Baltic Rim Economies

Estonia – Latvia – Lithuania – Poland

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Estonia

GDP growth slowed down in the second quarter

Estonia's GDP grew by 5.9% y-o-y in the second quarter of 2004. During the first half of 2004, real GDP was 6.3% larger, compared to the corresponding period in 2003. The GDP growth decelerated from the previous quarter, when the growth rate was 6.8% y-o-y.

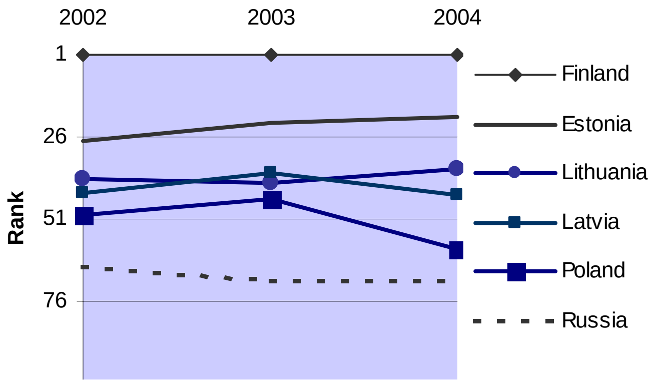
In the second quarter, the value added, at constant prices, increased most in construction, by 15.5% y-o-y. Manufacturing grew by 10%, storage and communication by 9% and wholesale and retail trade by 6% y-o-y. The value added decreased in the primary sector and in mining and quarrying.

Regarding the expenditure approach, private consumption and gross fixed capital formation increased rapidly. Private consumption expenditures grew nearly 7% y-o-y and gross fixed capital formation more than 20% y-o-y. This caused a significant increase in domestic demand, which increased from 102.8% to 108.7% of GDP at current prices, up by 9.5% y-o-y at constant prices. In the second quarter of 2004, exports were 19% and imports 23% larger compared to the second quarter of 2003.

Estonia's growth competitiveness the 20th best

According to a recent comparison by the World Economic Forum (WEF), Estonia's growth competitiveness was ranked as the 20th best among 104 countries. A year before, Estonia was ranked 22nd. In 2004, Finland was ranked in 1st position, Lithuania in 36th, Latvia in 44th and Poland at 60th. Estonia was noteworthy by a significant margin, as being the most competitive economy among the 10 new EU countries. The Growth Competitiveness Index (GCI) is composed of three component indexes: the technology index, the public institutions index, and the macroeconomic index, which are calculated based on both "hard data" and "survey data".

WEF's GCI rankings in 2002-2004



Source: World Economic Forum

In the WEF's business competitive comparison (BCI index) Estonia was ranked as 27th, and was also the best among EU accession countries. United States was ranked in 1st position.

Current account deficit exceeded 20% in Q2

In the second quarter of 2004, Estonia's current account deficit recorded 20.9% of GDP. The record-high deficit was attributable to the wide trade deficit last spring, due to the sharp rise in imports before Estonia joined the EU.

Based on recent economic development, the deficit might decrease in the third quarter. Within the July-August period, exports and imports have grown nearly the same rate. However, the whole year's deficit will be larger than expected in the beginning of this year.

Construction prices rose in the third quarter

In the third quarter of 2004, construction prices increased faster than consumer prices. Compared to the same period in 2003, construction prices were 7.5% higher, whilst consumer prices went up by 4.0% y-o-y.

Private persons' borrowing up by 51% in a year

Estonian banks issued EEK 1.6 bn worth of private loans in September. This is an all time record. The private loans amounted to EEK 26.1 bn, which is 51% more than a year ago, when the stock was EEK 17.3 bn.

In August, private loan volume increased over private deposit volume for the first time. Housing loan rates had been at a record-low level e.g. with an average rate at 3.9% In August. According to analysts, the prices of houses are going up because of cheap loans. In the last four years, prices of apartments have more than doubled.

Some business highlights

- Tallinn city government approved to build a 114.5m highrise building in Tallinn. The building will have 35 stories and it will be located in Tallinn's business district.
- The Tallink Group will order a new passenger ship from the Finnish Aker Finnyards. The ship will start sailing on the Tallinn-Helsinki route in spring 2006, and costs EUR 165 mln.
- Estonia's largest garment maker Baltika opens three new stores in the end of October, two in Riga and one in Warsaw. Baltika has 78 stores in five countries.
- Unemployment insurance fees may lower in 2005 or 2006. At present, the tax rate is 1% of wages for employees and 0.5% for employers. According to the proposal of the UIF council, the rates would be reduced to 0.7% and 0.35% respectively.
- The net sales of enterprises increased by 15% y-o-y in the second quarter of 2004. The share of trade companies' sales made up 40% of total sales. In Estonia, there are 31 300 enterprises which employ 398 100 persons.
- Two Estonian companies, Heinola Sawmill Machinery and Hekotek won an EEK 200 mln contract for supplying forest processing and sawmill equipment to Russia. The contracts are part of Metsä-Botnia's investment project in Leningrad oblast.
- Mootorreisid (Eurolines) plans to open a Helsinki-Warsaw bus route this year.
- Hansapank launched a 5-year EUR 750 mln Floating Rate Eurobond at 26 basis points over Euribor, to finance its general operations in the Baltics and to refinance existing debt. According to Hansapank, the transaction is the largest financial institution bond issue from the accession countries.
- Finnish food company Atria acquires a majority stake of Estonian meat company Valga Lihatööstus by the end of this year. Valga's market share is around 15-20%.
- Silja Line opened a new cruise route between Stockholm and Tallinn. Tallink has been the only operator in this route so far.
- Plastone Oy, a Finnish plastic details producer, plans to open a plant next year in Saue near Tallinn.

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	6,3	1-6/2004
Industrial production (y-o-y %-growth)	14,6	4,1	-3,4	14,6	8,9	8,2	9,8	7,2	1-9/2004
Inflation (CPI, end of period, y-o-y %-change)	12,5	6,5	3,9	5,0	4,2	2,7	1,1	3,9	9/2004
General government budget balance (% of GDP)	2,1	-0,2	-4,3	-1,0	0,3	1,0	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	3 009	1-8/2004
Imports* (EUR million, current prices)	3 127	3 529	3 224	4 615	4 798	5 079	5 734	4 458	1-8/2004
Current account (% of GDP)	-11,4	-8,6	-4,4	-5,5	-5,6	-10,2	-13,2	-16,5	1-6/2004

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

Latvia

Latvia's GDP grows quickest among the Baltics

Latvia's economy grew by 7.7% in the second quarter of 2004 compared to the corresponding period for 2003. Correspondingly in the first six months, GDP grew by 8.2% y-o-y. Thus the Latvian economy is still growing at the quickest rate amongst the Baltic States.

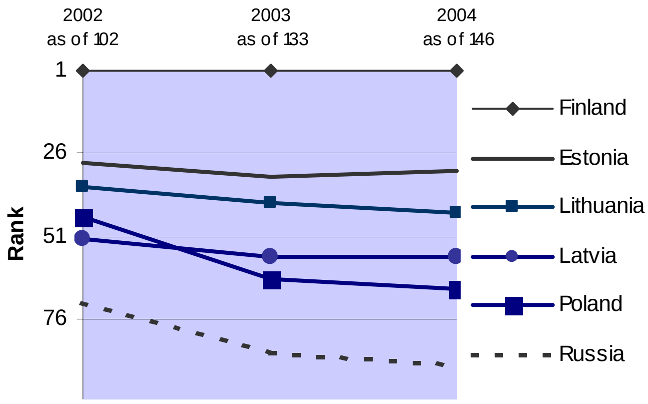
In the second quarter, the GDP increase was mainly based on growing domestic demand. At constant prices, trade grew by 8% y-o-y, transport and communications by 11%, manufacturing by 6% and construction by 12% y-o-y. The structure of the main industries remained quite stable, but some rapid changes were observed within the industries. In retail trade, the motor vehicles trade went up by 32% y-o-y, and the trade of electrical goods and construction materials both grew more than 20% y-o-y. In manufacturing and construction, the manufacture of chemical products increased 44% y-o-y, and the construction of hotels more than doubled. In transport, regular flights by Latvian airlines doubled, and Riga airport's passenger turnover grew by 42% y-o-y.

… and inflation is the highest among EU states

According to Eurostat's harmonised CPI data, the highest inflation among EU states in August was observed in Latvia. Latvian prices increased by 7.8% y-o-y, when the EU-25 average was 2.3% y-o-y.

In September, the annual price increase slowed to 7.7%, whilst a minor month-on-month increase was still observed. In the third quarter of this year, construction prices were 8.9% higher compared to the corresponding period for 2003.

TI's corruption rankings in 2002-2004



Source: Transparency International

The anti-corruption organisation Transparency International has published its Corruption Perception Index for the year 2004. Most of the countries in Baltic Sea Rim, except Estonia, are rather dropping their positions than improving upon them. In the 2004 comparison Latvia was ranked in 57th position, so Latvia's ranking remained the same as a year ago.

Latvian banks the most profitable in the first quarter

According to a survey by the Latvian banking association, Swedish banks Skandinaviska Enskilda Banken (SEB) and Swedbank dominate the Baltic banking sector. Parex Banka differs from the leaders of the banking market, because it is owned by two private persons, Valeriy Kargin and Victor Krasovitsky. In addition Riemutu Banka (4th biggest in Latvia) and Aizkraukles Banka (5th) are owned by private persons. The Sampo Pank (operates in Estonia) belongs to the Finnish Sampo Group. Foreign investments in core capital of banks make a 51% share in Latvia, whilst the corresponding share in Lithuania and Estonia is around 85-90%. There are 23 banks in Latvia, 13 in Lithuania and 8 in Estonia.

The Latvian banking sector was the most profitable in the Baltic's in the first quarter of 2004, by its EUR 37 mln aggregate profit. Simultaneously Estonian banks earned EUR 24 mln and Lithuanian banks EUR 17 mln. The Latvian banks' aggregate profit in the eight months of 2004 was LVL 71 mln, up by 55% y-o-y.

CA deficit expanded in the second quarter

Latvia's current account deficit of the balance of payments in the second quarter of 2004 reached 17.4% of GDP. The deficit widened due to rapidly rising imports in the months preceding Latvia's accession to the EU, and thus due to their increasing goods deficit. Compared with the corresponding period of the previous year, the exports of goods increased by 20% and imports by 31%.

In the second quarter of 2004, the volume of foreign direct investments (FDI) in Latvia reached LVL 101 mln, whilst direct investments abroad totalled LVL 21 mln. The bulk of investments were made by re-invested profits. During the first half of this year, FDI in Latvia increased notably from 2003. German direct investments in Latvia have expanded notably, by 51% y-o-y in the first half of 2004.

GDP in Riga region exceeds 3-4 times other regions

According to the CSB, in 2002, GDP per capita in Riga region was LVL 4 418, thereby 1.8 times more than the national average LVL 2 433. The second-richest territory was Pieriga with 66% of the average, and the poorest was Latgale with 48% of average GDP per capita. Of the six statistical regions of Latvia, only Riga (138%) exceeds the average GDP per capita level of the ten new EU countries.

Some business highlights

- Latvia's 10th biggest bank, Latvijas Krajbanka, is listed in Riga Stock Exchange from October 27.
- Finnish fast food company Hesburger plans to expand its operations in Latvia and Estonia. Hesburger has now 11 outlets in Estonian and 1 in Latvia. According to the company, it could have 20 restaurants in both Estonia and Latvia in future.
- Exigen Latvia, a subsidiary of the US based Exigen group, will develop an IT system for managing copyright fees for Universal Music Group and Warner Music Group. According to experts, this is the biggest IT order in Latvia so far.
- According to the Latvian Association of Light Industry, 80% of wearing apparel produced in Latvia is exported under the customer's brand or even without it.
- The Port of Riga has lost ferry passengers to Tallinn and Klaipeda due to the high port fees. The number of passengers has dropped by 25%, whilst the number of passengers is increasing in its main competitors. Riga Port has become one of the most expensive ports in the Baltic Rim after it raised fees last spring.
- Kesko Food opened the first Citymarket hypermarket in Latvia. The company in Latvia is developing two types of shopping concepts - food supermarket networks Citymarket and the low price shopping network Supernetto.
- Two Baltic hotels, Hotel Bergs in Riga and Three Sisters in Tallinn, have been listed in the World Top 100 hotel list by American magazine Conde Nast Traveller.
- Ventspils Nafta Terminals transhipped 24% less oil in the 8 months of 2004. According to the company, that was due to an increase of oil export duty in Russia.
- Turnover of retail trade companies grew by 13% y-o-y in eight months of 2004.

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	8,2	1-6/2004
Industrial production (y-o-y %-growth)	6,1	2,0	-8,8	3,2	6,9	5,8	6,5	6,9	1-8/2004
Inflation (CPI, end of period, y-o-y %-change)	7,0	2,8	3,2	1,8	3,2	1,4	3,6	7,7	9/2004
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	317	Q2/2004
Unemployment (% end of period, LFS data)	14,1	13,7	13,2	13,3	12,9	11,6	10,3	9,9	Q2/2004
Exports* (EUR million, current prices, average exch. rate)			1 613	2 020	2 232	2 416	2 559	2 041	1-8/2004
Imports* (EUR million, current prices, average exch. rate)			2 758	3 453	3 910	4 284	4 634	3 515	1-8/2004
Current account (% of GDP)		-9,7	-9,0	-6,4	-9,0	-7,0	-8,6	-13,7	1-6/2004

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

Lithuania

GDP up by 7.3% in the second quarter

In the second quarter of 2004, Lithuania's GDP expanded slightly more than was earlier estimated, and climbed up by 7.3% y-o-y. In the first half of this year, Lithuania's economy grew by 7.2% y-o-y. According to the Vilnius Banka's recent forecast, the economy will grow by 7.3% this year, and 7.1% in 2005. According to NORD/LB Lietuva's forecast, GDP will expand 7.5% this year.

In the second quarter, growth was based on an increase in all the main industries except mining and quarrying. Manufacturing expanded rapidly by 17% y-o-y, retail and wholesale by 12%, hotels and restaurants by 7%, and transport and communications by 7% y-o-y.

The growth of domestic demand continues. In the second quarter, final consumption expenditure increased by 8% y-o-y, and households' consumption even slightly more, due to growing earnings (5% y-o-y). Gross fixed capital formation grew by 15% compared to the corresponding period in 2003. Exports grew nearly 7% and imports almost 15% y-o-y.

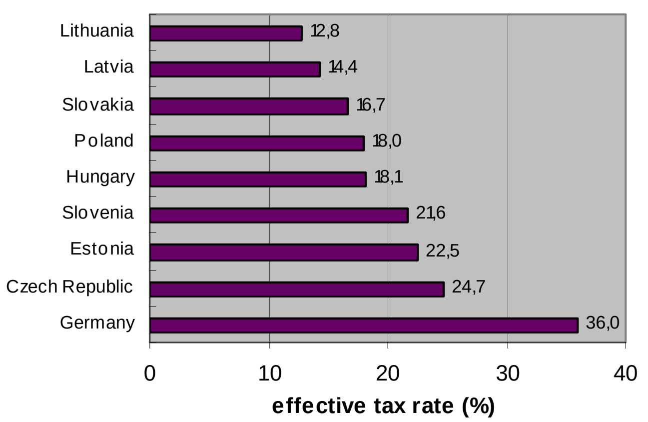
Since 2003, Lithuania's industrial production has been growing much faster than in other Baltic States. Within the first eight months this year, industrial production grew by 11.4%, and manufacturing even faster by 13.5% y-o-y. The most rapid growth was noticed in the manufacturing of radio, television and communication equipment, up by 38% y-o-y, and in the manufacture of furniture, which increased by 34%.

Exports and imports up by 17% in eight months

In the first eight months of 2004, Lithuania's exports and imports has grown side by side. In eight months, the export of mineral fuel grew by 42% y-o-y, and the export of machinery and equipment by 43%. In imports, plastic and rubber products increased by 27%, prepared foodstuffs by 24%, and mineral fuel by 21%. Both in exports and imports, relative growth has been largest in iron and steel.

In the second quarter of 2004, Lithuania's current account deficit expanded by 40% over the quarter mainly due to the rapid increase in imports last spring. Also, the deficit was boosted by the reduction in the service surplus and current payment balances. However, the current account deficit is modest compared to Estonia and Latvia. By the end of June, Lithuania's current account deficit accounted to 10% of GDP.

Effective tax rates in some new EU members



Source: Kauppalehti [ZEW]

According to calculations by the German Zentrum Für Europäische Wirtschaftsforschung (ZEW) and the Ernst & Young, Lithuania's effective corporate tax is the lowest in the EU. The effective tax rate includes all taxes and related costs, and also depreciation allowances. According to the ZEW, corporate tax rate will get lower in the five new EU countries in this year. Therefore tax rate harmonisation between old and new member states is not on the horizon.

FDI increased on the first half of 2004

On June 30, 2004, foreign direct investment stock reached LTL 14.7 bn (EUR 4.3 bn). Accumulated FDI increased by 7.0% from the beginning of this year, and 4.4% from the corresponding date in 2003. During the first half of 2004, major investments in Lithuania were made from Austria and Russia. The share of FDI from EU-25 was 62% of total FDI flows. Within the January-June period, investments in manufacturing covered 53% of total FDI.

In Lithuania, the main foreign investors are Denmark (16% of total), Sweden (14%) and Germany (9%). Combined EU-25 share is 75%, and CIS's share 8% of the total stock.

Budget revenue exceed projections

Lithuania's budget revenue in the first nine months exceeded projections by around LTL 170 mln, excluding assistance from the EU. In January-September, Lithuania received more than LTL 704 mln in EU assistance.

According to the State Privatisation Fund, Lithuania earned LTL 377 mln from privatisation actions during the first nine months of 2004. As a whole, 432 privatisation transactions were implemented. In the corresponding period last year, the number of privatisation actions was larger but generated less money to the state budget.

Some business highlights

- Income of transport, communication and service enterprises grew by 11.7% y-o-y in the second quarter; Turnover of retail trade enterprises grew by 10.2% y-o-y over January-July 2004.
- Bull, the French IT company, has established a subsidiary in Lithuania, and plans to expand in other Baltic States. Bull Baltija is to offer its services to the public sector and banking.
- The Lithuanian road builders' consortium Tiltra won a tender in Poland, worth over EUR 10 mln.
- Irish investment company Duke House Asset Managers has contracted the Lithuanian construction company Constructus to build a new shopping centre, Gedimino 9, in Vilnius.
- According to a recent study conducted by Market.Lab, 63% of Lithuanian companies tend to use only one way of transporting consignments, their own transport. Estonian and Latvian companies usually buy their transporting services.
- Belgium based Iki, the 2nd largest retailer in Lithuania, will expand to Latvia by the end of this year. The company will take over existing shops and build new ones.
- Lithuania's leading bank Vilniaus Bankas, a member of SEB group, is to buy 90% of Ukrainian Bank Agio. The value of investment is about EUR 22 mln, and needs to be accepted by the national authorities.
- Irish low-cost airline Ryanair, which started flights from Riga in October, may enter Lithuania next year. According to Ryanair, they are looking at two potential airports, Vilnius and Kaunas.
- Leituvos Dijas announced that it has halted construction of an underground natural gas storage facility in Vaskai. The EUR 160 mln project may be abandoned.
- Mazeikiu Nafta announced in late September that it has secured the crude oil supplies for the last quarter of 2004. Russian Yukos owns 53.7% stake of MN.

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	9,7	7,2	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	11,4	1-8/2004
Inflation (CPI, end of period, y-o-y %-change)	8,4	2,4	0,3	1,4	2,0	-1,0	-1,3	3,2	9/2004
General government budget balance (% of GDP)				-2,5	-2,0	-1,5	-1,9		1-12/2003
Gross wage (period average, EUR)	173	208	231	263	274	293	306	354	Q2/2004
Unemployment (% end of period, LFS data)	14,1	12,6	15,3	16,1	17,5	13,0	11,6	11,3	Q2/2004
Exports* (EUR million, current prices, average exch. rate)			2 583	3 841	4 778	5 526	6 135	4 593	1-8/2004
Imports* (EUR million, current prices, average exch. rate)			4 340	5 650	6 767	7 943	8 441	6 237	1-8/2004
Current account (% of GDP)	-10,2	-12,1	-11,2	-5,9	-4,7	-5,2	-6,6	-9,9	1-6/2004

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

Poland

GDP grew by 6.5% in the first half of the year

As expected, Poland's GDP growth slightly decelerated in the second quarter of 2004. However, in the second quarter, GDP expanded by 6.1% y-o-y, and reached 6.5% annual rate in the first half of this year.

In the second quarter, consumption grew by 3.8% and gross fixed capital formation by 3.3% y-o-y. Industrial gross value added increased strongly by 12.8%, a bit less than in the first quarter, whilst value added in construction decreased by 2.8% y-o-y. The growth of exports was the main contributor for economic growth. The growth rate of domestic demand was 5.1% y-o-y, decreasing slightly from the previous quarter.

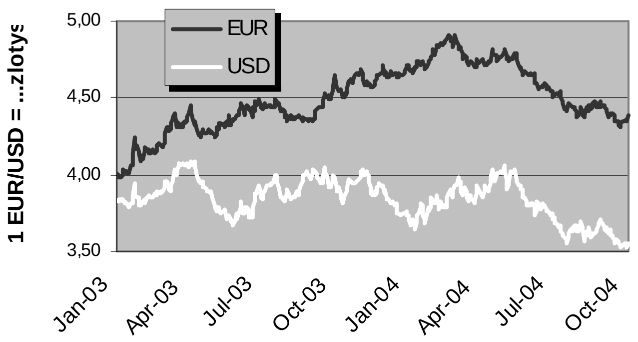
According to the Polish Academy of Science (INE PAN), the Polish economy will grow about 5% this year. During the forthcoming quarters, exports will remain as a the main engine of growth, accompanied by increasing investments. However, according to INE PAN, the growth rate will decline in the second quarter of 2005 due to the decline of exports. The main condition for maintaining rapid growth is to encourage companies towards investment. The European Commission forecast, however, is that Poland's economy will expand by 5.8% in 2004, and only Latvia and Lithuania will grow faster among the EU states. Despite the more optimistic scenario for this year, the Commission agrees with the opinion that GDP growth will decelerate in coming years below the 5% annual rate, which still exceeds forecasts for old member states. The World Bank and IMF's experts' forecasts are in line with the forecast by INE PAN and the European Commission.

Rapid growth in industry and exports continues

In the first nine months of this year, sold production of industry increased nearly 15% compared to the corresponding period in 2003. Manufacturing grew even faster by 17% y-o-y. In manufacturing, the most rapid growth was observed in the manufacture of radio, television and communication equipment (29%), and in the manufacture of electric equipment (22%).

Poland's exports grew rapidly in the first eight months of 2004. In zloty terms (at current prices), exports grew by 33% y-o-y, whilst imports grew 28% y-o-y. In euro terms, corresponding growth rates were 22% and 17% y-o-y. If the strengthening of the zloty against the euro continues, the growth of exports may decelerate.

Zlotys exchange rate in 2003-2004



Source: National Bank of Poland

Poland is not ready for the euro

According to the European Commission's Convergence Report 2004, Poland is not ready for the euro. Poland does not meet any of the Maastricht criteria: legal compatibility, price stability, government budgetary position, exchange rates and long-term interest rate convergence. The commission concluded that there should be no change in the status of Poland as a "Member State with a derogation".

However, Polish politicians believe that Poland will meet the fiscal criteria necessary to enter the Eurozone within three years.

Starting a business (2004)

	Estonia	Latvia	Lithuania	Poland	OECD average
Number of procedures	6	7	8	10	6
Time (days)	72	18	26	31	25
Cost *	7.5	17.6	3.7	20.6	8.0
Minimum capital*	49.7	41.4	62.8	237.9	44.1

** % of GNI per capita*

Source: World Bank, Snapshot of Business Environment

According to the World Bank, starting a business in Poland is more complicated than compared to the average OECD countries or the Baltic States. In addition, the cost of establishing and the minimum capital requirement are much higher than in other states in the Baltic Rim.

Poland has succeeded weakly in recent international comparisons by the World Economic Forum and the Transparency International (see pages 1 and 2 in this review).

Some business highlights

- According to the Conference of Poland's Special Economic Zones (SEZs), more than PLN 15 bn has been invested in SEZs, and more than 62 000 new jobs created. Another 120 000 persons have been employed in surrounding areas.
- Polish farmers will receive subsidies around PLN 11.6 bn this year. This is almost three times more than they received from the state before their EU accession. Most of the farmers will spend the money for investments in production machines.
- The world biggest chewing gum producer, Wrigley, will move its production from Phoenix (US) to Poznan.
- The US based company, Whirlpool is to spend EUR 100 mln to modernise and expand production facilities at the former Polar plant in Wroclaw.
- Swedish furniture giant Ikea plans to invest PLN 1.5 bn (EUR 340 mln) in the next three years in a new furniture store in Lodz, and in its retail centres and suppliers.
- PMB, the Danish based garment producer, will close its factory in Pila by the end of 2004, because of its lack of orders, falling prices, and the influx of cheaper clothes from China.
- Carrefour Polska will invest EUR 110 mln in new stores within the coming 18 months. In addition, the company plans to launch a further 30 stores in 2006-2007.
- According to C&W H&B ranking, Warsaw is the 20th attractive business centre. A year ago, Warsaw ranked in 22nd position.
- Russian veterinary surgeons are controlling 75 Polish dairies, which try to obtain permits to Russian markets. Inspections on meat, poultry and fish companies will start after that. Final decisions will be made later in Moscow.
- PKO BP privatisation: the Treasury Minister stated, that due to criticism surrounding the way the bank is being privatised, this will be the last privatisation that will be sold to the public in such a way. There has been a wide public debate on whether foreign investors are able to buy shares or not, and what is the amount of shares that will be sold.
- PGNiG privatisation: the Treasury Minister stated that a decision on the sale of state own shares shall be made during the next six months. According to the Minister, the Government will probably keep a 51%-stake of PGNiG.

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	6,5	1-6/2004
Industrial production (y-o-y %-growth)	11,5	3,5	3,6	6,7	0,6	1,1	8,4	14,6	1-9/2004
Inflation (CPI, end of period, y-o-y %-change)	13,2	8,6	9,8	8,5	3,6	0,8	1,7	4,4	9/2004
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	19,1	Q2/2004
Exports* (EUR billion, current prices, average exch. rate)		25,1	25,7	34,4	40,4	43,4	47,5	36,6	1-8/2004
Imports* (EUR billion, current prices, average exch. rate)		41,5	43,2	53,1	56,2	58,3	60,4	45,1	1-8/2004
Current account (% of GDP)	-3,0	-4,1	-7,0	-6,0	-3,9	-3,5	-1,9	-2,1	1-6/2004

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

Lithuania in the Baltic Sea Rim after EU Enlargement

by Audrius Brūzga

Lithuania's accession to the EU along with Latvia, Estonia and Poland, has brought about 'tectonic' changes in the Baltic Sea Rim. The Eastern littoral states of the Baltic Sea are now firmly locked in a 'jig-saw puzzle', called Europe. They are also an integral part of the Baltic Sea Area, a most dynamic and promising region in Europe. We, in Lithuania, see plenty of opportunities opening before us in this new environment. We know there are also challenges ahead and an ever-growing urge to work together with partners for a common interest.

Here is Lithuania, a new EU member, in a nutshell: a future cohesion Member State with a dynamic economy, a borderland state with 922 km of eastern EU border, a country bridging the Baltic Sea and Central Europe and advocating a strong trans-Atlantic link. How does this translate in real life? Lithuania will continue to advocate the EU Cohesion policy as a means to narrow the economic and social gap in the enlarged European Union. The disparities between the countries are even more visible in the Baltic Sea context. At the moment Lithuania accounts for only 42% of GDP per capita among the EU-25. The 'catch-up' process, therefore, is an essential element in the economic performance of the country.

This is also one of the reasons why Lithuania supports the Lisbon process. We think that it is absolutely imperative for the EU to become a dynamic, competitive and knowledge-based economy in order to be able to compete on the global level. It is also a 'win-win' strategy for Lithuania and her fellow EU neighbours. Today we know that the Lisbon strategy is in need of good 'repair' because it is failing. Perhaps, the working group of Mr. Wim de Kok will come up with solutions on how to make these repairs, but first and foremost, we need faith in the declared goal for the EU to have the best economy in the World. Without it and without the commitments of the governments concerned, the efforts will be in vain.

Part of the problem in many EU countries is the economy itself. In sharp contrast, the economy of Lithuania is doing extremely well. It is perhaps the major driving force in the development and progress of the country. The impressive growth of GDP, a low budget deficit and low inflation rate are indicative of a healthy and vibrant economy. "Ballistic Baltic"- that's how US investment bank Goldman Sachs characterised Lithuania.

EU membership, of course, is a key factor here. The opening of the single market, substantial EU financial assistance and a significant increase in FDI will be beneficial for the entire country. Specific sectors, such as the manufacturing industry, wholesale and retail and also agriculture are expected to gain even more from the EU enlargement than others. In the years 2004-2006 Lithuania will receive financial assistance from the EU in the amount of EUR 2.7 bn, which accounts for 1.5 – 2.0 % of GDP growth.

However, for the most part the economy is growing because of reformed taxation, finance and market regulation. Generous foreign and national investments, expanding exports and growing domestic consumption have played their important roles in stimulating the Lithuanian economy. Expectations are that in such an environment, a sustainable annual GDP growth of 6 to 7 % in the medium term looks very realistic.

EU membership has also brought along some not-so-welcome changes, particularly those affecting trade regimes with third countries. Of special interest and importance are relations with our neighbours in 'Wider Europe': Russia, Ukraine, Belarus. According to an EU Membership Impact Study, commissioned by the Lithuanian Ministry of Economy in 2003, import to Lithuania from third countries will be 5.9 % more expensive than before. On the other hand, the increase in import costs from Russia will be 'cushioned' by the EU's General System of Preferences (GSP). As far as exports are concerned, Ukraine, as a target market for Lithuanian manufacturers, will become more expensive by some 12-13%. Perhaps, a certain comeback is possible when Ukraine joins the WTO and negotiates a trade regime with the EU. Lithuania is certain to advocate a speedy conclusion to such an agreement, and actively promotes EU perspective for Ukraine. We think that Ukraine belongs to Europe and that she has to be integrated into the EU's single market. This may happen gradually, over a period of time, when adequate reforms are implemented. Successful and consistent reforms, as indeed in Russia and one day in Belarus also, will have a direct positive effect on economic growth of our entire region.

And then there is also the Kaliningrad Region, another EU borderland in the Lithuanian neighbourhood. Given the favourable geographic location and the positive EU enlargement fallout effect, the region is in a good position to turn into a very attractive place for business. The long-awaited Targeted Federal Programme for the Development of the Kaliningrad Region up to 2010 should lay the foundations for the economic transformation of the region and provide favourable conditions for foreign investors. In addition, Lithuania is a strong advocate in the EU of adopting a special EU programme or action plan for the economic and social development of the Kaliningrad Region. The transit of people and goods from Russia to Kaliningrad through the territory of Lithuania goes according to the rules agreed by the EU and Russia, to the satisfaction of all the parties involved. However, this operational transit regime is only one important element in the efforts to foster better access and engagement with Kaliningrad. Entrepreneurship is the road to success. Lithuania already happens to be a major partner with the Kaliningrad Region, coming third after Poland and Germany in terms of FDI and first in terms of the number of companies with foreign capital. There are at least 600 Lithuanian enterprises doing business in Kaliningrad. Most of the Lithuanian investments went into the food-processing industry, manufacture of furniture and electrical appliances, the service sector and construction.

The interest of our business people in the markets of our Eastern neighbours is only natural. It is, of course, profit-oriented. But there is more to this than meets the eye. Integrated regional economies will boost our global competitive powers and will bring about stability and prosperity to the whole region. There is, however, one important issue to address in this context, and that is infrastructure. The development of cross-border infrastructure networks is instrumental in building a modern and competitive region. Furthermore, without the adequate infrastructure we will not be able to connect with the rest of Europe.

Construction of the 'Via Baltica' motorway, a major transport artery running through the Baltics and Poland to Central Europe, has been a priority project for the countries involved for a number of years now. As the 'Via Baltica' is nearing its completion, this cooperative approach needs to be put to work in another no less ambitious project known as 'Rail Baltica'. The increasingly congested European roads point to only one viable alternative – railroads. The European Commission has placed strong emphasis on the development of modern railway networks. It is no accident then, that 'Rail Baltica', a brand new European gauge rail track, with high-speed trains running from Tallinn to Warsaw, has been included in the Quick Start programme. The estimated cost of the project, partly financed by the EU, is EUR 3.9 bn. The first stage, a track from Kaunas to Warsaw, is expected to be completed by 2010. This requires rapid and effective cooperation among the countries involved, both in their public and private sectors. A good network of roads and railways, together with the motorways of the Baltic Sea, will help to build an integrated multimodal transport system, which is beneficial to the whole region.

Transport and energy issues, of which the construction of a new gas pipeline through the Baltics and implementation of the Power Bridge electricity grid connection to Poland will continue to feature on the Lithuanian agenda. The Baltic Sea Area will not 'breathe' at full capacity if it has no proper outlets to the outside world. EU policies and directives have to be complemented by the New Neighbourhood opportunities and enhanced by the trans-Atlantic partnership. A combination of these three ingredients is also likely to produce the most desirable results for the countries on the Baltic Sea Rim.

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Internationalisation of Estonian Economy through Foreign Direct Investments (FDI)

by Alari Purju

Post-socialist economies have, in general, low levels of domestic savings due to their low levels of incomes. The source of foreign direct investments (FDI) is foreign saving and so additional resources will be available, contributing to the process of restructuring, economic growth and the development of technology in the recipient countries. Estonia has been one of the most successful Central and Eastern European countries in attracting FDI on a per capita basis. In addition to invested resources, the spill-over of business culture, plus an additional demand for local companies are important results of the FDI-s.

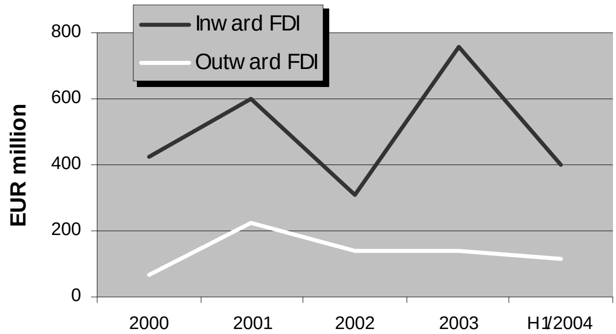
There are, in principle, three components in FDI: equity capital - the purchase by foreign direct investor's shares of an enterprise in a country other than its own - reinvested earnings and intra-company loans or intra-company debt transactions. The inward and outward FDI-s have been different sides of the same coin and created a basis for the internationalisation of economy.

The Estonian economy is closely connected the economies of Finland and Sweden via trade linkages. These countries are also the two most important sources of inward FDI, creating together 67% of the FDI-s into Estonia. Sweden is Estonia's greatest single FDI investor. The bulk of the FDI from Sweden has gone into the Estonian banking, transport and communication sectors. The major part of FDI from Finland has been directed towards the manufacturing, transport, trade, construction and real estate sectors. One reason why Finnish investors invest more in wholesale and retail trade is that majority of tourists visiting Estonia come from Finland. Those companies are also serving tourists in Estonia, especially in the capital. On the 30th June 2004, FDI into Estonia formed EUR 5.9 billion. The income of foreign direct investors in 2003 was EUR 543 mln or 10.6% from all invested money (direct investment stock in Estonia). From earned money, EUR 403.5 mln or 74.3%, was reinvested. The FDI-s have annually created up to one third of the gross fixed capital formation of Estonia.

The majority of Estonian outward FDI was converted into real estate, rent and business services and the finance. Approximately two thirds of the FDI went into Latvia and Lithuania. The total amount of outward FDI was EUR 938 mln on 30th June 2004. For further analysis of sources of outward FDI-s, it is reasonable to separate direct and indirect investors. Direct investors are domestically-owned firms from that country. Indirect investors are themselves affiliates of foreign parents, located outside a country.

On that basis, it is possible to separate into two periods, outward FDI from Estonia. Until 1998, locally-owned Estonian companies formed the majority of Estonian outward investors. After the financial crises in Russia in August 1998, Swedish commercial banks acquired the majority of shares in the two largest Estonian banks. The target of those bids was the already created Baltic network. On a minor scale, that also occurred in other sectors. So, the majority of Estonian outward investments have been acquired by foreign firms and the Estonian direct outward FDI projects were transformed into indirect ones in that process.

Inward and outward FDI in 2000-2004



The FDI-s played a major role in internationalising economies, linking the business units in different countries into a joint network. The inward FDI have been a pre-assumption for outward FDI during the second stage of that process. Prospective EU membership also played an important role, targeting the Baltic market as an overall region. It was possible to forecast that they would become EU members in the near future. This meant the harmonisation of the institutional framework and lower transaction costs for foreign investors. Estonia is a connecting link and firms registered in Estonia function as agents of Swedish and Finnish outward investors targeting the Baltic markets as a wider area for economic activities. The question for future research would be the role of Estonia as a possible mediator for Scandinavian investments towards Russia after EU enlargement.

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Estonia's FDI, EUR million

Indicator	2000	2001	2002	2003	H1/2004
GDP (current prices)	5 926	6 304	6 761	7 109	4200*
Gross fixed capital formation	1 519	1 798	2 145	2 285	1350*
Inward FDI	424	603	307	756	398
Outward FDI	66	225	140	137	118
Gross fixed capital formation / GDP (%)	25.6	28.5	31.7	32.1	32.1
Inward FDI / GDP (%)	7.2	9.6	4.5	10.6	9.5
Inward FDI / Gross fixed capital formation (%)	27.9	33.5	14.3	33.1	29.4

Sources: Statistical Office of Estonia, Bank of Estonia, author´s calculations **estimate*

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