. This was the first time that short-term, middle-term and long-term goals were defined.

VN searches ways to restart deliveries by pipeline

According to vice president of Latvijas Naftas Tranzits (VN's shareholder), Ventspils Nafta Terminals could restart crude oil supplies by pipeline only by selling a controlling stake to the Russians. Otherwise, the company would have to lay off its employees and start freezing assets.

Ventspils Nafta Terminals transhipped 21% less oil and oil products during the first 6 months of 2004 compared to the analogous period in 2003.

Some business highlights

- Jeld-Wen, the US-based doors and windows producer, plans to build a new wood treatment facility in Aizkraule. The value of investment is EUR 40 mln.
- Irish Ryanair, European largest low-fare airline, announced that it starts to offer cheap flights from Riga to London, Frankfurt and Tampere from 31 October. Riga will be the first city in the new EU member states that the company will operate in; another low-price airline, British EasyJet, negotiates to start flying to Baltics.
- Latvian Parex Bank has set up a subsidiary in Ukraine; Ukrainian Privatbank acquired a 95%-share of Latvian Paritate Bank.
- VP Market starts to build the Riga Akropolis Center in October. The total floor-space will be more than 100 000 sqm, and the estimated cost about EUR 135 mln.
- Danish Brewery Group acquires Cido, the leading Latvian Juice maker. The price was undisclosed, but estimated to be around EUR15 mln.
- A joint venture of Latvian Ferrus and the Russian automotive producer ZIL, and German AKG (vehicular cooling systems), are building new plants in Jelgava.
- The aggregate profits of Latvian banks increased by 50% y-o-y up to LVL 49.6 mln in the first six months of this year.
- Lithuanian retailer VP Market moves its headquarters to Riga. The company has founded over 80 shops to Latvia in recent years.
- Eko Energijas Standards plans to invest EUR 10 mln in a wind park in Alsunga.

Latvia - main economic indicators	1997	1998	1999	2000	2001	2002	2003	2004	as of
GDP (y-o-y %-growth, constant prices)	8,3	4,7	3,3	6,9	8,0	6,4	7,5	8,8	Q1/2004
Industrial production (y-o-y %-growth)	6,1	2,0	-8,8	3,2	6,9	5,8	6,5	7,9	1-6/2004
Inflation (CPI, end of period, y-o-y %-change)	7,0	2,8	3,2	1,8	3,2	1,4	3,6	6,7	7/2004
General government budget balance (% of GDP)		0,1	-4,0	-2,6	-2,0	-2,3	-1,6		1-12/2003
Gross wage (period average, EUR)	183	202	225	268	282	297	298	291	Q1/2004
Unemployment (% end of period, LFS data)	14,1	13,7	13,2	13,3	12,9	11,6	10,3	11,5	Q1/2004
Exports* (EUR million, current prices, average exch. rate)			1 613	2 020	2 232	2 416	2 559	1 479	1-6/2004
Imports* (EUR million, current prices, average exch. rate)			2 758	3 453	3 910	4 284	4 634	2 586	1-6/2004
Current account (% of GDP)		-9,7	-9,0	-6,4	-9,0	-7,0	-8,6	-9,5	Q1/2004

Source: Central Statistical Bureau of Latvia, Bank of Latvia, Ministry of Economics, author's calculations *special trade system

Lithuania

Estimated GDP-growth 6.9% in the second quarter

According to preliminary calculations, Lithuania's GDP grew by 6.9% year-on-year in the second quarter of 2004. Thereby GDP grew in the first half-year by 7.3% compared to the first half of 2003. Due to rising inflation, the Vilniaus Bankas predicts that the whole-year growth will reach 8.7% y-o-y.

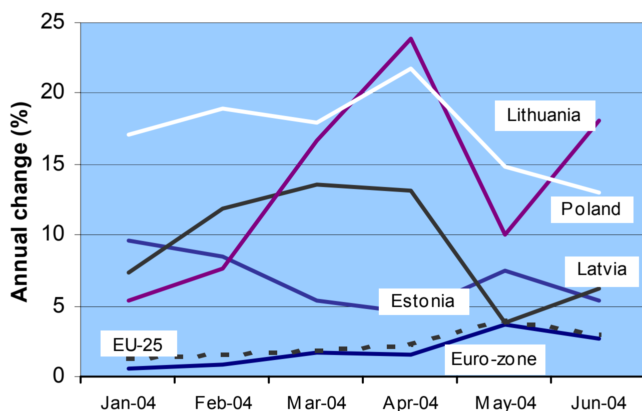
However, inflation has remained at a moderate level compared to Latvia and Estonia, or the other new EU countries. In July, zero month-on-month (CPI) inflation was registered. According to recent forecasts, inflation is expected to remain around 2.0-2.5% in 2004-2005. On the other hand, production prices have risen faster. In July, the production prices were 8.7% higher than in July 2003. The prices went up by 1.6% from the previous month due to a 3.4%-rise in petroleum products.

Industry and trade are growing fast

Since the year 2000, Lithuania's industrial production has grown at the fastest rate among the EU countries (EU-25). Within the first six months of 2004, the sales of Lithuanian industrial production grew by 13.4% y-o-y. In the second quarter the growth was even larger, as sales grew by 17% compared to analogous period in 2003.

Within the first half-year period, manufacturing grew over 16% y-o-y. The manufacturing of radio, television and communication equipment grew by 51% y-o-y, the manufacturing of fabricated metal products 46% and the manufacturing of refined petroleum products 42%. Also the manufacture of furniture grew rapidly by 38% y-o-y. Correspondingly the largest decline was observed in the manufacturing of leather and related products, down by 54% y-o-y. In June, the manufacture of refined petroleum products increased nearly 69% from the previous year.

Industrial production, the first half of 2004



Source: Eurostat

Lithuania's retail trade's turnover has increased nearly 50% since 2000. During the first six months of 2004, the retail trend turnover grew by 12% from the corresponding period for 2003. Trade grew throughout the categories, but it was strongest in the retails of furniture and household equipment, up by 36% y-o-y. Also, the retails of textiles and clothing grew rapidly.

According to Baltic Business News, the growing influx of imported cheap food is forcing Lithuanian food producers to reduce their prices. The retailers' selection has enlarged e.g. in the case of sugar, pasta, chocolate and tomatoes. Retailers suppose this trend is likely to continue in the future.

Exports and imports grew 15% in the first half-year

During the first six months of 2004, Lithuania's exports grew by 15.5% and imports by 15.2 y-o-y. In exports, the largest annual growth was noticed in iron and steel (62%), electrical machinery and equipment (53%), mineral fuel (39%). Exports of vehicles and transport equipment dropped by 25%. Mineral fuel's share went up to 23% of the total exports.

Imports grew in all the main product categories. The most rapid relative increase was observed in imports of iron and steel (73%) and in imports of plastics and rubber products (28%). Imports of machinery and equipment grew by 21% y-o-y, and constituted 19%-share of total imports.

Due to the changes in foreign trade statistics methodology as from May 2004, the data is not fully comparable with the previous months and last year. This remark also concerns Estonia's and Latvia's recent foreign trade statistics.

1.5 bn litas for Lithuanian transport infrastructure

During 2004-2006 Lithuania will receive around LTL 1.5 billion (EUR 430 mln) from the EU for the restructuring of country's transport infrastructure. The bulk of the money will go to the road builders and companies engaged in the production of railway management systems and equipment. Lithuanian cohesion fund strategy includes 26 transport infrastructure projects for the total amount of LTL 4.1 billion.

According to estimates, the structural funds from the EU would increase Lithuania's GDP growth from 1.2% this year, to 1.8 % in 2006.

Some business highlights

- Vakaru Medienos Grupe (VMG) and Swedish furniture giant IKEA are to invest 40 LTL 40 mln (EUR 11.6 mln) in a new furniture factory in Kazlu Ruda.
- The Baltic's only hydroelectric power station, the Kruonis Hydropump Plant, plans to expand its operations by four new units, with the help of foreign investors.
- Ukio Bankas (UB) is to open a branch office in Moscow. Last April, the company opened an office in Kiev, Ukraine.
- Lithuanian bourse, Lithuanian National Stock Exchange, changes its name to Vilnius Stock Exchange. Nordic-Baltic OMHEX owns 81%-share of the bourse and the offer to buy up remaining shares for small shareholders was placed in June.
- Russian experts have approved about 70 Lithuanian meat and fish producers and dairies (BBN, as of August 2) to export their products in Russia, and nearly 20 companies have been denied. The final list will be announced by September 1.
- The number of passengers served in Lithuanian airports increased by 31% y-o-y in the first 6 months. At the same time the number of flights grew by 11% y-o-y.
- TeliaSonera's subsidiary Amber Mobile Teleholding (AMT), acquired a 10%-stake in the Lithuanian mobile service provider Omnitel. This makes TeliaSonera the sole shareholder of the company.
- Real estate transactions increased by 47% y-o-y up to 47 000 transactions in the first six months of 2004.
- The Lithuanian Airlines (LAL) carried 24% more passengers in the first six months of 2004 compared to the analogous period in 2003. Lithuanian privatisation authorities are planning to resume efforts to sell the airline this year.
- Lithuanian banks' combined net profit was LTL 134 mln, and increased by 7% y-o-y in the first six months of 2004.
- Due to the Yukos crises, Mazeikiu Nafta had to adjust its forecast for crude oil exports through the Butinge terminal from 13 mln tons to 10 mln tons in this year.

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	-1,7	3,9	6,4	6,8	9,0	7,3	1-6/2004
Industrial production in sales (y-o-y %-growth)	3,3	8,2	-9,9	2,2	16,0	3,1	16,1	13,4	1-6/2004
Inflation (CPI, end of period, y-o-y %-change)	8,4	2,4	0,3	1,4	2,0	-1,0	-1,3	1,9	7/2004
General government budget balance (% of GDP)				-2,5	-2,1	-1,5	-1,7		1-12/2003
Gross wage (period average, EUR)	173	208	231	263	274	293	306	332	Q1/2004
Unemployment (% end of period, LFS data)	14,1	12,6	15,3	16,1	17,5	13,0	11,6	13,0	Q1/2004
Exports* (EUR million, current prices, average exch. rate)			2 583	3 841	4 778	5 526	6 135	3 336	1-6/2004
Imports* (EUR million, current prices, average exch. rate)			4 340	5 650	6 767	7 943	8 441	4 553	1-6/2004
Current account (% of GDP)	-10,2	-12,1	-11,2	-5,9	-4,7	-5,2	-6,6	-9,0	Q1/2004

Source: Statistics Lithuania, Bank of Lithuania, author's calculations *special trade system

Poland

GDP growth expected to decelerate

In the first quarter of this year, Poland's GDP expanded nearly 7% y-o-y. According to analysts, the growth is expected to slow down to around 6% in the second quarter. The whole-year growth is expected to place around 4.5-5.5%. The Polish government predicts the growth will reach 5.7% y-o-y.

A long-awaited increase of investments was observed in the first half of 2004. Investments grew by 9% from the analogous period of 2003. The main investors were industrial companies that are exporting a large share of their output. They also started employing more staff.

Industrial output grew by 18% in six moths

Industrial production has grown rapidly since late 2003. In the first half of 2004, production grew by 17.6% from the corresponding period for 2003. Manufacturing grew by 21% y-o-y, in which the largest increase was observed in the manufacture of motor vehicles (72% y-o-y), transport equipment (44%), and radio, television and communication equipment (30%). Retail sale grew by 12.4% y-o-y.

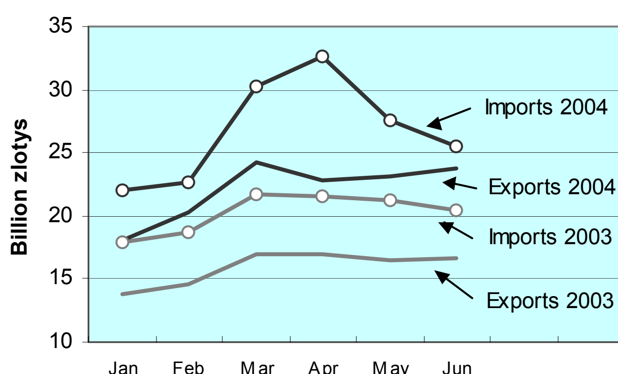
From privatisation roughly 21% of full-year target

According to the Treasury Ministry, Poland received nearly PLN 2 bn from privatisation during the first seven months of 2004. PLN 1.5 bn of the amount went to the state budget; thereby only 21% of full-year target, PLN 7 bn. The Polish government expects gross privatisation revenues to reach PLN 8.8 bn by the end of this year. The bulk of the money came from further sales of previously started projects. The largest transaction was the sale of the power company Gornoslaski Zaklad Energetyczny to Swedish Vattenfall for PLN 823 mln.

Although the privatisation performance remains weak, as it was also last year (40% of the expected amount), however, the target is still possible to attain. The large share of estimated revenue should be realised due to the privatisation of PKO BP, Poland' s largest bank. The sale of a 30%-share is expected to bring PLN 5-6 bn. The public offer is planned for October.

According to Rzeczpospolita, medium and large-sized companies from abroad invested in Poland by USD 2.4 bn (about EUR 2.0 bn) in the first half of 2004. When taken into account the estimated amount of small investments, the total amount could reach USD 3.8 bn in the first six months.

Poland's foreign trade in the first half of 2003-2004



Source: GUS

Foreign trade deficit narrows

During the first half of 2004, Poland's exports grew by 38% y-o-y, in current zloty-term prices. At the same time imports grew a bit slower by 32%. However, within May-June of this year, the growth of exports accelerated whilst the imports peak quietened down. In April, the trade deficit recorded PLN 9.7 bn, but in June the deficit narrowed to PLN 1.8 bn.

Polish government to limit imports of used cars

The Polish government plans to introduce new measures for imported old cars, in order to limit the hugely growing imports of used cars from Western Europe. The introduction of tighter inspection rules before they can be registered would benefit car producers who have their factories in Poland, e.g. Fiat, Volkswagen and Opel (controlled by General Motors). The new rules would come into force in October.

Poland is the only EU country which charges excise tax for used imported cars, whilst such kind of regulation does not apply to used cars purchased in Poland. In the first seven months of 2004, nearly 215 000 new cars were bought in Poland, up by 7% y-o-y. Since May the demand has been falling.

Budget for 2005

The government has accepted its initial budget limits for 2005. Revenues are to amount PLN 168.4 bn and expenditures PLN 207.2 bn. Thereby the budget deficit is expected to decrease by PLN 6.5 bn from 2004. Economic growth is expected to be at 5%, average inflation at 2.8%, and salaries should grow less than 2.8% year-on-year.

The budget plan has been criticised due to the fact that none of the acts comprising the Hausner Plan have been passed.

Some business highlights

- Ispat Polska Stali (IPS), a subsidiary of Indian steel group LNM Group, will invest PLN 2.4 bn (around EUR 500 mln) in its four newly-acquired mills. LNM acquired Polskie Huty Stali earlier this year.
- The US based car-breaking systems producer Wabco Automotive Products Group plans to invest EUR 25 mln in a new facility in Wroclaw. With a planned research and development centre, the plant will employ more than 360 employees.
- Three German manufacturers have agreed to build new production plants in the Lodz Special Economic Zone, in order to make products for German BSH Bosch und Siemens Hausgerate, which is building a new plant in Lodz.
- Siemens will spend EUR 15 mln to enlarge its research and development centre in Wroclaw; Samsung Electronics is to double jobs at its R&D centre in Warsaw, as 100 people will be employed by the end of 2004.
- German publisher Bauer will invest EUR 85 mln in a new print shop in Wykroty.
- British paper product manufacturer DS Smith plans to build a new corrugated board factory in Kutno. The estimated cost is EUR 21 mln.
- Portuguese Tiner plans to invest EUR 50-60 mln in a new logistics centre in Katy Wroclawskie.
- The Arka Real Estate Investment Fund, managed by the Polish unit of The Allied Irish Bank, BZ WBK, is the first real-estate fund to debut on the Warsaw Stock Exchange; Medical company Swissmed Centrum Zdrowia is preparing its debut on the WSE in September, and it will be the first medical company listed in the WSE.
- The consortium Gdansk Transport Company (GTC) will build 90 km of the A1 highway from Gdansk to Nowe Marzy for EUR 504 mln by 2007. Work is expected to begin in May, 2005.
- Danish Crown, the Europe's largest meat processor, and Finnish HK Ruokatalo are forming a joint venture with the aim of taking over Sokołów, Poland's largest meat processing company. HK is the largest owner of Sokołów, with a 30%-share.

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	3,8	6,9	Q1/2004
Industrial production (y-o-y %-growth)	11,5	3,5	3,6	6,7	0,6	1,1	8,4	17,6	1-6/2004
Inflation (CPI, end of period, y-o-y %-change)	13,2	8,6	9,8	8,5	3,6	0,8	1,7	4,6	7/2004
General government budget balance (% of GDP)	-1,2	-2,4	-2,0	-2,2	-4,4	-5,1	-4,5		1-12/2003
Gross wage (period average, EUR)	288	314	401	472	557	544	501	475	Q2/2004
Unemployment (%, last survey in the year, LFS data)	10,2	10,6	15,3	16,0	18,5	19,7	19,3	20,7	Q1/2004
Exports* (EUR billion, current prices, average exch. rate)		25,1	25,7	34,4	40,4	43,4	47,5	27,9	1-6/2004
Imports* (EUR billion, current prices, average exch. rate)		41,5	43,2	53,1	56,2	58,3	60,4	33,9	1-6/2004
Current account (% of GDP)	-3,0	-4,1	-7,0	-6,0	-3,9	-3,5	-1,9	-1,6	Q1/2004

Source: Polish Official Statistics, National Bank of Poland, Ministry of Economy, Labour and Social policy, author's calculations *special trade system

Latvia on the European Ship

By Valdis Krastins

It is very easy to assume that all the new member countries have boarded the EU ship with the same luggage. The Copenhagen criteria, the need for universal adherence to the Stability pact and to universal human rights instruments, efforts to make the law system compatible with EU regulations – the constant rehashing of these and other mandatory-for-all tasks during the accession time was almost bound to create an illusory vision of all ten now neatly alike, equally positioned and ready to start a sportsmanlike competition. Nothing could be further from reality. Every country has had its own development and is entering the EU on its own terms, dictated by history and the resources presently available.

During the last decade of the 19th century and the first decade of the 20th century, Latvia was a heavily industrialized region of the Russian Tsarist Empire, producing many items for the all-Russia market, including, for instance, ships, railway cars etc. At the beginning of First World War most of these industries were evacuated to Russia, the rest was destroyed by military action.

It took the newly independent Latvian state ten years to build an economical system functioning in accordance with available resources, with the geopolitical and trade situation, which, with the rise of Soviet empire, was an absolutely different one. The result was a deeply satisfactory one, putting Latvia at the end of 1930-ies on par with, for example, Denmark by GDP, income per head, educational level. The trade balance was positive, notwithstanding the fact that Latvia had to import practically all its energy sources.

The Soviet occupation and consequent incorporation into the USSR put an end to all these positive developments. The first year of Soviet rule was spent uprooting everything and everyone, especially "the class-enemy" – Latvian farmers, businessmen, not to speak of former officials and politicians. Then came the Second World War, the shadowy years of German occupation, and by the end of it in 1945 Latvia was worse off than in 1920, and under a renewed foreign, Soviet occupation at that.

During the first 25 years of the post-war period the Soviets tried to rebuild the pre-existing industries, many of which were then geared to the needs of the military machine. For instance, a leading enterprise – VEF, was transformed into a leading military communications factory completely under the control of military HC.

Then came a still more menacing turnaround in Soviet policies. The efforts of a group of nationally minded people at the local Communist leadership to keep the economical development of Latvia in some proportion to the needs of the so-called Soviet Republic created in Moscow a suspicion of separatist tendencies. From there came a directive to integrate Latvia completely into an all-Union system and abandon every attempt to keep it separate.

It started a period of frenetic factory building, sometimes in glaring contradiction with local resources and needs. For instance, in Daugavpils a factory was built for producing metallic chains for all kinds of combustion engines; its production covered up to 50% of Soviet needs. A gigantic microchip factory was erected in Riga, for a time the only enterprise in USSR producing laundry machines was in Riga, it was in this city that 50% of Soviet electrical trains were built. An immense pharmaceutical factory was created near Riga, producing for all-Union needs. So were huge textile and knitwear plants, producing many times more that could be absorbed by local market, not to speak of glass fibre producers etc.

The scheme was simple and effective in political terms: raw materials and workforce brought in, production out, leaving local authorities with the social, ethnic and environmental fall-out. Logistics or other economical considerations did not play a role, it was a question of integrating Latvia completely - ethnically and economically - into the Soviet system.

That was the ethnically, socially sensitive and economically awkward background for the first Latvian government after regaining independence in 1991 in its efforts to return to market economics. All the following ones have been involved with reprivatisation, restructuring and splitting up procedures, trying to convert the Soviet era giants into something economically reasonable and feasible, at the same time making the banking system work and coping with the environmental side, which was completely ignored under Soviet rule. This has not gone easily at all, especially after Latvia started aiming at being a member of EU. The national debt and budget deficit had to kept under strict control; both are and have been within the boundaries prescribed.

Even now, retrospectively, there is a debate in Latvia about the debt and budgetary restrictions maybe playing too big role in holding back the rebuilding of a normally functioning Latvian economy – especially because the Latvian farming industry could not be the source of income that it was in the twenties and thirties of the last century. But it was decided to "hold the line", to take the restrictions as a price for obtaining EU membership and the funding that comes with it. It was maybe the most difficult decision to take in connection with Latvian membership of the EU.

Now the first and foremost task is to direct EU financing and Latvian co-financing where it is needed most in the long-term perspective. It means regional development – especially where the Soviet-built factories had to be closed for economical reasons. Then the support for small and medium size enterprises, thus creating a safe economical buffer zone and giving the population in the countryside a chance to make a decent living, because farming as it is still known to many Latvians, has little hope of being successful. The farming side of the EU membership may be the most difficult, sensitive and painful one; the ideas about it are still being formulated. Then there is a need to enhance the road and railroad system, modernise ports, put money into the forest industry as the foremost Latvian natural resource.

But the most important task is to enhance and speed up monetary turnover, the cash flow. Foreign trade is one of the options for that. Latvia has been doing well in this field but not enough, as the restructuring of the economy has diminished the percentage of industrial products in GDP. Nevertheless foreign trade is now 70% with EU countries (in 1991 Latvian output went almost completely to the rest of the Soviet Union). Russia would be a natural and welcome trade partner, but as long as Russia is still coping with the emotional consequences of the loss of Balticum and is putting up artificial trade barriers, there is not much hope for improvement. A further opening up of EU markets in connection with our membership is therefore a most welcome development.

It should be clear by now to the reader that Latvia will not be in favour of abandoning its control of the fiscal system; low taxation is and will be very important in creating a competitive framework for investments. Nor would the idea of European federalism find many supporters in Latvia so soon after escaping another so-called "union". Much more attractive is the idea of close cooperation with other Baltic Rim countries, especially with Nordic Council countries. But we feel that here too, all should be done in the European context, as the feeling of being a part of Europe, where we belong, is very dear to the heart of every Latvian.

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Key Trade and Transport Facilitation Issues in the Baltic States

by Lauri Ojala

On May 1, 2004 Estonia, Latvia and Lithuania joined the European Union. This had a significant impact on day-to-day business and trade practices both with EU and non-EU countries, notably that of Russia. However, the three Baltic States had already largely integrated to the world economy, and from a macroeconomic point-of-view, the EU membership did not dramatically change their trade or Foreign Direct Investment patterns. This also applies to multinational firms with operations in the Baltic States; they expected no major change in operations after May 1, as indicated in a forthcoming survey conducted by the European Logistics Association.

The Baltic economies have grown rapidly during recent years, and since 1998, the annual growth rates have exceeded the EU's average growth rate by 4-5 percent units and the latest forecasts expect the Baltic States' strong growth to continue in the next two years. Today, the EU is the main trading partner: in the first quarter of 2004, 68% of Estonian exports and 52 % of imports 52% was with the EU-15. For Latvia, the figures were 61% and 49%, respectively. In Lithuania, the EU trade covered only 43% of exports 41% of imports.

Interestingly, very few problems with trade documentation and border crossing practices in intra-EU trade were reported to our TTFBS team (see box below). Much of customs clearance work disappeared in intra-EU trade. As a consequence, many customs, customs brokers and freight-forwarding staff have become redundant. Persistent border crossing delays affected the trade with EU countries in late 2003, but the change to EU customs procedures was smooth in Estonia and Lithuania, but less so in Latvia.

The main trade, transport and border crossing problems are with Russia, and to lesser extent with some other CIS countries. Solutions to these problems are often political, and thus beyond the means of individual firms or authorities. The principal areas needing improvements are (i) border crossings with Russia (notably the Terehova and Grebneva border crossing points in Latvia) and Belarus where excessive delays occur; (ii) data exchange systems between ports and custom warehouses; and (iii) improved customs relations between the Baltic countries and Russia.

The key logistics problems of EU-Russian trade relate to dealing with Russian authorities, such as customs clearances, goods inspections and border crossings. International transport between the EU and Russia was perceived as being less of a problem. The new Russian customs code that came into force in January 2004, has markedly improved the situation. It provides a framework for feasible border crossings, transiting goods under customs bond, bonded warehousing services and customs clearance services. However, it remains to be seen how well the reform will be implemented in the Russian Customs, with approximately 63 000 staff.

Transport, storage and communications is an important sector in all current and new EU countries, but its share of Gross Domestic Product (GDP) is the highest in the Baltic States. In 2002, 15.5% of the Gross Value Added (GVA) in Estonia, 14.5% in Latvia, and 13.7% in Lithuania was produced by the transport, storage and communications sector. About 35% of the sector's GVA is produced in transport, 35% in storage and the remaining 30% by communications. In other words, transport and storage contributed from 10% to 11% of the countries' GDP in 2002.

Transport services trade is important for the Baltic States. Latvia has the highest net cash flow from trade in transport services, a situation mainly attributable to transit flow of oil and related products by railways and pipeline. By contrast, Estonia has the highest value of transport services sold to and bought from other countries, indicating the high degree of internationalisation of the Estonian transport sector. In 2003, trade of transport services generated a positive net flow of USD 595 million for Latvia, USD 470 million for Estonia, and USD 414 million for Lithuania.

The demand for transport grows rapidly in the Baltic States. In particular, demand for consolidated transport services, such as scheduled road transport and related terminal service, has grown fast. Moreover, privatisation has been widely used as a vehicle to restructure transport and transport infrastructure markets. Public-private partnerships have been introduced as a mechanism for providing good quality transport and infrastructure services at a reasonable cost.

The volume of transit oil and oil products handled at Baltic States and Russian Baltic Sea ports has increased from 50 million tons in 1997 to over 100 million tons in 2004. The economic impact of oil transit traffic through the Baltic States is significant to these countries: transit revenues represent 5 to 8 percent of GDP of the three Baltic countries.

The three countries have invested substantially in their TEN-T transport infrastructure. In 1996-2001, Estonia invested 235 million euros, of which almost half was in ports. In the same period, Latvia invested almost 370 million euros, 2/3 of which went into railways. Lithuania invested 270 million euros, half of which went into roads. For 2002-2010, Estonia and Latvia intend to spend over 600 million euros each; Estonia mostly on roads and ports and Latvia mainly on roads. Lithuania plans to invest over 1 300 million euros, mostly on railways and ports. Combined, this makes almost 2 500 million euros, not even counting the proposed Rail Baltica project.

The main short term activities include enhanced IT systems for ports and airports and regular monitoring of Customs and Supply Chain performance. In the medium term, apart from improving transport infrastructure, the capacity building of transport and trade authorities needs to continue. Other activities, albeit difficult to implement, include the need to enhance the public sector's possibilities to expropriate land for infrastructure projects of substantial public interest at lower than market prices as in the current legislation. A solution to Russia's current rail tariff policy should also be found as soon as possible.

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The article is based on the Trade and Transport Facilitation study in the Baltic States (TTFBS) conducted by Prof. Ojala and his team in April - August 2004 for The World Bank. Further reference in these issues can be found in Ojala et al. (2004) Transport Sector Restructuring in the Baltic States toward EU Accession, downloadable at: <http://wbln0018.worldbank.org/ECA/Transport.nsf/ECADocBynid/5FC55219E4D31FC685256E76005E27B4?Opendocument>

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