Baltic Rim Economies
Estonia – Latvia – Lithuania – Poland
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Estonia

Estonia's economic growth accelerates

Despite the enfeebled economic development in the old EU countries, Estonia's robust economic growth nonetheless accelerates. In the first quarter of 2005, Estonia's GDP expanded by 7.2% y-o-y. The growth was based on the rapid increase in both domestic demand and external demand. Concerning economic activities, the sharpest value-added increase was observed in hotel and restaurant services and in financial intermediation, both up by 17% y-o-y. Manufacturing also grew strongly by 10% and domestic trade by 9% compared to the corresponding period in 2004. However, production in the primary sector and mining decreased, especially in forestry and fishing, which both went down by 16% y-o-y. In addition, the growth of construction decelerated significantly, although it grew by 1.5% y-o-y.

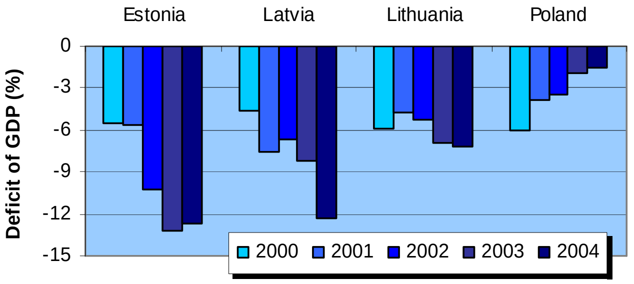
According to the Estonian central bank's recent forecast, Estonia's GDP will grow by 5.7% this year and around 6% during the years 2006-2007. The growth is expected to be based, more than ever, on external demand.

Current account deficit narrowed in the first quarter

According to Estonia's preliminary balance of payments, the current account deficit narrowed in the first quarter of 2005, both over the quarter and compared to the corresponding quarter in 2004. The current account deficit amounted to EEK 3.5 bn (EUR 224 mln), which is 10.2% of projected GDP. Estonia's trade deficit almost halved over the quarter, whilst the service surplus narrowed. According to the preliminary data from the first four months this year, Estonia's exports grew rapidly by 28% y-o-y, whilst imports grew much lower, by 12% compared to the corresponding period in 2004.

Estonia's foreign direct investment stock increased rapidly in the first quarter this year. The investment stock reached EEK 141bn (EUR 9 bn) by the end of the quarter, which is 22% more than at the end of 2004. Compared to the first quarter of 2004, Estonia's FDI stock increased by 48%. This robust increase of investment stock was mainly based on Swedbank's takeover of Hansapank, the market leader in the Baltic banking market. Due to this transaction, Estonia's FDI structure also changed substantially. The share of Swedish investments in Estonia is now 54.5% of the total FDI stock, up by 10 percentage points from the end of 2004.

Current account deficit in 2000-2004



Source: National statistical authorities

Estonia to pay EUR 46mln for excess sugar stock

The European Commission's sugar committee ruled that Estonia's "excess sugar stocks" amounted to 91,500 tons on May 1, 2004 when Estonia joined the EU. The fine is likely to be EEK 715 mln (EUR 46 mln) as a fine for excess sugar stock is at EUR 500 per ton. The Estonian government has tried to convince the EC that about a half of the estimated overstock was possessed by private persons, not speculative companies. So far Estonia has ordered nearly 30 companies to pay a penalty for their excessive sugar stocks and most of them have contested the order in court. In addition to Estonia, the EC has ordered five new EU countries, including Latvia, to eliminate their excess sugar stock by the end of November 2005. Estonia will bring the "excess sugar stock" case to the European Court of Justice after the EU rejected its plea to reduce the size of the sugar surplus.

Estonia and Russia signed a border treaty

The border agreement between Estonia and Russia was signed in Moscow on May 18 by the ministers of foreign affairs. Before the treaty comes into force, ratification from the Russian parliament is needed. The Estonian parliament ratified the treaty after a brisk debate on textual details. However, Russia might refuse to ratify the treaty due to clauses which were added to the treaty by the Estonian parliament.

The border treaty determines the state frontier between Russia and Estonia in accordance with the former administrative border between the Russian and Estonian Soviet Federal Socialist Republics. According to the Tartu peace treaty (1920) between the Estonian Republic and the Soviet Russia, Estonia received lands in Leningrad and Pskov regions, but they were returned to Russia after the World War II.

Some business highlights

- Tallinn Water was listed in the Tallinn Stock Exchange on June 1. It is the first company to be listed on the main list of the bourse after a break of six years. The cable TV and telecommunication operator Starman was also listed on the Tallinn bourse in late June. Hansabank will be de-listed from the bourse as from July 1 due to Swedbank's takeover.
- Finnish-based Viking Line plans to register its Rosella ferry in Estonia in order to lower its employment costs.
- Microlink, the Baltic's largest IT company, will be taken over by Elion (Eesti Telekom), Lattelekom and Lietuvos Telekomas, which are all largely controlled by the Swedish-Finnish telecom operator TeliaSonera.
- Biodiesel Ltd. plans to build a new biodiesel plant in Paldinski Port. The investment is worth EEK 330 mln (EUR 21 mln).
- The Estonian distribution company Smarten plans to build the Baltic's largest distribution centre in Assaku close to Tallinn. The centre will cost EEK 250 mln.
- Estonian spa operator SPA Viimsi Tervis is to invest EEK 250 mln (EUR 16 mln) in a health spa in Croatia. The new spa will be opened by the end of 2007.
- Pharmadule Emtunge, the British-Swedish based manufacturer of pharmaceutical products, plans to set up a plant in Juri industrial park in Tallinn. The investment is worth EUR 3.2 mln and the plant will employ 70 workers.
- Trigon Gardening, established by Finnish businessmen and investment banker Joakim Heenius, is to develop a large gardening centre close to Tallinn. The centre will have over 3,500 square metres and will cost about EEK 60 mln.

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	7.2	Q1/2005
Industrial production (y-o-y %-growth)	4.1	-3.4	14.6	8.9	8.2	11.0	7.5	8.7	1-4/2005
Inflation (CPI, end of period, y-o-y %-change)	6.5	3.9	5.0	4.2	2.7	1.1	5.0	2.8	5/2005
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	466	475	Q1/2005
Unemployment (% end of period, LFS data)	10.2	12.9	13.9	11.9	11.3	9.3	8.5	9.5	Q1/2005
Exports (EUR million, current prices)	2 252	2 239	3 445	3 698	3 642	4 003	4 747	1 847	1-4/2005
Imports (EUR million, current prices)	3 529	3 224	4 615	4 798	5 079	5 715	6 738	2 413	1-4/2005
Current account (% of GDP)	-8.6	-4.4	-5.5	-5.6	-10.2	-13.2	-12.9	-10.2	Q1/2005

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

Latvia

Latvia's GDP grew by 7.4% in the first quarter

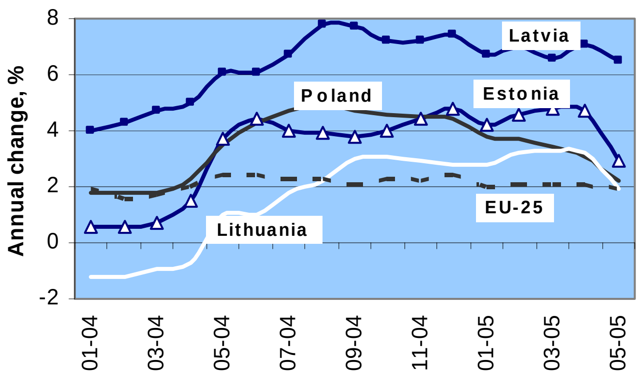
Latvia's strong economic growth continued, as expected, in the first quarter this year, since its GDP increased by 7.4% from the corresponding period in 2004. During the first quarter, GDP growth was driven by the rapid increase in construction and trade, which both grew by 16% y-o-y. Transport and communications grew also rapidly by 11% y-o-y. The relatively sharpest growth was observed in the fishery sector, as its output increased by 60% y-o-y. The Latvian central bank kept its GDP growth forecast at 7.5% for 2005.

However, the growth of manufacturing stopped (down by 0.1% y-o-y) due to a drop in the processing of wood, which declined nearly 7% from the corresponding quarter of 2004. In the manufacturing sector, the steepest increase was recorded in the production of construction materials, which increased by 31% y-o-y driven by the brisk construction output and investment boom. According to Eurostat, Latvia's construction sector grew the most rapidly among the EU-25 countries during the first quarter this year, followed by Slovakia and Malta.

Number of foreign tourists up by a third

The number of foreign visitors in Latvia increased by 32% y-o-y in the first quarter of 2005. According to the survey by the Central Statistical Bureau, the average length of stay was 1.4 days, although 70% of the visitors stayed in Latvia less than 24 hours. The average visitor spent 35 lats per day, up by 4 lats from the corresponding period in 2004. Nearly two thirds of foreign visitors were Estonian or Lithuanian residents. In 2004, the number of foreign visitors grew by 23% y-o-y.

Harmonized consumer price index (HCPI)



Source: Eurostat

Although the annual inflation rate lowered significantly in Estonia, Lithuania and Poland in May, due to the removal of the EU accession-related price effect in May 2004, Latvia's inflation still runs quickly. In May, the average level of consumer prices was 6.3% higher than a year before. The most rapid increase was observed in the prices of health care, transport and food products, each of which rose more than 10% y-o-y. Moreover, the forthcoming price hikes in gas tariffs since next August will have a rising effect on prices, although its effect is calculated to be minor.

In the first quarter of 2005, Latvia's consumer prices went up by 6.7% y-o-y, whilst the Latvian average monthly wage increased by 16% within this period (See figure in page 4).

Exports grew 37% y-o-y in the first four months

Latvia's trade deficit narrowed significantly during the first four months in 2005, since Latvia's exports increased by 37% y-o-y (in current prices). Correspondingly imports to Latvia increased by 19% within this period.

Although the robust growth in exports was based on the increase in all main product groups, the sharpest increase was observed in the exports of base metals and related products (up by 70% y-o-y), in the exports of machinery and mechanical and electrical appliances and equipment (52%) and in the exports food products and non-alcoholic beverages. The main export group, wood and wood products, still covered 26% of the total export value, whilst its share has decreased remarkably during recent years. On the import side, the steepest increase was noticed in the imports of mineral products and in base metal and metal products.

Latvia joined the ERM2 regime

Latvia made a significant step towards the introduction of the euro, since it joined the Exchange Rate Mechanism II (ERM2) at the beginning of May with its already established exchange rate against the European single currency. The lat was pegged to the euro on January 1 at LVL 0.7028. Latvia undertook a unilateral commitment to maintain the lat's exchange rate fluctuation within ±1% of the central rate, although the standard fluctuation rate in the ERM2 is ±15%.

The ERM2 is a necessary step to become a full member of the EMU and to introduce the euro. The national currency has to remain within the ERM2 at least two years. However, Latvia's forthcoming EMU entry depends on whether the Maastricht criteria are met. Currently Latvia meets other criteria well, but high inflation might delay its EMU entry, which is scheduled to take place in early 2008. Estonia and Lithuania joined the ERM2 in June 2004, and they intend to enter the EMU from the beginning of 2007.

Some business highlights

- Latvian bank's aggregate profit increased rapidly by 95% y-o-y in the first five months of 2005, up to LVL 76 mln (EUR 108 mln). According to the Association of Commercial Banks, Hansabanka has become the largest bank in Latvia in terms of assets, thus overtaking the previous leader Parex Banka.
- Estonian shipping company Tallink plans to launch regular passenger ferry traffic between Riga and Stockholm in April 2006. According to the intention plan, the company will allocate two ships to the route, both carrying 1,500 passengers.
- The fibreglass manufacturer Valmieras Stikla Skiedra plans to invest EUR 35 mln in a new production facility over the next 2-3 years.
- Estonian real estate company Armija opened a new 390-bed luxury hotel in Jurrmala, close to Riga, in June. The investment was worth EUR 17 mln.
- The US Treasury has named two Latvian banks, Multibanka and VEF Banka as primary money laundering concerns.
- Latvia's mobile phone operators LMT and Tele2 are unwilling to share their existing networks with Bite, the new arrival in Latvian telecommunication market. Bite GSM wants to lease its competitors' networks during the start-up phase.
- During the first five months of 2005, Riga Airport's passenger number increased by 91% y-o-y, whilst in Tallinn Airport the corresponding number increased by 44% and in Vilnius by 43% y-o-y.
- The Freeport of Ventspils will build a new coal transhipment terminal, worth LVL 35 mln (EUR 50 mln). The terminal will be rented to the JSC Baltic Coal Terminal company.
- A new ferry line between Ventspils and Mõntu (Saaremaa) was opened in May. The M/S Scania ferry operates four times a week and can carry out 300 passengers along with 80 cars.

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	7.4	Q1/2005
Industrial production (y-o-y %-growth)	2.0	-8.8	3.2	6.9	5.8	6.5	6.0	1.2	1-4/2005
Inflation (CPI, end of period, y-o-y %-change)	2.8	3.2	1.8	3.2	1.4	3.6	7.3	6.3	5/2005
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	323	Q1/2005
Unemployment (% end of period, LFS data)	13.7	13.2	13.3	12.9	11.6	10.3	10.3	9.9	Q1/2005
Exports (EUR million, current prices, average exch. rate)		1 613	2 020	2 232	2 416	2 559	3 175	1 235	1-4/2005
Imports (EUR million, current prices, average exch. rate)		2 758	3 453	3 910	4 284	4 634	5 616	1 952	1-4/2005
Current account (% of GDP)	-9.7	-9.0	-6.4	-7.6	-6.7	-8.2	-12.3	-9.6	Q1/2005

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

Lithuania

GDP growth slowed down in the first quarter

Lithuania's GDP expanded by 5.6% y-o-y in the first quarter of 2005. Despite the rapid growth, this was the lowest quarterly GDP increase since the first quarter's rate in 2002.

In the first quarter of 2005, the steepest value-added increases were observed in market service activities, and within this group, in hotel and restaurant services (up by 14% y-o-y), in retail and wholesale trade (9%) and in transport and communications (8%). The value-added in industrial production grew quite slowly, by less than 4% y-o-y, although the value-added in manufacturing increased significantly faster by 7% from the corresponding period in 2004. The value-added in construction recorded a 5%-increase y-o-y.

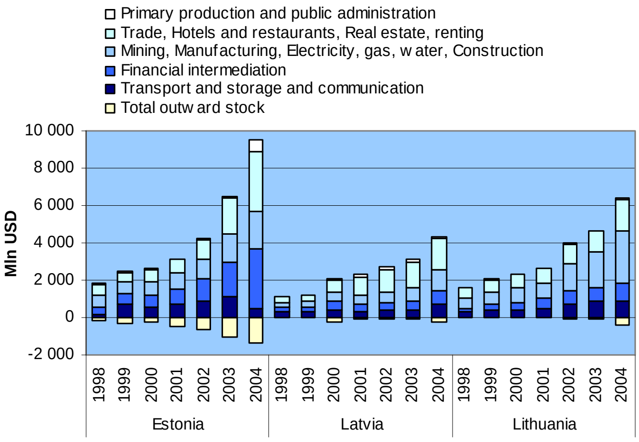
Lithuania's GDP growth in the first quarter was still based on the increase in domestic demand, but growth rates, compared to previous years, declined significantly. According to Hansabank's recent Baltic Outlook, Lithuania GDP will grow by 6.8% this year. The EC's spring forecast predicts that Lithuania's economy will grow by 6.4% in 2005.

External balance improving

Lithuania's current account deficit amounted to LTL 829 mln (EUR 240 mln) in the first quarter this year. In relation to GDP, the current account deficit went down to 5.6%, whereas it was 7.2% in the corresponding quarter a year earlier. This was mainly due to a remarkable decrease in the trade deficit, which lowered by LTL 235 mln y-o-y. On the contrary, Lithuania's surplus in its service account slightly diminished.

Lithuania's positive trend in foreign trade has continued during the first four months in 2005. Lithuania's exports increased by 25% y-o-y within this period, whilst imports increased by 17%. The steepest increase was noticed in the exports of iron and steel and in the exports of mineral fuel.

FDI stock (USD) by economic activities 1998-2004



Source: The World Bank, Ojala et al. (2005); National central banks

Lithuania's foreign direct investment stock amounted to LTL 17.5 bn (EUR 5.1 bn) by the end of March. Therefore the FDI stock increased strongly by 22% y-o-y. During the first quarter this year, Lithuania's FDI inflow made up LTL 567 mln, about 150 mln less than in the corresponding period in 2004. Nearly two-thirds of the total inflow accrued from reinvested earnings. The largest investment flow was recorded in the manufacturing sector, about 41% of the total inflow.

Lithuanian parliament approved a tax cut

Lithuania's parliament has approved a cut in the income tax rate, down from the current 33%-rate to 27% from mid 2006. The income tax will be further reduced to 24% from January 1, 2008. In order to compensate for the tax loss, the parliament passed a law on the so-called solidarity tax. The parliament decided to introduce a temporary profit-based 4%-social tax, which will be in effect for two years, in 2006-2007. From the beginning of 2008 this temporary tax will be cancelled, bringing the profit tax back to its current rate of 15%.

According to representatives of foreign investors, Lithuania may lose a significant quantity of foreign investment due to this solidarity tax. Financial analysts have predicted that about LTL 1 bn in profit generated by FDIs will go abroad this year. The main problem of the tax reform is considered to be its temporary nature, not the reform itself.

Several candidates interested in Mazeikiu Nafta

According to the Baltic Times magazine and the BBN news service, there are at least three candidates hoping to acquire Yukos' 53.7%-share in the Mazeikiu Nafta (MN) oil refinery and terminal complex. The well-known Russian oil giants Lukoil and TNK-BP have confirmed their interest in taking over Yukos' share in MN. The third company, which has recently expressed its interest, is Austrian-based Baltic Holding, a company associated with the Russian gas monopoly Gazprom, as Gazprom-owned Gazprombank holds a controlling stake in the Baltic Holding company. Currently Gazprom owns a minority share in Lietuvos Dujos, the Lithuanian gas company. In addition, the international trading and refining company Vitol has been named as a candidate for acquiring the Yukos' stake. Yukos and the Lithuanian government are also negotiating a possible increase in the government's share in MN, seeking to capture a controlling stake. Currently the state owns a 40.6%-stake in the Baltic's only oil refinery.

Yukos is reportedly to seeking USD 800-900 mln for its stake in the Mazeikiu Nafta oil refinery and Butinge oil terminal. The agreement is expected to be made this summer.

Some business highlights

- Finnish Rautakirja (Sanoma WSOY Group) bought a 100%-stake in Lietuvos Spauda, the leading kiosk chain in Lithuania. Lietuvos Spauda has approximately 600 kiosks in Lithuania. In last December, Rautakirja acquired a 51%-stake of the Lithuanian press distribution company UAB Impress Teva.
- The British furniture manufacturer Christie Tyler has started to build a new plant in Alytus, the sixth largest city in Lithuania. The plant will employ around 300 persons by the end of 2005 and probably 300-600 more in 2006.
- Vilnius-based IT and telecommunications company Fima won the privatisation tender to buy off Lietuvos Avialinjos (Lithuanian Airlines) airline.
- Lithuanian construction company Panevezio Statybos Trestes (PST) will build a soya oil plant in the Kaliningrad region. The total cost is LTL 100 mln (EUR 29 mln) and the plant is scheduled to be opened in late 2006.
- The low-cost airline Ryanair will enter Lithuania next autumn. The company will launch daily flights from Kaunas to London (Stansted) on September, 22. Ryanair aims to carry 100,000 passengers a year in the Kaunas-London route.
- Hanner, the Lithuanian real estate company, will invest USD 6 mln in a multifunctional office and residential centre in Ukraine's capital Kiev. The company invests an additional USD 8 mln in the purchase of land.
- Lithuanian pharmaceutical manufacturer Sanitas acquires the Hoechst-Biotica company in Slovakia for EUR 12.7 mln.
- The Lithuanian Communications Regulatory Authority has decided to issue three 3G mobile telephony licenses simultaneously.

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	5.6	Q1/2005
Industrial production in sales (y-o-y %-growth)	8.2	-9.9	2.2	16.0	3.1	16.1	10.8	3.6	1-4/2005
Inflation (CPI, end of period, y-o-y %-change)	2.4	0.3	1.4	2.0	-1.0	-1.3	2.9	2.0	5/2005
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	368	Q1/2005
Unemployment (% end of period, LFS data)	12.6	15.3	16.9	17.9	13.0	11.6	10.6	10.2	Q1/2005
Exports (EUR million, current prices, average exch. rate)		2 583	3 841	4 778	5 526	6 158	7 451	2 703	1-4/2005
Imports (EUR million, current prices, average exch. rate)		4 340	5 650	6 767	7 943	8 526	9 875	3 576	1-4/2005
Current account (% of GDP)	-12.1	-11.2	-5.9	-4.7	-5.2	-6.9	-7.2	-5.6	Q1/2005

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

Poland

GDP growth plunged in the first quarter

In the first quarter of 2005, Poland's GDP grew by only 2.1% compared to the corresponding period a year before. Therefore the slowdown of economic growth was even worse than expected (around 3%), although all the signals pointed to an economic slackening. The main reason behind this weak result was a significant slowdown in the growth of investments as they increased by only 1.0% y-o-y, against 7.4% in the previous quarter or against the forecasted two-figure rate. Moreover, individual consumption grew by 1.7% y-o-y in the first quarter this year, whilst in the corresponding period of 2004 it increased over 4% y-o-y. Concerning economic activities, the sharpest value-added increase was observed in the construction sector, up by 5.3% y-o-y. Value-added in the service sector increased by 2.5% and in industry by 0.9%.

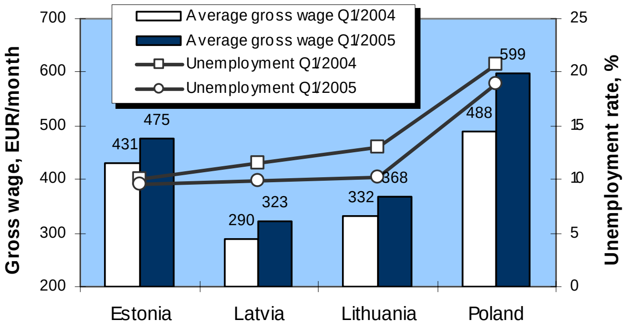
However, according to many analysts, the expected 4%-growth rate for 2005 is still possibly achievable. The weak growth in the first quarter was due to the base effect on the corresponding quarter of 2004, when the Polish economy expanded by 7.0% y-o-y driven by the EU accession boom.

Inflation decelerates

Poland's inflation rate declined more than expected in May, since consumer prices rose by 2.5% y-o-y (see page 2). Therefore inflation forecasts for this year might be overestimated. Moreover, the annual inflation rate is expected to be declining to 1.0-1.5% level in the forthcoming months.

Poland's central bank is expected to cut interest rates again, after the weak GDP figures from the first quarter. The bank may even move its bias from its current "neutral" to an "easing" policy to support the growth of investments.

Average gross wage and unemployment rate



Source: National statistical authorities

Polish employees average gross wage grew by 3.6% y-o-y in the first quarter this year. The average gross wage amounted to PLN 2,415 (EUR 599) However, in terms of euros, the average wage increased sharply, more than 110 euros due to the appreciation of the zloty against the euro.

According to a recent labour force survey, Poland's unemployment rate declined in a year by 1.8 percentage points down to 18.9%. Amongst the new EU countries, the unemployment rate in Poland and Slovakia is remarkably higher than any others'. In the Baltic States, there has a been significant downward trend in their unemployment rate, whilst in the other EU entrants the respective rate has remained quite stable during recent years, nonetheless below the Baltics' current rate.

However, according to estimates by the Ministry of Economy and Labour, almost one third of Polish registered jobless persons are working in the shadow economy. Moreover, another one third of them are such long-term unemployed people who are not actively seeking work and they might be unable to accept any work offer. Currently, the unemployment rate varies from a 6.5%-rate in the City of Warsaw sub-region to a 34%-rate in the Elk sub-region in north-eastern Poland.

Over the past year, approximately 100,000 Polish migrant workers have legally moved to Britain.

Growth of industry and trade stopped

A declining trend in the Polish industrial and trade sectors continues. Poland's industrial production increased by only 0.5% y-o-y in the first five months of this year. By comparison, industrial production grew by 18% y-o-y within the corresponding period in 2004. During the first five months of 2005, the most significant increase was recorded in the manufacturing of radio, television and telecommunication equipment, up by 16% y-o-y, and in the manufacturing of machinery and equipment, which went up by 13%. On the contrary, the manufacturing of textiles and clothing decreased notably.

In the first five months of 2005, Poland's retail trade decreased by 0.6% compared to the same period in 2004. The sharpest decline was observed in the sales of motor vehicles, down by 18% y-o-y. However, during the corresponding period a year earlier, retail trade grew by 16% y-o-y, especially driven by the steep increase in the sales of motor vehicles and related products. Therefore this weak growth in industry and retail trade arises from, at least partly, to robust growth in the comparative period, just before Poland's EU entry.

Exports up 3%, imports down 8.5% within 4 months

The growth of Poland's foreign trade, in terms of zlotys, dropped in the first months of 2005. In the January-April period, exports grew by 3% y-o-y, whilst imports decreased by 8.5%. However, the strong zloty did not hamper Polish exports as much as expected. When measured in euros, exports grew by 20% y-o-y. However, the EU countries share declined both in exports and imports, and the share of other European countries increased in this period.

Some business highlights

- The US-based retail giant Wal-Mart has officially announced its plans to enter the Polish and Hungarian markets. According to the company's executive director, they are rather looking to take over an existing network than creating a new one.
- The US-based spirits distributor CEDC has entered into exclusive negotiations to buy a majority stake in Polmos Białystok, the second largest vodka producer. The Treasury aims to gain at least PLN 1 bn from the privatisation of the company.
- The Polish government has decided to sell a 20%-stake in the automotive plant FSO to Ukrainian AvtoZAZ.
- Due to the merger of UniCredito Italiano and HVB, Poland's second and third biggest banks, Pekao and BPH, are likely to be merged. This merger will create the largest bank in Poland. Currently these two banks employ 28,000 persons.
- Fuji Seal, the Japanese plastics packaging manufacturer, will build a production plant in Kutno (in Łódź SEZ). The investment is worth EUR 40 million.
- The Polish insulin producer Bioton has started the construction of its new factory close to Moscow. The investment is worth EUR 49 mln.
- US-based Polimeni International will invest EUR 55 mln in the new commercial centre in Poznań.
- The French pasta producer Alpina Savoie is to invest PLN 40 mln (EUR 10 mln) in a production facility in Sulechów. The plant should be completed by June 2006.

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	5.4	2.1	Q1/2005
Industrial production (y-o-y %-growth)	3.5	3.6	6.7	0.6	1.1	8.3	12.3	0.5	1-5/2005
Inflation (CPI, end of period, y-o-y %-change)	8.6	9.8	8.5	3.6	0.8	1.7	4.4	2.5	5/2005
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	599	Q1/2005
Unemployment (%, last survey in the year, LFS data)	10.6	15.3	16.0	18.5	19.7	19.3	18.0	18.9	Q1/2005
Exports (EUR billion, current prices, average exch. rate)	25.1	25.7	34.4	40.4	43.4	47.5	60.0	22.0	1-4/2005
Imports (EUR billion, current prices, average exch. rate)	41.5	43.2	53.1	56.2	58.3	60.3	71.6	24.2	1-4/2005
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

The New Latvian Role in the Baltic Sea Region

by Artis Pabriks

Traditionally, geographic location has been considered the main source of economic well-being for the Baltic States. However with increased globalisation new factors that contribute to the national growth are emerging. The rapid development during recent years indicates that Latvia and its neighbors Estonia and Lithuania have been successful in making full use of these factors, in addition to the traditional location-based benefits, e.g. transit. So Latvia sees its future as the inspirational catalyst of regional development and that of the EU.

The values Latvia brings to the table include economic dynamism, governmental efficiency and open economy.

Economic Dynamism

Economic dynamism refers to development as measured by both economic figures and attitudes. Since 1999, when the Russian economic crisis struck, the Baltic States have exhibited GNP growth in excess of 6% for most of the years and Latvia even reached 8.5% in 2004. Naturally such growth is attributable to the low-income base and rapid foreign direct investment growth. However there are also several factors that comprise the macroeconomic environment facilitating these economic activities. These factors include the level of tax burden, the business and investment climate, labour availability and skill level.

Latvia has one of the lowest tax burdens in the European Union. Despite criticism from some of the Western European countries, Latvia strongly believes that lower taxes and simpler administration (e.g. a flat tax rate) best meet the challenge of the general trend of global efficiency, both in corporate and governmental sectors.

Although Latvia's performance in business and investment climate indicators has not always been consistent, it has been improving lately. Efficiency is the key challenge in this area and should be the focus in Latvia and in other countries in the region if they want to compete successfully in the global marketplace.

The availability of labour and skills is perhaps the single most critical aspect that needs to be addressed for the future development of Latvia. Quantitatively the available employee pool is decreasing due to low birth rates and outbound migration. Qualitatively the match between education and the needs of society and business needs to be constantly addressed. Long-term labour productivity needs to be improved in order to sustain the economic development.

Whilst not directly linked to the economic figures, societal attitudes play a key role in supporting the development. Whilst a low income level is naturally a strong motivator for increased effort (e.g. Latvia has one of the longest work hours in EU) a strong desire to succeed is prevalent in Latvia. With its business environment and attitude, one can say that in Latvia seems much closer to a curious mix of American style business dynamism than to a traditional model and of European economies based on high social values protection.

Governmental efficiency

In the environment of capital mobility and nearly all-encompassing information, governmental efficiency plays a key role in ensuring the competitiveness of a country. An inefficient government would not be able to survive with low taxes. Latvia with its low tax burden can be used as a good example of government efficiency; the small size of the country allows identifying the opportunities for further improvements. Still, in the light of increased competition from China, India and other Far Eastern countries, the countries of the Baltic should actively investigate opportunities for mutual cooperation that would increase efficiency.

Open economy

Whilst difficult to accept emotionally, a decrease in international trade barriers is the key to competitive development. Consequently, Latvia strongly supports the provisions directed towards minimising the cost of doing business internationally and opening its market. This philosophy has been reflected in the legislation regulating state purchases, business registrations, land ownership and profit repatriation.

Outlook

The huge potential for growth in several underdeveloped sectors in Latvia – be it infrastructure or construction – will provide possibilities for sustained economic growth in the medium term. From the investors' perspective, one should also continue to fully use the advantage that Latvia serves as a natural bridgehead for any economic activities in the Baltic States. This, in turn, is in the interests of the whole region.

In conclusion, Latvia's role on the Baltic Rim region should be not only viewed as a transit point, but also as a catalyst and example of efficient operations in corporate and governmental sectors. Especially, when currently EU-15 countries are experiencing an economic downturn, the experience of Latvia and other Eastern Europe countries should be further investigated to propose actions that would improve the competitiveness of each and every county and the EU as whole.

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The Baltic Countries and Integration into the EU Innovation Environment

by Jari Hyvärinen

Ongoing globalisation process increasingly supports the use of highly-skilled employees and R&D for industrial innovations, quality requirements and technological change. Technology and know-how transfer foster the accumulation of human and knowledge capital in low-wage countries and facilitate its survival in international production sharing. However, firms in developed countries prefer highly-skilled employees, especially in R&D, even if wage costs are high. R&D has a positive impact on performance and product quality and it relates positively to outsourcing.

The efficient partnership between final and intermediate producers requires a sufficient infrastructure. This is an urgent topic after the Baltic countries have joined to the European Union. These countries need a new national innovation regime that combines financial governance with governance in production and governance in innovation. The Baltic countries will be able to survive competition in the future enlarged-EU market when the contracting environment with the EU firms and foreign direct investments are assured.

When considering industrial FDI and outsourcing to the Baltic countries, mostly these were under the remit of multinational companies and they have utilised their internalisation advantage to expand their activities in the CEE markets, because it has been more advantageous to produce closer to consumers and hire high-skilled and low-wage Baltic employees. Moreover, the Baltic firms need these core investors from abroad who could be helpful in installing new methods of corporate governance and managerial incentives as well as enclosing Baltic firms in market-based information, know-how and innovation networks (Hyvärinen – Borsos 1994; Hyvärinen 1996, 1999, 2004).

So-called endogenous growth theory which was developed in the early 1990s emphasised that the R&D resources and therefore innovations is one of the main sources of economic growth. We suggest that in Baltic circumstances the endogenous growth effect might work: a small open economy with slightly higher human capital than in the rest of the world starts to trade with its intermediate goods, its investment in human capital can give an ever-increasing impact on growth. We argue that, in the Baltic countries, the advantages of EU industrial integration might be higher than the effects of integration in the EU countries, because small economies are more flexible to adapt R&D-intensive production compared to larger applying CEE economies.

A signal to Baltic firms is that they should be active in hiring skilled personnel when they take part in the EU outsourcing process. This generates the final producers' incentives to search for their conceivable partners from such a region, and Baltic firms might be better off by finding more profitable contracts with the EU final producers. As discussed in the previous section, the starting point for highly-skilled employees in R&D is estimated to be at a higher level in the Baltic countries. The next task is to find a partner among the EU final producers to fulfill their practical skills in their firm-specific training programs.

Innovative Critical Mass around Skill Spillovers is needed

Baldwin (1989) proposes that a critical mass around successful spillovers is needed and those can be found in the regions in which similar types of firms work as clusters and knowledge is spread in co-operating projects. When the successful spillovers take place in regions in which similar types of firms work as clusters, the Baltic capitals, Tallinn, Riga and Vilnius fulfill such a purpose. Moreover, several studies such as Lundwall – Johnson (1994) and Gregersen – Johnson (1997) stressed especially that institutional learning is needed so that innovations can be successfully implemented. However, to become such a regional cluster the learning economies or regions need international R&D integration and thus cross-border skill spill-overs. Baltic institutional change should move towards such a learning economy.

Externalities are important with rapid technological change and EU-Baltic Co-operation

Firstly, it can be argued that the active improvements of the Baltic governmental regimes are one of the key factors when considering fluent externalities and the rapid entry of new technologies. Especially in the Baltic countries, innovations need interactive R&D co-operation with EU firms and technological programs, and without the adaptation of the Baltic institutions, the growth of innovative activity might be moderate. The co-operation should be focused more clearly on targets that match with the production sector, such as education, information technology, EU technical standards, applied research and other parts of the knowledge infrastructure.

Secondly, the economy, with the increasing force of learning and technological change, is responsible to check, and when necessary revise, those governmental regimes (Gregersen – Johnson 1997). As found directly after the re-independency of the Baltic countries, traditional infrastructure investments such as energy and transport have already been finished or are in the home stretch. As the targets of industrial policy, these will become less important after their decreasing costs in the near future but for that reason the regimes should be focused more clearly on targets, by matching with the production sector, such areas as education, information technology, EU technical standards, applied research and other parts of the knowledge infrastructure.

Thirdly, in relation to EU-Baltic technological co-operation, the benefits of the spill-over effects are main externalities, and highly advisable for Baltic firms because it might be the fastest way to mitigate the EU technology gap.

As found above, international dissemination of new ideas and technologies takes place by international industrial integration and through the operations of multinational corporations, and the spillover effect is positively related to efficiency gains, both in intra-industry and inter-industry spillovers. Imitation and other externalities are premises but the Baltic firms should take other innovative steps of their own.

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