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Baltic Rim Economies

Estonia – Latvia – Lithuania – Poland

Bimonthly Review 2▪2005

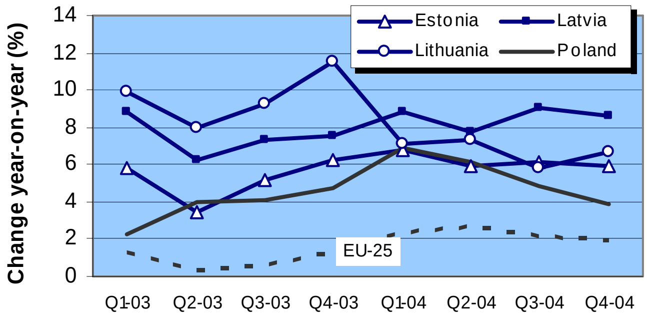
Estonia

GDP grew by 6.2% in 2004

Estonia's gross domestic product increased in 2004 by 6.2% compared to the previous year. Therefore Estonia's economic performance exceeded forecasts – once again. In the fourth quarter of 2004 GDP grew by 5.9% y-o-y.

Last year's strong economic growth was based on the value added increase in all the main economic sectors, except mining and quarrying, fishing and forestry. Relatively largest growth was observed in hotel and restaurant services, up by 11% y-o-y, supported by the powerful increase in foreign visitors. Added value also increased rapidly in financial intermediation (11% y-o-y) and in manufacturing (10%). Domestic demand and private consumption expanded by 6.6% and 6.1% respectively, thus slightly quicker than in 2003. Gross fixed capital formation grew nearly 7% which is slightly more than a year before but notably less than during the years 2000-2002. On the contrary, the growth of exports increased sharply after three weak years.

Real GDP growth quarterly 2003-2004



Source: National statistical authorities, Eurostat

Inflation remains at high level

In the first quarter of 2005, the consumer price index increased by 4.6% compared to the corresponding period for 2004. Over the quarter, prices increased most in housing, up by 2.5%. Construction prices are still rising quickly since they went up by 8.4% y-o-y in the first quarter.

Income tax will fall to 20% by 2009

Estonia's new government, the coalition of the Reform party, the Centre party and the People's Union, intends to continue income tax cuts. The government plans to the cut income tax rate from the current 24% down to 20% by the end of 2009. Therefore the tax cutting programme continues along the line of previous government, but the time schedule will be spread over four years instead of the previously planned two years schedule. Estonia dropped its income tax rate by 2 percent units down to 24% at the beginning of 2005.

In 1994, Estonia became the first country in Europe to introduce the flat income tax system. Following this, many countries in Eastern Europe, as well as Latvia and Lithuania, have copied Estonia's example.

Current account deficit slightly narrowed in 2004

Estonia's current account deficit slightly narrowed in 2004 due to positive development in the latter half and formed 12.7% of estimated GDP. In absolute terms, however, the value of deficit increased by almost a billion kroons to 17.5 bn. The goods account deficit expanded by nearly EEK 2.8 bn, although exports (up 18% y-o-y) grew slightly faster than imports (17%). However, this increase in the goods deficit was offset by the expansion of the service account surplus. Foreign direct investment in Estonia amounted to EEK 11.6 bn (EUR 740 mln), which is 7% less than in 2003. Nearly three-fourths of this consisted of reinvested earnings.

In 2004, the share of exports to EU-25 area decreased by 2 percent units to 80% of total exports, due to the share of EU-15 countries which declined remarkably from 66% to 62%. On the contrary, exports to CIS area grew strongly by 54% y-o-y. Cross-trade between the Baltic States is also growing, since the combined share of Latvia and Lithuania increased strongly both in Estonia's exports (to 12%) and imports (to 10%).

Swedbank took over Hansabank

Swedbank succeeded in its aim to take over Hansabank. According to the bank's statement on April 6, Swedbank held more than 98% of the shares of Hansabank. Last February Swedbank announced its bid to acquire all the shares of Hansabank and offered EUR 11 a share. Afterward the bank raised its offer to EUR 13.50 a share, as the initial price was considerer to be too low by most shareholders.

Hansabank is the largest bank in the Baltic States and controls about one third of the Baltic banking market. Hansabank also plays a crucial important role in the Tallinn Stock Exchange (TSE) due to its typical 75% share of the bourse's daily exchange. Swedbank has previously stated that it intends to delist Hansabank from the TSE.

Some business highlights

- The net sales of Estonian enterprises totalled EEK 376 billion kroons (EUR 24 bn) in 2004. The net sales increased by 14% compared to 2003, which is more than the annual growth in 2003 and 2002, 9% and 13% respectively.
- Estonia's second largest bank Eesti Ühispank has been renamed to SEB Ühispank. A similar name change was also carried out in SEB's banks in Latvia (SEB Latvijas Unibanka) and Lithuania (SEB Vilniaus Banka).
- Russian-controlled freight carrier Spacecom, which competes with Estonian railways, considers ending its business due to high infrastructure fees. A dispute over the fees has carried on ever since the company started operating in Estonia.
- In 2004 Tallinn was a more popular travelling destination compared to Stockholm, Helsinki or Riga. Hotels in Tallinn served nearly 1 mln tourists, up by 31% y-o-y.
- Hotel management company Raffles International will enter to Tallinn. The 28-storey Swissotel Tallinn Estonia has 239 rooms and will be opened in early 2007.
- Authorities of St. Petersburg announced in March that they have approved plans to build three new oil terminals on the Baltic Sea. Two of them will be developed by German Oiltanking and Russian Severo Zapadny and one by Russian TNK-BP. Russia has also started to build the Ust-Luga port near the Estonian border.
- Finnish S-Group plans to build a new 180-rooms hotel "Sokotel" in Tallinn. The hotel will be located next to Hotel Viru, which is owned by S-Group.

Estonia - main economic indicators	1998	1999	2000	2001	2002	2003	2004	2005	as of
GDP (y-o-y %-growth, constant prices)	5.2	-0.1	7.8	6.4	7.2	5.1	6.2		1-12/2004
Industrial production (y-o-y %-growth)	4.1	-3.4	14.6	8.9	8.2	11.0	7.5	5.8	1-2/2005
Inflation (CPI, end of period, y-o-y %-change)	6.5	3.9	5.0	4.2	2.7	1.1	5.0	5.0	3/2005
General government budget balance (% of GDP)	-0.3	-3.7	-0.6	0.3	1.4	3.1	1.8		1-12/2004
Gross wage (period average, EUR)	262	284	314	352	393	430	492		Q4/2004
Unemployment (% end of period, LFS data)	10.2	12.9	13.9	11.9	11.3	9.3	8.5		Q4/2004
Exports (EUR million, current prices)	2 252	2 239	3 445	3 698	3 642	4 003	4 747	855	1-2/2005
Imports (EUR million, current prices)	3 529	3 224	4 615	4 798	5 079	5 715	6 738	1 055	1-2/2005
Current account (% of GDP)	-8.6	-4.4	-5.5	-5.6	-10.2	-13.2	-12.7		1-12/2004

Source: Statistical Office of Estonia, Bank of Estonia, Eurostat, author's calculations

Latvia

Latvian economy grew a record-high 8.5% in 2004

Latvia's economic growth remained robust in the last quarter of 2004. GDP expanded by 8.6% y-o-y supported by the strong growth in construction, transport and retail trade.

In 2004, the Latvian economy grew the fastest among EU countries, since the whole year's GDP growth totaled 8.5% compared to 2003. The growth was based on the rapid value added increase in all of the main industries. The highest increase was observed in hotel and restaurant services, in construction, and in the transport sector, all of which grew around 13% y-o-y. Domestic trade increased by 10% and manufacturing by 8% y-o-y. Latvia's robust economic growth was based on the strong increase in domestic demand, driven by a particular increase in investments and private consumption.

Latvia's external balance weakened notably last year. The current account deficit expanded almost 75% y-o-y and totaled a record high 12.3% of GDP. This sharp increase arose from a higher deficit in goods and income accounts and a decrease in their service surplus. However, foreign direct investment in Latvia more than doubled year-on-year.

According to the recent forecast by the European Commission, Latvia will maintain its position as the fastest growing EU country during the forthcoming years. Latvia's GDP is expected to increase by 7.2% this year and 6.9% in 2006. Correspondingly, according the EC's forecast, Lithuania's GDP will grow by 6.4% and 5.9% respectively and Estonia's growth is expected to remain around the current 6% level.

Retail trade and exports up, manufacturing down

Latvian retail trade increased rapidly during the first two months of 2005, since retail trade turnover grew nearly 21% y-o-y. Latvia's exports grew even faster in this period. Exports increased extremely by 34% y-o-y, whilst imports grew by 28% compared to the first two months a year ago.

On the contrary, the growth of industrial production stopped during the first two months this year.

Comparison of employment costs, EUR

Country	Pay	Social security	Total Pay & benefits
Belgium	36 527	12 667	53 577
Sweden	36 363	11 891	52 800
...	...	...	...
Poland	**6 495**	**1 307**	**8 257**
Estonia	**5 687**	**1 877**	**7 621**
Lithuania	**4 247**	**1 317**	**5 649**
Latvia	**3 799**	**915**	**4 752**
...	...	...	...
China	1 445	851	2 368
India	1 654	304	2 024

Source: Mercer HRC 2005

Employment costs in Eastern European EU countries are, on average, less than a quarter of the corresponding costs in the EU-15 countries. Moreover, according to Mercer Human Resource Consulting, employment costs in Latvia are less than a half of these costs in Hungary and the Czech Republic. Among EU countries, the highest employment costs were noted in Belgium and the lowest in the Baltic States and in Slovakia.

Steep rise in construction prices

In the first quarter of 2005, consumer prices in Latvia increased by 6.7% y-o-y. In March, once again, the annual consumer price index recorded the highest value in the EU. Within the first three months of this year prices rose by 2.1%. In this period the highest price increase was noticed in food products and fuels.

Construction prices rose steeply rise last year this sharp rise also continued in the first quarter of 2005. Construction prices went up by 10.8% y-o-y, which is the highest annual ascent since 1998.

Latvia's inflation is expected to remain notably above the Maastricht criteria during 2005-2006, although the EU accession-related price effect disappears from annual statistics. Therefore high inflation may delay Latvia's entering the euro zone, although Latvia currently fulfils all the other criteria. According to recent estimates, Latvia's EMU membership could take place on January 1, 2008 at the earliest.

Housing market prices grew fastest in Latvia

According to the European Council of Real Estate Professions (CEPI), Latvian housing market prices grew the fastest last year, followed by Lithuania, among 21 European countries by comparison. Latvian housing prices accelerated by 35% y-o-y and the prices of apartments by 30% compared to 2003. Correspondingly, according to the Acro Real Estate company, housing prices in Riga city centre increased last year about 50-85% and in Old Riga by 100% from the previous year.

Prices of houses and apartments are still moderate compared to other EU countries. According the CEPI study, the average sale price for an apartment in Riga was EUR 800 per square metre and respectively in Vilnius EUR 725, whilst in the most expensive European capitals the average prices reached over EUR 4,000 per square metre. However, CEPI forecasts that there will be further significant price rises in Riga over the next five years.

Some business highlights

- Latvian banks' aggregate profit increased by 68% y-o-y up to LVL 42 mln within the first quarter of 2005. In 2004 the banks' profit totalled LVL 116 mln.
- L&P Baltic Brygg, the Swedish subsidiary of Latvian Laval un Partneri went bankrupt in Sweden. Swedish trade unions launched a boycott against the company in December 2004 because the company refused to sign a collective contract with the unions. The Latvian company was contracted to build a school in Sweden.
- Finnish fast food company Hesburger plans to open 3-4 restaurants in Latvia this year. During the forthcoming years Hesburger plans to have 30-40 restaurants in Latvia and aims to be the largest fast food chain in Latvia.
- Grindeks, the largest Latvian pharmaceutical company, considers acquiring a 47% share of Jelfa, one of the largest pharmaceutical manufacturers in Poland. Grindeks' medicine "Mildronats" won first prize in the "Made in Latvia" competition which was organised by the LCCI.
- Lithuanian Bite GSM, controlled by Danish TDC, has won an auction for third UMTS/GSM license in Latvia. Bite GSM paid LVL 6.7 mln (EUR 9,5 mln) for the licence, whist the starting price was LVL 1.3 mln. According to the bid rule, the company has to invest EUR 150 mln in an independent communication network.
- Czech airline CSA started flights from Riga to Rome in March. The company is controlled by the Czech State. Latvian national air carrier airBaltic launched direct flights to Istanbul and to Girona (Barcelona) in March. The company also starts flights to Munich and Paris in late April.
- Riga Airport is developing a new 90-hectares business park near the airport. The business park will include hotels, office buildings and logistics centres.

Latvia - main economic indicators	1998	1999	2000	2001	2002	2003	2004	2005	as of
GDP (y-o-y %-growth, constant prices)	4.7	3.3	6.9	8.0	6.4	7.5	8.5		1-12/2004
Industrial production (y-o-y %-growth)	2.0	-8.8	3.2	6.9	5.8	6.5	6.0	-0.8	1-2/2005
Inflation (CPI, end of period, y-o-y %-change)	2.8	3.2	1.8	3.2	1.4	3.6	7.3	6.4	3/2005
General government budget balance (% of GDP)	-0.6	-4.9	-2.8	-2.1	-2.7	-1.5	-0.8		1-12/2004
Gross wage (period average, EUR)	202	225	268	282	297	298	314		1-12/2004
Unemployment (% end of period, LFS data)	13.7	13.2	13.3	12.9	11.6	10.3	10.3		Q4/2004
Exports (EUR million, current prices, average exch. rate)		1 613	2 020	2 232	2 416	2 559	3 175	550	1-2/2005
Imports (EUR million, current prices, average exch. rate)		2 758	3 453	3 910	4 284	4 634	5 616	864	1-2/2005
Current account (% of GDP)	-9.7	-9.0	-6.4	-7.6	-6.7	-8.2	-12.3		1-12/2004

Source: Central Statistical Bureau of Latvia, Bank of Latvia, Eurostat, author's calculations

Lithuania

GDP expanded by 6.7% in 2004

Lithuania's GDP increased by 6.7% year-on-year in 2004. Rapidly growing domestic demand was the main engine behind their economic growth, as it also was in 2003. In 2004, gross fixed investment grew strongly by 23% y-o-y and household consumption by 9% compared to 2003.

With regard to economic activities, the most notable value added increase was observed in manufacturing and in the wholesale and retail trade, both of which grew around 11% y-o-y. Transport, storage and communication expanded by 8%, and hotel and restaurant services by 7% compared to the previous year. On the contrary, the growth of construction slowed down remarkably. Construction increased by 4% y-o-y, whilst during the years 2002 and 2003 the value of construction increased by 22% and 28% y-o-y respectively.

Growth in manufacturing sector 2004, % y-o-y

	Estonia	Latvia	Lithuania	Poland
Total manufacturing	**9.8**	**6.2**	**11.9**	**14.5**
Food products and beverages	4.1	6.5	3.9	5.9
Textile products	2.0	-6.6	7.5	9.4
Clothing	-9.4	5.9	-9.8	-6.7
Wood products	13.9	5.9	7.0	12.0
Publishing and printing	14.3	3.8	6.2	7.2
Refined petroleum products	…	…	23.7	6.2
Chemical products	19.9	22.2	0.0	9.7
Rubber and plastic products	-0.7	15.1	12.5	13.7
Metal products	7.5	5.0	29.8	19.0
Machinery and equipment	10.4	8.8	11.7	16.2
Electric machinery and equipment	40.9	10.2	20.4	9.3
Radio-, tv- and communication equipm.	45.0	18.3	14.4	36.1
Medical, precision and optical instrum.	20.0	…	21.6	5.3
Motor vehicles and trailers	17.6	…	90.2	56.4
Other transport equipment	2.2	1.6	17.2	25.2
Furniture; other manufactured products	5.5	10.4	33.5	14.5

Source: National statistical authorities

The strong growth in Lithuania's industrial production continued in 2004, although the growth rate slightly decelerated in the latter half of the year. The growth in manufacturing reached 12% y-o-y, driven by the broad increase in all the main industries, particularly in the manufacture of refined petroleum products, which expanded by 24% y-o-y.

However, the growth of industrial production slowed notably within the first two months of this year compared to the corresponding period in 2003. The production and distribution of electricity, gas and hot water decreased nearly 11% y-o-y due to the closure of the first unit of the Ignalina nuclear power plant. In addition, the growth of the manufacturing of refined petroleum products and the manufacturing of machinery and electric equipment ceased. Manufacturing, however, grew in the first two months nearly 6% y-o-y driven by the strong increase in the metal and food industries.

Trade deficit narrowed in January-February

Lithuania's exports grew faster than imports during the first two months this year. Exports increased nearly 19% y-o-y, whilst the growth of imports recorded 13% compared to the same period in 2004.

A steady growth in retail trade continued within the first two months of 2005. Retail trade turnover expanded by 7% y-o-y. The most rapid increase was observed in the sales of textiles and related products and in the sales of furniture and household equipment and appliances. The turnover of restaurants and catering enterprises rose by 23% y-o-y.

Lithuania to reduce income tax from 33% to 24%

Lithuania's four governing coalition parties have signed an agreement on tax reform. According to this plan, residents' income tax rate will be reduced from the current 33% to 24% between the years 2006 and 2008. The first cut to 27% is planned to be implemented on July 1, 2006 and another cut down to 24% in early 2008.

However, the financing of these income tax cuts remains on the table. The government has planned to introduce a so called solidarity tax in order to finance the budget gap resulting from the income tax cuts. According to the plan, this temporary solidarity tax will be calculated based on the companies' turnover. Lithuania's public deficit increased last year due to loose budget discipline (see page 4).

FDI inflow quadrupled in 2004

The inflow of foreign direct investment grew steeply in 2004. Such investment in Lithuania made up LTL 2.15 bn (EUR 620 mln), which is almost the quadruple amount compared to 2003. In 2004, reinvested earnings covered about a half of the FDI and equity investment made up 40%. Moreover, more than a half of the FDI was directed towards manufacturing. At the end of 2004, accumulated FDI stock in Lithuania amounted to LTL 16.2 bn (EUR 4.7 bn). In contrast to the FDI structure in Estonia and Latvia, the largest share of FDI in Lithuania has been made in the manufacturing sector.

Lukoil or TNK-BP to control Mazeikiu Nafta?

Oil deliveries to Mazeikiu Nafta's oil refinery ceased again in April due to Yukos crises. According to the Lithuanian Economy Ministry, other Russian oil producers have lined up to take Yukos' place as oil suppliers to the refinery. The minister also stated that Lukoil and a few other suppliers guarantee deliveries in the second quarter. Lukoil and TNK-BP are considered being the most likely contenders to take control of the MN. Mazeikiu Nafta consists of an oil refinery, an oil terminal in Butinge and the pipeline company Naftotiekis. Russian Yukos owns a majority share of Lithuania's largest company, and has been reluctant to sell its shares.

Some business highlights

- Lithuanian retail giant VP Market's turnover increased by 21% y-o-y in the first quarter of 2005. The company currently operates in all the Baltic States and Romania and plans to open 100 new supermarkets this year. VP Market has also stated that it would open 200 outlets in Bulgaria over a five-year period.
- Linas ir Viza plans to build new methyl ester production facility in the Klaipeda Free Economic Zone. The investment is worth over EUR 50 mln.
- The Lithuanian State Property Fund has started to privatise the air carrier Lithuanian Airlines. The fund aims to get at least LTL 9.3 mln from the privatisation.
- Russian EuroChem has acquired a 91.15% share of Kedainiai-based fertiliser manufacturer Lifosa. The Russian chemical company bought the shares form Cyprus-registered Eolian Trading Limited.
- A Lithuanian company has opened a fish-processing company Vinchyunai-Rusin in the Kaliningrad region. The investment in new plant is worth USD 7 mln. The company plans to sell its production to Russian markets.
- Lithuanian enterprises' aggregate profit rose by 36% y-o-y in 2004 and totalled LTL 5.5 bn. Correspondingly their aggregate sales grew by 23% y-o-y.

Lithuania - main economic indicators	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**as of**
GDP (y-o-y %-growth, constant prices)	7.3	-1.7	3.9	6.4	6.8	9.7	6.7		1-12/2004
Industrial production in sales (y-o-y %-growth)	8.2	-9.9	2.2	16.0	3.1	16.1	10.8	1.8	1-2/2005
Inflation (CPI, end of period, y-o-y %-change)	2.4	0.3	1.4	2.0	-1.0	-1.3	2.9	3.2	3/2005
General government budget balance (% of GDP)	-3.0	-5.6	-2.5	-2.0	-1.5	-1.9	-2.5		1-12/2004
Gross wage (period average, EUR)	208	231	263	274	293	311	335		1-12/2004
Unemployment (% end of period, LFS data)	12.6	15.3	16.9	17.9	13.0	11.6	10.6		Q4/2004
Exports (EUR million, current prices, average exch. rate)		2 583	3 841	4 778	5 526	6 158	7 451	1 234	1-2/2005
Imports (EUR million, current prices, average exch. rate)		4 340	5 650	6 767	7 943	8 526	9 875	1 503	1-2/2005
Current account (% of GDP)	-12.1	-11.2	-5.9	-4.7	-5.2	-6.9	-7.2		1-12/2004

Source: Statistics Lithuania, Bank of Lithuania, Eurostat, author's calculations

Poland

GDP growth reached 5.3% in 2004

Poland's economy grew by 5.3% y-o-y in 2004, which was the highest annual increase since 1997. However, economic growth slowed down significantly in the second half of the year. In the last quarter of 2004 GDP expanded by 3.9% y-o-y, whilst during the first and second quarters GDP grew more than 6% compared to the corresponding period in 2003. According to the European Commission's recent forecast, Poland's economy will grow around 4.5% in 2005 and 2006.

Last year's economic growth was based on the rapid increase in exports and, particularly in the latter half, on the increase in domestic demand. In 2004, private consumption grew by 3% y-o-y remaining at the same level as throughout this decade. However, gross fixed investment turned upwards and increased by 5% compared to 2003. In the last quarter of 2004, investments grew more than 7% compared to the corresponding period in 2003. During the years 2001-2003, Poland's investment recorded negative growth rates.

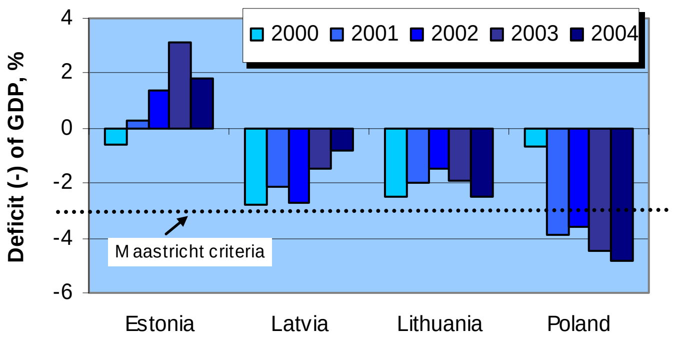
Poland's industry grew rapidly in 2004, although its growth rate decelerated in the latter half. Industrial production increased by 12% and manufacturing by nearly 15% y-o-y. In manufacturing, the most rapid increase was observed in the manufacture of motor vehicles and trailers, up by 56%, and in the manufacture of radio, television and telecommunication equipment.

Manufacturing and retails down, construction up

According to the preliminary data by GUS, Poland's industrial production increased by only 0.7% y-o-y during the first quarter of this year. In addition, retail trade sales decreased by 0.4% within this period. Moreover, retail sales in April are expected to fall significantly behind last year's volume. However, construction output expanded rapidly by 15% y-o-y in January-February and by nearly 6% y-o-y in the first quarter of 2005.

The decline in the sales of manufacturing and retail trade indicates that GDP growth in the first quarter of 2005 will slow down to around a 3.0-3.5% rate compared to the first quarter of 2004. However, the Polish economy and industrial production expanded extremely rapidly just before Poland's EU accession, and therefore this comparison period is not highly representative of the Polish economy in general.

General government budget balance in 2000-2004



Source: Eurostat

Due to positive economic development in 2004, Poland's public deficit did not reach a record-high level last year, as it was predicted in early 2004. According to GUS and Eurostat, Poland's national debt amounted to PLN 386 bn in 2004 and constituted 43.6% of GDP. However, based on the methodology of the Polish Ministry of Finance, Poland's public debt is remarkably larger and constituted around 50% of GDP, which is, nonetheless slightly less than in 2003.

Although Poland's public deficit widened in 2004, it was notably lower than was feared due to positive macroeconomic development and higher revenues. However, public deficit was once again well above the Maastricht criteria.

FDI inflow recorded the highest value since 2000

According to the Polish Information and Foreign Investment Agency (PAIiIZ), foreign direct investment in Poland amounted to USD 7.9 billion in 2004. This is 23% more than in 2003 and the highest annual inflow since the record-high year 2000, when FDI in Poland recorded USD 10.6 bn.

In 2004, more than 41% of foreign direct investment was made in the manufacturing sector and almost 27% in financial intermediation. In manufacturing, investment in transport equipment (automotive production) covered more than one fifth of FDI in manufacturing, and almost 10% of total FDI. The most important investor countries were France (20% of the total inflow), the Unites States (18%) and Germany (15%). During recent years the proportion of greenfield investments has increased remarkably. Whereas in 2002 greenfield investments constituted 37% of all investments, the corresponding share was 58% in 2004. On the contrary, the share of privatisation revenues has been decreasing.

According to the PAIiIZ, Poland FDI stock climbed up to USD 84.5 bn at the end of 2004. France reinforced its position as the biggest investor, followed by the Netherlands, the United States, Germany, the United Kingdom and Italy. Finland occupied the 18th place with its 20 investment projects worth nearly USD 600 mln.

Some business highlights

- Five telecommunication operators have submitted their bids for new GSM1800 /UMTS licenses. The bidders are PTC/Era GSM, Polkomtel/Plus GSM, Centertel/Idea, Netia Mobile and Qiana Investments (owned by Hutchinson). The decision will be made on May 9.
- A new regulation allows service companies to use the privileges of the Special Economic Zones (SEZ). The approval was admitted to firms operating in the following businesses: IT, R&D, accounting, auditing, bookkeeping, and call centres.
- The IT company Hewlett-Packard has signed an investment agreement with the Polish government. HP will establish a financial and accounting services center in Wrocław, and create at least 1,000 new jobs. The investment is worth over USD 50 mln over the next five years.
- Greek snack producer Chipita plans to invest EUR 20 mln in its production unit in Łódź Special Economic Zone. The investment will create 300 new jobs.
- German truck producer MAN plans to build a factory in Starachowice. The investment is estimated to be worth EUR 30 mln.
- The Treasury Ministry has delayed the privatisation of PZU, the largest Polish insurance company. In 2004, the company posted a net profit of PLN 2 bn.
- Swedish furniture giant IKEA is to begin the construction of 40,000m^2 shopping centre and home furnishing outlet in the Targowek retail park in Warsaw. The investment worth over EUR 70 mln is expected to be completed in spring 2006.
- Cloetta Fazer, the Swedish-Finnish based confectionery manufacturer, will close its subsidiary in Gdansk this year.
- Central European Distribution Corporation (CEDC) is to buy shares in the vodka producer Bols for the sum USD 265mln. CEDC is also one of the three investors which are interested in buying a majority stake in Polmos Bialystok.

Poland - main economic indicators	1998	1999	2000	2001	2002	2003	2004	2005	as of
GDP (y-o-y %-growth, constant prices)	4.8	4.1	4.0	1.0	1.4	3.8	5.3		1-12/2004
Industrial production (y-o-y %-growth)	3.5	3.6	6.7	0.6	1.1	8.3	12.3	3.1	1-2/2005
Inflation (CPI, end of period, y-o-y %-change)	8.6	9.8	8.5	3.6	0.8	1.7	4.4	3.6	3/2005
General government budget balance (% of GDP)	-2.1	-1.4	-0.7	-3.9	-3.6	-4.5	-4.8		1-12/2004
Gross wage (period average, EUR)	314	401	472	557	544	497	505		1-12/2004
Unemployment (%, last survey in the year, LFS data)	10.6	15.3	16.0	18.5	19.7	19.3	18.0		Q4/2004
Exports (EUR billion, current prices, average exch. rate)	25.1	25.7	34.4	40.4	43.4	47.5	60.0	10.1	1-2/2005
Imports (EUR billion, current prices, average exch. rate)	41.5	43.2	53.1	56.2	58.3	60.3	71.6	11.1	1-2/2005
Current account (% of GDP)	-4.1	-7.6	-6.0	-2.9	-2.6	-2.2	-1.6		1-12/2004

Source: Polish Official Statistics, National Bank of Poland, Eurostat, author's calculations *estimate

A common Baltic Sea investment agency could attract new capital into the region

by Kari Liuhto

The countries surrounding the Baltic Sea are highly dependent on the economic relations between them. Of all Baltic States' foreign trade, clearly more than half takes place with other countries that surround the Baltic Sea. The dependency of Poland, Sweden, Finland and Denmark on trade within the area is slightly less, but still around 40%. The Baltic Sea nations account for one-fifth of Russia's foreign trade and one-tenth of Germany's.

In spite of the globalisation, it is probable that regional co-operation in the Baltic Sea region grows. The EU accession of the Baltic States and Poland, and the expanding energy co-operation between the EU and Russia increases further the economic ties between the countries surrounding the Baltic Sea. The Baltic Sea is Russia's most important route for transporting oil abroad, which strengthens the region's importance in the EU-Russian energy-related co-operation. The Baltic Sea maintains this position at least until the end of the next decade, when oil exports through the Barents Sea and the Sea of Japan may exceed those going through the Baltic Sea.

Foreign direct investments are not increasing the amount of capital within the region

According to a UN report, foreign direct investments in the Baltic Sea Region have grown at an exceptional rate. The amount of foreign direct investment more than trebled between the years 1995 and 2003. The growth of such investments in the Baltic Sea economic area has even outstripped that of China!

Inward FDI stock in the BSR (million USD)

Baltic Sea Region (BSR-9)	1995	2000	2003	Change 1995-2003
Denmark	23 801	66 701	76 195	320 %
Estonia	688	2 645	6 511	946 %
Finland	8 465	24 272	46 400	548 %
Germany	192 898	470 933	544 604	282 %
Latvia	615	2 084	3 320	540 %
Lithuania	352	2 334	4 960	1409 %
Poland	7 843	34 227	52 125	670 %
Russia	5 465	25 226	52 518	961 %
Sweden	31 089	93 970	143 230	461 %
Total BSR-9	271 216	722 392	929 863	343 %
Other				
EU-25	1 161 997	2 356 102	3 509 032	302 %
China (incl. Hong Kong)	362 401	803 815	876 519	242 %
USA	535 553	1 214 254	1 553 955	290 %

Source: UNCTAD

Nevertheless, we cannot yet talk of a 'China phenomenon' in the Baltic Sea Region. New external foreign capital is going into China, strongly supporting growth and creating new jobs. Here, on the other hand, foreign investment growth can largely be attributed to investments between Baltic Sea countries. In other words, capital is being transferred from one shore of the Baltic Sea to another, so the total amount is not increasing.

The companies in the northern and western parts of the Baltic Sea are particularly active in the region's internal investments. The Danes are particularly active in Lithuania and Latvia. Finland is among the three most important investors in Estonia and Sweden. Swedish and German companies are significant investors allover the Baltic Sea Region. It is important to notice that also the companies based in the Baltic States, Poland and Russia have started their expansion abroad. This expansion has so far concentrated on the nearby countries i.e. the Baltic Sea Region.

All Baltic Sea countries would benefit from external capital investment

In order to boost the economic growth of the Baltic Sea region, we need capital to flow in from outside the area. Because of the Baltic Sea economy's internal interdependence, new capital growth in the region would also benefit those countries that are not direct recipients, and therefore, it would now be mutually beneficial to initiate co-operation aimed at attracting external capital into the region.

Tighter co-operation is more a question of the will to make it work than of significant financial outlay, because national investment agencies are already collecting most of the necessary information. The next step would be to gather all this national information in a common Baltic Sea investment agency that would be accessible and free-of-charge for all.

An agency such as this could operate in a virtual fashion. Potential investors could easily study investment possibilities in all the Baltic Sea countries via a common internet portal. These web pages could then be linked to those of national and even regional investment bureaus, allowing the investor to make direct contact with whoever is actually offering the investment support service.

A joint investment service for the Baltic Sea countries would be a natural extension to the co-operation that has long taken place between Baltic Sea states, towns, chambers of commerce and universities. As well as the countries actually bordering the Baltic Sea, inviting Norway and even Belarus into the agency could prove to be a wise decision for the future.

Kari Liuhto

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Intra-FDI stock in the BSR (rank)

Recipient country (data as of), stock by countries %, (rank)

Investor country	Denmark (2003)	Estonia (2004)	Finland (2003)	Germany (2002)	Latvia (2004)	Lithuania (2004)	Poland (2004)	Russia (2004)	Sweden (2003)
Denmark	***	2% *(6.)*	4% *(5.)*	1% *(12.)*	8% *(3.)*	15% *(1.)*	3% *(9.)*	~	3% *(9.)*
Estonia	~	***	~	~	8% *(5.)*	8% *(6.)*	~	~	~
Finland	2% *(8.)*	24% *(2.)*	***	2% *(10.)*	8% *(6.)*	8% *(5.)*	1% *(17.)*	~	16% *(3.)*
Germany	4% *(6.)*	2% *(7.)*	5% *(4.)*	***	15% *(1.)*	11% *(3.)*	13% *(4.)*	11% *(4.)*	6% *(6.)*
Latvia	~	1% *(13.)*	~	~	***	2% *(13.)*	~	~	~
Lithuania	~	~	~	~	1% *(16.)*	***	~	~	~
Poland	~	~	~	~	~	1% *(16.)*	***	~	~
Russia	~	2% *(9.)*	1% *(11.)*	~	7% *(8.)*	8% *(4.)*	1% *(20.)*	***	~
Sweden	20% *(2.)*	46% *(1.)*	54% *(1.)*	2% *(8.)*	11% *(2.)*	15% *(2.)*	5% *(7.)*	~	***
Total BSR-9	27%	77%	64%	5%	59%	68%	21%	11%	26%

~ less than 0.5% of total FDI Source: National statistical authorities, central banks and investment agencies

Finnish firms expanding their operations in the Baltic Sea Region

by Riitta Kosonen and Piia Heliste

Finnish firms have been active in the Baltic States and especially in Estonia since the beginning of bilateral trade between Finland and the Soviet Union. It seems that the Finns have come to stay in the Baltic States.

The motives for Baltic operations have somewhat changed in the course of time but in general, the operations of Finnish firms have grown constantly. Companies seeking for cost advantages have often later realised also the local market potential. Finnish providers of business services that have followed their customers to the Baltic countries have later expanded their customer base to local actors. Finnish firms in the fields of information technology, textile and furniture, have been seeking for cost advantages particularly in Estonia through outsourcing or own production operations. Retailers, foodstuffs industry and construction companies have been attracted by the growing Baltic markets.

Among the Baltic countries, Estonia has been the easiest market for Finnish firms to enter. Most Finnish firms have succeeded well in Estonia, and some Finns have even gained the position of a market leader (e.g. HK-Ruokatalo, Vaasan&Vaasan, TeliaSonera). Considering the large number of Finnish firms operating in Estonia, there seem to be relatively few firms that have clearly failed. Estonia has actually been a test market for internationalisation for many Finnish firms. For example, Elcoteq, which is currently operating globally, started its internationalisation from Estonia in the early 1990s. At the break of the millennium, also Finnish retail and foodstuff companies started to look for growth through internationalisation and often headed to Estonia. In the future, one factor challenging foreign operations in Estonia is the lack of labor force. In certain sectors there are already major difficulties in finding professional labor force. Companies often train their employees themselves.

In Latvia, Finnish firms have encountered considerably more problems due to the unpredictability and lack of cooperation of the state or local administration. The stumbling of several Finnish firms in Latvia indicates that the Latvian business environment is clearly more difficult than e.g. in Estonia. Although there are Finnish firms active in various sectors in Latvia (e.g. telecom, foodstuff, retail), individual investments made have been relatively small in value.

As a rule, Finnish firms have entered Lithuania following their competitors. Therefore, they have faced relatively severe competition in the Lithuanian market. However, it seems that Finnish operations in Lithuania have not witnessed any major problems as in Latvia. Finnish investments to Lithuania have been fewer in number but larger in value compared to Latvia. Investments have mainly been targeted to telecom, foodstuff, retail and energy sectors.

During the past 10 years, the business environment has undergone tremendous changes in the Baltic countries. Especially Estonia has developed rapidly, and Finnish firms have a very positive image about Estonia's business environment. The Estonian legislation and other formal institutions regulating the firms' operations are on a western level. However, being based on German and other Central European models, the Estonian legislation partly differs considerably from the Finnish one. For example, as regards issues concerning ownership of land and real estate, the knowledge of local lawyers is often indispensable. The problem is the lack of precedents and as yet unestablished legal praxis, which sometimes shows in unexpected court rulings.

Also informal institutions in Finland and Estonia are becoming more similar. This is due to the foreign investments flowing to Estonia and importing western business practices. On one hand, business practices are modernising as the older generations are withdrawing from working life. Younger than 30-years-old-Estonians have not worked in Soviet companies. On the other hand, there are still some clear differences between Finnish and Estonian business lives. For example, the role of personal relations is emphasised in Estonia, and the personal network of a candidate may be a central factor affecting the selection of a local partner or manager. Companies try to achieve good contacts e.g. with the local administration, which may in many cases speed up and ease problem solving. Corruption was a considerable problem in Estonia especially in the beginning of the 1990s. Lately, however, corruption has clearly diminished, although there are still some regional differences. In general, the corruption situation is much better in Estonia when compared to Lithuania or Latvia, not to mention Russia.

Many Finnish firms nowadays view the Baltic countries as part of their home market, which covers the entire Baltic Sea region. Estonia alone is no longer an interesting target market. Rather, Estonia opens avenues to business opportunities in the East (Russia) and South (other Baltic countries). However, Estonia's potential as a stepping stone to Russia has so far not realised. Trade with Russia was expected to accumulate as the double tariffs were removed in conjunction with the EU membership. High expectations have been undermined e.g. by increasing import tariffs of metals from Russia. Russia has also tightened e.g. the hygiene requirements of imported Estonian foodstuffs. Nevertheless, all the Baltic countries undoubtedly have good preconditions to compete for transit trade to/from Russia as their ports and other communication infrastructure are improving. As the cost advantages are gradually disappearing, the competitive advantage of the Baltic countries will most likely increasingly base on their logistic potential.

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