



### Estonia

#### Estimated GDP growth 6.2% in the third quarter

Robust economic growth continued in the third quarter. According to the preliminary estimate by the Statistical Office of Estonia, GDP grew by 6.2% y-o-y, and was therefore a bit stronger than in the second quarter this year.

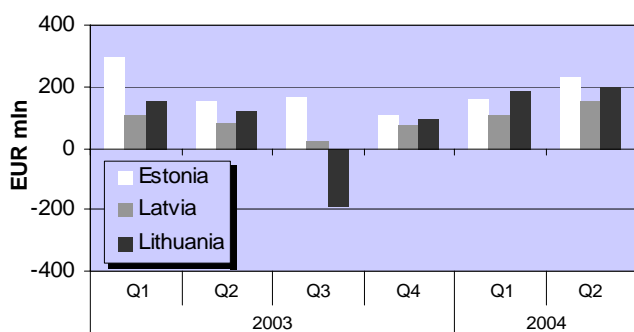
The Bank of Estonia forecasts that this year's economic growth will be 6.2% y-o-y, thereby 0.7% more than the bank's prior forecast. Respectively, according to the central bank, GDP growth is expected to reach 5.6% in 2005 and 6.0% y-o-y in 2006.

#### The growth in trade and construction slowed down in the third quarter

In the third quarter of 2004, the net sales of trade enterprises increased by 12% from the corresponding period in 2003. However, the growth of total net sales decelerated from the previous two quarters this year. That was mainly due to lower sales by car dealers and fuel retailers. In retail sales, the sales of alcoholic beverages and tobacco products grew by 19% y-o-y in the third quarter.

The production of construction enterprises grew by 4% y-o-y in the third quarter. The growth rate slowed down notably compared to the first and second quarters of 2004. However, the Eurostat reported that Estonia's construction sector grew the fastest among the EU-25 in the second quarter.

#### Foreign direct investment flows in the Baltic States



Source: Central Statistical Bureau of Latvia

In the second quarter of 2004, the inflow of foreign direct investment grew both over the quarter and compared to the corresponding quarter in 2003. At the end of June, Estonia's FDI stock was EUR 5.9 bn. Correspondingly FDI stock in Latvia reached EUR 3.1 bn and in Lithuania EUR 4.2 bn.

During the second quarter, the net (in)flow of FDI amounted EUR 228 mln. A half of this was comprised of real estate, renting and business activities, as well as one fourth by manufacturing. Investment from Denmark and Finland covered 40% of total direct investments. The largest single investment undertaken in 2004 is the building of a new pulp plant in Kunda by the Estonian Cell, a subsidiary of the Norwegian-owned Larvik Cell. The project will cost EUR 170 mln.

#### Electronics industry grew rapidly in ten months

Estonian industrial production grew nearly 7% within ten months of 2004 and manufacturing by 8% y-o-y. The growth has been based on the rapid increase in the manufacture of radio, television and communication equipment and apparatus (39%) and in the manufacture of electrical machinery and apparatus (34% y-o-y). In addition, the production of wood products has grown by 13% compared to the corresponding period in 2003. On the contrary, the manufacture of food products and beverages (4%) and the manufacture of textile products (1%) have grown much less in this period.

#### The rise in employment stopped

Estonia's unemployment rate has remained around 10% during the last two years. Since 2001 the number of employed people has increased, comparing with the corresponding period of the previous year. However, according to a recent labour force survey, the number of employed people decreased by 12,000 units y-o-y in the third quarter of 2004. The employment rate dropped by 1.2% y-o-y down to 56.9%. The unemployment rate was 10% as in the previous survey.

In the third quarter of 2004, the average gross monthly wage was 7,021 kroons (EUR 449). The average gross wage was 9.2% higher than in the third quarter of 2003. The wages increased most in construction, by 19% y-o-y. The average wage was highest in financial intermediation, EUR 874 per month, and lowest in fishing, at about a half of the average.

According to a recent survey by Fontes, average real wages will rise by 8.4% in 2004. Fontes forecasts that real wages will grow a bit less next year, by 6% y-o-y. The survey covered 139 firms.

#### Some business highlights

- A 50-50 joint venture of Swedish ICA Baltic and Finnish Kesko Food has received the green light from the EU's competition authorities. The joint venture contract was signed in June 2004, and covers the companies' operations in the Baltics.
- German based retailer Lidl has acquired several properties in Estonia for its forthcoming stores. The first Lidl discount stores will be opened next autumn.
- Tallinn Port plans to raise the prices of port services from January 1, 2005. According to the plan, e.g. the charge for tankers would increase by around 50%. Since the authorities have not yet approved the new rates, the plan might not be realised from the beginning of the year.
- Russian companies have invested extensively in Estonia this year. Recently the transport company Severstaltrans acquired 70 percent of the Estonian Oil Service company, and the food producer Nutritec acquired the Estmilk Production.
- The Finnish Construction Trade Union has imposed an embargo on 21 Estonian firms, which have not provided information on the pay and working conditions of their workers. However, about of half of the companies are owned by Finns. This year Finns have been keen in establishing construction companies in Estonia.
- Estonian Railways informed that it has terminated its contract with the Russian based Spacecom (Severstal), the first private carrier in Estonia, due to unpaid fees. Spacecom has disputed the tariffs imposed by Estonian Railways as unfair.
- The Estonian Minister of Finance has recommended that retailers should start pricing their products both in euros and kroons from the beginning of 2006.
- Bravocom, the first Estonian-owned mobile operator, launched its full services in November. Estonia introduces number portability from January 1, 2005.

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	6.6	1-10/2004
Inflation (CPI, end of period, y-o-y %-change)	12.5	6.5	3.9	5.0	4.2	2.7	1.1	4.7	11/2004
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	449	Q3/2004
Unemployment (% end of period, LFS data)	9.8	10.2	12.9	13.9	11.9	11.3	9.3	10.0	Q3/2004
Exports (EUR million, current prices)	1 891	2 252	2 239	3 445	3 698	3 642	3 996	3 446	1-9/2004
Imports (EUR million, current prices)	3 127	3 529	3 224	4 615	4 798	5 079	5 734	5 009	1-9/2004
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

## Latvia

### Economic growth accelerated in the third quarter

Latvia's GDP rose by 9.1% y-o-y in the third quarter of 2004. Therefore the Latvian economy is, again, the fastest growing economy among the Baltic States as well as among all the EU countries. In the third quarter, this growth was mainly based on the increase in construction, up by 11% y-o-y and in the service sector, up by 10%. Within the service industry, transport, storage and communications increased by 17%, and hotel and restaurant section by 19% y-o-y. The growth of manufacturing slowed, down to 5%-growth y-o-y.

During the first nine months of 2004, Latvia's economy has grown by 8.5% compared to the corresponding period in 2003. The driving force has been the growth of construction and services, which covers nearly 73% of the total GDP. Retail trade has been one key actor behind this robust growth. In the first ten months this year, retail trade turnover grew by 12% y-o-y. The retailing of textiles and related products grew by 43% and the retailing of foodstuff by 30% from the same period in 2003.

### A borrowing duty to dampen borrowing?

The Bank of Latvia has recommended introducing a duty on borrowing in order to dampen the borrowing spree. The duty could be implemented by increasing the duty for the registration of a property which is purchased for a mortgage loans in a land register. According to the bank, the Irish experience shows that such a duty is working to avoid the overheating of the economy. In Latvia, the growth in borrowing is the second fastest amongst EU countries, after Lithuania.

The central bank has recently raised the refinancing rate by 0.5% to 4.0%, and increased the compulsory base of reserves to calm inflation. In November, consumer prices were 7.2% higher than a year ago. During recent months, Latvia's annual inflation has been the highest in the EU.

### Specialisation in manufacturing, 2001

	High- technology	Medium-high- technology	Medium-low- technology	Low- technology
<i>Persons employed (%)</i>				
<b>EU-25</b>	9.1	26.7	25.0	39.1
<b>Estonia</b>	6.7	9.7	16.5	67.1
<b>Latvia</b>	2.8	10.3	12.7	74.2
<b>Lithuania</b>	5.4	9.2	14.8	70.6
<b>Poland</b>	5.0	21.4	25.0	48.4

Source: Eurostat

According to Eurostat, the Latvian manufacturing industry is strongly concentrated in low-technology industries. In 2001, nearly three-quarters of Latvian industrial employees were working in low-technology industries, whilst the corresponding EU-25 average was below 40%.

Moreover, Latvia's manufacturing is strongly dependent on labour-intensive manufacturing activities. According to Eurostat, 42% of Latvia's value-added in manufacturing (in 2001) was based on labour-intensive activities. This share was the largest among the EU-25 countries, where the average amount was about 14%. However, the share of labour-intensive manufacturing was also relatively large in Estonia, Lithuania and Poland and it seems to be correlating strongly with the GDP per capita.

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	8.5	1-9/2004
Industrial production (y-o-y %-growth)	6.1	2.0	-8.8	3.2	6.9	5.8	6.5	5.7	1-10/2004
Inflation (CPI, end of period, y-o-y %-change)	7.0	2.8	3.2	1.8	3.2	1.4	3.6	7.2	11/2004
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	318	Q3/2004
Unemployment (% end of period, LFS data)	14.1	13.7	13.2	13.3	12.9	11.6	10.3	10.0	Q3/2004
Exports (EUR million, current prices, average exch. rate)			1 613	2 020	2 232	2 416	2 559	2 592	1-10/2004
Imports (EUR million, current prices, average exch. rate)			2 758	3 453	3 910	4 284	4 634	4 578	1-10/2004
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

### Net turnover of enterprises increased by 21% in Q3

According to the CSB, the net turnover of Latvian enterprises grew by 21% or by LVL 747 mln in the third quarter, compared to the corresponding quarter in 2003.

During the third quarter, Latvian enterprises' short term credits grew by 3%, but long term credits were unchanged. Short term credits covered 59% of the total liabilities to creditors. The liquidity indicators did not change remarkably.

According to the data released by the commercial register, 4,233 companies were liquidated in the first eleven months of 2004, or 42% more than in 2003 as a whole. The liquidation boom is linked to the need to re-register companies under the new law.

### Exports in 10 months exceeded 2003-exports

Latvia's export and imports have grown extremely rapidly this year. During the first ten months, exports grew by nearly 26% y-o-y and imports by 24%, when measured in the Latvian lats. Therefore exports in January-October 2004 exceed exports last year in total.

In the January-October period, wood and articles of wood constituted 32% of the total exports, followed by base metals and related products, which covered 14% of the total export value. The sharpest increase was observed in the exports of machinery and mechanical appliances, up by 45% y-o-y.

### Lat will be pegged to the euro from January 1

The Bank of Latvia will repeg the Latvian lats from the SDR basket of currencies to the euro on January 1, 2005. The lats will be repegged at the market rates fixed by the European Central Bank (ECB) on the preceding working day (December 30, 2004). The exchange rate of the lats against the euro will be calculated using the SDR rates formula, similar to the standard procedure.

### Some business highlights

- Latvia's government has set the initial price for the third UMTS/GSM licence at LVL 1.3 mln (EUR 1.9 mln). The new operator is required to invest at the minimum EUR 150 mln in setting up a new network within one year. The auction will be held in January 2005.
- Low-cost airline EasyJet has launched a new Riga-Berlin route, which is the company's first route from/to Riga; CSA Czech Airlines will launch the first direct Riga-Rome route in March 2005; airBaltic starts regular flights to St. Petersburg in December and will open a regular Riga-Istanbul route in March 2005.
- Finnish Sampo Bank acquires Latvian Maras Banka, which specialises in mortgage lending to individuals. Maras Banka is one of the smallest banks in Latvia.
- German E.ON Energie GmbH is interested in the planned coal-burning electricity generator in Liepaja. The value of investment is around EUR 500 mln. Latvia's state energy company Latvanegro and the E.ON Energie have begun working on a feasibility study which should be published in December.
- Alcatel has won a EUR 47.6 mln turnkey contract to modernise the Latvian railway network. Siemens has disputed that the price offered by Alcatel was too low, about 26% cheaper than the second ranked contender proposed.
- Latvia's new government has included airBaltic in the list of companies that might be privatised for money. Currently the state owns 52.6%-share and SAS 47.2% of the airline.
- Balasta Properties plans to build a high-rise building "da Vinci" in Riga in 2005-2006. The building will cost around EUR 40 mln.
- Latvian ice hockey arena developer Stadiums is seeking general contractor and equipment provider for rebuilding the Skonto stadium for the 2006 World Championships. The city needs a second ice hockey arena for the tournament.
- Ecolines, the Latvian low-cost bus carrier, have started to operate the Riga-Tallinn and Riga-Tartu route.

## Lithuania

### GDP growth dropped in the third quarter

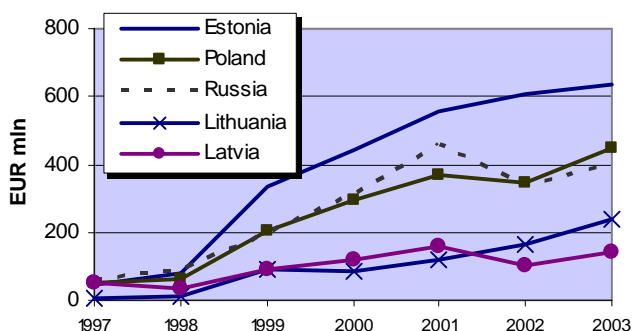
Lithuania's economy grew by 5.8% in the third quarter compared with the corresponding period in 2003. Therefore the annual growth was significantly lower than in the first and second quarter, and the lowest quarterly-growth since the first quarter of 2002. Over the third quarter, the growth was mainly based on the increase in the wholesale and retail trade, hotels and restaurants and manufacturing. Over the first three quarters of 2004, GDP increased by 6.5% y-o-y.

### Trade deficit decreased in January-October

In the first ten months of 2004, Lithuania's exports increased by 18% and imports by 16% y-o-y. The trade deficit decreased by almost EUR 180 mln compared to the corresponding period in 2003. Although the growth of exports has been broad based, the export of mineral fuels grew by 46% y-o-y and covered 25% of total exports.

Lithuania's exports grew extremely rapidly in the third quarter of 2004. However, due to the rise in export prices (especially in oil-related products) the growth of exports did not contribute the real GDP growth as such.

### Finnish FDI stock in some Baltic Sea economies



Source: The Bank of Finland

According to recent data from the Bank of Finland, Finnish direct investments in the Baltic States and Poland increased in 2003. Estonia's share is still dominant when considering new EU member states or other eastern European countries. However, Finland's FDI stock in Lithuania, relatively speaking, grew most among the Baltic States and Poland, by 45% y-o-y in 2003.

### More than one-third of Lithuanians are able to save

According to a recent survey by the market analysis and research company RAIT, more than one-third of the Lithuanians make enough money to save. However, nearly half of them who have extra money do not make deposits in a bank or invest in shares or bonds – they prefer to keep their savings at home. According to the survey, the largest share of people able to save is in the age group of 20-29 years (44%) and 30-39 years (43%). The smallest share is amongst people aged over 70 years.

### Lithuania the cheapest in price survey

According to a survey by Stockholm-based Pricerunner, Lithuania and Estonia are the cheapest European countries. The survey covered 18 European countries and was based

on the prices of 48 goods. Prices in Lithuania are 26% below the European average, and in Estonia 19% under this average. On the contrary, Nordic countries are the most expensive, led by Norway, where prices are 21% over the European average. The survey was carried out in October.

### Not defined date for the euro's introduction

Lithuania's new government programme does not specify a date for the introduction of the euro in Lithuania. According to the programme, the date depends on the country's economic growth and financial stability. Earlier the Bank of Lithuania has estimated that Lithuania could adopt the euro in 2007.

### Uncertainty about Mazeikiu Nafta's fate continues

It is still unclear how the possible breakup of Russian oil giant Yukos will affect the Lithuanian oil refinery Mazeikiu Nafta. However, several alternatives are on the table. Russian gas and oil giants Gazprom and Lukoil are rumoured to be interested in acquiring Yukos' shares in MN. In addition, according to the Baltic Times, the EBRD is considering a 10-18% stake in the refinery.

The Lithuanian government has rejected a request by Yukos to postpone the deadline (by 120 days) concerning the company's option to buy additional shares of MN from the state. Yukos had earlier declared its wish to acquire an additional 9.7%-share of the Lithuanian refinery and port complex. Currently Yukos owns 53.7%-stake of MN.

Mazeikiu Nafta has recently reported its dramatic growth numbers. The company tripled its net earnings, up to EUR 130 mln in the first nine months of 2004, from EUR 34 mln in the corresponding period in 2003. However, according to the Lithuania's Ministry of Economy, MN's earnings grew more moderately, by 114% y-o-y, when measured by Lithuanian accounting principles. The values published by MN were based on the US GAAP standards. During the first ten months, Mazeikiu Nafta refined 23.5% more crude oil compared to the corresponding period of 2003.

### Some business highlights

- Estonian gambling operator Olympic Casino opens its first casino in Kaunas. The company has 4 casinos in Vilnius and plans to launch four more casinos in Lithuania next year.
- Irish low-cost carrier Ryanair plans to introduce flight from Lithuania by October 2005. The company plans to operate from Kaunas to Hamburg, Frankfurt, London, Milan, Rome, Stockholm and Tampere.
- Finnish travel operator KohdematkatKaleva has acquired the Lithuanian bureau of Carlson Wagonlift Travel. KohdematkatKaleva acquired the Estonian Herman Raisid last spring and plans to acquire a travel agency in Latvia in the near future.
- Djem Bank, the Belarusian commercial bank, is in a process to set up a branch in Vilnius. If the Bank of Lithuania issues a licence, Djem-Bank will be the first Belarusian bank in Lithuania.
- Lithuanian VP Market has opened an extension of its shopping mall Akropolis. After the extension, with a total area of 108,000 square metres, Akropolis is the largest shopping mall in the Baltic States. VP Market has also received permission from the city council to build an Akropolis shopping centre in Kaunas.
- The number of bankruptcies grew by 12% y-o-y in the third quarter of 2004. Half of the bankruptcies were trade companies and 18% were industrial companies.
- Colliers International, a worldwide real estate company, has decided to open a branch in Vilnius in January 2005. The company opened its first office in the Baltic States last spring in Riga.
- Russian company Deko-Wood is interested in building a pulp plant in Lithuania. In the past, interest in such a type of project had been expressed by the Finnish company Stora Enso, and Thai and Canadian investors.

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	6.5	1-9/2004
Industrial production in sales (y-o-y %-growth)	3.3	8.2	-9.9	2.2	16.0	3.1	16.1	10.5	1-10/2004
Inflation (CPI, end of period, y-o-y %-change)	8.4	2.4	0.3	1.4	2.0	-1.0	-1.3	3.0	11/2004
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	365	Q3/2004
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	6 031	6 031	1-10/2004	
Imports (EUR million, current prices, average exch. rate)	4 340	5 650	6 767	7 943	8 441	8 029	8 029	1-10/2004	
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

## Poland

### GDP growth slowed to 4.8% in the third quarter

Poland's economic growth slowed down in the third quarter compared to the first and second quarters of this year, when growth had been influenced by Poland's EU entrance. Within the July-September period, GDP grew by 4.8% y-o-y. The result was a disappointment for many analysts and politicians. Domestic demand has been growing slower than expected, since investments are still at a very low level. Expenditure on fixed assets increased only 4.1% y-o-y in the third quarter or 3.7% y-o-y in the first nine months of 2004. During the first nine months of 2004, Poland's GDP increased by 5.9% y-o-y.

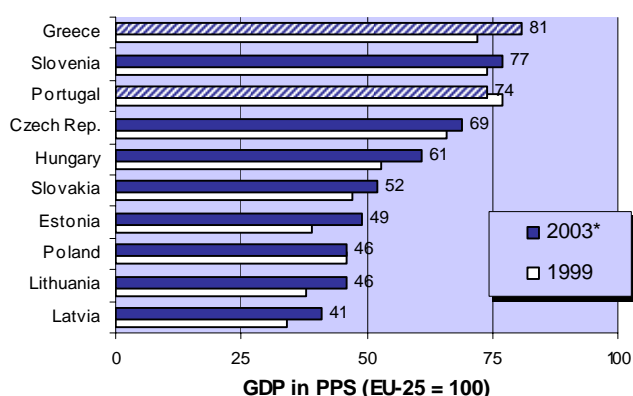
In 2004, the rapid growth in industrial production has been the main engine for economic growth. The growth in industrial production dropped significantly in October, but returned to the previous growth-stage in November.

### Prices rose by 4.5% y-o-y in October-November

The rise in consumer prices has accelerated during the last two months. The driving forces behind the rise have been the high prices of fuel and the EU entry-related price effects on some products, e.g. agricultural products. Poland's inflation will still remain at a relatively high level during the forthcoming months due to prices rises of gas and energy.

However, inflation is not expected to be a major problem for Poland. The situation in the labour market contributes to the lower inflation. Moreover, the disinflationary benefits provided by the strengthening of the zloty will push inflation down. Since May 2004, the zloty has been strengthening strongly against the euro and the US dollar. Although the strengthening of the zloty lowers Poland's foreign debt expenditures, it might threaten exports and thus depress economic growth. This concern has been expressed recently by the Prime Minister Belka and Deputy Prime Minister Hausner.

### GDP per capita in some EU member states



Source: Eurostat

Poland, together with Lithuania, is the second poorest EU country. According to statistics published by Eurostat, GDP per capita in Poland has remained relatively at the same level since 1999, at 46% of the EU-25 average. On the contrary, GDP per capita in the Baltic States has increased rapidly in this period. According to Eurostat, Slovenia has already passed Portugal, the poorest EU-15 country.

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	5.9	1-9/2004
Industrial production (y-o-y %-growth)	11.5	3.5	3.6	6.7	0.6	1.1	8.4	13.1	1-10/2004
Inflation (CPI, end of period, y-o-y %-change)	13.2	8.6	9.8	8.5	3.6	0.8	1.7	4.5	11/2004
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	513	Q3/2004
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	48.5	1-10/2004
Imports (EUR billion, current prices, average exch. rate)		41.5	43.2	53.1	56.2	58.3	60.4	58.4	1-10/2004
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

### More profit, less bankruptcies

Polish companies' net financial result increased by 207% y-o-y up to PLN 46.7 bn in the first nine months of 2004. The companies' total net profit nearly doubled and the total loss almost halved from the corresponding period in 2003.

During the first nine months of this year, the number of bankruptcies dropped significantly, by 45% y-o-y.

### Privatisation revenues will exceed 10 bn this year

According to the Treasury Ministry, Poland's privatisation revenues totalled PLN 9.5 billion during the first eleven months of 2004. Revenues from privatisation are expected to reach 10.5 billion by the end of this year, whilst the target for 2004 was set at PLN 8.8 bn. According to the Ministry, the figure will fall to around PLN 5.7 bn next year.

This year's good result is mainly based on the sale of shares in the PKO BP bank. Due to the bank's successful debut on the Warsaw Stock Exchange, Poland earned about PLN 7.6 bn from the sales of a 37.7%-stake of the bank's shares in November.

### Budget for 2005: deficit PLN 35 bn

Poland's Parliament has passed the budget for 2005. The budget foresees revenues of PLN 210 bn and expenditures of PLN 175 bn. Therefore the budget deficit is expected to be PLN 35 bn. In 2004, the budgeted deficit is PLN 43.5 bn. However, according to Deputy Prime Minister, the budget deficit in 2004 will be 2-5 billion zlotys lower than predicted, as a result of growing tax and privatisation revenues.

The Polish government is planning a major change in their VAT regulations. The government plans to decrease the basic rate of VAT from the present 22% to 19%. The government also intends to eliminate the 0% and 3% tax rates, leaving the 7% rate only on indispensable goods.

### Some business highlights

- Warsaw Stock Exchange's main index WIG has reached a record-high level during recent weeks. In December, the index crossed 26 000 points for the first time.
- US-based Hewlett Packard (HP) plans to open a European financial and accounting service centre in Poland in early 2005. The centre is expected to create 1,000 jobs in five years.
- Wadowice-based Maspex has made two acquisitions abroad. The company has acquired Czech-based Walmark's non-alcoholic beverage division, and it has acquired a controlling stake in the Hungarian beverage producer Olympos.
- Italian Brembo Group, which manufactures braking systems, plans to invest EUR 40 mln in a brake disc foundry in the company's existing plant in the Katowice Special Economic Zone. The investment will create at least 200 new jobs by 2007.
- LG Electronics, the Korean electronics producer, plans to invest USD 110 mln in plasma television production in Mlawa. Another Korean company Daewoo Electronics has similar investment plans in Poland.
- TZMO, a Torun-based hygienic material producer will open a new factory in India. TZMO is one of the largest exporters in Poland.
- The Polish division of AIG, the world's largest insurance company, is to expand to the Baltic States. Sales are planned to start in the second quarter of 2005.
- Poland's national airline LOT has introduced a cost-cutting programme. The company plans to cut costs by PLN 500 mln by 2006. LOT will also launch its own low-cost carrier named Centralwings.
- Swedish furniture giant IKEA plans to invest EUR 75 mln in three factories in North-Eastern Poland. The investment would create 1,000 new jobs.
- Norwegian-originate Orkla Foods has taken over the Polish company Elbro, which is market leader in Poland for several types of frozen products. Orkla already owns two food companies in Poland, Superfish and Kottlin

## Doing Business in the Baltics – a World Bank Perspective

by Thomas Laursen and Roger Grawe

### Background

The Baltic countries have grown rapidly since the mid-1990s, but income levels remain at less than one-half of those prevailing in Western Europe. The overarching question now is whether the high growth rates of recent years can be sustained over the medium-long term, thus allowing for rapid convergence toward average EU income levels. There is little doubt that part of the recent dynamics reflects the very low starting level a decade ago, with strong productivity growth owing partly to continued labour shedding and the reallocation of resources toward more productive sectors and with high investment rates responding partly to the need for upgrading a depleted capital stock. More recently, rapid credit growth has fuelled a boom in domestic demand, resulting in large current account deficits, which cannot be sustained indefinitely. At the same time, however, investment and productivity growth also reflects the general improvement in the investment climate and substantial inflows of foreign direct investment, augmenting not only investment but also transferring know-how and new technology. It is difficult to disentangle the relative importance of all these factors, but looking more closely at the business and investment climate may help.

### Business and investment climate

The Baltic countries generally compare favourably with other new Central European EU member countries on various indicators of doing business and investment climate (Annex). Among the Baltic countries, no consistent ranking seems possible. While Estonia leads according to several indicators (economic freedom according to the Heritage Foundation index, competitiveness according to the World Economic Forum and IMD indices and overall transition according to the EBRD transition indicators), Lithuania comes out on top according to the World Bank assessment of ease of doing business. In fact, Lithuania now ranks among the Top 20 globally in this assessment, with the other two Baltic countries close behind. Slovakia is the only other country in the region included in this group, one place behind Lithuania.

The same is true when looking at other aspects of the investment climate such as macroeconomic stability, production costs and financial sector development. The Baltic countries — in the context of their fixed exchange rate regimes — have all pursued prudent fiscal policies and have low levels of debt and inflation. Estonia and Lithuania were in the first group of countries (along with Slovenia) to join the ERM-2 — the “waiting room” for Euro adoption — and Latvia is expected to follow soon, despite a burst in inflation following EU accession. Nevertheless, rapid credit expansion and high current account deficits remain a source of concern. Production costs are relatively low in the Baltic countries, with average wages around EUR 400 per month (some 30% lower than the largest Central European countries) and effective corporate tax rates are also among the lowest in the region. In terms of financial sector development (as measured by assets or credit to the private sector as a share of GDP) Estonia and Latvia are broadly in line with the average for the region (although far behind the EU15), while Lithuania has only come about half as far.

Looking at foreign direct investment inflows (FDI), the Baltic countries again seem relatively attractive, with FDI in Estonia for example, amounting to an average of 7% of GDP in 2002-03 compared to an average of 4% of GDP in Poland, Hungary, and the Czech Republic during the same period. However, available evidence suggests that most of this foreign investment has gone into relatively low-value added and low-skill labour intensive industries

### Key challenges

Looking ahead, even with the relatively conducive investment climate, the Baltic countries face a number of important challenges in order to sustain high growth rates in the face of increasing competitive pressures, both from other countries in the region and from countries further East. While the prospects for maintaining macroeconomic stability are favourable, the risks from continued rapid credit expansion and large current account deficits should not be underestimated. Perhaps the most important area where further reforms are needed is privatisation of the remaining large state-owned enterprises and strengthening competition, particularly in the energy sector. Banking and financial market development remains a key priority, not least in Lithuania, with easier access to finance for new, entrepreneurial, small- and micro-enterprises a top priority. Additional efforts are also required to increase flexibility in the labour market, including reducing the tax wedge. Finally, there is ample room to improve the legal system, especially relating to bankruptcy, creditor rights and enterprise restructuring, as well as regulations affecting land registration and use, the latter certainly in Lithuania. Corruption remains an important challenge, especially in Latvia and Lithuania. In the longer run, improving further the quality of education and building national innovation systems will be crucial to develop a knowledge-based economy and move up the technology ladder in production and exports. Nevertheless, if the dynamism of recent years is a good indicator, there is the fundamental commitment of both private and public sectors in all three countries to a successful reunion with the European family, which suggests that doing business in the Baltics will continue to be a winning proposition.

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## Annex (Doing Business in the Baltics – a World Bank Perspective)

## INDICATORS OF DOING BUSINESS AND INVESTMENT CLIMATE

	scale (high - low)	Estonia (rank)	Latvia (rank)	Lithuania (rank)	Other EU8 countries average*
<b>Index of Economic Freedom 2004</b> (the Heritage Foundation)	1-5	1.76 (6)	2.36 (29)	2.19 (22)	2.60
<b>Growth Competitiveness Index 2004</b> (World Economic Forum)	7-1	5.08 (20)	4.43 (44)	4.57 (36)	4.45
<b>The Business Competitiveness Index Ranking</b> (World Economic Forum)	Ranking	27	49	36	
<b>IMD - World Competitiveness Ranking 2004</b>	U.S.=100	68.43 (28)	n.a.	n.a.	53.71
<b>EBRD Transition Indicators 2004</b>	4.3-1				
<i>Large scale privatisation</i>		4.0	3.7	3.7	3.7
<i>Small scale privatisation</i>		4.3	4.3	4.3	4.3
<i>Governance &amp; Enterprise restructuring</i>		3.3	3.0	3.0	3.2
<i>Price liberalisation</i>		4.3	4.3	4.3	4.2
<i>Trade &amp; Forex systems</i>		4.3	4.3	4.3	4.3
<i>Competition Policy</i>		2.7	2.7	3.0	2.9
<i>Banking reform &amp; interest rate liberalisation</i>		4.0	3.7	3.0	3.6
<i>Securities markets and non-bank financial institutions</i>		3.3	3.0	3.0	3.2
<i>Overall infrastructure reform</i>		3.3	3.0	2.7	3.2
<b>Doing Business 2005</b> (IBRD/The World Bank)				17	
<b>Starting a Business</b>					
<i>Number of procedures</i>		6	7	8	9
<i>Time (days)</i>		72	18	26	47
<i>Cost (% of income per capita)</i>		7.5	17.6	3.7	14.5
<i>Min. capital (% of income per capita)</i>		49.7	41.4	62.8	86.6
<b>Hiring and Firing Workers</b>					
<i>Difficulty of hiring Index 0-100</i>		11	78	33	19
<i>Rigidity of hours Index 0-100</i>		80	20	40	52
<i>Difficulty of firing Index 0-100</i>		40	50	40	28
<i>Rigidity of employment Index 0-100</i>		44	49	38	33
<i>Firing costs (weeks)</i>		33	42	38	29
<b>Registering Property</b>					
<i>Number of procedures</i>		4	10	3	5
<i>Time (days)</i>		65	62	3	164
<i>Cost (% of property value)</i>		0.5	2.1	0.9	3.3
<b>Getting Credit</b>					
<i>Cost to create collateral (% of income per capita)</i>		43.0	1.5	4.1	7.7
<i>Legal rights Index 10-1</i>		..	8	4	6
<i>Credit Information Index 6-0</i>		5	4	3	4
<i>Public registry coverage (per 1,000 adults) **</i>		0	6	44	10
<i>Private bureau coverage (per 1,000 adults) ***</i>		95	0	0	132
<b>Protecting Investors</b>					
<i>Disclosure Index 7-0</i>		4	5	6	5
<b>Enforcing Contracts</b>					
<i>Number of procedures</i>		25	23	17	27
<i>Time (days)</i>		150	189	154	647
<i>Cost (% of debt)</i>		10.6	11.0	14.1	11.5
<b>Closing a Business</b>					
<i>Time (years)</i>		3.0	1.1	1.2	4.2
<i>Cost (% of estate)</i>		8	4	8	19
<i>Recovery rate (cent on the dollar)</i>		40.0	85.0	52.4	35.8

\* Czech Republic, Hungary, Poland, Slovak Republic, Slovenia

\*\* Number of individuals and firms listed in the public credit registry with current information on repayment history, unpaid debts or credit outstanding. The number is scaled to country's adult population (per 1,000 adult population). If a public registry does not operate, the coverage value is 0.

\*\*\* Number of individuals or firms listed in the private credit bureau with current information on repayment history, unpaid debts or credit outstanding. The number is scaled to the country's adult population (per 1,000 adult population). If a private bureau does not operate, the coverage value is 0.

## CBSS and the Economic Cooperation in BSR

by Hannu Halinen

The Baltic Sea Region is a heterogeneous area, reflecting clear diversities; it is like a mosaic composed of local, regional and national activities. On an intergovernmental level, diversities also prevail, although European integration has recently made its mark in economic and political fields. Under these circumstances, is there a sufficient enough basis to talk about a common identity, to identify the Baltic Sea Region as a brand? I think one can distinguish a common BSR vision commensurate, at least, with the Mediterranean – a vision based upon such features as competitiveness, human development (education, culture, tourism, welfare state) and an ICT/information society.

The BSR has undergone a paradigm shift during the last fifteen years, with the emphasis moving from political to economic, social and environmental development. This has affected the role of the four main intergovernmental organisations in the region, the Council of the Baltic Sea States (CBSS), the Nordic Council of Ministers, the Arctic Council and the Barents Euro-Arctic Council.

As a follow-up to the Baltic Sea Summit in June 2004 in Laulasmaa, Estonia, the CBSS is engaged in reassessing its role within the regional playground after the EU enlargement. To be specific, the Heads of Government expressed expectations on our cooperation to become more pragmatic and result-oriented. The process of exploring new approaches to economic cooperation complementary to the EU agenda is underway. The search for a new niche that the CBSS could occupy in regional affairs would require a certain reprioritisation, taking into account three parallel processes: EU enlargement, Russia's accession to the WTO and developments within the creation of the EU-Russia within the four "Common Spaces". It is probable that first outlines of the re-evaluation work led by the permanent CBSS Working Group on Economic Cooperation (WGEC) would be already sketched by the next CBSS Ministerial meeting in Szczecin, in June 2005.

The economic cooperation in the CBSS is based on two documents adopted by the Ministers in charge of Trade and Economy; the Bergen (2000) and Moscow (2002) Action Plans. The WGEC was established in 1993 with a wide and flexible mandate of monitoring and developing the overall cooperation in the economic field. It is tasked to identify ways and means of increasing the perception of the BSR as an attractive area for investments.

Such topics as reducing barriers to trade and investment, including the promotion of entrepreneurship, the improvement of conditions for the border-crossing of goods, the fight against corruption and enhanced cooperation with the Russian North-West regions are high on the agenda for the current Polish Chairmanship in CBSS. At present, particular importance is given to the investment promotion.

There is a general understanding that the infrastructure around the BSR and, first of all, at its Eastern part, needs significant improvements. Such a situation impedes both the growth of trade and investment, as well as efforts by the

member-states to increase competitiveness. It is thereby assumed that the "infrastructural" topic could be successfully addressed on a regional level, subject to an appropriate commitment by the member-states. In this conjunction the feasibility of a new regional financial institution for Northern Europe, in complementing the existing institutions, could be considered.

Due attention should also be given to the "soft" infrastructure – the ITC, as one of its key and essential prerequisites for economic growth. I would refer to the work within the Northern e-Dimension Action Plan (NeDAP) aimed at strengthening the leading position of the BSR in building an information society. The NeDAP is run by the CBSS Group of Senior Officials on an Information Society. As of 2005, the efforts of the SOIS would be enhanced by an expert and the financial potential of the Nordic Council of Ministers (NCM). Furthermore, the idea of establishing a Common Baltic Information Space could provide a substantial contribution to the fulfillment of the Lisbon Strategy, at least here in the BSR.

One of the key conditions for strengthening competitiveness is a closer link between the economic actors and education/research institutions. Innovation and advanced technical solutions, especially in the field of SMEs, could be crucial for both market expansion and attracting new investments. A knowledge-based economy is a goal that needs to be consistently pursued to this end.

Along with the WGEC, some other CBSS family working structures with a specific profile such as, the ad-hoc Working Group on Transport, Baltic 21, and BASREC – cooperation in the Energy sector, are also contributing well to economic cooperation. An increased coordination of activities between them, as well as with other regional actors, including the EU Commission, the BDF, the Barents Euro-Arctic Council, the NCM, the OECD, and the Baltic Sea Forum – Pro Baltica, is indispensable.

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