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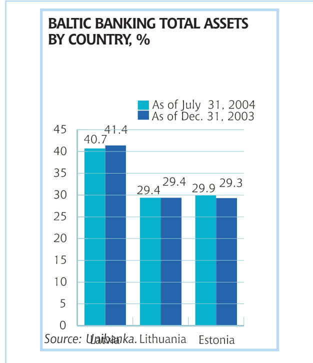

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The BALTIC COURSE

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As the Union's "family life" has shown during the first months after accession, the Baltic states entered the EU quite smoothly. It is to be noted, though, that the countries which seriously started preparing for accession long ago were generally better off. However, nobody actually could have predicted some of the recent events. Thus, transit of goods through Baltic territory has reduced, and so have cargo loads at the Baltic seaports. That was partially the reason behind the Baltic states' efforts to diversify their export directions, e.g. as shown by our special report on the Latvian President's recent visits to Spain and Kazakhstan.

In the *BC* Baltic States Development section, we traditionally cover energy and transport issues, as well as logistics, finances, bank activities and integration in the region. As for integration among the Baltic states, I cannot help quoting a remark made by the new Latvian ambassador to Lithuania about the *BC* role in this process: "...it is good that there's a magazine in the region reflecting problems of the whole region. It should be demonstrated at least on pages of your magazine that this region has many things in common, both historically and contemporary". We think that among such common things is the Baltic states' drive for wellbeing of their citizens and efforts to enhance future economic growth. The only problem is that of taking adequate and right decisions by those who are supposed to make them.

As regards the European Union issues, we have chosen to address a very sensitive and interesting theme, e.g. that of taxation in the EU and in one of its member states. As an example, we have turned to personal taxation in Denmark. The choice of this topic is even more urgent at present as pessimism about economic outlook in Europe is still present in expert analysis. On the other hand, people in the Baltic states do not know very much about the EU taxation system, and various challenging ideas have been expressed in the EU headquarters and in the member states on possible taxation unification in the Union. We wanted to reveal some major points in national and EU taxation, first of all, concerning taxes on the personal, citizens' level.

We present contemporary statistics on the Baltic states' economic development and other interesting materials as well.

Eugene Eteris, BC's International Editor

LABOR PARTY WINS PARLIAMENT ELECTIONS IN LITHUANIA

P. Lileikis

VIKTOR USPASKICH: 39 seats in the parliament.

The newly-established Labor Party created a sensation in the Lithuanian parliament elections this October by winning 39 seats on the 141-member legislative body. Former ruling coalition of Social Democrats and Social Liberals came in second with 31 seats in the parliament and Conservatives have 25 seats.

By mid-November the Labor Party, the Social Democrats and Social Liberals, and the bloc of the Farmers Party and the New Democracy Party lead by **Kazimira Prunskiene** had signed the coalition agreement.

The Labor Party headed by **Viktor Uspaskich** finally accepted the rather strict demands by the former ruling parties, and together they formed a new coalition with nearly indestructible majority in the parliament.

Arturas Paulauskas will keep the post of the parliament speaker. **Algirdas Brazauskas** will continue as the prime minister. The remaining six portfolios will be given to the Labor Party with the party leader Uspaskich expected to undertake the responsibilities of the economy minister.

MORE LAYOFFS AT KREEHOLM TEXTILE PLANT

Kreenholm textile plant in Narva, a city in northeastern part of Estonia, will lay off another 1,000 people during coming 15 months. By the end of 2005, the company's staff of 4,000 people will be cut down to 3,000. *Kreenholmi Valduse AS* director general **Matti Haarajoki** said the layoffs will affect the entire company but none of the existing factories or workshops would be closed.

"At the same time we are going to bring to Narva the spinning factory equipment from Sweden that would enable us to increase production significantly. As the company seeks to increase profits, we have to cut all kinds of indirect costs," said the company's director general.

At the beginning of 2004, the Kreenholm plant employed 4,400 people; 400 were laid off this spring when the company closed one of its spinning factories.

NATO INVESTMENTS IN LITHUANIA

Runway renovation in Zokniai airport, located near Siauliai in northern Lithuania, which has begun at the end of August, is just the beginning of a NATO investment program according to which about 100 million euros can be poured into the airport facility over the next few years.

The ongoing renovation project at the Zokniai airport, serving as the military base for four F-16 fighter planes assigned by the alliance to patrol the Baltic air space, is aimed to repair 500 sq.m of the runway surface. The local road building company *Siauliu plentas* that has to complete the work by October won the tender for the contract.

The BC archives

THE ZOKNIAI AIRPORT: Investment of about 100 million euros is quite real in the next few years.

Contacts with NATO experts, who visited Siauliai twice to assess future prospects of the Zokniai airport and estimate the cost of this undertaking, gave Lithuanians the reason to believe that repairing one runway will not be enough, e.g. entire airport shall be fully renovated and upgraded in 2006-2007.

LATVIA BEATS SPAIN AS SITE FOR US FIBERBOARD PLANT

The US Corporation *Jeld-Wen* will build a huge wood fiberboard plant near Aizkraukle, a small town some 100 kilometers southeast of the Latvian capital Riga. The plant, which will supply fiberboard used in making of doors to several *Jeld-Wen* factories in Europe, is to become operational in October 2005. The investments in the project are estimated at around USD 40-50 million. The production facility will cover up to 12,500 sq.m, and an area of roughly the same size has been designated for preliminary processing of wood and storage of raw materials.

Jeld-Wen's vice-president **John Pierce** said they had chosen Latvia as the site for the new fiberboard plant after six months of assessing other possible locations in a number of European countries. "Spain was Latvia's main rival for a long time but in the end we preferred Latvia because of stable economy, highly-qualified staff, cooperative government and, naturally, rich timber resources," he said.

RUSSIAN AMBASSADOR TO LATVIA COMES FROM ENERGY SECTOR

The BC archives

VIKTOR KALUZHNY: High-ranking politician.

Russian President **Vladimir Putin** has signed a decree appointing **Viktor Kaluzhny** as Russia's new ambassador to Latvia. Lately Mr. Kaluzhny had been serving as the Russian deputy foreign minister and the Russian President's special representative for dealing with issues related to the Caspian Sea status. Previously he was the Russian fuel and energy minister.

Latvian parliament foreign experts believe that Mr. Kaluzhny's appointment as the ambassador to Latvia confirms Russia's special interest in relations with countries members in the EU and NATO as a Russian foreign policy priority.

"Simply said, Latvia now plays in a different league and politicians of a higher rank are being sent here," said the Latvian parliament foreign committee chairman **Aleksandrs Kirsteins**.

TO EUROPE VIA THE BALTICS

Georgian President **Mikhail Saakashvili**, accompanied by the country's Foreign Minister **Sandra Elizabeth Roelofs**, paid an official visit to Lithuania, Latvia and Estonia in mid-October. Further bilateral cooperation and consultations over the Baltic states' reform experience during their preparation for the EU membership were in the focus of this tour.

"Georgia is a democratic state that has a lot in common with the Baltic states and there's no way we can be pulled back into the past... We will be moving towards Europe and no 'dark force' can stop us", the Georgian leader told the Estonian press.

This is the first time since restoration of independence when a Georgian president has visited the Baltic states. In the meantime, two Lithuanian presidents have already visited Georgia, i.e. **Algirdas Brazauskas** made a trip to Tbilisi in 1996, and **Rolandas Paksas** went there in 2003.

VENTSPILS NAFTA READY TO SELL CONTROLLING STAKE

In order to renew pipeline oil deliveries from Russia to Latvia's Ventspils port, the Ventspils-based concern *Ventspils nafta (VN)* will have to sell to Russia the controlling stake in its oil terminal subsidiary *Ventspils naftas terminals (VNT),* or else the company will have to lay off staff and freeze assets, **Vladimir Solomatin**, a member of *VN* council and vice-president of *Latvijas naftas tranzits (LNT)*, the largest private shareholder in *VN*, said in the interview to Latvian business daily *Dienas Bizness*.

"We will take any chance we can to renew crude oil supplies via pipeline — it all depends on the price and the terms", said Mr. Solomatin. "We are open to negotiations, only interest from the Russian side is needed. If Russia set its mind on it, supplies could be renewed in a matter of days".

G.Diezins, A.F.I.

VN: We are open to negotiations, we lack only Russian interest.

According to the *VN* report, total fixed assets and non-material investments related to oil transportation through Ventspils are evaluated at about 16 million lats. *VN* largest shareholders are *LNT* and the Latvian state.

KLAIPEDA PORT LEADS IN CONTAINER CARGOS

Regardless of the decline in overall cargo turnover, Lithuania's Klaipeda port on the Baltic Sea still leads other Lithuanian, Latvian and Estonian ports by the number of containers processed. In eight months of this year, Klaipeda port reloaded 106,800 TEU, a 34% growth on a year-to-year basis.

Latvia's Riga port, which was the leading Baltic port by eight-month results last year, this January-August reloaded 106,200 TEU, up 27% from the same period in 2003.

REAL ESTATE ATTRACTS AUSTRIANS

The largest Austrian realty group *Immofinanz* is planning to invest around 50 million euros in Baltic real estate market, Latvian business daily *Dienas Bizness* reported.

"I think we have to start working in the Baltic market as well. Mostly we invest in various segments of commercial properties and a little bit in the apartment market too, but new market investments in housing projects is not our priority," said *Immofinanz Corporate Finance* executive director **Edgar Rosenmayr**, who recently visited the Baltic states.

T.Strakhova

IMMOFINANZ: We plan to invest in Baltic states about 50 million euros.

"I can't say that you have very many objects for investment, and that the Baltic states could be overfilled with foreign capital. It would be easier to find the right direction for investment here compared to Prague, for example, where lots of foreign capital flowed in and that caused the real estate prices to rise. Investments there might not justify", he said.

"In Riga we see greater prospects in the trade-sales areas. In other Baltic states the investment opportunities are more scattered among various types of commercial properties, e.g. it would be logistics and sales facilities in Tallinn while office and logistics facilities seem to be the main investment opportunities in Vilnius", said Rosenmayr.

CLAIM BY BANKA BALTIJA LIQUIDATORS REJECTED

The Stockholm regional court in early September rejected the claim by liquidators of Latvia's bankrupt *Banka Baltija* against its former auditors *Coopers & Lybrand* (now *PricewaterhouseCoopers*) for compensation of SEK 2 million (LVL 142.2 mln) in damages.

DENMARK BANS BALTIC HERRING FROM LATVIA

Denmark has banned Latvian fishermen from unloading at Danish ports Baltic herring meant for human consumption, claiming high dioxin contents in the Baltic Sea catch. The ban was introduced at the beginning of July and applies to all nations hauling fish in the southern Baltic Sea.

Latvian Fisheries Industry Association (LFIA) president **Inarijs Voits** suggested that Denmark had introduced the ban for its own economic reasons, as Denmark consumes plenty of fish meal used for feeding cattle and etc. "After the Baltic states joined the EU, the Danes felt that competition was growing tougher as growing amounts of products were imported to the EU. It does not suit them that Baltic herring is imported for human consumption purposes because the vast local industry processes Baltic herring into fish meal used to feed chicken which later on are consumed by people. This is a profitable business which amounts to several hundred thousand tons of fish meal a year".

G.Diezins, A.F.I.

INARIJS VOITS: Latvian Fisheries Industry Association has filed a protest.

The Latvian Fisheries Industry Association has filed in the European Commission a protest against the Danish ban.

3G MOBILE COMMUNICATIONS

Lithuania, Belarus, Poland, Russia and Latvia at an international meeting, which took place in Nida, a resort in Lithuania, late August reached an agreement on the frequencies for the third-generation (3G) UMTS mobile communications.

"We are happy that we have finally reached the agreement with Russia and Belarus as the armed forces of these countries use radars that can block the operation of 3G mobile communications network in neighboring countries," said **Mindaugas Zilinskas**, director of Radio Communication Department attached to the Lithuanian National Communications Regulatory Authority.

ESTONIAN CASINO OWNERS IN TROUBLE

The BC archives

TAAVI VESKIMAGI: There are too many gambling halls in Estonia.

Forthcoming increase in Estonian gambling tax from 5,000 kroons to 7,000 kroons per slot machine and from 15,000 kroons to 20,000 kroons per gambling table will wipe out of the market one-third of casino operators. As a result, the tourism business will suffer hard, said *Kristiine Kasiino*. In future, the amusement industry may leave small towns and the countryside altogether with the gambling places concentrating in the Estonian capital Tallinn, warned *Kristiine Kasiino* board chairman **Enno Heinla**. **"**In three years up to one-third of casino operators will go out of business," he said.

The plan to raise excise tax on alcohol and the gambling tax at the same time, coupled with higher port fees for passenger ships in the port of Tallinn, suggests that the Estonian tourism policy as such is changing, said Heinla.

Estonian Finance Minister **Taavi Veskimagi** is certain that the planned gambling tax rise will not affect the entertaining business in the country. At present, there are too many gambling halls in Estonia, he said.

OGRE KNITWEAR CO REPLACES LOSS WITH SHARES

Latvia's largest knitwear producer *Ogre* has made public its plans to decrease the company's registered capital by 5.836 million lats, replacing the loss in previous years with shares. The company's registered capital will be reduced from current 17.165 million lats to 11.329 million lats by reducing a share value from one lat to 0.66 lats. The shareholders are still to vote on this proposal.

COUNTRY MUSIC FOR EVERYONE

Every year, usually at the end of summer, a great music festival is organized in Lithuania. Visitors can be lost in fascinating air of songs and dances originating from Anglo-Celtic ballads, songs by Wild West farmers and cowboys, as well as from Slavic and Lithuanian quadrilles with roots going down to ancient history and culture of about every nation.

Each year Lithuanian country music capital Visaginas for two days forgets about its "nuclear" mission [Visaginas is populated mostly by the staff of the nearby Ignalina Nuclear Power Plant — Ed.]. Over ten years the *Visagino Country* festival has evolved from an obscure event into one of the most prestigious European festivals, featuring only true world country music stars. The artists' fees now reach 40,000 litas (over EUR 10,000).

V.Bogdanovich

ROLANDAS PAKSAS: Lithuanian politicians are not going to miss any country's music festival.

This year among foreign participants in the festival were groups from Germany, Luxembourg, France, the US and Canada, the UK, Norway, Poland and Russia.

INSURED AGAINST EARTHQUAKE

On September 21 when Lithuania was suddenly shook by earthquake tremors with the epicenter in the neighboring Kaliningrad region, the Russian exclave in the Baltics, only few companies felt fully protected. These were *Mazeikiu Nafta* oil refinery, *Snaige* refrigerator plant in Kaliningrad, *Dvarcioniu Keramika* ceramic tiles producer and a couple of other companies. They had insurance contracts covering damages from earthquake, quite an unusual natural threat in the Baltic region.

LITHUANIAN BATTERIES: MADE IN CHINA

The BC archives

SIRIJUS: Russia still remembers this trademark.

Klaipeda-based Lithuanian dry-cell battery plant *Sirijus* that went bankrupt several years ago was bought by *Baltijos finansu vystymo grupe,* which decided, first, to rename it into *Naujasis Sirijus*, and, second, to move battery production to China for economic reasons. The decision was quite rational and clever, and now company shareholders are ready for another unexpected turn in the company strategy, i.e. this fall the company would launch in China production of electric household appliances (tea kettles, irons, vacuum cleaners) for the Baltic and Russian markets.

Russia still remembers the *Sirijus* trade mark; therefore, it has been picked as the destination for the first big trial batch of electrical household appliances straight off the conveyor belt in the Chinese plant. The company has selected as its main target consumers with low income as none of the products will cost more than 100 litas. *Naujasis Sirijus* will send its Chinese-made products also to other markets important for the company — Latvia and Estonia. Until recently, the Baltic neighbors received 40% of the Lithuanian company's output, i.e. dry-cell batteries, electric light bulbs, extension cords and flashlights.

OPTIMISTIC FORECAST

Lithuanian hardware and software wholesale market is likely to grow by 20% this year to some 635-700 million litas, according to forecasts by leading market analysts. "Sales should rise due to tax reliefs introduced for the growing market of household users and increasing corporate investments into information technologies," said **Vytautas Stunzenas**, director of *GNT Lietuva*, one of the largest Lithuanian IT wholesalers.

Ailing sides of Baltic economy

By Olga Pavuk

Shadow economy — a topic that used to be so popular in the 1990s and early 2000s — is now itself retreating into shadows. According to national statistics, the share of shadow economy in the Baltic states' GDP has been decreasing rapidly in the years preceding the EU accession. In fact, experts have different opinions on the matter.

LATVIA: CORRUPTION ON ALL LEVELS

Since 1993 shadow economy effects in Latvia have been analyzed both by the Central Statistics Office (CSO) and the Finance Ministry; the latter's assessment was very much different from the official statistics. The Ministry's latest analysis of the matter was carried out in 2001; after that the CSO started using analogous system for assessing shadow economy. By 2001 its volume in Latvia had been reduced to the level of 1993-1994, amounting to 23.2% of GDP. Current official statistics show a further decline to 17% of GDP.

It should be noted that, according to results of the European Commission study "Shadow Economy in the Enlarged EU", Latvia had one of the highest shadow economy rates among the EU member states in 2000 at 18% of GDP (somehow, the Latvian Finance Ministry's estimate was at 27.4%).

Well-known Latvian economist, Ms. **Raita Karnite**, believes that shadow economy in Latvia accounts presently for some 30% of GDP. "It's just my assumption and it isn't based on any specific facts but I believe it reflects the real situation. I think that most of the shadow economy today is made up of wages paid in envelopes [unofficial cash payments slipped to workers in envelopes to avoid taxes — Ed.]," she said. The expert also presumed that the falling share of shadow economy could be one of the reasons behind steep economic growth in Latvia.

"Local companies expand their business and production at ever increasing rate. They have also been cooperating with Latvian banks more extensively, both in taking loans and seeking the EU funding. For these reasons, they have to make their accounting more and more transparent, and this leaves less room for shadow economy," said Ms. Karnite. She expects further decline of shadow economy in future because business taxes are comparatively low so far and local business people have a different set of mind than businessmen in Russia or Italy where shadow economy is a kind of lifestyle. "The more businesses cooperate with banks and claim EU funds, the faster shadow economy's share will shrink," said the economist.

"Latvia hasn't seen a shadow economy upsurge like the one early this year for several years," said *Neatkariga Rita Avize* daily Deputy Editor-in-Chief, **Juris Paiders**, who has been studying shadow processes in the country for many years.

"Today this phenomenon can be observed at its absolute scope. Let's compare official monthly wage in the last quarter of 2003 (147 lats) and in the first quarter of this year (140 lats). The downward trend is obvious. But here's the paradox — retail trade turnover did not go down. On the contrary, it increased sharply. It signals that businesses are not compensating for the price growth legally, through official wages. Thus, the private sector could not compensate for the inflation this year by raising official wages. It means simply that the price growth was set off by rising shadow economy. If an employer pays a worker a net wage of one lat, he has to pay about the same amount in taxes. If he pays wages from shadow turnover, he saves a lat on taxes," said Mr. Paiders.

He also gave an example of shadow economy growth: "Until recently, there were three farms in Latvia which brewed homemade beer. They brewed beer in small amounts, few hundred liters a month, and the turnover was some 2,000 lats a year. When the new EU rules took effect, when one had to pay 500 lats for a license and also make a deposit of 2,000 lats, only one such brewer remained on the market. The other two now make beer only for themselves and their friends, or so they claim. It is a very alarming signal indicating that production has simply become unprofitable today. Of course, not all small and medium-sized enterprises will go shadow but the shadow share in a small Latvian company will increase considerably, with exception of monopolists and successful businesses which pay all taxes and have the highest profits in the country."

It has to be taken into account that Mr. Paiders does not regard smuggling as part of shadow economy. He thinks that one should look at the tax system for reasons underlying shadow turnover growth. "The upsurge of shadow economy is due to, firstly, individual businesses being taxed twice the amount levied on limited liability companies. Secondly, meeting formal requirements of legal employment is beyond economic capacity of a small business (as in the case with beer brewers). As to combating shadow economy, its economic pre-conditions need to be tackled first," said Mr. Paiders. "It's a pity that the fight against shadow economy in our country stalls over stubborn refusal or unwillingness to understand what exactly we have to fight. Under the government led by Prime Minister **Einars Repse**, we fought consequences by exposing unofficial wages in envelopes. Repse was imitating the fight. Those efforts were just for showing off. One should have looked into the causes of the problem and studied the origins of the process..."

Corruption is another dark side of shadow economy. So far there has been a lot of talk, but very little action. "Organized crime, corruption and robbery of the state have risen to a dangerously high level.... We have to do everything to stop it," Latvian Interior Minister **Eriks Jekabsons** announced after a regular meeting with Prime Minister **Indulis Emsis**. Mr. Jekabsons recognized that corruption in Latvia was apparent at all levels, i.e. political as well as economic and social.

LITHUANIA: SOME TAKE, SOME GIVE

A survey "Manifestations of Corruption in Selected Counties and Municipalities on a National Level in 2004" conducted by Lithuanian branch of *Transparency International* and carried out this June showed that during last 12 months 18.4% Lithuanian residents have had encounters with the Traffic Police and 9% of respondents had bribed traffic cops. It means that every other driver, who has violated traffic rules, made pay-offs to the police. The situation with medical services is similar: 76.2% of respondents had sought medical advice and 31.5% had paid doctors "unofficial fees".

Most surprisingly, survey results cast a shadow of corruption over higher education establishments as 6.9% of respondents had dealt with these institutions during last year and 1.9% or every third student had made unofficial payments to lecturers.

Corruption is traditionally high among customs officers, in courts and cases concerning real estate proprietary rights' restitution. Mr. **Alexander Dobrynin**, an expert of the Lithuanian branch of *Transparency International*, pointed out that corruption is not a one-sided phenomenon: "Some people take bribes, but there are also those who give". When the respondents were asked whether they would pay a bribe, if they had to settle a similar problem in future, 82.4% said they would pay the traffic cops and 40.8% would pay doctors "under the table".

According to the Lithuanian Department of Statistics, shadow business makes up one-sixth of the Lithuanian economy. In 2002 shadow economy in Lithuania was estimated between 15.2% and 18.9% of GDP. In comparison to 1995-1996, the share of shadow economy not reflected in the tax system has slightly decreased from 19.1% at that time.

In 2002 about 14.3% of profit in the non-financial business sector was not declared. The lowest rate of undeclared income was observed in the energy industry (1.8%) while the highest rate was in fisheries (50%). Forest industry has managed to hide from the state 35.6% of profit, personal services sector 32.9%, textile industry 25.2%, printing industry 17.8% and furniture producers 15.4%.

There were about 104,000 unregistered paid workers, mostly in construction (23%) and processing industry (23%) as well as in agriculture, hunting business and tree-logging (20% each).

As to concealing wages to paid staff, income of nearly one-fifth (23%) of all officially and unofficially hired workers remained undeclared in 2002.

Lithuanian Prime Minister **Algirdas Brazauskas** believes that shadow economy is a problem common to all post-Soviet countries and the trend still persists also in Lithuania: "The fight against corruption and shadow economy is one of the most important tasks of the Lithuanian government", he said.

ESTONIA: SHADOW ECONOMY PROVIDES JOBS

Investigation unit at Estonian Tax and Customs Department in the first half of 2004 has brought before the court 95 persons accused of smuggling and tax crimes. Damages caused by the offenders exceed 100 million Estonian kroons. According to the Department press secretary, in the first half of this year the tax administration has sent to prosecutors' offices 74 criminal cases (on 135 counts involving 95 suspects). Investigators have estimated the pecuniary damages to the state and potential damages at about 122 million kroons. At the end of June there were 121 criminal cases on the record at the national tax administration.

In September the Tallinn City Court completed first proceedings in Estonia on money laundering charges. The court found **Denis Belyakov**, 31, and **Andrei Mikhailov**, 32, guilty of money laundering in large amounts and tax fraud and sentenced them to five years in jail, of which three years they will spend in prison. For the rest of the term, it will be a suspended sentence plus a three-year probation period. The convicts will also have to reimburse 100,000 kroons loss caused by their actions and transfer to the State Treasury 12.409 million kroons through the Tax and Customs Department. Other defendants in the case were given suspended sentences for tax crimes. According to the indictment, the accused were selling in Estonia fuel smuggled into the country from Russia and thus caused some 12 million kroons of losses to the state in unpaid taxes. Belyakov and Mikhailov started their illegal activities in 2001 by buying an off-shore company and hiring fictitious persons as the company managers.

Olev Laanjarv, official in Lasnamae district in Tallinn, estimates the annual share of shadow economy in 2003 around 25-35 billion kroons: "The money is spent on consumption, helps to create jobs and provide investments but it is not reflected in the GDP statistics. Our politicians have to decide whether the national economy needs this money or it should be completely excluded from the turnover together with other shadow features."

Interviewed by the Russian-language *Molodezh Estonii (Estonian Youth)* newspaper, Mr. Laanjarv said: "When watching processes under way in the world, one realizes that Estonia cannot be an exception. The British estimate their shadow economy share at 15%, Germans at 8-12%, French at 13-18%, and Spanish at 16-22%. In the EU the average shadow rate is 7-19% but in Eastern Europe the figure is higher and varies from 15% to 38%. The estimate for Estonia is 25-35%".

Mr. Laanjarv believes that shadow economy produces values and gives jobs to many people. There are up to 100,000 of such workers in Estonia, and their wages total 500-600 million kroons. No social or income taxes are paid from this money but it is used for consumption which in its turn helps to feed small businesses, improves collection of indirect taxes and lightens the burden of the state in maintaining people who couldn't find for themselves jobs in the "official" sectors of economy. Once the shadow economy is done away with, quite many of its products will be gone too, causing certain social tensions.

Shadow economy can't be just destroyed. Conditions have to be created to make the illegal sector interested in legalizing itself. In other words, growth in the legal sector must be faster than in the illegal one. Both people and money are to be motivated to move to the legal side of the economic development. It should be taken into account that the countries which had set out to combat shadow economy with inappropriate measures only made it larger in the end. In essence, shadow economy looks like a malignant tumor and any attempt of swift interference can only provoke its further growth. •

Gazprom

Age of “blue salvation”

By Mikhail Tuzhikov
Baltic correspondent, Transport Rossii

Gas has penetrated into almost all spheres of human activity, persistently pushing aside other types of energy resources. Environment-friendly “blue fuel” now feeds household gas cookers, furnaces of heat energy plants, turbines of sea vessels and river boats, car engines; it is also used as raw material in chemical industry. Many countries in the world have become dependent on this cheap fuel but only few have gas fields. The “blue gold” reality is here to stay.

HOW MANY AND HOW MUCH?

The growing share of gas in the energy consumption is due to its low price as compared to other types of fuel, attractive qualities such as being an easily controllable and reliable fuel as well as increasing capacity of gas power plants, rising household consumption, diminishing popularity of nuclear energy and corresponding environmental considerations.

According to estimates by the International Gas Union as of January 1, 2004, known world natural gas reserves in 80 countries with gas fields on their territory amounted to 172.1 trillion cubic meters or 70 times more than the current production level.

Top ten “blue gold” countries in the world (in trillion cubic meters): Russia — 47.6, Iran — 26.6, Qatar — 25.8, Saudi Arabia — 6.8, the United Arab Emirates — 5.9, USA — 5.3, Algeria — 4.5, Nigeria — 4.5, Venezuela — 4.2, Iraq — 3.1. These countries together own 78% of world gas reserves.

World gas production has increased 13 times since the beginning of the 1950s. Experts expect gas to make up 30-50% of the world energy balance by the middle of the 21st century. In opinion of the EU experts, gas consumption will double already by 2020 and the percentage of gas used in electric power production will grow from 20% in 1997 to 30% in 2020. And liquefied natural gas is likely to become the most perspective sector in the gas industry as the fourfold growth of the market from present day is anticipated.

Meanwhile depletion of off-shore gas fields in the North Sea that belong to the Netherlands, Norway and the United Kingdom will lead to increased dependency of Western and Central Europe on gas import — it is expected to double, reaching 66%. Social consequences of such reduction in gas production have to be considered too. Norwegian experience in developing North Sea gas fields has shown that one worker in oil-gas industry provides employment for 10-12 jobs in related industries (chemistry, engineering, communications, transport, food industry, etc.).

Presently, gas supply on the European market is still higher than demand but the situation is going to change after 2010. Gas resources’ deficit in the region is likely to stay, and Russia (as represented by *Gazprom*) as well as Algeria and Norway will retain their dominant position as major gas suppliers. For a number of historical and economic reasons as well as its geographical position, *Gazprom* is the leading monopolist in Central and Eastern European markets. Suffice it to say that Russian gas deliveries cover presently almost 100% of natural gas consumption in the Baltic states.

The price for “blue energy”, as well as for “black gold” — oil, is constantly growing. In 2001 gas prices in Russia — the world’s greatest superpower by gas reserves — was USD 16 per 1,000 cubic meters, by 2010 the price will reach USD 59-64 in estimate of the Russian Federal Energy Commission. For the record: gas production price at the site of the wells in Yamal region in Russia is about USD 4 per 1,000 cubic meters. Today the difference between Russian gas sales prices in the Russian Federation and the European countries is fivefold — USD 19.8 and USD 100.4 per 1,000 cubic meters respectively. With excise tax and customs duties it will be USD 130. As a result, gas price in the EU is more than 2.5 times higher than the coal price and slightly lower than the oil price. So far Baltic states have been getting Russian gas at a favorable price — around USD 40 per 1,000 cubic meters.

BALTIC STATES FALL INTO EUROPEAN DEPENDENCY

The Baltic states which recently joined the EU have also fallen into the all-European dependency on Russian gas deliveries, although gas consumption is being constantly increased. Latvian gas utility *Latvijas Gaze* president **Adrians Davis** has estimated that gas consumption in Latvia could reach 2.6 billion cubic meters in 2015 (in 2003 Latvia imported a total of 1.9 billion cubic meters of natural and liquefied gas), Lithuanian gas consumption is likely to reach some 7 billion cubic meters (from 6.25 billion cubic meters in 2003) and Estonian gas consumption will grow to 1.5 billion cubic meters (from 1.25 billion cubic meters last year).

Baltic gas industry is controlled by Russia's *Gazprom* and the ITERA international business group (in which 46% of shares are held by *Itera Group NV* registered in the Netherlands Antilles). *Gazprom* is the sole natural gas supplier to Lithuania and together with *ITERA* also provides gas delivery to Latvia and Estonia.

LATVIA'S SPECIAL STATUS

Latvian gas market has been monopolized by *Latvijas Gaze* (share capital is divided into 39.9 million shares). *Latvijas Gaze* largest shareholders are *Ruhrgas Energie Beteiligungs AG* (35.6%), *E.ON Energie AG* (11.5%), *Itera Latvija* (25%), *Gazprom* (25%). Minority shareholders jointly hold 2.9% and the Latvian government 117 shares.

Every year *Gazprom* delivers to Latvia about 1.15 billion cubic meters of natural gas, and so far Latvians pay for it three times less than many European states. This is explained by geographic proximity, existence of a united gas supply system in the former territory of the Soviet Union and favorable for Latvia natural gas rates.

"Latvia enjoys a special status due to its strategic facility, i.e. Incukalns underground gas storage", said *Gazprom* deputy board chairman **Alexander Ryazanov**. *Itera Latvija Co.Ltd.* President **Juris Savickis** expressed certain pessimism: "Prices in Latvia will level up with European prices. And then our people will definitely have to pay more for gas. For now Russia certainly sells gas to us at prices lower than in the EU".

ESTONIA AIMS AT FINLAND

Largest shareholders in the Estonian gas concern *Eesti Gaas* are Russia's *Gazprom* (37%), Germany's *Ruhrgas AG* (32.3%) and Scandinavian *Fortum Oil&Gas OY* (17.7%). *ITERA* holds 10% of shares of *Eesti Gaas*.

The Estonian company plans to build an underwater gas pipeline across the Gulf of Finland to start selling gas to Finland. The throughput of the pipeline will be 700 million to one billion cubic meters a year. At present *Eesti Gaas* is conducting a technical and economic feasibility study of the project and is also studying the Finnish demand for natural gas. The construction of the gas pipeline will begin presumably in 2007. *Eesti Gaas* management has said that the new pipeline will allow to make more use of Estonia's gas pipelines and also to use gas reservoirs in Latvia for deliveries to Finland. Once connected to the Estonian gas line, Finland will become less dependent on Norwegian gas suppliers.

LITHUANIA EXTENDS CONTRACT WITH RUSSIA

In summer 2004 *Gazprom* bought from the Lithuanian government 34% of shares in Lithuanian gas utility *Lietuvos dujos* (Lithuanian Gas) for 100 million litas. Germany's *Ruhrgas* which acquired 34% of the company's shares two years ago is seen as the strategic investor in *Lietuvos dujos*. After the deal with *Gazprom*, the Lithuanian government holds 24.36% in *Lietuvos dujos*; *Ruhrgas* and *E.ON Energie* jointly hold 35.49% and another 6.15% of shares belong to small investors.

Gazprom

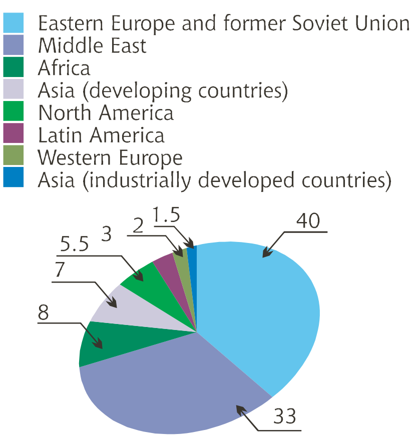
GAZPROM AND LIETUVOS DUJOS: Extending long-term gas supply contract for Lithuania.

In 2003 *Gazprom* delivered to Lithuania 3.012 billion cubic meters of natural gas and deliveries in 2004 are planned at 3.160 billion cubic meters. The long-term gas supply contract between *Gazprom* and *Lietuvos dujos* has been extended until 2015 at the price the parties have agreed to calculate based on the price formula connected to prices for alternative types of fuel.

The Baltic states have talked for a long time about the need to get rid of "the Moscow influence" by building a gas pipeline from Norway. Gradually they came to realize that Norwegian gas will be much more expensive than gas from Russia and gave up the idea. So, gas salvation era on Russia's part continues. At least for the time being ... •

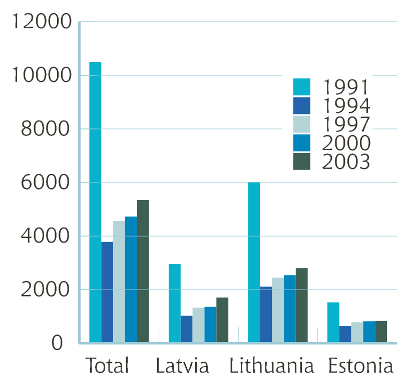
WORLD GAS RESERVES AS OF JAN. 1, 2004, %

Total – 172.1 trillion m^3



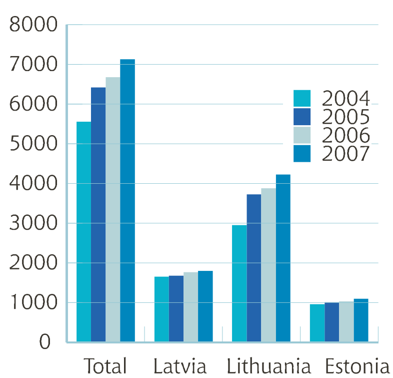
Source: Oil & Gas Journal.

NATURAL GAS CONSUMPTION IN THE BALTIC STATES*, MLN M^3

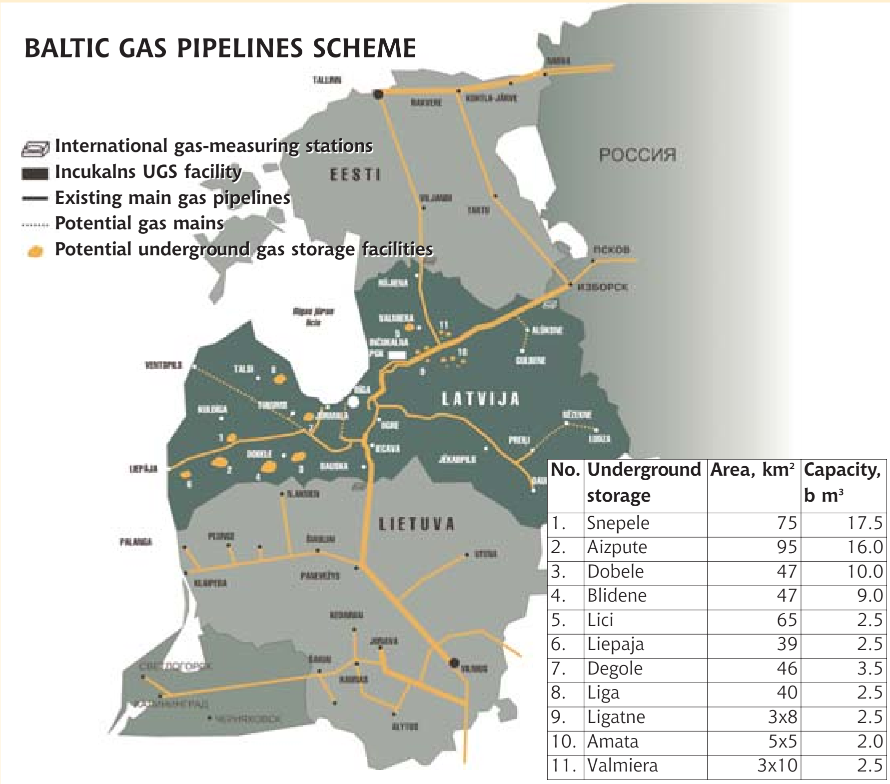


* Without liquefied natural gas consumption.
Source: Latvijas Gaze.

NATURAL GAS CONSUMPTION IN THE BALTIC STATES (FORECAST)*, MLN M^3



* Without liquefied natural gas consumption.
Source: Latvijas Gaze.



No.	Underground storage	Area, km²	Capacity, b m³
1.	Snepele	75	17.5
2.	Aizpute	95	16.0
3.	Dobele	47	10.0
4.	Blidene	47	9.0
5.	Lici	65	2.5
6.	Liepaja	39	2.5
7.	Degole	46	3.5
8.	Liga	40	2.5
9.	Ligatne	3x8	2.5
10.	Amata	5x5	2.0
11.	Valmiera	3x10	2.5

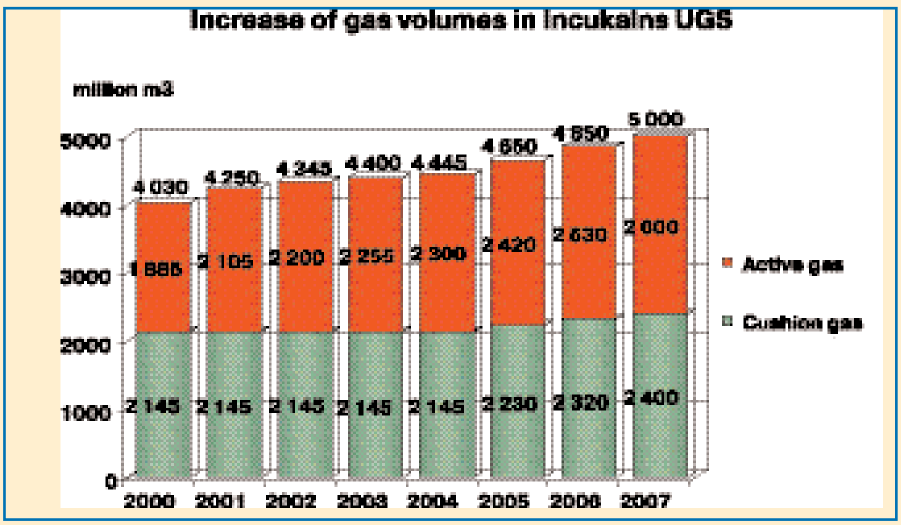
European

By Natalya Vostrukhova

The Incukalns natural gas storage facility is situated just few dozen kilometers off the Latvian capital Riga. Approaching the facility, one can see a small but very well-kept site of a modern factory.

On a hill-side covered with immaculate British-style lawn rises an accurate grid of pipelines with a complicated system of various pipe interconnections, special installations forming a huge gas pumping and cooling system and wells. But every unit in this "gas-plant" is an element of a complicated installation chain. The Incukalns facility is a modern technological complex of ground (visible) and underground (invisible) equipment. For example, functional wells and the equipment controlling gas transmission under the ground are scattered for many kilometers around the central facility site. A team of about 120 experienced professionals is engaged here, serving the Latvian "gas field", as the locals call the place. There's no doubt that they are top-class experts with adequate special training.

The Incukalns is a unique European underground storage facility created by nature itself. Deep in the ground there are reservoirs filled with natural gas to accumulate reserves for the winter season when gas consumption increases 4-5 times as compared to summer time. Latvia is one of few countries in the world which during the cold season of the year can use its own "basement storage" to satisfy both local demand in natural gas and also supply it to the neighboring countries. "Blue fuel" from outskirts of Riga is delivered to Latvian, Estonian and Russian consumers: during last winter season Latvian gas utility *Latvijas Gaze* transported gas from Incukalns storage to Estonia, Pskov and Novgorod regions in Russia and to Lithuania. When Russia stopped gas supplies to Belarus, the deficit was covered from Latvia. So, uninterrupted heat and energy supply can be ensured for neighbor-



reservoirs in Latvia accounts for about 70 billion cubic meters.

STORAGE FACILITY'S LAYOUT AND SAFETY MEASURES

Incukalns is not just one of the largest gas storage facilities but is a strategic gas supply component of the Baltic Sea region and north western Russia, as well. As a site of such great importance, the Incukalns is being developed in line with the European standards under watchful eye of Western and Eastern gas industry experts. The facility and situation in the underground gas reservoirs are monitored by both local and foreign specialists from Russian institutes *VNIIGAZ* and *Giprospetsgaz* and German companies *Pipeline Engineering GmbH, Untergrundspeiher und Geotechnologie – Systeme GmbH.*

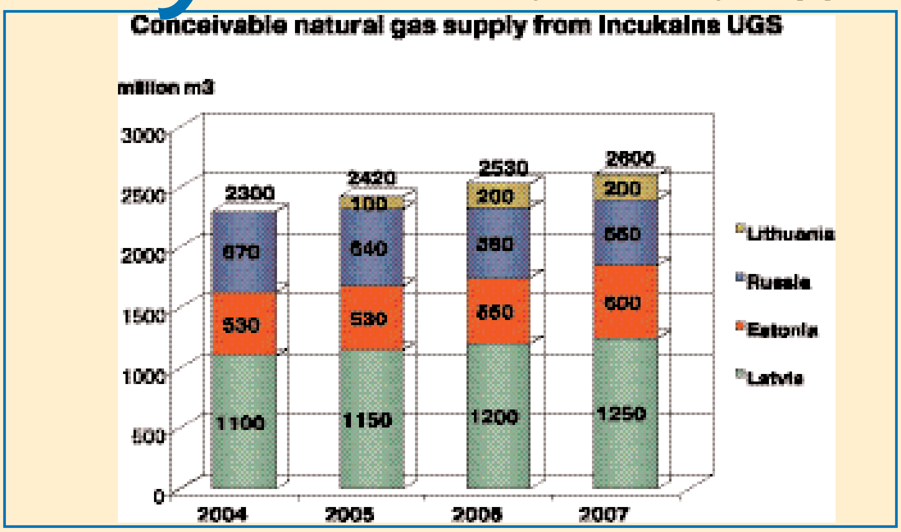
From environmental point of view, these safety concerns at Incukalns are understandable. But there are reasons why the facility poses no threat to environment. Gas is being kept not in any man-made containers but in pores of a hat-shaped 50-meter thick sandstone layer, protected from all sides by gas-impermeable layers of clay. There isn't any oxygen concentration there and gas ignition at such great depth is just impossible. White Cambrian sandstone forms a natural underground reservoir at 600-800 meters beneath the surface. Underground water filling up the sandstone structure is displaced by gas being pressure-pumped in; afterwards these waters displace gas when it is to be pumped out to the surface.

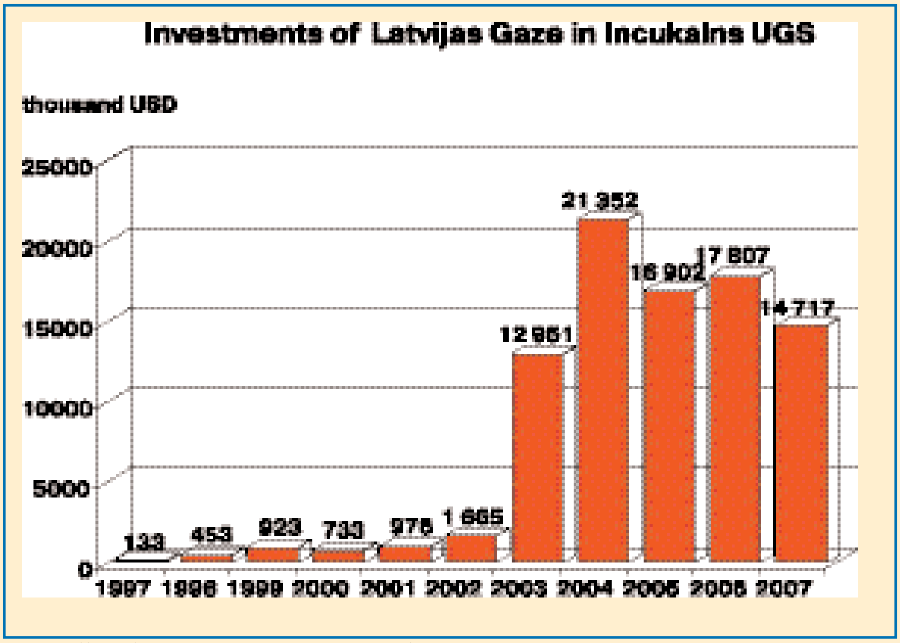
Gas is being pumped into the porous sandstone layers and removed from it by means of special ground and underground technological equipment.

gas depository

ing countries due to the existence of the Latvian gas depository.

According to expert estimates, Incukalns can hold twice as much gas than Latvia can consume in a year. The facility's current capacity is 4.4 billion cubic meters, of which 2.1 billion is cushion gas (untouchable reserves) and 2.255 billion active gas for current consumption. *Latvijas Gaze* expects gas consumption to grow in future both in Latvia and other Baltic states therefore the company is reviewing possibilities for expanding gas storage facilities. A study revealed that Incukalns can receive totally up to 6 billion cubic meters of natural gas; half of the amount will be in "active status". Potential storage of 11 other natural gas



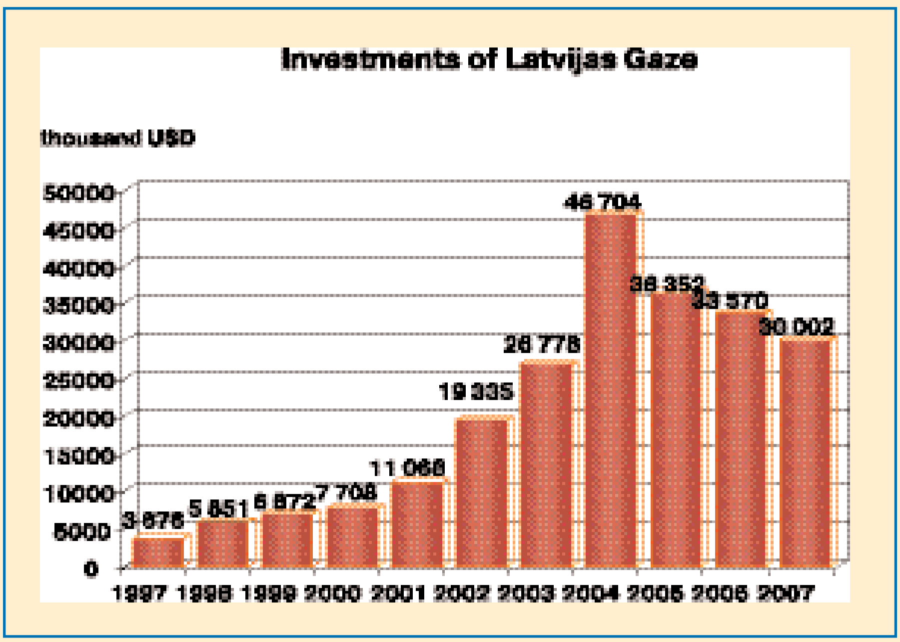


measured again. Only after these manipulations gas is transported into the main gas line and further on to consumers. It should be mentioned that through 36 years of Incukalns' history there hasn't been a single emergency situation there. In addition to specific safety systems at all technological installations, the Incukalns is a closed and strictly guarded territory.

TECHNOLOGY MODERNIZATION

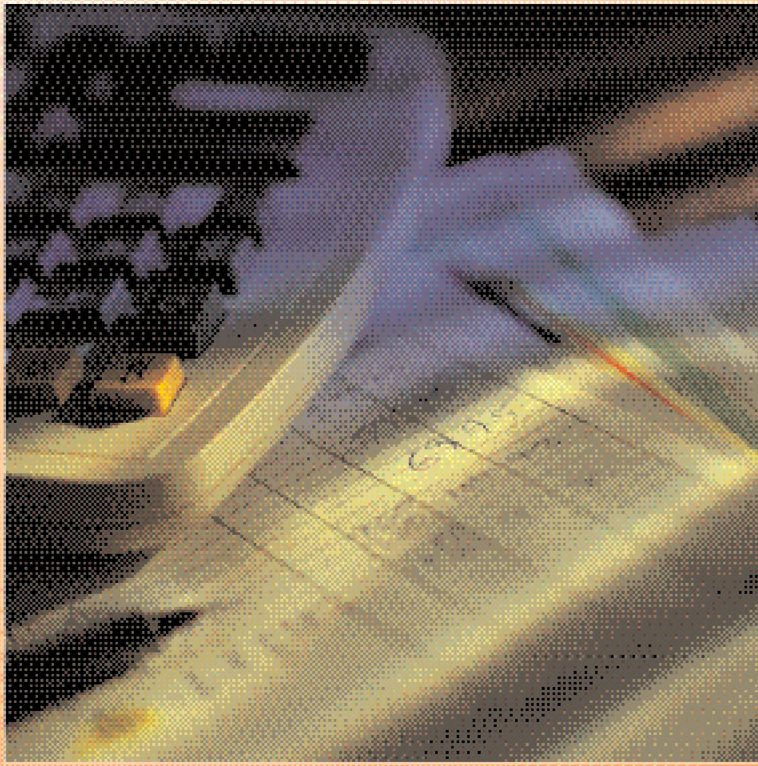
Acquisition, storage, transportation and sale of environment-friendly fuel — these are the main business perspectives of *Latvijas Gaze*. Therefore making Incukalns underground storage facility a part of the joint Baltic, Russian and European gas supply complex is seen as a priority. For this reason the company has developed and approved a new development project and has also planned much larger investments for Incukalns.

Naturally, the process is not simple. During the pumping-in procedure gas is cleared of all unwanted particles and measured. At the compression station gas is pressured three times and brought up to the level required for pumping in, which is about 105 bars. During this process gas temperature is rising and therefore gas needs to be cooled off in a special pipeline system after each pressurized phase. Only then special gas collectors distribute it evenly between 93 operational wells (there are as many as 180 wells but about half of them are in a stand-by position) through which gas passes into the reservoirs. At the peak periods in gas consumption it is extracted from the reservoir, depressurized, dried, filtered and



Over 70 million US dollars will be invested in order to upgrade the existing gas supply systems and safety arrangements in the whole Incukalns facility; last year USD 13 million were spent on that. Some efforts will continue to install a stand-by compressor, to renovate existing gas compression station, wells and all relevant units for pumping in or removing gas. Renovation of the operational management and that of the control center would provide modern supervision of the whole technological process at the Incukalns facility. This will further improve safety of the facility and stability of gas supplies. Upon completion of the investment project in 2008 the Incukalns gas underground storage facility will meet all European standards. Nevertheless, *Latvijas Gaze* will keep investing in safety and stability of gas supply in the region. •

WELCOME!



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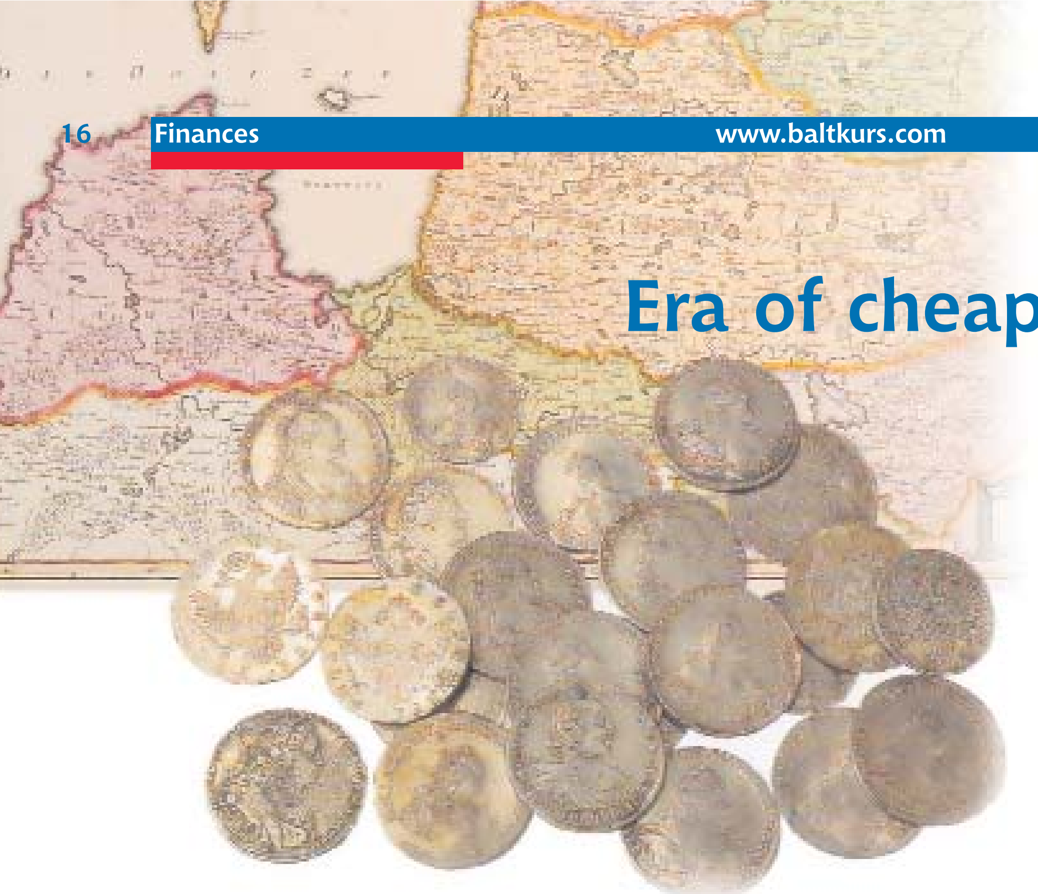


Era of cheap loans is gone

By Olga Pavuk

In mid-2004 interest rates fell for long-term deposits in Baltic credit institutions and grew for short-term deposits. Latvian deposit rates still remain the highest among the Baltic states. Bankers predict gradual decrease of mortgage lending and growth of loan rates in the Baltics. As lending grows steadily, increasing number of borrowers find they are unable to make regular payments in due time.

In Latvia, there are 22 commercial banks, and a branch of a foreign bank. Lithuania has 10 banks and 2 foreign bank branches, and Estonia 6 banks and one foreign bank branch. During first seven months of 2004 Baltic banks' total assets in euros have grown by 15.8% or EUR 3.39 billion to EUR 24.86 billion, according to *Latvijas Unibanka* report.

LATVIA LEADS BY DEPOSIT RATES...

According to the Latvian Central Statistics Office, the average weighted annual interest rate on long-term deposits made in Latvia in national currency this June was down 0.7 percentage points from June last year and also fell 0.6 percentage points on a year-to-year basis. Lithuanian rates this June were at 3%, flat month-on-month but down 0.6 percentage points from June 2003. In Estonia the rates dropped 0.1 percentage point from May to 2.2% in June but lost one percentage point as compared to June last year.

The average weighted annual interest rate on short-term deposits made in Latvia in national currency this June was 3.4%, rising 0.4 percentage points both from May and June 2003. The Lithuanian rates were at 1.1%, up 0.1 percentage point from May but down 0.3 percentage points on a year-to-year basis. Estonian rates in June were on the April level of 2.7%, up 0.6 percentage points from June but down 0.4 percentage points from June last year.

Two Lithuanian commercial banks, *Sampo* (which belongs to the Finnish banking group *Sampo)* and *Hansabankas* (a member of the largest Baltic financial group *Hansabank)* increased rates on USD deposits in September. The interest rates were raised due to changes on the market, and the upward trend of rates on deposits and loans in the US dollars will continue in future, said *Sampo* bank. *Sampo* will pay 2.1% interest on one-year deposits in US dollars, up 0.6 percentage points from a year before; *Hansabankas* increased the rate by 0.5 percentage points.

Representatives of other Lithuanian commercial banks announced that they have not yet decided about raising their rates on USD deposits. According to the Lithuanian central bank, term deposits in US dollars made by Lithuanian individuals and corporate bodies (including commercial banks and other financial institutions) totaled 3.75 billion litas at the end of July.

... AND LOAN RATES, TOO

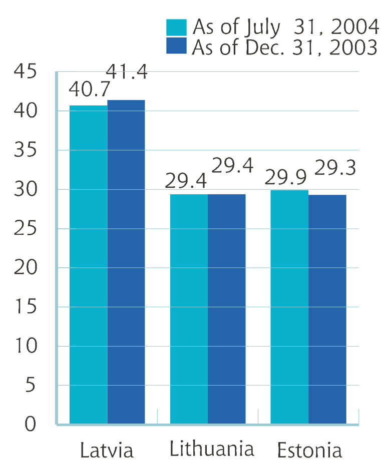
Loan rates in Baltic credit institutions moved in different ways in June but Latvian rates still remained the highest in the region, the Latvian Central Statistics Office reported lately.

Thus, the average weighted annual interest rate on long-term loans in national currency this June was 8% in Latvia, rising 0.6 percentage points from May and one percentage point from June 2003. The Lithuanian rates were at 6%, up 0.1 percentage point from May and 0.2 percentage points from June last year. Estonian rates in June were 5.4% on average, down 0.2 percentage points from May but up 0.1 percentage point year-on-year.

For short-term loans in national currency, the average weighted annual interest rate in June was 7.5% in Latvia, unchanged from May but climbing 1.9 percentage points from June 2003. In Lithuania, the rate was 5.8%, up 0.3 percentage points from May and down 0.1 percentage point from June last year. The Estonian rate this June was 5.9%, down 0.4 percentage points from a month before and fell 1.2 percentage points from June 2003.

The average loan rate in Latvia is around 7-8%, but some banks offer rates twice as low, e.g. *NORD/LB Latvija* bank. The bank's analysts think that Baltic banks still have a large potential for lending growth as indicated by the low ratio of domestic loans to GDP which is well below the corresponding figure in the euro-area. In Lithuania this ratio is

BALTIC BANKING TOTAL ASSETS BY COUNTRY, %



Source: Unibanka.

25.2%, in Latvia 45.4% and in Estonia 59.7% but in euro-area countries this ratio is 160.5%. *NORD/LB* expert **Vadim Titarenko** predicts that interest rates on loans issued in the US dollars and euros will rise in future under influence by actions of the European Central Bank and the US Federal Reserve.

Total amount of loans granted by Latvian banks has increased by 716.024 million lats (23.9%) from the beginning of the year to total 3.717 billion lats at the end of July. Mortgage lending by Latvian banks has risen by 330.936 million lats (41.1%) since early 2004, including growth by 54.393 million lats (5%) in July, and totaled 1.137 billion lats at the end of the month, according to information from the Latvian Association of Commercial Banks. Mr. Titarenko expects gradual slowdown in mortgage lending growth. The growth forecast for 2005 is 40% in Latvia, 31.2% in Lithuania and 25% in Estonia.

Hansabanka is the Latvian market leader, boasting 109.556 million lats (42.7%) growth of mortgage lending in first seven months of 2004 to 366.109 million lats; its share of the Latvian mortgage loan market at the end of July reached 32.5%.

Latvijas Unibanka was the runner-up, having increased its mortgage lending by 39.614 million lats (27%) in seven months of 2004 to 186.367 million lats. Its market share is 16.4%.

Parex Banka is in the third place with a 43.303 million lats (52.6%) growth of mortgage lending in January-July 2004 to 125.576 million lats and takes 11% of the market.

These three banks jointly take 59.6% of the mortgage lending market. Out of 23 Latvian banks, only *Latvijas Tirdzniecibas banka* does not offer mortgage loans.

At the end of June 2004 *Hansabank* concern controlled 50% of the Estonian mortgage loans market. Its share of Lithuanian and Latvian markets was 30% and 24% accordingly. The credit portfolio has grown by EUR 1.41 billion or 37% year-on-year.

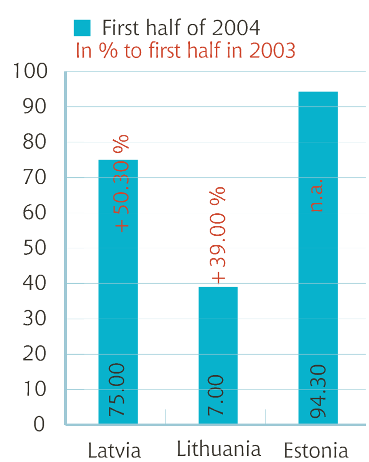
CENTRAL BANKS WILLING TO TAKE MEASURES

NORD/LB Latvija analysts think that rapidly growing lending in Latvia does not represent a threat to economic development. However, the Bank of Latvia experts hold a different view. “Borrowers in Latvia keep assuming additional risks in hope that currency exchange rate fluctuations in future will be smaller than the difference in interest rates. We have warned long ago about the consequences and likely losses from such actions, calling on people to avoid currency risk. Now this risk keeps rising: events in recent months show clearly that the era of low rates and therefore also of cheap loans is over,” Bank of Latvia president **Ilmars Rimsevics** said at a news conference in July.

Analysts expect rates on loans in the US dollars to keep growing towards the end of the year, said Mr. Rimsevics, therefore borrowers, who undertake additional currency risk, can no longer fully protect themselves against growth of interest rates.

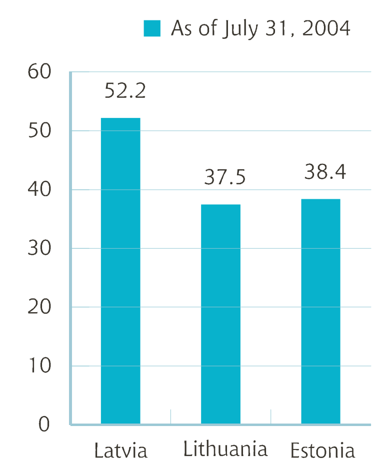
According to the Latvian central bank, in 2004 lending in Latvia has been growing every month, hitting a record-high rate of 42.8% in May. Amount of loans issued in foreign currencies has risen particularly fast — growth by more than 50% in May as compared to the same month in

PROFITS OF BALTIC COMMERCIAL BANKS, MLN EUR



Source: BNS.

BALTIC BANKS’ COMMERCIAL LOAN PORTFOLIO, GROWTH IN % TO 2003



Source: BNS.

NEW SIGNBOARDS FOR SUBSIDIARIES

In 2005 Baltic banks controlled by Swedish financial group *Skandinaviska Enskilda Banken (SEB)* will add to their names the abbreviated title of its largest shareholder — *SEB*. These banks will then be called *SEB Uhispank, SEB Unibanka* and *SEB Vilniaus banka*s, thus underlining their international status.

Similar plans have been made for the Vilnius branch of the German bank *Vereins- und Westbank* which will be renamed as *Hypo-Vereinsbank*.

SEB MOVES INTO UKRAINE

Vilniaus Bankas, the Lithuanian subsidiary of the Swedish banking concern *SEB*, has acquired over 90% shares in Ukraine’s *Bank Agio*. *Vilniaus bankas* paid SEK 200 million (LTL 76.3 mln) for the shares in the Ukrainian bank. *Bank Agio* assets total EUR 58 million (LTL 200.3 mln), and it ranks 53rd among Ukrainian banks. Acquisition of *Bank Agio* is part of the *SEB’s* ambitious plan to strengthen its positions in Northern Europe and meet the requirements of its business clients in Eastern Europe.

LATVIA’S *BIB* OPENS REPRESENTATION IN MOSCOW, LONDON NEXT IN LINE

Latvia’s *Baltic International Bank (BIB)* has opened its first foreign representation office in Moscow. More than 60 percent of the bank’s clients are non-residents, and *BIB* has also received a permission to open a representation in the United Kingdom which will be situated in central London. *BIB* co-owner and board chairman **Valery Belokon** said the bank was opening foreign representations to strengthen and develop relations with correspondent banks, regulatory and other institutions in foreign countries as well as to promote its name abroad. By assets at the end of July 2004, *BIB* ranked 20th among 23 Latvian banks.

TOUGH COMPETITION

Estonia’s *Sampo Baltic Asset Management (SBAM)*, owned by the Finnish financial group *Sampo*, has announced its plan to open a branch in Lithuania. Because of tough competition in the Swedish banking sector, *Sampo* will stay away from it, focusing instead on further development of its operations in Finland and the Baltic states, the group’s CEO **Bjorn Wahlroos** told *BNS*. In Lithuania, *SBAM* strategy is to take up a share of the market in long-term savings in cooperation with *Sampo* bank and *Sampo gyvybes draudimas* insurer.

GOOD BUY

The Lithuanian Competition Council in July approved the plan by the local branch of *Nordea Bank Finland* to take over part of assets held by the Vilnius branch of Poland's *Kredyt Bank S.A.* The Bank of Lithuania has already approved the takeover. *Kredyt Bank* has some 80 employees in Lithuanian capital and *Nordea* has a staff of some 50 people. According to the Bank of Lithuania, at the end of May 2004 the *Kredyt Bank* Vilnius branch had 450.3 million litas in assets, a credit portfolio of 344.5 million litas and held 64.5 million litas in deposits.

NEW NAME FOR OLD BANK

Latvia's *Baltijas Tranzitu Banka (BTB)* has changed its name to *Baltic Trust Bank*. No changes were made in the bank's management. *BTB's* president **Edgars Dubra** said the bank wanted to buy shares in some foreign banks either in the East or in the West. Founded in 1992, *BTB* ranks 12th among 23 Latvian banks in terms of assets as of late August this year. *BTB* largest shareholders are Latvia's *Finstar Baltic Investments* (49.8%) and Swiss company *Korowo Invest AG* (22.6%). Russian millionaire **Oleg Boiko** is a major co-owner of *Finstar Baltic Investment*.

SAMPO PANK BORROWS EUR 110 MLN

Estonia's *Sampo Pank* this October signed an agreement about a 110 million euros syndicated loan for a period of five years. The lead managers are *Soome Sampo Bank* and *Saksa NORD/LB,* joined by *NORD/LB Luxembourg S.A*, *Danske Bank*, *Helaba Landesbank Hessen-Thuringen* and *LRP Landesbank Rheinland-Pfalz* as managers, *Baden-Wurttembergische Bank AG* and *Erste Bank* as co-managers, and *Landesbank Saar* and *Banco Popolare di Verona e Novara S.c.r.l. London Branch* as participants. The loan was issued without any guarantees with the bank's general commercial operations serving as a security.

CARNEGIE BANK STARTS TRADING ON TALLINN STOCK EXCHANGE

Nordic investment bank *Carnegie Investment Bank AB (CAR)* started trading on the Tallinn Stock Exchange on October 25, 2004. *CAR* became a member of the Tallinn Stock Exchange this spring. All in all, the Tallinn Stock Exchange has 13 members, including five firms doing the trade from abroad.

LARGEST BALTIC BANKS' ACTIVITY, H1 2004, IN MLN EUR

	Assets	Capital and reserves	Deposits	Loans	Profit, June 2004
Latvia					
Parex Banka	1616.77	158.68	1325.37	841.91	9.07
Hansabanka	1595.81	149.43	1005.54	1163.92	19.45
Unibanka	1435.03	136.54	863.02	1177.69	12.11
Rietumu Banka	769.46	53.44	696.11	229.04	9.28
Aizkraukles Banka	142.04	35.27	457.46	149.83	5.78
Lithuania					
Vilniaus bankas	2702.76	172.17	1503.49	1520.85	17.64
Hansabankas	2014.66	164.39	1346.94	922.96	15.31
Nord/LB Lietuva	881.95	56.17	479.93	611.45	0.05
Bankas "Snoras"	585.45	60.26	252.11	111.88	3.01
Ukio bankas	403.61	33.02	211.10	62.91	1.47
Estonia					
Hansapank	7308.61	726.46	2150.50	2554.70	91.19
Uhispank	1889.46	216.20	987.49	1536.22	22.87
Sampo pank	524.09	36.74	294.35	384.49	3.46
Eesti Krediidipank	100.80	6.12	78.43	48.65	0.33
Tallinna Aripanga	30.87	7.66	16.51	13.08	0.20

Source: BNS.

2003. This is largely due to existing difference of interest rates on loans issued in the Latvian lats and foreign currencies.

In order to curb influence of various macro economic risks like high budget deficit, high inflation and foreign trade deficit on the national economy, the Bank of Latvia raised the re-financing rate from 3% to 3.5% in March. But the move did not have any considerable effect on the pace of lending growth. More and more borrowers chose to take loans not in lats, but in other foreign currencies, and that way the banks undertook the currency risk.

"When the re-financing rate was raised, the lat-denominated currency rates increased temporarily but returned to the previous level after sizeable influx of foreign currency to the Latvian money market," said the Bank of Latvia.

The Bank of Latvia decided in July to raise the mandatory reserve requirement for credit institutions to 4%. When asked about the expected effect of the move, Mr. Rimsevics said it could push up inter-bank rates, which would then increase loan rates accordingly. This step would make borrowers more cautious and help to bring down domestic consumption.

If commercial banks failed to respond, their profits would shrink because they need to transfer to the Bank of Latvia more funds on which they would get less profit than they could receive if the money was issued in loans. "It is also possible that we would have a little of everything — higher loan rates and lower bank profits," said the central bank president. He added that after raising the mandatory reserve requirement, several dozen millions of lats will be withdrawn from the economy and the rapidly growing lending will somewhat slow down.

The Bank of Latvia's head also voiced concern that higher mandatory reserve requirement might have diverse effects on banks in Latvia, considering that smaller banks relying on deposits as the source of funding will have more problems than banks using outside resources.

Mr. Rimsevics said this was the last instrument that the Bank of Latvia could use to put brakes on steep economic growth in the country, and the only thing that the central bank could do next was to further increase the mandatory reserve requirement. He said that the Bank of Latvia will keep watching the economic development and in absence of any result may introduce even higher mandatory reserve requirement. "It is the task of the Bank of Latvia to ensure stability of prices in the country," said the central bank president.

The Bank of Lithuania at the beginning of September lowered the capital adequacy ratio for commercial banks doing business in Lithuania to 8% from 10%. The central bank believes that this will enable the banks to offer more loans. By way of exception, the 10% ratio will still be applied to *VB busto kreditu ir obligaciju bankas*, a subsidiary of *Vilniaus bankas*.

"This decision in fact will improve ability of banks to offer services by assuming greater liability. At the same time, operations by *VB busto kreditu ir obligaciju* *bankas* are currently highly risky due to great exposure to a single risk in relation to the bank's profile, i.e. it issues mortgage loans and therefore is strained by all the problems related to changes in the real estate market," the Bank of Lithuania board member **Audrius Misevicius** told *BNS*.

The decision to lower the capital adequacy ratio was made with the view to create for Lithuanian commercial banks equal conditions for competition in the EU where the effective capital adequacy ratio is 8%.

The Bank of Lithuania introduced the 10% capital adequacy ratio in 1996. According to information from the central bank, the capital adequacy ratio in the Lithuanian banking system was 12.77% as of July 1, 2004.

NUMBER OF DEBTORS GROWS

Steady growth of lending has resulted in the fact that more and more people in Latvia find themselves unable to make regular payments in due time. The Register of Debtors shows that every tenth client going to a bank for a loan already has a bad history of previous problems with paying back the principal amount or interest.

As of September 1, 2004, there were 16,130 individuals and corporate entities on the black list, a 4.4% growth from early August. Those, who have missed a payment of more than 100 lats under a loan for more than 60 days during last 14 months are entered in the register. The Bank of Latvia set up this electronic database in July 2003, and credit institutions regularly update the register with information about clients with whom they have problems. Every time when a client asks for a loan, an inquiry for information about the person is sent to the Register of Debtors.

Since launching of the black list, the central bank has received about 112 thousand inquiries and in about 11 thousand or 10% of cases the reply indicated problems in the prospective client's financial past. Such clients face either immediate rejection of their loan application or higher interest rate on the loan they seek.

Among 16,139 individuals (mainly) and corporate entities listed in the register as of September 1, 2004, there were 281 non-residents. All in all, the register contains information about 18,977 "problematic" loans. This figure differs from the number of blacklisted clients because some of them had taken several loans at a time.

In the nearest future some 3,000 debtors from the special lists of insurance companies will expand the register. The Latvian Insurance Association executive director **Juris Dumpis** said that the respective amendments to the Law on Credit Institutions were waiting to be passed by the parliament. In addition, the Latvian Association of Leasing Service Providers has also announced its willingness to add to the Register of Debtors information about their non-compliant clients. •

Expert opinion

With cautious optimism

Leonid Ruderman, **Dealers' department head at Latvia's *Parex Banka*, who has been working in the bank for 10 years, comments on the situation in the Baltic banking sector.**


M.Morkans

LEONID RUDERMAN: Our banks will grow faster than the European ones.

What changes have taken place in the Baltic banking sector after the EU accession of the three Baltic states?

These are mostly qualitative changes. And first of all, the EU accession actually forced the banks to play by the European rules, e.g. we have to fulfill these standards and even be better. Apart from the EU requirements, Baltic banks have to comply with local rules too, which are very often even tougher that the European standards. With formal borders gone, the potential market is expanding and makes us prepare for broader competition. Leading Baltic banks have solid foundation for that, which gives rise to a cautious optimism that our banks will be growing faster than the European ones.

What is the background for such optimism?

First, it's fresh blood, so to say, which is going to take into consideration mistakes made by our colleagues. Second, we are not burdened by problems of previous years or the infrastructure that needs to be maintained today. But our striving for progress is bigger. If you are fresh, alert, full of strength and energy, you are more competitive. The EU accession was a major impetus for development of the Baltic economies and our banks will have much more work to do.

How would you describe the current situation on the lending market?

We have to assess what we have already done and where are we going to do. If we look at the ratio of private debts to GDP, it was almost nil after disintegration of the Soviet Union but today it stands at 30-40%. In developed countries this ratio is even higher - 70-80%, in some countries like the UK, for example, it is even above the GDP. We can conclude from this fact that the Baltic lending market has great potential for growth.

What is your opinion about the securities market development in the Baltics?

It will definitely have to be integrated into the European market because there won't be any local currencies any more. By January 1, 2008, at the latest, all Baltic states will adopt the common European currency, and all stock issues will have to be converted into euros. Corporate issuers have to start building up some history, because requirements to securities' issuers in the euro-area will be tougher. It is government securities that currently prevail on the market, but local interest rates are leveling up with the European rates. In Lithuania for most part they already are comparable, in Latvia interest rates (premiums) are slightly higher due to the fact that the Latvian lats is pegged to the SDR basket, but they go down with every year.

The nominal amount of government securities in Latvia and Lithuania will most probably increase in view of the national budget deficit. In percentage to GDP, the deficit is decreasing, but it grows by the amount. This means that more government securities will be issued. Estonia, which prefers to stick to tight fiscal policy is an exception rather than the rule. •

From debit cards to credit cards

By Dmitry Nikolin
Payment Card Department, Head, Baltijas Tranzitu banka

The rising number of cards and transactions shows that the Latvian plastic bank card market is growing. Those involved in card market development expect positive changes after joining the EU, hoping to see the end of the existing card payment processing monopoly.

Presently all 22 banks functioning in Latvia issue plastic payment cards. Nine banks issue VISA cards, 19 banks issue MasterCard cards and two banks distribute cards by agreement with their partner banks.

Large banks (top five) offer full range of card services. They participate in product promotion programs and advertising campaigns. *Baltijas Tranzitu banka, Hansabanka, NORD/LB* and *Parex Banka* are among the banks working with innovative products. *Hansabanka* and *Unibanka* have kept local cards. VISA takes efforts to convert cards issued by Latvian banks into VISA Electron system. History of card development in Latvia shows that the system of local cards is short-lived, e.g. *Latkarte*, the first chip card in Latvia, and *Globus* card are no longer in existence.

Lately Latvian banks have been actively promoting their products, in particular on the resident consumers' market. At the same time, high share of non-resident assets makes banks look for ways to reach resident businesses and develop plastic cards for their use.

FINANCIAL TERRORISM

According to the Law on Personal Deposit Guarantees, the Latvian government guarantees personal and corporate deposits in commercial banks up to the amount of 6,000 lats (EUR 9,000).

From June 1, 2001, the control over credit institutions, the securities market and insurance companies passed from the Bank of Latvia onto the Finance and Capital Market Commission (FKTK). The task of the FKTK is to protect interests of the financial market participants. Recently the FKTK has been paying special attention to the problem of money laundering and the fight against the so-called "terrorists" (persons on the Financial Action Task Force or FATF list of suspected terrorist financiers).

On October 1, 2003, the Bank of Latvia launched the Debtor Register containing records on non-compliant borrowers, loan frauds, etc. This register undoubtedly has had positive influence on newly issued loans. Previously banks made decisions about granting card overdrafts at their own risk. Now they can check a reliable source to see whether the client is not a debtor of another bank. Legislative amendments are on the way to allow leasing companies wholly owned by banks and Latvian-registered insurance companies to use the Debtor Register's data and blacklist their own unreliable clients.

The BC archives

The next stage in development of the register for loan debtors is the creation of a "positive" loan network collecting information about all issued loans, which would give a qualitatively new impetus for the banking business. However, current legislation does not permit banks to disclose information about all loans issued to clients. Disclosure of such information about an individual to a third party would be a violation under the Law on Personal Data Protection.

GROWTH POTENTIAL

About 94% of all cards issued in the country are plastic debit cards functioning as wages' accumulating accounts. Bank card holders in Latvia are served by 865 automated teller machines (ATMs) and over 8,300 point-of-sale (POS) terminals. Banks encourage clients to use cards for payments rather than for cash withdrawals; they organize various promotion campaigns for card payments. Every year the card payment processing company *Bankserviss* together with 4-5 banks organizes a campaign *Pay With Your Card!* with prizes for lucky winners. VISA also organizes and funds campaigns to increase VISA card usage and stimulate clients to pay with cards for their purchases whenever possible.

Plastic card market development in Latvia dates back to 1993. The process of market distribution has slowed down recently, and the re-distribution of clients has started. Nevertheless, the number of cards issued still indicates great potential for market growth.

The Latvian government plan to require that all wages and salaries (for non-budget organizations too) should be paid exclusively through banks will result in growing number of cards issued and, most importantly, being in active use. From 1993 to June 2004 about 1.24 million cards currently active have been issued in Latvia. Most of them (93.3%) are debit cards and the rest (6.7%) are credit cards. The number of credit cards is growing slightly (by 0.6% in the second quarter of 2004). Non-residents hold about 20% of the cards. Thus, out of 1.6-1.9 million potential clients (employed persons, unemployment benefit recipients, pensioners and students) in Latvia, less than one million people use cards in the country.

DEVELOPMENT TRENDS

Plastic card market development trends in Latvia are determined by the economic situation and telecommunications development in the country. The Latvian GDP has been growing steadily in recent years. At the same time, Latvian wages are among the lowest in the EU. Upon growth of wages, payment card sector is bound to grow as well. Today a card in one's pocket does not imply a special status or prestige — it is just a way to pay for goods and services. The growing number of cards, transactions and points of sale indicate the market growth.

The transition from debit cards to credit cards is under way on the card market. Large banks have started promoting cards among a wide range of consumers, contrary to previous years when Classic or Gold card meant a large security deposit at the bank. In line with Western traditions, cards are issued with a credit limit. The main requirement is to have one's salary remitted to the bank. Commissions (annual fees) are also being reduced. Some banks use such promotion practices as issuing to their depositors cards with a credit limit without charging the annual fee.

Large banks introduce the scoring system (i.e. evaluating the client's quality on a points scale) for quick and convenient control of loan risks. Scoring allows for significant speeding up of the card issue confirmation process by removing internal administrative barriers within the bank. This system also makes it simpler to decide the amount of the credit limit. By introducing the scoring model, banks take into account not only the client's income, but also his profession, family status, length of service with his current employer and, of course, the credit history. Each of the parameters is evaluated with a certain number of points that are used to produce the "overall score" of the client. Based on this result, the program makes the decision whether a client is allowed to have a card, what kind of card (Classic, Gold or Platinum) and to what credit limit.

EXPECTED CHANGES

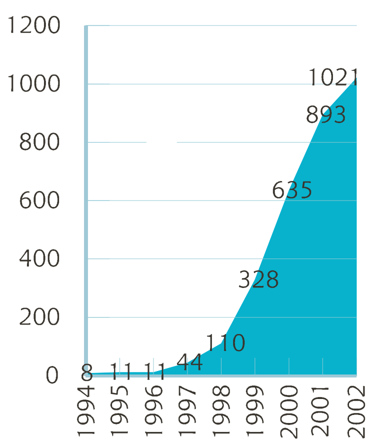
Latvia's accession to the EU has made card services more important. "The law of universal price" means a single rate for domestic and cross-border (between the EU member states) non-cash transactions. At present, a domestic transfer in lats costs 0.2-0.3 lats in Latvia while a transfer in euros would cost EUR 10 or more. It is unlikely that banks would charge EUR 0.54 for a transfer in euros. It is more likely that charges for a domestic transfer in Latvia will be in the range of EUR 2-5. Charges for paying one's bills through the Internet bank, which has become a customary practice, will increase dramatically. Against this background, additional services in paying bills by means of payment cards (as regular payments or payments through ATMs) look attractive.

The EU regulations concerning payment cards also require that a client should receive full information about all commissions without exception (including the conversion fee) and undertake liability for loss of a card (up to EUR 200 unless specified otherwise by the local law). The EU regulations do not apply "the law of universal price" to card payment services regarding domestic and intra-EU transactions. The existing card payment processing company will not introduce discounts on intra-EU transactions. Thus, the banks in Latvia stand to take additional loss from transactions in the EU member states. At present, some 65% of all cross-border transactions involve the EU member states.

The EU "single banking license (SBL) law" which enables banks to open branches in any EU member state without receiving a license (provided that the bank has already been licensed in one of the EU member states), is not likely to affect the Latvian banking market. The European practice shows that banks keep opening subsidiaries rather than branches. Latvia will hardly be an exception to this practice. Moreover, banks are obliged to get an additional license from VISA or MasterCard to be able to issue cards in another country. Naturally, the license is not free, and banks have to do some careful calculation of the expected profit in order to cover the start-up costs for business in Latvia. In our expert opinion, entry of any new players does not seem likely at the existing level of average commissions on Latvian market.

Some unofficial survey among Latvian banks has shown that plastic card market players are optimistic for the EU, hoping to see the end of the existing card payment processor's monopoly. Some banks count on a leading processor agent from Estonia, others turn to Western Europe, and another group anticipates birth of a new Latvian card payment processor. Considering that within the EU common market card service by foreign banks will be easier, certain activity from European executives shall be expected. At present, a European company performs a feasibility study on possible plastic card business in Latvia. •

PAYMENT CARDS ISSUED IN LATVIA, IN THOU.



Compiled by the author from various information sources.

CARD PAYMENT STATISTICS IN LATVIA
(in round figures)

Date	Number of payment cards issued			Number of ATMs and POS terminals	
	Debit cards[1]	Credit cards[2]	Total	ATM[3]	POS[4]
Mar. 31, 2004	1 119 359	73 861	1 193 220	861	13 007
June 30, 2004	1 153 722	82 955	1 236 677	865	13 582

[1] Debit cards issued (including local cards, cash cards and other debit cards according to the VISA/MasterCard classification).

[2] Credit cards issued (including Charge, Revolving Credit, Classic, Gold, Business, Platinum, Virtual and other cards according to the VISA/MasterCard classification).

[3] Number of functional ATMs as of the last working day of the given quarter of the year.

[4] Number of points of sale as of the last working day of the given quarter of the year (as identified by traders). A point of sale (POS terminal, cash machine equipment, e-shop, etc.) is a place for using card at a sales company, service company, etc. (including a bank branch).

Source: Latvian Commercial Banks Association.

New office space in old capitals

Ober-Haus, real estate agency

New top-class offices are still a rarity in the Baltic capitals. For now, most of such projects are under way in Vilnius, the Lithuanian capital. For comparison, we provide a survey of office spaces available in other Baltic capitals and also in Warsaw where seven modern office buildings are to be completed by the end of 2004.

VILNIUS: TOWERS RISE, RENT TOO

Supply. More than 40,000 sq.m of modern offices are being built in Vilnius during 2004, bringing total modern office space in the Lithuanian capital to 130,000 sq.m. Offices offered on the market at the start of 2004 include:

Europa Tower with its 33 floors is the tallest office building in the Baltic states. Lithuanian developer *Hanner* constructed *Europa Tower* and adjoining *Europa Retail Centre* as part of the larger downtown re-development alongside the Konstitucijos Avenue, including the Europa Square and the new Vilnius city government offices. Total space in the tower is 15,700 sq.m, with rents varying from 17.4 to 19.7 euros per sq.m.

Office Plus is one of the three new office buildings in the so-called “business triangle” just outside the city centre. The five-storey building with area of 5,500 sq.m developed by local developer *MG Valda* was opened in April 2004. This project was aimed at lower rents than the average in this region, e.g. rent is expected to be about 11.6 to 13 euros per sq.m).

Victoria: Lithuanian developer *MG Valda* has begun construction of the 16-storey *Victoria* building, which will be the tallest building in the business triangle. The *Victoria* will be opened in spring 2005. Pre-leasing has begun with rents from 14.5 to 17.4 euros per sq.m.

BCC 2: Lithuanian developer *EIKA* is implementing a twin tower project, building the *Baltic Commercial Centre 2* (BCC 2) as an exact twin to the BCC next door. BCC2 will add 6,200 sq.m to the business triangle.

Vilbra Centre: a new Lithuanian investment company *Vilbra* opened a modern Class A 3,500 sq.m business center on the Svitrigailos Street in the Vilnius center in spring 2004. The main advantage of this building is its good location and attractive rents at 11.6-13 euros per sq.m.

Merko: Baltic developer *Merko* will open its new office block with 6,200 sq.m of space for rent in December 2004. The modern office building on the Laisves Avenue is already being leased out.

One of the largest projects in 2005 will be an A-class office building with the area of 8,000 sq.m on the Ukmerge Street next to the 15-storey *Hanner* building. Local developer *Vilenlita* will build the new office block. Construction started in the second half of 2004.

Further from the city center, in the Zirmunai residential district, two new business buildings are up for rent. *Zirmunai Business Center* was opened in August 2003, with 40% of the total 7,000 sq.m space leased. Rents vary from 10.4 to 11.6 euros per sq.m. The other suburban office building, the *Ogmios-Hanner Centras* will be a part of the large-scale re-development project of a former 50-hectare Soviet military base in Vilnius. The re-development will include hypermarkets, Class B offices, and modern warehouse projects. The *Ogmios-Hanner Centras* was opened in March 2004 with 4,800 sq.m for rent at 11.6 euros per sq.m.

Demand. Until now, almost all Class A buildings have been leased out before the opening day. The demand remains strong, and vacancy is lower than 10%. With the large amount of new space, vacancy may rise to 15 % by the end of 2004.

Rent. Until now, property owners in Vilnius were getting more or less stable rents. But this period may be running out now with average rents for the Class A office space at 16-19 euros per sq.m in the prestigious business centers while in other Class A buildings prices are lower at 13-16 euros per sq.m. Rent in new Class B buildings varies from 10 to 11.6 euros per sq.m.

RIGA: BANKS BUILD OWN OFFICES, OTHERS WAIT

Supply. Riga has only 15,300 sq.m of modern Class A office spaces, a tiny number which will more than double with the opening of one new building, the 18,500 sq.m landmark *Sunstone* in the fall this year. However, while the economy stays strong, few have taken a chance on speculative office development.

Sunstone is a beautiful new landmark building constructed on the Daugava River overlooking the Riga Old Town on the opposite bank. The construction was finished in the fall of 2004 and the *Sunstone* has immediately become the most recognized building in Riga. The tower was developed by local bank *Hansabanka* mostly for its own use and has total area of 18,500 sq.m, of which 6,500 sq.m are reserved for rent at 20 euros per sq.m.

There are also 50,000 sq.m of Class B space on the market. The rest of the Riga office market consists of converted flats or Soviet-era buildings that need renovation.

Valdo Office Tower: Latvian developer *Valdo* has opened a 12,600 sq.m Class B building on the bank of the Daugava River, just a 10 minutes drive from the Old Riga.

North Gates: The second phase of the Class A project was opened in July 2004 with another 2,000 sq.m of office space.

Unibanka headquarters: SEB group’s subsidiary in Latvia, *Unibanka*, in April 2004 opened its new 9,500 sq.m headquarters in Ramava district which is at 20 minutes drive from the city center.

Two other office buildings will be put up for rent in 2004, including the 1,800 sq.m *Terbatas Center.* The Baltic construction firm *Merks* has announced the plan to build an 8,000 sq.m office project in the CBD (Central Business District) area by the end of 2005.

Demand. Although to a small degree, demand still outstrips the new supply on the rental market. The greatest demand is for out-of-center sites with comfortable car access and parking facilities. As rent is the most important factor, the biggest demand is still for Class B premises.

Clients mostly require quality premises equipped with appropriate communications necessary for work and security systems. A pleasant view through the office windows is also of certain importance. Interior decoration of the premises is considered to be of minor importance. Most companies want the premises to be ready for painting but wish to make the choice of colors and materials themselves.

B.Kolesnikov, A.F.I.

RIGA: The 18,500 sq.m landmark Sunstone.

Rent. Class A space or expensive offices is still not a priority for Latvian companies. Lack of supply notwithstanding, rentals for Class A premises continued sliding steeply, down 20% in one year to 15 euros per sq.m. In the beginning of 2004 Class A office rental rose to 17 euros per sq.m. Rents for quality Class B office space fell less to 8-11 euros per sqm.

TALLINN: COMPANIES PREFER OWNERSHIP TO RENTING

Supply. Almost no new supply has come to the Tallinn's tiny office space market. Total Class A office stock was 105,000 sq.m at the beginning of 2004 with vacancy at 5%. The addition of 20,000 sq.m to the market in 2004 may increase vacancy to 6% by the end of the year.

City Plaza: Local construction company *Estconde* opened its 23-storey *City Plaza* in May 2004. The 7,000 sq.m building is already 65% pre-leased. Rent is around 12-16 euros per sq.m. Most of the tenants are local law firms and consulting companies.

Admiral House: Local builder *Merko* and its partner *Manutent* are developing 8,100 sq.m of office space for sale in the port area. The building will be completed by the end of 2004 and more than 60% of the space is already booked. The selling price is 1,200-1,400 euros per sq.m.

Demand. Favorable loans have increased interest in buying office spaces. Many companies follow the German model of owning, not renting the office space and wish to reduce their rent expenses by replacing them with monthly loan payments. Interest rates for companies today are 5-6%.

Rent. Rents for Class A CBD buildings vary from 11 to 16 euros per sq.m. *Ober-Haus* expects Class A office rent to reduce slightly by around 5% over the medium term. Due to the balance of supply and demand, we do not anticipate Class B office rent to drop below the current rate of 9-13 euros per sq.m in the center and 6-10 euros sq.m outside the center.

WARSAW: ECONOMIC REBOUND DRIVES DEMAND

Supply. Total modern office space in Warsaw has now reached 1.9 million sq.m, with six new buildings opened in the CBD last year:

Saski Crescent: a 15,000 sq.m development by *AIG/Lincoln*. The primary tenants are the building's leasing agent, *Jones Lang LaSalle*, the Danish mortgage bank *Nykredi*t, and project managers *EC Harris*.

Liberty Corner: a 8,200 sq.m building at 5 Mysia Street developed by the *Von der Heyden Group*.

Articom Center: a 5,050 sq.m building, including retail units on the ground floor and five stories of office space, developed by *Litewska Development*.

Merlini: a 2,300 sq.m building at 107 Pulawska, developed by *Rezydencja Merlini*. The building was opened in April 2003.

IBC: a 16,000 sq.m building developed by *GE Capital Golub Europe* opened in May 2003. The primary tenant is *PriceWaterhouseCoopers*. The developer plans to build a second phase of the building, if enough pre-development leases are acquired.

Metropolitan: 33,500 sq.m of Class A office space in a prime location in the city center on the Pilsudski Square. The building was designed by British architect **Lord Foster**, and developed by US developer *Hines*. The first tenants to sign were *McKinsey & Com*pany (2,200 sq.m) and *Amerbank* (2,200 sq.m).

Seven new office buildings are opening in Warsaw this year: *Articom* (5,000 sqm), *Jasna Center* (7,000 sqm), *PAST* (7,200 sqm), *Mistral* (12,000 sqm), *Kliwer* (6,000 sqm), *Crown Point* (10,600 sqm) and *Catalina* (14,000 sqm).

Rondo 1 developed by *Rondo ONZ Project Development* will be the biggest office building in the CBD. It will deliver a massive 103,000 sq.m Class A office space to the market in 2005.

Demand. With few large companies moving, the fastest growing demand segment is for small and medium size office space ranging from 50 to 350 sq.m with an average net rent of 12-15 euros per sq.m. Rental price appears to be much more important than the standard within this fast-growing market segment. Take-up activity was focused on non-central areas (164,000 sq.m) in continuation of the 2002 trend. In the CBD area, 104,000 sq.m of modern office space was taken up. Among major office lease transactions last year could be mentioned: *Commercial Union* which took 7,400 sq.m in the *Crown Point*, *Compensa* with 4,500 sq.m in the *Mistral, BRE Leasing* with 1,700 sqm in the *Stratos*.

Rent. The new supply of office buildings has kept vacancy rates at 16% at the beginning of 2004, and rent continued to fall. Put in perspective, however, total vacancy at roughly 180,000 sq.m approximately equals one-year's take-up of office space. With far fewer square meters entering the market in 2004 and demand strengthening due to the economic rebound and the EU membership, we see vacancies reducing and rents strengthening in the near future. Office rents have stabilized in Class A CBD buildings at 16-22 euros per sq.m. Rents for high standard buildings located in non-central areas (Class B) range from 12 to 17 euros per sq.m. Service charges in Class A and B buildings are between 2.5 and 6.5 euros per sq.m. •

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Disputes between state and individuals

By Lilita Buike

Administrative courts started functioning in Latvia on February 1, 2004. Business community's active part has been waiting for this moment with great impatience and interest, hoping that finally legal relations between state institutions, civil servants and subjects of private law disputes will be put into order as the Latvian Administrative Procedure Law enters into force and changes in Latvian judicial system take effect.

Kaspars Berkis, the acting chairman of one of the district administrative courts in Latvia, kindly agreed to explain to the *BC* the meaning of the administrative procedures and district administrative courts' functions.

What does an administrative procedure include, and what kind of cases fall into the administrative court's competence?

The administrative proceedings actually govern relations between the state and individuals regulated by the public law. The administrative court is competent to deal with legal disputes between the state institutions, municipal authorities and individuals.

How does the court exercise control over an administrative act issued by some public body and over the legality and adequacy of actual actions taken by the institution?

The judicial control over administrative acts issued by public institutions or legality of their actions is exercised through detailed examination of the administrative act in question. Has the institution acted within the limits of its competence? Did it substantiate the adoption of a given act? Was the decision adopted in the due legal procedure? Were the required deadlines met? The court will also look into other circumstances relevant to the particular case.

According to the Latvian Administrative Procedure Law (LAPL), the court, when examining circumstances of the case, shall act according to the principle of objective investigation. Could you explain court actions in line with this principle?

The administrative court follows the principle of objective investigation, which means that the court has the right and obligation to gather evidence, give the parties of the administrative procedure instructions and recommendations in order to establish the true circumstances of the case and ensure fair and just hearing of the case.

In carrying out public administration functions and issuing administrative acts, institutions act by the authority vested in them by the state, and an individual is therefore put at a disadvantage in relations with the state. For this reason, LAPL provides for compensation and equalization of the opportunities available to individuals and the state. Of course, plaintiff retains his obligation to cooperate in collecting evidence. Plaintiff is not relieved from the obligation to produce evidence he has. Thus, the principle of objective investigation definitely makes participation of an individual in court proceedings much easier.

The Administrative Procedure Law allows for hearing of a case in the form of both oral and written proceedings. The latter is an innovation in the sphere of law and therefore written proceedings are unknown to many participants in court proceedings. What is the essence of oral and written proceedings, and what kinds of cases are dealt with by a written one?

The use of oral or written proceedings is determined by the circumstances of the case. In case of oral proceedings, the circumstances of the case are presented at the full court. Written proceedings are possible on two occasions: if both parties have given their written consent to such proceedings and if the judge finds that existing evidence in the case is sufficient for dealing with the case in this manner.

How do you feel about administrative cases decided without prosecutor's participation?

The Administrative Procedure Law has been written in the manner ensuring maximum protection of rights and interests of an individual, and there is no need to involve a prosecutor in the administrative proceedings. A prosecutor has different functions that have to be carried out according to the Law on Prosecutors' Competence.

Decisions of which institutions are most frequently brought before the administrative courts?

As general court statistics show, most frequently people challenge decisions by the State Revenue Service, administrative acts taken by municipalities, decisions by the Traffic Police and the National Police.

Evaluating legal quality of administrative acts issued by state institutions and municipal authorities, what are the most common deficiencies in administrative acts that serve as the grounds to make them void?

There is a trend, e.g. the institutions more and more frequently put their decisions in the form that meets provisions of the Administrative Procedure Law. As one of the functions of the administrative court is to control actions taken by the executive branch (where they concern individuals), the state executive bodies have to assess not only the decisions they have made but also possible improvements to the decision-making procedures. There's no need to stress the fact that the court has annulled this or that decision.

The most important thing is to analyze motives behind this annulment and to draw conclusions on what exactly needs to be improved in the decision, e.g. whether it needs better argumentation, or whether all requirements for drafting and adopting the document have been observed. There are issues that have to be solved by a public administration body or institution because nobody is interested any more in a simple fact that the administrative court makes void administrative act of a public administration body. We are interested in seeing that the public administration agencies should adopt and issue quite substantiated and legally accurate administrative acts.

T.Strakhova

KASPARS BERKIS: There's no need to stress the fact that the court has annulled this or that decision. The most important thing is to analyze motives behind this annulment and to draw valuable conclusions.

Shall we praise administrative courts for that?

I think definitely yes. The administrative court deserves, at least partly, the merit for the fact that now state institutions have to reckon with the fact that many administrative acts have been challenged. State institutions have to bear in mind that their decisions are being evaluated, and an institution may not pass acts that do not comply with the Law on the Administrative Procedure requirements, either in its form or in the contents. I think this is one of those stimuli, which are aimed at civil servants starting to apply the Administrative Law procedures and beginning to see to it that their administrative acts should be perfect both in the form and in the contents, trying to find adequate arguments and include them in their decisions.

What costs shall plaintiffs expect to bear when turning to administrative courts?

When filing an application with the district administrative court, a state fee of 10 lats is collected.

It has to be mentioned, that due to unsubstantiated decisions or illegal actions by some institutions, individuals often suffer damages; therefore, the longer the administrative procedures last, the bigger are the damages.

I fully agree with you and have always underlined that the court should always analyze the cases expediently. I can assure you that our court makes every effort to process the cases as quickly as possible, being aware that speedy resolution of the case is important for the plaintiff.

Aren't you concerned that in a couple of years the administrative courts will be just as overloaded with cases as the courts of general jurisdiction, as we know it now, and hearings will have to be scheduled for a year or two to come?

I think this must be prevented at all costs. If the number of cases to be processed as well as the workload per judge increases, we will have to think about employing more judges. We will also have to do something about the floor space as the current court premises include five court rooms, and we will be facing a serious deficit of court rooms when all twenty judicial panels will start working.

What problems the administrative court will have to encounter in its work?

As in every institution's start-up period, the administrative court also has its own subjective and objective difficulties. We have not resolved the issue concerning sufficient literature and courtrooms for the court's work. The court must have a law library with legal literature in at least one or two copies. Access to recent administrative law publications is quite important, and there is a wide range of sources.

Now the EU legal requirements are being introduced, and questions arise about their implementation. In this relation, judges have a lot of information to study and learn.

As to the number of judges, we do not have enough of them yet. Twenty judicial panels have been planned for our administrative court but currently we have only twelve judges in action. This is one of the reasons why cases are not processed as swiftly as the court and judges would want to, because judges have a great workload and many cases to work on. There are strict requirements to be met for candidates to administrative court judges. I hope that soon we will have a complete staff and the court would start working at full capacity. Then, I think we will be able to process cases more quickly. •

Mobile Financial Advisor

By Oleg Bozhko

There are over one million mobile telephone users in Latvia (the number of PC users is five times less). Half of mobile telephone users have modern phones (with WAP, MMS, etc. functions) but they do not always have even a simple calculator. Mobile telephones are developing in the multimedia direction while computing options have remained the same as ten years ago.

At present, a project called Mobile Finance Advisor (MFA) is under way to make mobile phones do financial and/or mathematical calculations.

After completing the project, MFA will be able to make complicated mathematical calculations (up to matrix operations), setting formula for computation (like in Excel), pulling out intermediate results memorized as buffer resources. Formulas can include conditional operations, which allow for programming of the process, making a row of calculations in a single run.

The main purpose of the project is to make financial calculations, e.g. such as loan's calculations (leasing, mortgage, etc.), calculations including full picture of a chosen lending option (such as principal and interest payments, payments still to cover at any given time of the loan period, including accumulated results and adjustments), see the drawing.

Of course, the creditor\financial institution will present you with its own calculation, but MFA will enable you to communicate with the creditor on equal terms. You will also need to do calculations in cases of changing your credit line. Reverse calculations are possible as well. For example, knowing the maximum monthly installment that the user can afford to pay, he can determine the length of loan period (i.e., number of monthly or annual installments) or the interest rate for selecting the creditor with such rate.

The next block of calculations concerning investments is generally meant for businessmen. Here you can get an investment project evaluated by any known method: payback period, net present value (NPV), internal rate of return (IRR), modified internal rate of return (MIRR), etc. MFA has "packed" all requisites concerning these methods into a menu that could be understood even by non-financial professionals.

The third financial block is for evaluation of securities with fixed interest rate (e.g. bonds). The computer's theory makes accurate bond value calculation at the given coupon and market interest rates as well as maturity time, and vice versa, i.e. it calculates the interest rate based on the security value. A comparison of calculated results with actual figures enables user to make the investment decision, e.g. to sell, to buy or to hold.

Yet another computer's block is meant for calculations in respect of securities with variable interest rate, e.g. stocks. Here the theory does not give unambiguous answers (too many influencing factors), and the calculations are estimates only. Still, they allow for sufficiently accurate evaluation of the investment situation.

In a more distant future, it is planned to calculate investment risks on all pan-Baltic blue chips and mutual funds as well as currency risks.

MFA can communicate with the users in three languages. According to preliminary estimates, the mobile advisor's services will cost from 1 to 3 santims per inquiry; first digit is an estimated price for GPRS subscribers, the second one is for all others. On trips to Estonia, Lithuania or Russia, the tariff may grow to 6-12 santims because of high GPRS roaming costs.

It is expected that the biggest demand for MFA devices would be among college and senior high school students, who represent the most perspective target audience for any commercial business in the Baltics, as well as new businessmen due to computing service accessibility.

Contrary to the Internet, present mobile link definitely identifies the user and makes possible further contacts with him with offers, advertisements, etc. Based on inquiries submitted to MFA, it is even possible to determine the range of user's interests, e.g. consumer's loan, investment project, types of securities (stocks or bonds), etc.

At the moment, MFA project is 50% complete but additional funding is required to finish the work. A mobile on-line banking project (without SMS use) is also being developed but the degree of completion is only 15% for the same abovementioned reason. So far only one on-line banking system is operational in Latvia, i.e. that of *Nordea*.

As the next step after introducing mobile banking, a concept is being considered for the project of a mobile system for payment of goods and services at shopping centers, gas filling stations, parking lots and in public transport, which could become an alternative to the payment system using regular payment cards. •

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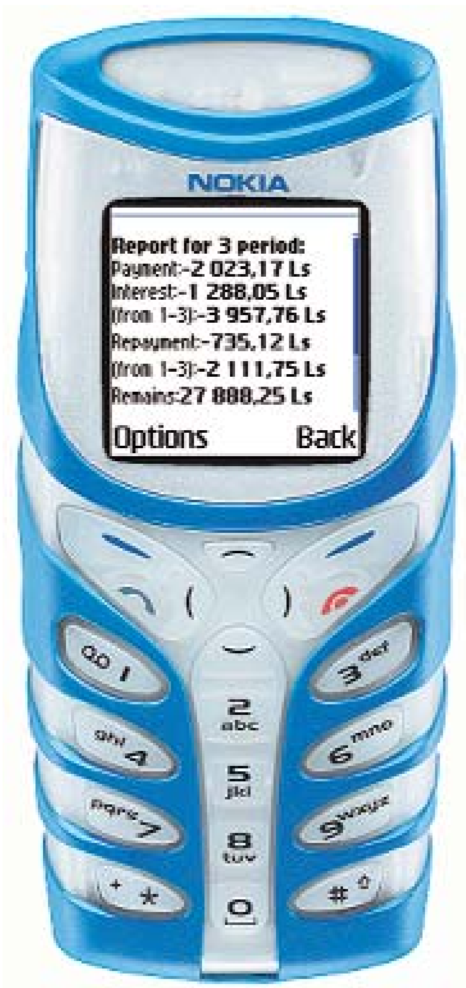

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United by com

By Olga Pavuk

New Lithuanian ambassador in Latvia **Osvaldas Ciuksys** is certain that the Baltic states together will solve most of the issues important for our region. Transport and logistics, financial mediation and business services — these are going to be the main components of Baltic economic development in the near future, said the new ambassador.

OSVALDAS CIUKSYS AND VAIRA VIKE-FREIBERGA: Prese

Mr. Ambassador, all three Baltic states joined the EU and NATO in close ranks. Could it be that in future our nations are going to be perceived as one entity, defined in the present world as *the Baltics*?

I am quite sure that things definitely move that way. The farther away we are from our region, the stronger the trend to perceive us as one entity. Even in France, Germany or Switzerland lay people hardly know the difference between Lithuania, Latvia and Estonia. Our region is too small not only in the eyes of the general public but also for businessmen who mostly take the pragmatic approach. Investors regard as potentially interesting market the one with at least 7-8 million people. Foreign representations' model in our countries is a proof to that, i.e. in most cases one representation office is enough for all three Baltic states, not to mention large companies which manage to supervise our three markets from Warsaw.

Quite naturally, the EU and NATO also treat us as one region in the same manner as they perceive Nordic states or Benelux countries. All these factors have shown that our region is seen as a single entity. This trend will persist in future too.

What factors are likely to stimulate this perception?

We are united by common interests. Primarily, we have to improve general living standards in the region. Second, we have to ensure public security. There are other common issues, in which we must not compete but shall seek solutions together, e.g. infrastructure — railways and motorways, ports, energy industry, gas and oil pipelines. All those are the prerequisites for our future prosperity. Frankly speaking, the situation with infrastructure, both in your country and ours, is not exactly perfect yet.

Are there any preconditions for coordination among Baltic ports' operations or the ports will still remain rivals?

Every port would like, of course, to attract more cargos. Even at present I can see attempts towards coordination, e.g. exchange of experience and information, bilateral visits — Riga-Klaipeda, Klaipeda-Kaliningrad, Klaipeda-Tallinn. It is hard to compete with St. Petersburg and Primorsk because Russian tariff policy is favorable to them. Together we must achieve some unified tariff. Still, our ports have certain advantages from a business perspective. In some years life itself will make us to coordinate our actions.

The years of independence have demonstrated Lithuanian determination to conquer economic area of neighboring countries, first of all, in Latvia. We often hear about certain expansion of Lithuanian businessmen, Lithuanian producers' dumping tactics, etc. What can you say about this?

Maybe Lithuanian businessmen are slightly more active now. However, from what I heard when talking to Latvian businessmen about their plans and projects (starting with *Laima* chocolates, *Grindex* pharmaceuticals), I am sure that Latvians' presence on Lithuanian market will increase, albeit with a little delay.

What has happened is perfectly natural. Our market is larger than in Latvia or Estonia. Moreover, it is cheaper to go to neighboring countries where you know about the market situation and people's tastes than enter a less familiar market. This is, at the same time, a way of practicing business on a foreign company's playing ground.

Elections to the European Parliament in Lithuania showed a new star on the political horizon, i.e. the Labor Party headed by millionaire Viktoras Uspaskich. What effect can it have on the national economy?

I cannot deny the effect of politics on economy. Of course, the Labor Party will exert some influence on the government and parliament decisions.

But is it good that people from big business enter politics?

This trend is very good. These people know what it takes to earn litas or lats in practice. In addition, in theory they can also develop various opportunities, their own ideas. The main thing in politics is not to cause any harm, not to interfere with regular course of life. One always has to think about how to make conditions equal for all business people and create climate favorable to them, so that they would like going to work and could return home at ease without bodyguards at their side. It is very dangerous when the government passes decisions concerning separate companies' activity.

Do you see any specific features in economic development in each of the three Baltic states?

The question is subject to debate. We have to see the sectors of economy, which are perspective for GDP development, and those that are not. Latvian, Lithuanian and Estonian economies are service-based economies, as in most European countries. First of all, these are such sectors as knowledge-based sectors and the so-called "new economy", i.e. IT, biotechnologies, mechanical electronics.

Things that our countries have in common outnumber those in which they differ. We have differences only in the energy sector, the oil business. In all other economic aspects, we are alike, e.g. we are transit countries with ports, and we have small export-oriented markets, we represent the EU way to the East. Polish and Czech economies are in a completely different position, the league of states where it is possible to work for the domestic market. We can keep our local market busy for a very brief period: already now Lithuanian construction workers, furniture makers and textile producers complain that opportunities within the country have been exhausted. However, the said sectors constitute the main components in Lithuanian GDP.

What is your opinion about the likely key industries in ten years time?

I think the Mazeikiai oil refinery will still be in business in Lithuania. If we put oil business aside, then transport and logistics, financial transactions and business services will become the main components of our three Baltic economies. These are the sectors of economy that would generate the biggest profits. Of course, science-based production will grow as is seen from the interest provided by serious investors such as *Sonex,*

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nting credentials.

Alna, etc. that we already know. These sectors of production do not require resources from outside, the only thing you need is orders from customers. However, these prospects are for 20-30 years in future. In next 10-15 years, the industries, which today make most profits and export their output, will be struggling for survival with the help of their major customers from the EU. During the last decade, Lithuania has become the largest clothes-making producer in Europe. On one hand, it is very good, but this is a short-lived success. As soon as the EU cancels restrictions on imports from third countries, all orders would go to South East Asia; and not only orders for textiles.

What are the chances for cooperation among Baltic undertakings after the EU accession, or would competition still prevail?

At ports and in other sectors of economy takeovers and mergers will and already do happen. Especially, when major interests are involved. These questions are already being discussed on the level of professional associations of the three countries (textile producers, for example, who seek to protect interests of the industry, not just individual companies). There are many examples of business cooperation in legal services, banking, and advertising.

What is Lithuania's perception of the most perspective economic edifice?

All three Baltic economies are constantly integrating with Scandinavian countries. German dimension is a very important ingredient, especially for Latvia and Lithuania, a little bit less for Estonia. Financial market represents a life-blood importance for economy, and the banking sector is in the hands of the Scandinavian banks. German bankers have also joined in. Presently, there's still too many banks in the Baltics but in 10-15 years only 6-8 of them will remain in each country. Consolidation is under way both in Scandinavia and in other regions, and not only in the banking sector.

What will happen to the local capital?

A very favorable factor is working for us, i.e. we are small markets. National business will always have its place under the sun, some niches we will not let out of our hands, such as hotels, little shops, small and medium-sized enterprises that hold no interest for large investors. Lithuanian retailer *VP Market* is still a local business, which is actually strange. Retail chains, as a rule, tend to be concentrated in the hands of European tycoons. As time goes by, our companies will become international and have 50-70% of foreign capital, for most part Scandinavian one. If you want to know who is going to be an investor in future, look at the main banks' shareholders.

I always keep saying that one should not fear arrival of investors or shareholders. Workers at the *Mercedes* plant do not know who owns it. Of course, there will be less and less of purely national Lithuanian, Latvian or Estonian businesses. We cannot stop globalization processes. Borders have long ceased to matter much for economics. From economic perspective, it is no tragedy that business is no longer national, if you take a broader look at it.

What then is left for small countries?

The most important thing for the society is that an enterprise pays taxes, provides employment, growth and is expanding. That various social services in the country are developed, and people feel secure. In general, the public should not care who owns the plant. The registered capital is concentrated in the hands of a very small group of people, not more than 1% of population.

How do you see Russia's influence on the Baltic states' future?

The influence will be great. Of course, now we, each individual Baltic state and all three together, feel more self-assured and have greater weight in talks with Russia. There are 24 countries behind our backs, ready to support us at the level of the European Commission or the European Parliament, depending on what kind of questions need to be solved — political or economic.

For Baltics, Russia will remain the key source of energy resources. Energy exports will grow in tact with present and future Russian investments in development of the pipeline networks. Keep in mind allocations for Baltic ports' development, for Russia's plans to double or triple gas exports to Europe, etc. What Germany finds good in deals with Russia, will also be good for us. There will be some kind of guarantee to energy resource deliveries. It is important that Russia's new ambassador to Latvia used to head the Energy Ministry. The question of ethnic minorities has no future and it will lose any sense in twenty years. One has to bet on economy, as today all wars are won on economic fronts. As the Portuguese said: "We had been at war with Spaniards for hundreds of years; then they bought our banks, and the war was over".

With our accession to the EU, we have become more attractive for Russian investors. It can be seen especially well on the real estate markets of our countries. Russia was and will be a serious partner to us, both in trade and politics.

It is said that one should evaluate the diplomacy by what it helped to prevent rather than by what has been achieved. What have Lithuanian diplomats managed to prevent?

Generally, we have succeeded in preventing certain mutual accusations between separate companies. We are trying to solve problems that emerge in a regular working manner, without involvement of the press. The case of *Lisco Baltic Service* that has an international tint is an exception to the rule. The positive attitude by the Latvian party towards solving issues should be underlined.

What measures does your embassy implement for economic integration between Lithuania and Latvia?

Traditionally, we organize trips for Latvian journalists to Lithuania, trying to find new interesting areas. We hold seminars and presentations to Latvian businessmen about trade-fairs in Lithuania. Together with the Lithuanian Chamber of Trade and Industry, we arrange monthly meetings between Lithuanian business authorities and Latvian representatives interested in cooperation. One of the latest seminars was dedicated to the employment issues in Latvia. When the official part of the event is over, informal communications continue during a buffet or a bowling game.

What do you play, Mr. Ambassador?

I play basketball with our businessmen twice a week. I have to start playing also with The Foreign Ministry officials, who are fond of this game too; we have to play on both sides, so to say. •

In EU we have to play

By Tatyana Komorskaya

Armands Gutmanis, who was recently appointed as the Latvian ambassador to neighboring Lithuania, met with the *BC* correspondent at the Latvian Embassy in Vilnius, a small, cozy house on a green street named after famous Lithuanian artist M. K. Ciurlionis.

The new Latvian ambassador to Lithuania took his office at an unusually peaceful period in relations between the two countries. Long gone are the days when it took huge efforts for the two neighboring Baltic nations to agree on mutual borders on the ground, in the air and especially at sea, which caused the biggest controversy between Latvia and Lithuania. Numerous petty clashes over milk, meat and other customs issues, are also in the past now.

Mr. Ambassador, lately there has been only one incident between Lithuanian and Latvian companies that made the news: the Lithuanian ferry operator *Lisco Baltic Service* complained to the European Commission about the Riga port giving protectionist treatment to a rival *Rigas Juras Linija*...

As we are now in the EU, all such disputes will be sent to the European Commission for review. This is a logical turn of events after our accession to the EU. At the same time, I think that questions related to the competition, for example, between ports in Riga, Liepaja and Ventspils as well as Klaipeda, will not go away and might even get worse as the ports will fight over cargos to be transported to and from Russia, Belarus and Ukraine. Apart from the port issues, there are railway infrastructures where situation is complicated too. On one hand, transport sector importance will be growing and Lithuania and Latvia are going to develop joint projects because routes inevitably pass through all three Baltic states which makes us all natural partners. On the other hand, Latvian and Lithuanian railways are rivals when it comes to the said Belarus, Russian and Ukrainian cargos. This double-sided situation might as well increase the tension as cargo turnover grows.

We have some differences concerning joint projects, i.e. Latvia with the help of the EU funds is developing Riga-Moscow railway while Lithuania thinks that priority should be given to *Rail Baltica*, a project of a railway line along the Baltic coast from Tallinn through Riga and Vilnius to Warsaw that has already been approved by Estonia and Poland.

The Riga-Moscow railway stretch is financed from the so-called pre-structural funds. Undoubtedly, the North-South route is also important for Latvia. The *Rail Baltica* construction has reached the stage of project implementation and it is now up to experts, not governments to decide.

Recently the Baltic states asked the European Commission for assistance in solving the problem of discriminatory railway tariffs that Russia applies to Baltic cargos. Russia uses protectionist practices to support its ports and companies (e.g. the US does the same). Would you tell us how diplomats are involved in these issues?

Russia is not a member of the World Trade Organization (WTO) and therefore it can do almost anything it wants. And it is a huge country, which also means that Russia can do nearly anything it wishes. Latvia is not a very big state, and, moreover, it belongs to the EU and the WTO. When we talk about the ways a government can assist local business, then we usually mean legally based national measures towards development and protection of the domestic market. There are also prohibited measures. There are so-called green and red WTO baskets, and it's possible to say that a yellow one exists, as well. Of course, one can always find loopholes but everybody knows the rules when some big things are at stake. For example, if the US violates some rules that can end up with the WTO sanctions. It is something we witnessed recently when the WTO solved another dispute in the EU favor. Embassies of small countries like Latvia can assist businessmen only if they really need state protection and the state has given us such instructions. At present we are working on an idea to convene at the end of the year a seminar for Lithuanian tourist companies, presenting to them Latvia as local tourism destination.

What else can we offer to Lithuanians, if trips to Riga are so cheap and popular and cars with Lithuanian registration numbers stand in lines around Latvian water amusement park?

ELTA

ARMANDS GUTMANIS: We perceive the term "Baltic region" in a very positive way.

by rules

Winter tourism, for example. This kind of tourism is quite developed in Latvia along with the related infrastructure. We have hills for it and adequate equipment. During winter people from Riga on weekends travel to the hilly Vidzeme region in northeast Latvia in large numbers.

The Presidents of Baltic states recently agreed to hold a summit. Is the embassy working on any documents in this regard?

Our Presidents have been meeting regularly, at least once year since 1990. Presidents in the Baltic states have different competencies, e.g. Latvian President does not represent executive branch of power but Lithuanian President has acquired some executive powers. Therefore, legal documents and agreements in the traditional meaning of the word are not usually discussed. As a rule, a press communiquй is released about results of the meeting.

When our countries were still EU candidates, you once said: "For us the EU is a tool to modernize our political and economic systems, and we are ready to use this tool." How good are Latvia and Lithuania at this now, and is there any difference between us in this respect?

So far I haven't noticed any difference, and I think our countries are using this tool well enough since there have already been discussions in the press about the EU structural funds running out, never mind the actual amounts. And these were only first months of our membership, more tasks lie ahead, e.g. we have to get ready for the next multi-year EU budget, which begins in two years. It is not a question of how much money is available but about choosing priority sectors for investments, and how to be ready for that in due time. But the EU funds are not the only source of investments.

Of course, our embassy must follow the EU development trends in all directions in the country we work. There are plenty of various sub-sectors in the EU policy. Naturally, we are interested in the Lithuanian opinion regarding implementation of the EU funds or its position as to the next EU budget cycle; we are also interested in other countries' attitude towards these issues. As soon as we joined the EU, all 25 members are following positions of all 25 members. This is the core of the EU phenomenon, i.e. to coordinate positions in order to know what this or that member state thinks and then take a common decision. Watching positions requires a lot of work, but all this is perfectly natural.

What were your first impressions as the Latvian ambassador in Lithuania?

So far I have only met very responsive and nice people, e.g. Foreign Ministry officials, art critics, researchers, some politicians. Recently I met with the city mayor in Joniskiai, a town that historically hosts a small Latvian community. Of course, we will dedicate some time to this Latvian community and our fellow countrymen living here. In October we will have a small celebration on the occasion of the Latvian Society in Lithuania 15th anniversary. Thus, we have regular contacts with the Latvian diaspora here. True, we would like to have more money from state budget for this purpose.

What can you say about preserving national traits at the time of globalization, about historical roots of Lithuanians and Latvians and their effect on modern business?

"By the way, a few words about *The Baltic Course* magazine: I think it is good that there's a magazine reflecting the problems of the whole region. It should be demonstrated at least on pages of your magazine that this region has lots of things in common, both historically and contemporary. And this is the very Baltic identity that sounds pretty natural to Latvia. Contrary to Estonians, who occasionally flinch at being referred to as a Baltic nation, and to some Lithuanians, who would rather avoid this notion as well, we perceive the term "Baltic region" in a quite positive way, and just think that this notion needs to be represented both in cultural and business-like perspective".

We can witness these effects, there is no doubt about it, although the roots are different. First of all, there are purely ethnic roots, something that we do not share with Estonians. Understandably, these ethnic roots play a great role. The experience of the 1920s-1930s that we have in common with Estonia also has a certain importance, although not so big. The so-called "uniting factor" did not materialize during that period and thus its role should not be overestimated. Then, there was the negative experience of the Soviet rule. Of course, this theme has not gone away and we will see how it will develop this fall and next year. Russian President **Vladimir Putin** has already invited Presidents of the three Baltic states to celebrations of the 60th Victory Day anniversary in Moscow on May 9 next spring. Very many other state leaders have been invited to Moscow too, because it is going to be a great historical event. One cannot walk away from history; it has its good and bad parts. History has also become, regretfully, a part of our modern politics. Although, speaking specifically about Latvian-Lithuanian relations, I think we should not exaggerate all those herring or pork "wars", these are just big trifles.

As to national traits, or roots, one should first answer the question: what are the national traits anyway? Is it Latvian literature? Yes, we have writers. Is it movies? It's a little bit difficult to discuss, as there aren't really many of them. Is it folk song and dance festivals? Well, they take place once every two years or, in case of major festivals, once in four years. But is this all that one could call Latvian culture? I am not sure about it. There are a lot of other things like everyday culture, household culture, and metropolitan culture or business culture. Can we attribute all that to national culture when speaking about preserving and developing national traits?

By the way, a few words about *The Baltic Course* magazine: I think it is good that there's a magazine reflecting the problems of the whole region. It should be demonstrated at least on pages of your magazine that this region has lots of things in common, both historically and contemporary. And this is the very Baltic identity that sounds pretty natural to Latvia. Contrary to Estonians, who occasionally flinch at being referred to as a Baltic nation, and to some Lithuanians, who would rather avoid this notion too, we perceive the term "Baltic region" in a quite positive way, and think that this notion needs to be represented both in cultural and business-like perspective. •

Relations between Latvia and the Netherlands

By Aiga Birzina

Latvian President Vaira Vike-Freiberga plans to make a state visit to the Netherlands in January 2005. Relations between Latvia and the Netherlands are characterized by a certain positive dynamism, as the development of these relations was closely connected to securing the Dutch support for Latvia's integration into the EU and NATO, as well as deepening long-term bilateral ties.

B.Kolesnikov, A.F.I.

BULDURI HORTICULTURE SCHOOL: The Latvian President planted 30 out of 10,000 tulip bulbs, a gift from the Netherlands.

HISTORY OF RELATIONS

Relations between Latvia and the Netherlands are deep-rooted, dating back to the Middle Ages when the Hanseatic League commercially united some cities in Latvia and the Netherlands. Ties between Latvia and the Netherlands became especially close in the 16th-18th centuries. Already in the 16th century, Dutch ships were the dominating force in the main Baltic Sea trade waterways and Riga became their main partner, accounting for some 60% of the Dutch trade on the Baltic Sea Eastern coast. The citizens of Riga frequently visited the Netherlands, and the Dutch visited Riga, not only to engage in trade, but also to share experience in architecture, crafts and other spheres; both cooperation and trade rivalry tied the Duchy of Kurland with the Netherlands.

DIPLOMATIC RELATIONS

Diplomatic relations between the Netherlands and Latvia started on March 5, 1921. The first Latvian Ambassador to the Netherlands was **Oskars Voits** (residing in Berlin, 1925-1932). **Edgars Krievins** (residing in Berlin) held this office from 1938 until July 1940. From 1921 till August 1924 the Netherlands were covered by the Diplomatic Representative of the Interim Government **Olgerds Grosvalds** in Paris, but from July 1924 till October 1925 by Charge d'Affairs ad interim **Peteris Seja** (also residing in Paris). During the period between the two World Wars, the Netherlands had a diplomatic representation in Latvia by means of a residence in Copenhagen, starting from May 1922; from March 1939 the Netherlands had an Embassy in Riga.

Officially, the Netherlands did not recognize incorporation of the Baltic states, including Latvia, into the USSR; the Netherlands recognized the restored Republic of Latvia independence on August 27, 1991. In October 1997, Dutch Foreign Minister **Hans van Mierlo** officially opened the Embassy in Riga that had been operational already since December 1996.

The Latvian Embassy in the Hague was opened in January 1998. **Baiba Laizane** has been serving as the Ambassador of Latvia to the Kingdom of Netherlands from September 24, 2003.

In the Netherlands Latvia is also represented by two Honorary Consuls — **Hendrijk van de Roemer** and **Jan Shuur**.

Since September 12, 2000, the post of the Netherlands' Ambassador to Riga has been held by **Nicolaas Beets**.

On November 23, 2003, Latvians living in the Netherlands formed their society *Latvija*.

ECONOMIC COOPERATION

Economic cooperation between Latvia and the Netherlands has gained momentum, and trade turnover between both states is growing steadily. In 2003 Latvia exported goods worth USD 93.87 million (3.24% of total turnover), and imported from the Netherlands goods worth USD 162.47 million (3.10% of total turnover), thus placing the Netherlands on the 8th and 11th place among Latvia's import and export partners, e.g. in 2002 the numbers were USD 87.37 million and USD 136.65 million, respectively.

Latvia's trade balance with the Netherlands is negative at minus USD 68.6 million.

In 2003 Latvia exported to the Netherlands mainly wood and articles made of wood (USD 28.38 million or 30.21% of total exports), as well as metals and metalwork (USD 19.16 million or 20.41%) and textiles (USD 17.79 million or 18.95%). Imports have mainly consisted of machinery and mechanisms, electrical equipment (USD 47.64 million or 29.33% of total imports), agricultural products (USD 27.74 million or 17.07%), products of chemical and associated industries (USD 18.78 million or 11.65%), as well as vehicles (USD 12.56 million or 7.73%).

According to the *Lursoft* company operating the data base of the Latvian Business Register, there were 232 Latvian-Dutch joint ventures registered in Latvia as of November 8, 2004, with about 89.4 million lats combined foreign investments, which is the 7th largest FDI level in Latvia.

The largest Dutch investors (by participation in the registered capital of Latvian companies) are: *Co Beverages Holding Ii Bv* — USD 25.3 million; *Finhold Limited* — USD 14.9 million; *Swedwood Holding Bv* — USD 12.8 million; *Geit BV* — USD 11.7 million.

Taking into account the importance of the Netherlands' ports in the European and international context, cooperation between ports of Latvia and the Netherlands is regarded as a positive development. There is a mutual interest to intensify cooperation of both countries in this sphere. The Netherlands and Latvia are intensifying their cooperation in the sphere of cabotage; maritime container transport operates on a regular basis.

The Latvian Chamber of Commerce and Industry (LCCI) is cooperating with the Netherlands' Chamber of Commerce and Industry within the *Eurochambres* system on a regular basis. The LCCI also has established contacts with the chambers of commerce and industry in the Hague, Amsterdam and Rotterdam.

The Latvian Investment and Development Agency has started to implement a project concerning participation of Latvian businessmen in a product selection program for foodstuff and non-foodstuff products by the Dutch trade group *Royal Ahold* in order to find potential suppliers in the new EU Member States.

In May 2003 businessmen from Amsterdam visited Latvia and met with representatives of the Latvian Investment and Development Agency, the Ministry of Transport, as well as the largest ports. On September 25, 2003, the Netherlands-Latvian Chamber of Commerce was opened in Riga. The Amsterdam city and port representatives visited Latvia in October 2003; on November 20, 2003 a direct flight Riga-Amsterdam was launched. On November 26-27, 2003, the Dutch Foreign Trade Minister **Karien van Gennip** visited Latvia. Her visit was aimed at facilitating bilateral economic interests; a group of businessmen accompanied the foreign trade minister.

On April 1, 2004, the Latvian Economic Mission was opened in the Netherlands. Its main task is to promote export of Latvian goods and services to the Netherlands and attract Dutch investment to Latvia.

EDUCATION COOPERATION

Such bilateral cooperation takes place on all education levels — general (school cooperation projects for the Academic Program Agency), professional (the Vocational Education Center of the Latvian Education and Science Ministry cooperates with the Netherlands Innovation Centre) as well as higher education. The Dutch government offers grants to Latvian students enabling them to study for Master and Doctor degrees in the Netherlands on a yearly basis. A large part of Latvia's state-owned as well as private higher educational establishments have concluded cooperation agreements with the Dutch higher education institutions about exchange of students, teachers and scientists. The University of Latvia is cooperating with four Dutch universities, including Groningen and Amsterdam universities. In 2004, the University of Latvia joined one of the largest university networks of Europe — the *Utrecht Network*, administered by the Utrecht University. The Riga Technical University has been successfully cooperating with the Delft University of Technology, and the Jazeps Vitols Latvian Academy of Music — with Enshede Konservatorium and the Utrecht School of the Arts. The Latvian Academy of Arts, the Maritime Academy of Latvia, the Riga International School of Economics and Business Administration, the Rezekne Higher Education Institution, the Ventspils University College, etc. have acquired Dutch cooperation partners too.

DUTCH ASSISTANCE TO LATVIA

The Netherlands is an active donor to Latvia. After 1994 Latvia gained access to the Netherlands pre-accession project program (*PSO*), and pre-accession social transformation program (*MATRA*) concerning economic cooperation. The aim of the *PSO* pre-accession project program was to help future EU Member States strengthen their institutions that are responsible for economy by transposing EU laws; while the aim of the *MATRA* project program provided a helping hand in transposing laws in the field of social reforms. The total amount of financial assistance provided by *PSO* and *MATRA* programs from 1999 to 2003 has been approximately 4.6 million lats.

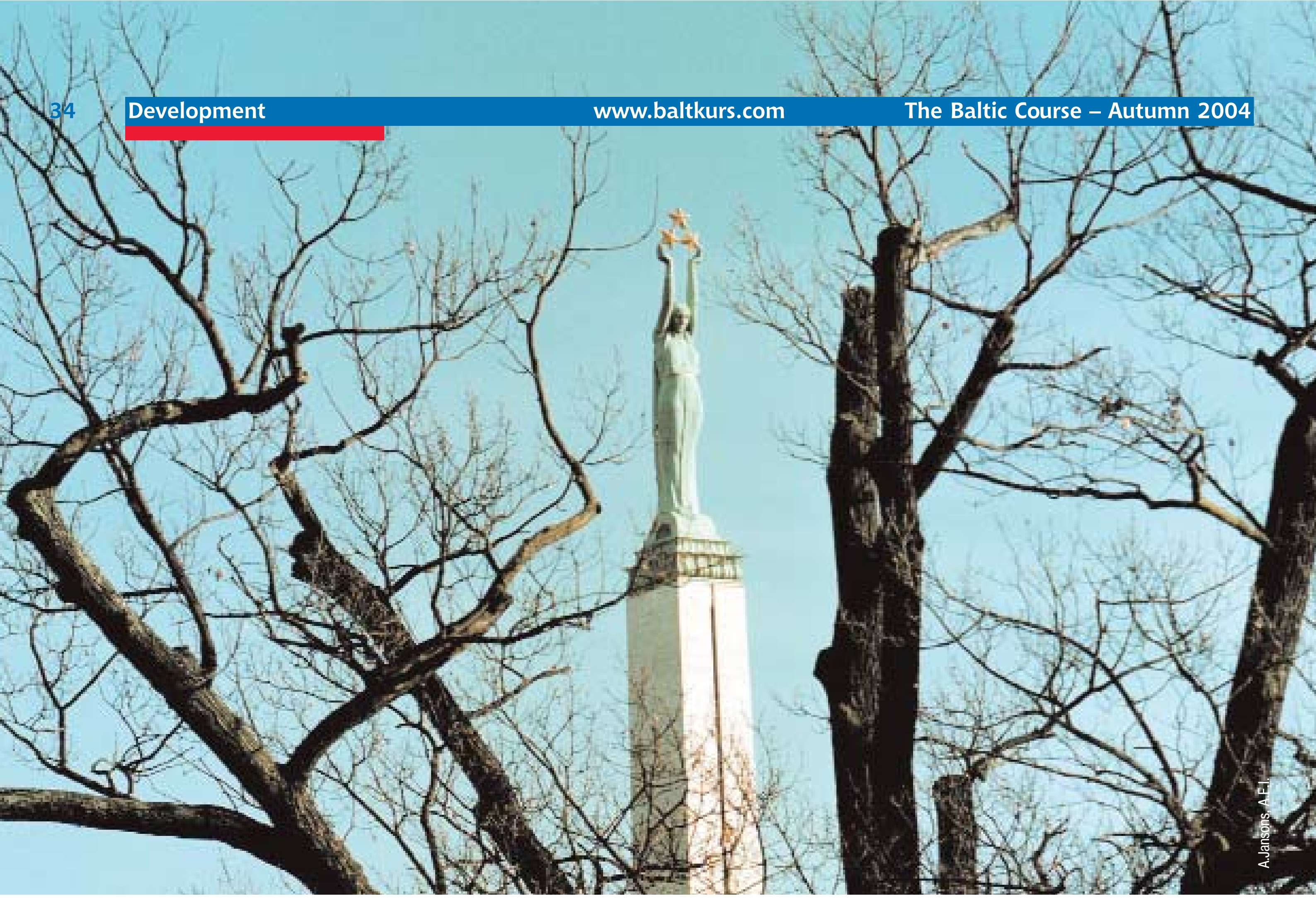
BILATERAL AGREEMENTS

- Agreement about Employment Facilities for Dependants of Members of Diplomatic Mission or Consular Office (in force since May 27, 2002);
- Agreement on Mutual Administrative Assistance for the Proper Application of Customs Law and the Prevention, Investigation and Combating of Customs Offences (in force since May 1, 1999);
- Agreement on Maritime Transportation (in force since September 1, 1997);
- Agreement on Promotion and Mutual Protection of Investments (in force since April 1, 1995);
- Convention for Prevention of Double Taxation and Tax Evasion (in force since January 1, 1995);
- Agreement for Air Services (in force since March 1, 1994);
- Agreement between Latvia and the Benelux Countries on Mutual Abolition of Visa Requirements (provisional application from June 1, 1999);
- Agreement between Latvia and the Benelux Countries on Readmission of Illegal Immigrants (not effective);
- Agreement between the Baltic states and the Benelux Countries on Road Transportation (in force from January 1, 1994). •

DUTCH DIRECT INVESTMENTS IN LATVIA, LVL

Year	Number*	Investments
1991	3	7561.38
1992	19	47539.00
1993	22	6151072.00
1994	22	2642834.00
1995	22	447032.10
1996	25	765483.00
1997	48	3839921.20
1998	6	12120657.33
1999	26	6380659.20
2000	37	1046192.88
2001	5	4706434.10
2002	19	8206155.62
2003	-24	34886495.50
2004	-48	10649110.57
Total		**91897147.88**

** Number of investment recipients.*
Source: Lursoft, Nov. 2004



Economic boom gains force

By Andris Vilks
Latvijas Unibanka

The Latvian economy is driven by steady domestic demand for goods and services as well as increasing external demand for industrial goods and services.

GDP RISES STEEPLY

The gross domestic product (GDP) growth in the second quarter of this year again was higher than expected. During this period GDP grew by 7.7%, whereas the analysts had forecast a 7-7.5% increase. In the first half of the year the economic upswing reached 8.2%, retaining the fastest growth rate in the European Union.

Although in the second quarter the growth was slower than in the first quarter (8.8%), a stable rise was observed in all major branches of economy. Unexpectedly good results were achieved in the transportation and communications industry which grew 11% despite port and railway transport producing only slightly better results than last year. An obvious progress was seen in the road transport, passenger traffic, communications services and warehousing. Achievements in the construction sector did not raise any doubts either and growth rates in the industry will be at the top for a long while. Growth in the processing industry and domestic trade declined by few percent to 6% and 8% accordingly. This trend is expected to continue also in the third quarter but the two industries are likely to show some growth again in the last quarter of the year.

As before, 73% of the GDP were made up by service industries demonstrating a steady growth. In the second quarter of 2004 financial and commercial services grew by 9%, and hotel and restaurant business expanded by 7%. Banks and the insurance sector are reaping substantial gains from the steady economic upswing in the country, concurrently encouraging it. The EU enlargement has fostered interest of foreign visitors in Latvia and we expect a 15-20% annual increase in the sector. The Riga airport is expected to double its passenger traffic.

It is too early yet to speak about a positive or negative impact of the EU factor on the Latvian economy. Competition in the local market has not grown noticeably and re-division of the local market has not yet begun. Many of the major companies in the neighboring countries have opened subsidiaries in Latvia. There is no doubt that the fast development and the particularly liberal economic environment will further facilitate inflow of foreign investments and transfer of production to Latvia. Supported by commercial banks and financial consulting firms, Latvian businessmen are ready to make use of the available EU structural funds. As the process started only this year, first positive returns will become visible next year.

Growth in the second half of the year might somewhat slow down, yet it is hardly unlikely that the rate will fall below 7%. Our forecast for the economic growth in 2004 is 7.5%, and it will probably stay around 7% for the next two years. The fast economic spurt of recent years notwithstanding, Latvia remains the most poverty-stricken member of the EU and a substantial slice of GDP is still unaccounted for as companies avoid declaring their profits.

GDP growth in the EU was slightly above 2% in the second quarter, which, unfortunately, is two times lower than in America or Japan. The fastest GDP growth among the EU members is currently observed in the Baltic states and Poland as well as Ireland that leads the EU old-timers.

NO LULL IN INFLATION GROWTH

After the unexpectedly high inflation in June and July analysts set hopes for August — the traditional month of lower prices. They wanted to find out whether the rocketing inflation was a temporary reaction to the EU accession or a new economic reality to be reckoned with. Unfortunately, the second version seems most realistic and we will be forced to adapt ourselves to the fast rise of prices also in the following months.

Although August brought a 0.1% deflation, it was considerably smaller than traditionally observed in recent years. The 12-month consumer price index had already jumped to almost 8%, reaching 7.8%! Average annual inflation at the moment is still 4.9%, but in view of developments anticipated in the following months it is likely to end up at 6.3-6.5%. The Bank of Latvia estimate is even more pessimistic. Upon release of the data for August, the central bank raised its inflation forecast to 7% and expressed concern that Latvia would not be able to introduce the euro at the planned time because it may fail to meet all the requirements for the move.

In August prices for clothing and footwear declined as usual. Food prices fell only marginally. Fuel prices rose and so did prices for hotel and public catering services. On a year-to-year basis, food prices rose by 11.5%, health services by 16.3%, transport, housing, restaurant and hotel services by more than 8%. In many cases the price rise was logically justified, yet more and more questions remained without sufficiently explicit answers. As our life is determined by the market economy and real competition, it is quite certain that in the nearest future we may expect re-division of the market with aggressive market players acting against the overall price boom and keeping prices flat or even lowering them to attract new customers.

PURCHASING POWER GROWTH CHOKES OVER INFLATION

The real purchasing power growth has been slowed down by rising inflation that on average grew faster than wages. Last year the average real wage growth was 7.8%, but this year it was down to 4.9% after the first quarter of this year and stood at just 3.6% after the first six months of 2004. In June and July wages grew a miserable 2.2% and 1.3% respectively. Knowing that annual average inflation may reach around 6% and neither increase in official salaries nor reduction of wages paid unofficially in cash can be expected in the middle of the year, we expect that real wage growth in 2004 will not be much larger than 2%. It is true though, that after amendments to the expenditure part of the budget, some funds will be spent to raise salaries to civil servants.

In the second quarter of the year average gross wage reached 209 lats (EUR 313) and net wage 149 lats (EUR 222). Year-on-year, gross wage grew by 9% and net wage by 8.2%. Still, Latvian wages remain the lowest among the EU member states. The gap between Latvia and the average EU level is widening, not closing. The private sector declares lower salaries than actually paid to the staff and the so-called “envelope salaries” [unofficial payments to workers that they get as cash in envelopes without payment of any taxes — Ed.] remain a strong reality. By official wages, Latvia is lagging behind neighboring countries. In the second quarter of 2004 gross wages in Lithuania grew by 5% to EUR 354, in Estonia by 7.3% to EUR 474 and in Poland by 4.5% to EUR 540.

ECONOMIC OVERHEATING ARGUABLE

The booming economy, the high and growing inflation, the expanding current account deficit, avid private consumption that has sent lending up by more than 40% annually is a constant cause for anxiety about likely overheating of economy. Most experts reject the possibility while some point out visible signs. The prevailing opinion is that the growth rate has already started to subside and this year, due to the EU accession, was exceptional in that it stimulated price hikes and imports. The central bank’s efforts to curb consumption by raising the base rate and mandatory reserves of commercial banks were not effective enough as the businesses preferred to use euros rather than the national currency, the Latvian lat.

MAIN INDICATORS

	1999	2000	2001	2002	2003	2004E	2005E	2006E
GDP real growth, %	3.3	6.9	8.0	6.4	7.5	7.5	7.0	7.0
Export growth (goods), %	-5.1	12.2	11.1	12.1	17.2	24.0	20.0	18.0
Import growth (goods), %	-8.3	12.2	13.8	13.4	19.7	23.5	19.0	17.0
Foreign trade balance, % of GDP	-16.9	-17.1	-18.3	-19.1	-21.2	-22.5	-23.5	-21.0
Retail sales growth, %	6.0	17.5	2.7	12.4	13.6	12.5	11.0	11.0
Total loan portfolio, % of GDP	20.1	23.2	31.7	37.3	47.5	60.0	72.0	81.0
CPI growth, %	2.4	2.6	2.5	1.9	2.9	6.4	5.4	3.5
Unemployment rate, %	9.7	8.4	7.8	8.9	8.6	8.6	8.4	8.2
Unemployment rate, jobseekers rate (ILO), %	14.3	14.4	13.1	12.0	10.6	10.3	10.1	9.8
Public budget balance, % of GDP	-3.7	-2.6	-2.0	-2.3	-1.6	-1.8	-1.9	-1.5
Current account balance, % of GDP	-9.0	-4.6	-7.6	-6.7	-8.2	-10.2	-9.0	-8.5
Foreign direct investment inflow, mln LVL	203	25	83	157	172	310	350	350
FDI/CAD coverage, %	53.4	115.2	21.1	41.2	33.1	42.5	48.6	46.4
Interest rate, long term nat. curr. loans (annual average),	13.2	10.3	10.4	8.5	7.5	9.0	8.5	7.0
Interest rate, short term nat. curr. loans (annual average), %	13.9	12.1	10.8	7.5	5.4	7.5	6.8	6.0
State debt, % of GDP	12.1	12.2	13.7	13.4	13.4	13.8	13.20	14.2

Source: Latvijas Unibanka.

CURRENT ACCOUNT DEFICIT EXPANDS IN WAKE OF EU ACCESSION

The EU accession brought forth an import boom in March and April but in June the balance of payments more or less regained its general tenor. Imports remain large but they are not as conspicuous as before. In the second quarter of 2004 the current account deficit expanded to 310 million lats (17.4% of GDP), growing more than two times from the year before! This is a staggering figure and we can only console ourselves by saying that the situation will improve in future. The export growth is also spectacular. The situation with the services is gradually improving, showing a larger positive balance than a year ago. By the year-end the current account deficit most likely will grow to 700-750 million lats, unfortunately rising above 10% of GDP. In the first half of the year the deficit reached 460 million lats (13.6% of GDP).

Foreign direct investments (FDI) keep growing. In the second quarter of this year FDI reached 101 million lats, and the semi-annual figure was 179 million lats, covering roughly 40% of the current account deficit. The accession to the EU and the NATO, followed by the fast economic upswing and the investment-friendly environment, will continue to support a more substantial inflow of foreign investments in Latvia (300-320 million lats this year). As the latest successful project we can mention a fiberboard plant to be built in Aizkraukle some 100 kilometers southeast of the Latvian capital Riga by a major US manufacturer of doors and windows, *Jeld-Wen*. Investments in the project are estimated around EUR 40 million. The plant it to become operational in October 2005 and will export its products to the EU member states (the UK, France, Spain).

EXPORTS GROW STEADILY

Compared with the same period the year before, exports have been growing for seven months in a row at the monthly rate of 20%. In July exports rose 21.4% but the growth from the beginning of the year was 23.4%. July was noted also for a sizeable growth of exports to Russia (up 69%) and Switzerland (up 18 times due to increasing exports of mineral products). Exports to the EU reduced from 76% to 72.6% of total Latvian exports. In July exports of mineral products and vehicles increased considerably, but their share in total exports is still negligible. Timber still remained the major export product but its share in total exports has gone down to 32%. In July 2004 it was smaller than in June and also fell from last year. However, export growth was observed for nearly all groups of commodities. Although exports to the UK and Germany shrank in July, the two countries still remain Latvia's major export partners. It must be mentioned that exports to Estonia, Lithuania, Denmark and Sweden have grown considerably.

In July imports increased by 15.5% but the growth rate from the beginning of the year was the same as for exports — 23.4%. In summer export growth slowed down as was already expected after the fast bounce in spring. In July imports of mineral products increased 21%. Growth in other groups of products was less noticeable — up to 5%.

The situation in the foreign trade sector is not going to change much in the remaining months of the year and both exports and imports are expected to grow 22%.

SLOWDOWN IN INDUSTRY AND RETAIL TRADE

The data for recent months show that we can speak only about a moderate industry growth. The production grew 8.5% in the first quarter but in the second quarter the growth rate fell to 6%. Compared to last year, industrial production was up 6% in June but grew only 3.5% in July. From the beginning of the year, industrial production has increased by 7.9%, including 8.4% growth in the manufacturing industry.

Although the slowdown is explained by the EU factor, it is too early to complain that our rivals from the EU have begun to undermine our industry. Some of the orders might have been made before May 1 and might have been followed by a small anticlimax but summer is not the best time to predict future events. In May and June growth in chemical industry was above the average and took the industry up to the top. Good results were achieved also in the wood-processing, production of rubber and plastic items, manufacturing of electric equipment and machinery as well as in the clothes-making industry. Fluctuations by month were observed in several branches of industry. However, production is expected to show faster growth in autumn.

Retail trade turnover maintains high growth rate, rising 13.8% in the second quarter of the year (13.1% in the first quarter). Since April, the growth rate has been decreasing gradually, though (11% in June, 9% in July). A sufficiently large increase in turnover was observed in the following commodity groups: food products, clothing and footwear, household goods and appliances. In the first quarter of the year car trade jumped 21% but will probably slow down again because the purchase boom in spring was caused by Latvia's anticipated accession to the EU.

Retail trade turnover in the third quarter is expected to be smaller than in the first half of the year but may again move up towards the year-end. Annual growth in the sector is likely to be around 12-13%. •

"Tigers" take time-out, or reasons not to follow obscurity

By Eugene Eteris

The Baltic states are extremely fascinated by Ireland's economic development model. The Irish economic success is very often associated with the "tiger-type" development, and so is the path of Baltic "tigers".

However, the striking difference between the two approaches is such that Ireland has been using the opportunities provided by the EU membership at full length, while the Baltic states set out to follow the tracks of the "Celtic tiger" with the purpose of getting rich. They are somehow trying all the time to find a model to emulate, or at least to copy, to enjoy similar success.

Two things are particularly attractive in the following obscure example, one is from the outside — generous funds from EU, the other from inside — low corporate taxes (see Table).

Over the last 15 years (1987-2003) Ireland's GDP per capita rose from 69% of the EU-15 average, or almost the same level as reached by the Baltic states currently, to 136% and the country became the 3rd richest member of the Union. Ireland was an example of progress for those, who wished to enjoy huge benefits from the EU membership; the latter opportunity was a major attractive moment for the Baltic states' politicians.

However, we have to dig deeper for roots of the Irish economic success, e.g. the country needed a stable and sensible microeconomic policies. The transfers from the EU budget were, of course, important — but they were less than 5% of the Irish GDP. What mattered most was the ability to attract foreign investments that were much larger than the EU financial support. The country's favorable demographics and a sharp rise in female participation in the workforce were the biggest contributors to its economic boom in the 1990s. A popular British economic weekly has recently acknowledged that fact (Leaders, *The Economist*, v. 373, No. 8397, October 16th 2004, pp.11-12).

This is what the Baltic states can learn from good EU examples; otherwise, these states should be careful to choose the right emulation model and not to act in obscurity.

First, the idea of low corporate taxes might work in these states for a while, although "the old EU members" do not agree on such a strategy.

Second, it is important to concentrate on good workforce skills and knowledge base. No doubt that the Baltics draw other EU members mostly by low labor costs, not attractive corporate benefits, argued the British weekly.

Just as in Ireland, these countries presently rely on achievements in education and training of experienced workforce that was produced with the help of investments from the EU. All the rest is specifically Irish tracks of the "tiger's" model...

There are three things that the Baltic states' leaders have to keep in mind in order to gain from the EU membership, i.e. fiscal policy, labor market flexibility and deregulation. It is necessary to cut public spending, and then they need to make their labor force more flexible and cultivated, be careful in emulating excessive European regulations and reduce the size of their governments. This is what the "Celtic tiger" actually has done about its development model. Otherwise, the Irish experience would not apply and simply lead to the wrong outcome. •

CORPORATE TAXATION IN THE EU

Average in the 15 "old" EU member states – 35.0%

Average in the 10 "new" EU member states – 21.5%

On a country-by-country basis, %	
Ireland	12.5
Lithuania	15.0
Cyprus	15.0
Latvia	15.0
Hungary	17.7
Poland	19.0
Slovakia	19.0
Slovenia	25.0
Estonia*	26.0
Portugal	27.5
Sweden	28.0
Czech Republic	28.0
Finland	29.0
Denmark	30.0
UK	30.0
Luxembourg	30.4
Austria	34.0
Belgium	34.0
Netherlands	34.5
Greece	35.0
Malta	35.0
France	35.4
Italy	37.3
Germany	38.3

** In Estonia zero corporate tax applies to companies re-investing their profits in the country.*

Source: The European Commission, "Top statutory corporate tax rates 2004".

Pessimism could be in the past, as boost for Europe grows

Editorial comments based on: European Economy, Spring 2004 published by the European Commission's DG for Economic & Financial Affairs.

EU EURO-AREA GROWTH

Stagnation period in the EU economic development began at the end of the year 2000; that year it witnessed the highest in the EU euro-area growth of 3.5%. Since then it has been declining all the time, surrounded by pessimism. For example, **Merrill Lynches**' late October outlook for global and European economic and corporate profits growth was quite pessimistic.

The EU euro-area growth can be seen during last 5 years in the following way (in percentage): 2000 — 3.5; 2001 — 1.6; 2002 — 0.9; 2003 — 0.4; 2004 — 1.7; and predictions for 2005 is about 2.3. For the whole European Union economic growth is predicted at 2.4%.

Unemployment has been during that time (2000-2004) at constantly the same level, i.e. between 8.0% and 8.8%.

The main reason for stagnation was a surge in the growth of exports and in particular the negative performance of investments. Private consumption provided no impulse to growth and the contribution of net exports turned negative due to a sharp rise in the growth of imports.

The world GDP growth has been at 3.7% in 2003 and world activity should expand at 4.5%, according to EU Ecofin estimates. However, in reality, pessimism about global economic development in October 2004 has reached its highest level for the last 3.5 years.

Inflation in the EU euro-area during last five years has been at the level of 2.1 in 2000 to 1.8 in 2004. Government debt (in percentage of GDP) has been at 69-71% during these years.

ACCEDING COUNTRIES

Despite weak growth in the EU the economies of the new Member States have been expanding at 3.6% in 2003. Private consumption supported growth, notably in the Baltic states. DG Ecofin mentioned two major factors that underpinned household spending: a) increased real disposable income; and b) greater access to credit because of the banking system development in the new EU states. Due to enlargement, investment growth moved from "negative level" in 2001-2002 to a meager 1.9% in 2003 and is expected to reach 5.7% in 2004 and 7.3% in 2005.

Unemployment rate in acceding countries has been constant as well, i.e. around 13.6% in 2000 to 14.3% in 2003, and expected 13.8% in 2005. Governmental debt has been gradually growing; it was at the level of 36.4% in 2000 and 39.4% in 2002, to 42.2% in 2003 and anticipated to reach 45% in 2005.

In general terms, accession generated positive growth in both 2003 and 2004; investments are becoming a driving force for growth. These new EU member states have had, on average, the general government deficit at 5.7% of GDP in 2003.

It is quite remarkable how the EU DG Ecofin described economic development in the Baltic states, e.g. for Estonia: "External account deficit set to narrow with growth becoming more export driven"; for Latvia: "Continued robust growth, widening current account deficit"; and for Lithuania: "A broad-based economic expansion." Good projection, we could say. •

European Union taxation policy: integration perspectives

By Dr. Eugene Eteris
European Integration Institute, Denmark

From the very beginning of the European integration approaches to issues connected to removal of fiscal barriers in the Community have been closely connected with the two systems of taxation, i.e. indirect and direct taxation. But such integration (or, better to say, unification) in the EU meant in fact efforts to harmonize national tax laws rather than creation of a Union-like taxation system. Behind such cautious measures were member states' efforts to develop their national economies. Therefore, indirect member states' taxation (VAT, excise duties and other fiscal barriers) has been subject to the Union's harmonization efforts, while direct taxation is subject to only a minimum degree of harmonization.

Initially, within first decades of the European Communities development, there were no questions concerning single or united "fiscal territory", although some coordination measures were deemed necessary for proper implementation of such market. It was clear that liberal approach in fiscal field in the last extent would work as tax barriers in creating genuine customs union.

FISCAL NEUTRALITY CONCEPT IN THE EU

Provision of certain equal fiscal conditions for the internal member states' common market was a major idea behind fiscal neutrality. Otherwise different taxation regimes in the form of tax barriers could easily replace customs barriers to trade. It happened quite often that abolishing customs duties (according to the Treaty provisions) some member states would raise their domestic taxation, in particular turnover tax, so that total burden on imports remained unchanged. Therefore Community efforts have been first of all and in fact, permanently, aimed at reducing national indirect taxation effect on trade within the member states' common market. Actually, fiscal neutrality was a balance tool between domestic production and imports. In order to reach this aim the turnover tax of the country of origin (or of the country of destination) would have to be imposed on all goods.

Among original six Communities member states, five had a system of cumulative multi-stage turnover tax (mstt). The system of the tax of the country of destination applied in the Community with the mstt-system did not prevent violation of the fiscal neutrality principle because the total tax was a function of the number of transactions involved up to the final stage of goods' distribution. Some articles in the original EEC Treaty (e.g. art. 97, now repealed) allowed the countries which levied a turnover tax calculated on an mstt-system to establish average rates in case of internal taxation on imported products. The word "allowed" is important, as the Treaty did not provide any rules for establishing such average rates; the Treaty just prohibited application of such average rates from being in excess of the taxation imposed in other member states. The latter were actually at liberty to establish their own mstt's average rates.

Another difficulty to overcome among the member states on the way to fiscal neutrality has been connected with the variety of different excise duties, i.e. specific taxes on consumption of various goods (from luxury products to alcoholic drinks, to tobacco, etc.). Such duties were not at all the same in all EU member states and the differences in excise duties could provide great disturbances in competition factors.

EU TAXES

Traditionally, national taxation classification consists of direct taxes, indirect taxes and social security contributions. First member states intending to form the Community were having different social and economic structures and rather dissimilar systems of taxation. These differences included both technical aspects of taxation and direct/indirect taxes' composition.

Indirect taxes. These taxes are levied on production and consumption; they are not born by traders and industry, but collected and passed on in the price of the final consumer on whom the burden falls. The major indirect tax is VAT, and it is important part of the whole Union budget; its resources represent 35% of the EU's "own resources". Since the first VAT Directive (11 April, 1967) the member states were required to replace their general indirect taxes by a common VAT system. The purpose was to achieve transparency in "de-taxing" of exports and "re-taxing" of imports.

Indirect taxes require some degree of harmonization because they affect the free movement of goods and freedom to provide services.

Direct taxes. They are paid and born by the taxpayers and include income tax, corporate tax, wealth tax and most local taxes. They total about 14% of the European GDP. There has been no harmonization or coordination of direct taxes in the EU.

The EU legislation does not specifically call for these taxes' alignment; some aspects of direct taxation do not in fact need to be harmonized or coordinated. They are left to the discretion of the EU member states, according to the subsidiarity principle.

Social security contributions (SSC). These are compulsory charges levied by social security organizations to pay for sickness, disability or unemployment benefits. SSC is paid both by workers and employers. This type of taxation represents the largest compulsory levy in value terms (over one trillion euros) which accounts for about 15% of the Union's GDP, and SSC breakdown shows that within this amount about 8% is carried by employers, 5% by employees and about 2% by self-employed people.

The EU has concentrated on coordinating national SSC systems to ensure that employees and businessmen moving within the EU do not pay SSC twice.

We have to acknowledge that differences in the EU member states' taxation structures do not have a direct effect on distortions to competition. Usually heavier taxation in some states is offset, for example, by superior public services or other external counterbalances. That could explain the fact that business in the EU didn't rush into those member states, which offered best tax conditions for goods or production. Corporate tax rate and VAT are still very different among the EU member states but there have not been consequential business migratory trends within the Union.

EU TAX HARMONIZATION DEBATE

Finance ministers of the three Baltic states agreed in Tallinn on August 26 that they would work together to prevent any income tax unification in the EU. At an informal meeting of the EU economy and finance ministers in the Hague on September 10 it was acknowledged that low corporate tax rates in some of the 10 new EU member states (mainly in the Baltics) could not cope with the EU structural support money provided for these states. Germany and France repeatedly pledged to harmonize tax rates and prevent "fiscal dumping" on the part of the new member states; France was the first to suggest suspending structural funds payments for states with low tax rates. The United Kingdom, however, strongly opposed any "tax harmony" in the EU. Latvian Finance Minister **Oskars Spurdzins** argued that the best way for new EU states to compete in the Union was with low tax rates for investors.

There are signs of concern from old EU members about "delocalization" of jobs from western to eastern Europe, where corporate tax rates average 21.5 % (in Lithuania — 15%, Hungary — 18%, Latvia — 19%) compared with 31.4 % in the old EU . Austria, for example, introduced from January 2005 the corporate tax at 25% which is the second lowest rate in the euro-area after Ireland.

CONCLUSION

As long as the EU member states' taxation systems are not really harmonized, there are certain grounds for different competition conditions within the EU internal market.

Introduction of the euro in 2002, greater transparency, and accession of ten new states, increased competition and other factors revealed serious obstacles to internal market connected with differences in member states' tax legislation. Distortions created by national tax barriers can be as harmful to competition as all sorts of quantitative restrictions to trade between member states (TEU, art. 25, 26). But bringing closer member states' taxation regimes was not an easy thing to perform.

Already in 1996 the Commission acknowledged two major constraints on tax coordination, i.e. the need for unanimous approval of taxation by the member states, and lack of comprehensive EU taxation policy. During September 2004 discussions in the newly composed Commission these issues provided additional impetus for quicker solution in view of enlargement.

The EU member states would like to have a sufficient degree of autonomy in taxation field as it is closely connected to the operation of their economic objectives. Therefore, harmonization of direct taxation could be a long-standing aim in the EU tax policy.

In the draft Constitution taxation regulations are within main issues regulating internal market (ch.1 in Internal Policies and Actions, part III, The Policies and Functioning of the Union). As in the TEU, taxation issues in the draft are placed between rules on competition and approximation of laws. The only formal difference is such that in the TEU these issues under regulation are called "tax provisions" whereas in the draft — "fiscal provisions"; there are four articles in the former (art. 90-93) and five in the latter (art. III-59 to art. III-63). In the newly elected Commission there is a separate commissioner for the EU taxation issues, and a sectoral DG "Taxation and Customs Union". As long as the tax schemes are not closely harmonized, they will have different influence on the conditions of competition between identical economic activities in the member states, which will bear different tax burdens.

And there is another thing to remember. We have to distinguish between two notions and processes in the EU cooperation efforts among its member states. The first one is "integration" and depicts most vital steps on the way to "United Europe", e.g. common market, customs union, the Economic and Monetary Union, and full political integration in the future. The second is "unification" and reflects instrumental mechanisms for harmonization of member states' internal policies with that of the Union. Such harmonization, first of all, does not cover all national economic

BREAKDOWN OF EU REVENUES IN THE EU BUDGET

	%	mln EUR
Traditional own resources	14	140
VAT, excise duties	30	300
GNP resource	45	450
Miscellaneous	11	110

Source: Author's calculations.

spheres and, second, the scope and the content of the whole harmonization process differ from one social-economic sector to another. For example, the EU educational policy does not include such harmonization at all; only coordination of the member states' policies is envisaged. Another example, the Treaty on the European Union does not call for harmonization of direct taxes in the member states. This trend to provide a clear-cut division between the EU and member states' competences is pursued in the new draft EU Constitution: it mentions exclusive EU measures and shared competences (by the Union and the member states), accompanied by coordinating and supporting EU efforts for national policies' development in the EU. •

Personal taxation in Denmark: example for Baltic states to emulate

By Eugene Eteris

Tax systems differ in various ways in different countries; in the Danish welfare society social and economic progress is secured by higher taxes than anywhere in Europe and probably in the world. Welfare society in this country is based on the idea that citizens must pay their taxes and get various services in return, e.g. medical treatment and hospitals, unemployment benefits and education, libraries, infrastructure, police service and so on. Although the taxes are high, people do not usually complain.

The state in Denmark takes on many tasks which people in other countries must pay for themselves. This is the so-called Scandinavian model of social protection; although there are countries that put the burden of citizens' social protection on companies, firms and the business community.

Danish experience provides certain interest for the Baltic states, as there are some comparative features both in territory, population and Scandinavian legacy. The present article mostly concentrates on personal taxation issues in Denmark as these taxes provide for the major part of state revenues: personal taxes — 46%, VAT — 19%, corporate taxes — 5%, labor market contributions — 8%, other taxes and revenues — 22%.

CONSTANTLY ADAPTING TO CHANGES

The Danish tax system has been changed frequently, as politicians constantly try to adjust taxes to the society's needs. Everybody in one way or another uses public system facilities and therefore must pay taxes, although not of the same amount. The Danish tax system is progressive, i.e. taxation level increases in line with the increase in one's income. As it is said in the country: the broadest shoulders bear the heaviest burden.

For example, public expenses for a child attending a kindergarten amount to about DKK 50,000 annually (about 5,300 lats), but parents pay only small part of it (depending on parents' income).

The Danish public system consists of a central government authority and that of 14 counties and 271 local municipalities/councils, each with their own responsibilities and share in the budget.

Thus, on one hand, regional counties and local councils are getting a share of the state budget for the implementation of their policies, on the other hand, they may decide the amount of the tax they will levy on their citizens and the way they would spend the tax money. Usually the tax rate depends on the county in which a citizen resides.

DIFFERENT TYPES OF TAXES

As in almost all countries around the world, the Danish tax system consists of direct and indirect taxation.

Direct tax is the tax paid directly on people's income, value of property, etc. Part of personal taxes goes to the state; people with the highest income pay proportionally more money to the state. Therefore the system is called a progressive or graduated tax system.

Then there is a municipal and county taxation that means that Danish local councils and counties determine their own tax rates. Another part of direct tax is labor market contributions collected from wages by employers. A small share of direct taxation is a church tax. About 86% of Danish population are members of the national Evangelical Lutheran Church and pay a share (varied from council to council) to the budget. Only persons christened in Denmark are regarded as members of the Church and are liable to church taxation. At last there is a property tax valued at the person's real estate evaluation once a year by public authorities. Such tax is paid on foreign property by Danish residents and on property owned in Denmark by other residents. Landowners pay taxes according to the size of the land.

Indirect taxes are the payments for acquiring goods and services, i.e. VAT, customs duties, ecological levies and excise duties. Such taxes are paid each time on any purchase and this tax is included in the price of all goods and services.

VAT accounts for 20% of the price of the articles. Ecological tax and excise duties are, in fact, taxes on the nation's natural resources. The idea behind this tax is that people should consume natural resources rationally. The same is true about duties on cars (the highest in Europe), petrol, coal, water, etc. Customs duty is a levy on goods purchased abroad in excess of DKK 1,350 (or about 100 lats). VAT rate in Denmark has changed during its 37-year history from 9.25% and 10% in 1967 and 1975 to 25% since 1992. VAT share in the national budget is about DKK 150 billion.

PERSONAL ALLOWANCES

Persons aged 18 or more are entitled to a personal allowance, which means that personal income of first DKK 34,400 is not liable to taxation (for those younger than 18 the "allowable" amount is DKK 25,600). Another kind of allowances are those for children up to the age of 18. Payments are made quarterly for all families in Denmark with children; allowances amount to DKK 8,000-12,000 annually (about 850-1,300 lats) depending on the child's age There are various other deductions from personal income, which depend on personal characteristics, e.g. special pension savings, foreign income, etc.

EXAMPLES OF LOCAL/MUNICIPAL SPHERES OF ACTIVITY:

- Primary and secondary schools,
- Kindergartens and youth centers,
- Nursing homes and elderly care service,
- Culture and sports facilities,
- Libraries,
- Water supply and purification.

SOME EXAMPLES OF GOVERNMENT/STATE RESPONSIBILITIES:

- Ministries and central government offices,
- Foreign economic development and politics,
- Defense, police and home affairs,
- Higher education facilities, i.e. universities,
- State education grants, subsidies for public transport,
- National highways and motorways.

MAIN TAXATION PAPERWORK

During November (the year previous to tax assessment) all Danes receive an advance tax assessment, which contains the figures forecast by the tax authorities to apply to a citizen in the forthcoming tax year; such assessment is called forthcoming taxation. The annual statement of taxable income shows the amount one pays in tax during the previous year. One can correct figures in advance tax assessments by placing correct figures on the form attached to the advance assessment.

Annual statement of taxable income is sent to Danish citizens between March and June; it is indicated in this statement how much tax had been paid in the previous year and how much tax one should actually pay. Very often this annual statement is accompanied by tax return information.

Up to the 1st of May everyone has to send the assessment for the coming year to local or regional tax authorities. Those involved in business activity send their assessments not later than 1st of July.

For the forthcoming year Danes shall receive from tax authorities a "tax card" with the amounts of personal tax rate and deductions, which will apply during this year. This card is to be always submitted to employers.

CONCLUSION

Among 46 European states, Denmark has not only the highest personal taxation level but at the same time the highest level of wages and remuneration. It's 15-20 times higher than in the Baltic states. At the same time, Denmark and other Scandinavian countries are among the most competitive in the world; thus, the recent World Economic Forum's assessment in October, 2004, made by about 9 thousand experts from 106 states has shown that among first ten there are five Nordic states — Finland, Sweden, Denmark, Ireland and Norway. Quite remarkable, that on the 20th place is listed Estonia, the only Baltic state to reach the prestigious competition results (another state from the list of new EU member states was Poland on the 60th place). On one hand, Scandinavian states (and Denmark is among them) have effective macroeconomic development (with positive budgets, good conditions for business development, lack of corruption, respect for legal order, etc.). On the other hand, major complaints by people in all these countries are about the level of taxation and tax regulations. But there is plenty of evidence that the present taxation system will survive in the foreseeable future. •

THE SHARE OF PUBLIC EXPENSES IN DENMARK, BY ACTIVITIES, IN %

Social welfare	42.3
Education	14.1
Health system	9.7
Public service	7.8
Defense and police	4.7
Business promotion	4.6
Transport and infrastructure	3.9
Culture and religion	2.8
Housing	1.6
Other public activities	8.5

Source: Taxation in Denmark, Financial Ministry Information, 2002, p.6; www.toldskat.dk

TAX REVENUES IN THE TOTAL DANISH TAX ALLOCATION, IN %

Income tax	50.2
VAT	19.2
Labor market tax	9.4
Real property tax	3.5
Compulsory levies	4.2
Ecological tax	1.5
Customs duties	0.4
Various other taxes	11.7

Source: Danish Tax Law, 2005. – Draft.

SOME EXAMPLES OF COUNTY'S RESPONSIBILITIES:

- Public hospitals and medical services,
- Road construction/maintenance, municipal bus transport,
- Upper secondary schools,
- Nature and environmental protection.

PERSONAL TAXATION IN DENMARK, IN %

The so-called "general tax" on all income	5.5
Average tax (on income of about DKK 191,200)	6.0
"Top taxation" (on income over DKK 285,200)	15.0-25.0
Local community and councils' tax	32.5
Church tax	0.7
Labor market contribution	8.0
Real property tax*	1.0
** from DKK 2.9 mln. in value*	

Source: Ibid, p.8

Wellbeing vs. wealth: an issue of common good!

Modern economy quite often, alongside providing impetus for development, creates problems it is supposed to solve: political, ecological and social, e.g. traffic congestion and noise, polluted air and loneliness, deficit of democracy and stress...

A few decades ago hungry children were a cause of national attention in Europe and the US. Now we have even bigger problem, which is children's overweight and damaging nutrition. Another urgent issue is the lack of adequate attention and care for children.

It seems that the market economy in most advanced countries, and new democracies as well, functions in a way certain people behave, i.e. unintentionally they create sublime problems and then put in extreme efforts to solve them.

Some nationally originated problems are quite specific: they are neither a creation of a state nor that of the market forces. Air, water, wildlife and forests are, of course, a common good and our common heritage. As well as city squares, sidewalks, national knowledge, language and democratic process. These "commons" are providing stability and continuity, but stay contradictory to the inherent market rules striving for profit.

Such "common heritage" is based on collective values contra private ownership and goods used for profit by the few. Most economic theories regarded "commons" as a primary economic source, i.e. forests are worthless until they turn into timber, quiet is worthless until it is surrounded by hotels; national policies are good until they create regional disturbances.

Economic theories change in line with ordinary life's transformations; and so does consumer's utility. Economic policy, first, is to become a policy of the "common heritage" and, only second, serve the market. Therefore the state is to promote both the commons and the market, although differently. A nation's wealth is to be based on both, i.e. on thriving commons' sector and on adequately prosperous market. The latter will endure, as it provides for initiative and progress, which is even more important for national wellbeing, as soon as states strive for a healthy and creative community.

On top of this, the state is to maintain a common good providing adequate legal structures and necessary government support. Big changes are needed in attitudes to "common good", both from governments and private parties. The time for that has come! •

Educational roots to progress

By Eugene Eteris
from Copenhagen

It was an outstanding day for both universities, the two leading academic and educational institutions in the Baltic region, and the modern world as well. At 15:10 on November 8, two famous women, Rector Linda Nielsen of the Copenhagen University and Rector Ludmila Verbitskaya of the St. Petersburg State University, in the presence of numerous deans from both universities signed a historic document, i.e. an agreement of cooperation. It has to be mentioned that it was the second agreement of this kind; the first one was concluded in 1999 but, according to both rectors, it somehow was not very efficient.

In a short interview to the *BC* international editor after signing of the bilateral agreement, the two rectors acknowledged three main ideas that had been kept in the new agreement: first, to secure the Baltic regional area of education and science; some of the activities already have taken place within the Baltic Sea Region University Network (BSRUN). Second, to provide for "common" comparable education programs in various fields; and third, to step up the exchange of students and teachers, providing necessary conditions for practical implementation of the educational cooperation in the Baltic region.

It became obvious from very informative presentations made by the Copenhagen University Pro-Rector **Jergen Olsen** and the St. Petersburg State University Vice-Rector **Stanislav Tkachenko** that the two big and important universities in Europe were just made for cooperation. Although the Copenhagen University is almost two times older than the St. Petersburg State University, the two universities are quite comparable in their activities. (See descriptions of the universities).

Danish and Russian universities have numerous cooperation agreements with educational institutions throughout the world, e.g. the SPSU has over 100 agreements with universities in 50 countries, the KU has exchange partnerships with about 230 European universities, as well as more than 100 universities in other parts of the world.

The SPSU Rector Ludmila Verbitskaya reminded the Russian readers of the *BC* that it would be possible for students at the SPSU University to acquire a "European diploma", starting somewhere in 2010. Almost all European states and Russia in November signed a corresponding regional agreement in order to facilitate the process of creating a mutually recognizable diploma in Europe. •

The BC archives

The BC archives

University of Copenhagen (KU), Denmark. Rector Linda Nielsen.
The KU was founded in 1479 by King Christian I with the permission of the Pope. It is the principal research and educational institution in Denmark. Internationally renowned scientists, who have worked in the KU, include physicist **Niels Bohr**, historian **Ludvig Holberg**, astronomer **Ole Remer** and physicist **H.C.Erested**. The KU research program for 2003-2007 is oriented towards three major themes: Religion in the 21st century, Body and Mind, Biotechnology. The KU educational efforts are based on six faculties offering about 200 programs for study in the humanities and health science, law, science and theology. The KU programs generally follow the so-called 3+2+3 structure, i.e. three degree program types: Bachelor's, Master's and PhD (plus several Professional Master's programs). The KU yearly budget is about USD 35 million. Total number of students is 32.5 thousand (full-time and part-time). More information on: www.ku.dk

St. Petersburg State University (SPSU), Russia.
Rector Ludmila Verbitskaya.
The SPSU is the oldest Russian university and it was founded by Emperor Peter the Great in 1724. In addition to 19 faculties, the SPSU also has 13 research institutes. Several Nobel laureates have taught at the university. The educational system is heavily based on the traditional 5-6-year term of studies, although the Bologna educational convention signed by Russia in 1988 has opened the way for the "3+2+3" system. Russian President **Vladimir Putin** is a graduate of the Faculty of Law at the SPSU. There are more than 30 thousand students at the SPSU. More information on: www.spbu.ru

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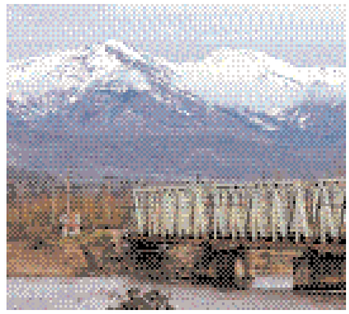

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Russian transit's Baltic course

Historically inevitable through political perspectives

The BC archives

By Nikolai Mezhevich
Professor, St. Petersburg University, Director, Center of Transborder Studies

Formation of new economic and political situation in European south and north yielded different results. The nature of economic processes in Bulgaria and Romania, destruction of power in Albania, political and humanitarian disaster in Yugoslavia, all this does not bear evidence of forward progressive movement but rather suggests sinking back into the past. Meanwhile the Baltic Sea region, weighed down by no less burdensome legacy of the antagonism between the two power blocs than in the Mediterranean area, for example, succeeded in living through the 1990s with minimum economic loss and, what's more important, with substantial gains.

The Baltic region's indisputable achievements in economic and political development are listed below:

- main security problems in the region could generally be qualified as "soft security" issues, e.g. combating terrorism, drug trafficking and resolution of environmental problems;
- the region in general demonstrates high level of cross-cultural communications, religious and confessional tolerance;
- the Baltics have come most close to the "united Europe" standards in the level, nature and quality of democratic institutions' development;
- regional authorities and in particular local councils are taking active part both in democratic processes and in economic reforms;
- economic data show a reduction of cross-regional differences in living standards and population's quality of life.

IDENTITY'S NEW QUALITY

The issue about a new quality of identity has been raised here not by accident. **Peter Unwin**, former British ambassador in Denmark, put it in the following way: "The Baltic individuality is a prize worth having. It does not preclude the sense of belonging in Europe. It will not replace national individuality and love for one's country. However, it encompasses the truth that there is something special about the Baltics. That reality survived during good and bad times. Its persistence is one more reason to feel confident about future of the Baltic Sea region."

This notion logically leads to the question why the quality of development in the Baltic region is different from that in South Eastern Europe?

The first theory can be described as an economic one. It used to be linked with indications that living standards at the end of the 1980s were higher in the Baltics than in the Adriatic and Black Sea regions. But it's not quite true. The Yugoslav republics (Slovenia, Croatia, and Serbia) had more reasons to be perceived as "the showcase of Socialism" than the Democratic Republic of Germany. Bulgarian GDP per capita was higher than in the most developed Baltic Soviet republics.

The second theory presumes that the Baltic coast was originally recognized as a no-conflict zone, historically free from military, economic and ethno-cultural controversy. In support of this theory, the Balkan wars are mentioned, using the popular quote about the Balkans being the powder keg of Europe. However, "brother-Slavs" were not the only ones to fight each other. That was also true about "brother-Scandinavians". Let us not forget Danish-Swedish wars over political control in the Baltics, conflicts in Swedish-Norwegian relations. German-Polish relations, just like Russian-Polish and Russian-German relations do not call for any comments. The brief period of Finnish independence was marked by two wars with Russia and a war with Germany. Therefore, the only two parties never at war with each other were probably Latvia and Estonia. All other participants of the political process in the Baltics have been living in constant confrontation for centuries. Nevertheless, modern international relations in the region are indeed somewhat different from the main trend in the world politics at the beginning of the 21st century. The ideology and practice of political cooperation in the region have proved to be stronger than many political ambitions.

RUSSIAN COURSE PECULIARITIES IN THE BALTICS

It should be noted that Russia also had showed itself in the Baltics in a manner different from that in other geographic areas.

The outlines of the modern foreign policy course in the region can be traced as far back into the history as to the policy of the Novgorod feudal republic. That was where, through interaction with other states and state-like formations, the basic principles and main approaches to international cooperation were formed:

- The treaties between Novgorod and the Hanseatic League, created in the 12th century, strictly defined rules for mutual trade, jurisdiction over merchant warehouses and other facilities, laid down terms for writs of trade protection, etc.
- Novgorod treaties gave detailed description of the outline of the state border and suggested a new trend of territorial division introduced into contract law.
- The contractual framework of Novgorod relations contained detailed regulations governing exchange of prisoners, restriction of military actions against certain groups of population, ambassadorial immunity.

Thus, strong ideas about a system of international relations, including economic relations, were formed in Russia already at the time of the Novgorod feudal republic, largely under influence from Western partners. The historical meaning of Baltic and Scandinavian directions in the policy of the Russian state was determined by the fact that the political process in this direction had actually never been interrupted since 12th century, even at the time of feudal disintegration and the Tartar-Mongol yoke.

The second most important peculiarity of Russian policy in the Baltics was the dominance of economic considerations. In this region economic cooperation priorities prevailed over the ideology of territorial expansion even back in the 12th-13th centuries.

The third major peculiarity of the system of international relations in the region was the large number of participants and comparatively small territory, the trend that has not changed in modern times either.

HETEROGENEITY OF THE TRANSBORDER REGION

The key reason for obvious success of Europe's Baltic region lies in the fact that a qualitatively new type of territorial community — ***a transborder region*** — emerged here because of the Cold War termination. Moreover, this region from the very beginning could encompass both states and separate territories of different states, the fact that underlines the heterogeneous nature of this transborder region from the point of view of its components. In addition, the most vital factor in this transborder region has been a network of a multitude of channels and links connecting its parts.

Examining the Baltics' role in Russian foreign policy, the following conclusions can be made:

1. Russia has significant economic, military and political interests in the Baltic-Scandinavian region.
2. Russia has searched for such models to secure its interests in the region that would correspond to Russia's existing interests and be adequate to the existing system of political and economic relations.
3. Russian interests in this region could be qualified as vital for its national security. These interests are highly stable in space and time and based on historical and ethnographic realities.
4. Russian transit through this region is becoming a logical national priority in conditions of political instability in a number of Eastern European and CIS regions as well as upon growing terrorist threat in the southern direction.

SPECIFIC RESULTS

Having defined its interests, Russia for a long time did not take any specific measures to carry them out. Russia started talking about building port facilities in the Baltics in 1992 but first concrete efforts appeared only eight years later. One should also remember that by that time attempts to "politicize" transit were already in the past, as it does not make much sense to politicize economic issues. Russia tries to get maximum profit by using the shortest and best routes to its Western European clients.

As Russia's economic situation improved, total cargo turnover at sea ports increased sharply in 2003. In the given situation, the role of the Baltic region also increased. In January-February 2004, oil exports through Russia's Baltic ports for the first time rose above oil exports through Russian ports on the Black Sea. In first two months of 2004, Baltic oil terminals handled 11% more oil for export than was sent through the Black Sea ports; the fact was even mentioned by the International Energy Agency (IEA) in March.

FUTURE PROSPECTS

According to the Russian government plans, cargo turnover at Russian ports on the Baltic Sea will grow to 190 million tons by 2010. Currently we can witness a move towards building and developing a whole complex including transport infrastructure, railway lines, customs terminals, oil terminals, gas pipelines, etc.

In the nearest future cargo turnover will grow mostly on the account of oil exports. Primorsk port handled 20 million tons of crude oil in the first half of 2004 as opposed to 6.5 million tons reloaded during the same period in 2003. Total half-year cargo turnover at Russia's major ports on the Baltic Sea, i.e. St. Petersburg, Primorsk and Kaliningrad, this year increased by 18.3 million tons. However, one should remember that aggregate cargo turnover of Russian ports in 2003 grew just 0.5% from 2002 to 104 million tons. Handling at Vyborg port rose by 15.8% to 1.9 million tons, at Vysotsk by 22.9% to 2.41 million tons, at St. Petersburg by 2% to 20.5 million tons.

Thanks to favorable tariff policy by Russian railways, ports in the Russia's Baltic enclave Kaliningrad showed good results in 2003. All ports and piers in Kaliningrad region last year reloaded 70% more cargos than in 2002.

Meanwhile cargo turnover in Baltic states (Tallinn, Ventspils, Riga, Klaipeda, Butinge and Liepaja ports) was up just 0.6% percent in the first half of this year. Naturally, the Baltic transit business is struggling to overcome the existing situation. As of September 3, Lithuanian railway increased rates for transportation of oil, oil products and ferrous metals in transit to Kaliningrad by 15% (only months after the previous rise by 11% in February this year). Such action can obviously help Klaipeda seaport. Nevertheless, from strategic perspective, the transit situation will never again become what it was in the mid-1990s. Upon favorable general economic conjuncture, there will be enough transits for many Baltic terminals, too. Provided, of course, that economic considerations would prevail over the trend to dramatize the issue.

SOMETHING ABOUT RUSSIAN TARIFF POLICY

Strange things appeared in political evaluation of financial regulations in transit business. Russian experts describe the current situation as "favorable tariff policy", whereas Baltic experts and politicians (Latvian, Lithuanian and Estonian transport ministers included) speak about "discriminatory rates".

In this context, the Baltic transport ministers' decision to turn to Brussels for advice, although quite logical, most likely would not yield positive results. It is hard to imagine a situation in which a country would intentionally disregard the economic criterion of maximizing profit. Another way out is more likely, i.e. transit diversification and provision of additional services, which would be the way for Baltic states to stabilize transit. This option has been ignored for quite a while.

For example, due to this fact, Latvia's Ventspils port lost significant share of Russian metal, mineral fertilizer and timber shipments and, in all probability, this will happen with coal too. In the 1990s, Ventspils, then a universal port, started reshaping itself into an oil reloading port. As long as there was a continuous flow of oil through the port, it meant extra income; presently it has turned into an extra problem.

In 2003, over 400 million tons of oil passed through Russian oil pipeline system run by *Transneft* company, out of which 207.5 million tons were for export, including 169.5 million tons being exported to countries outside the former Soviet bloc. Oil production in Russia has grown constantly and hit a post-Soviet record of 421 million tons in 2003 with the 2004 result planned at 450 million tons. As estimated by *Transneft* President **Semyon Vainshtok**, his company is already nearly 40 million tons short of oil transporting means; this and other oil companies have to export surplus oil by other, more expensive transportation means.

PORTS' MUTUAL INTERDEPENDENCE

There is another issue, which concerns ports' mutual complementarity and interdependence. In July 2004, a strike began in the St. Petersburg port, and because of delays in processing of cargos, clients started taking their shipments to other Baltic ports; as a result, port authorities had to fire personnel. In winter, the issue of mutual interdependence is very urgent throughout the Baltic territory's Russian side from Muuga port up to Primorsk.

The third important aspect concerning prospects for the Russian part of the Baltic transport complex relates to the fact that the Main Port of St. Petersburg is developing ahead of the plans laid down in the General Scheme for Development of St. Petersburg Transport Junction prepared by the city administration and the Russian Ministry of Transport. The cargo turnover growth to 35 million tons a year planned by the scheme for 2003 was achieved by the St. Petersburg port already in 2001 when it reloaded 36.9 million tons. Now qualitative changes of access roads to the port are needed; the price for its implementation runs up to hundreds of millions US dollars.

It has to be taken into account that the Russian government has not yet approved a decision about expanding the Baltic Pipeline System (BPS) capacity to 62 million tons a year. In Mr. Vainshtok's opinion, the BPS will reach the 50 million ton level by the end of 2004. But it will cost USD 1.9 billion to increase the annual capacity from 50 million tons to 62 million tons. Expansion of the existing pipeline system to allow for transportation of additional oil supplies to Primorsk will cost another billion US dollars. (As is well known, from 1985 to 2000 no new pipeline capacities were built in Russia. At the same time, during this period over 100 of 350 oil-pumping stations in the *Transneft* system were frozen or/and dismantled.)

Another vital aspect relates to cooperation within existing transport corridors. Undoubtedly, Russia can load its terminals with its own oil but Kazakh oil will already represent an "excess" load.

The conclusion might be such that prospects for Russian transits in the Baltics do not necessarily mean lack of perspective development for the Baltic ports. Qualitative growth of competition, improvements to auxiliary services, rather complicated search for ways to build trans-border cooperation, these are the issues for discussion. These are exactly the prospects for our common Baltic course. •


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Three agreements signed in Kazakhstan

Olga Pavuk

In the beginning of October, Latvian President Vaira Vike-Freiberga paid a state visit to the Republic of Kazakhstan. During the visit officials from transport, agriculture and finance ministries as well as about 50 Latvian business representatives accompanied the Latvian President, expecting to develop contacts with Kazakh business people. On this occasion, the *BC* together with the Latvian Investment and Development Agency (LIDA) published a special magazine edition, which was presented at the business forum in the Kazakhstan capital Astana.

LIDA

ASTANA: Vaira Vike-Freiberga surrounded by Latvian businessmen.

Latvian and Kazakh presidents signed three agreements during their meetings in Astana, i.e. on promotion and protection of investments, on economic, industrial, scientific and technical cooperation and on cooperation in combating terrorism, drug trafficking and organized crime. The first Latvian-Kazakh agreement on trade and economic cooperation was signed in 1994 and entered into force in January 1995. The agreement was denounced last year due to Latvia's expected accession to the EU; the latter has a partnership and cooperation agreement with Kazakhstan effective as of July 1, 1999.

TRANSIT BUSINESS A PRIORITY

Addressing the participants of the business forum, the Latvian President said: "Latvian-Kazakh economic relations have a huge potential that has not yet been used in full. This regards especially transit business". The business delegation consisted of representatives from major Latvian ports, the railway company, truckers and insurance firms. Latvian vice-premier and transport minister **Ainars Slesers** suggested that, alongside oil, cotton could also become a transit product to be transported from Kazakhstan to Europe. Latvia is ready not only to take care of cotton transit but also to organize a cotton distribution center that would serve all other EU member states. Kazakh businessmen have been offered to use Riga airport; Uzbek airline will soon start using Latvian capital as a stopover for its New York flights, with the new pricing policy promised by Latvian airport.

Kazakh companies are aware of advantages afforded by the free economic zones in Latvian ports as well as the quality of Latvian infrastructure. The cargo turnover between the two countries has increased more than 2.5 times during last four years, the amount of container cargos increased more than fivefold, and handling of all sorts of oils grew seven times. The container train *Baltic Transit* has already provided its impetus to growth of trade between the two states. *Latvijas dzelzcels* railway company board chairman **Andris Zorgevics** was very optimistic about future of Latvian ports in view of the agreement made by Latvian, Estonian, Russian, Kazakh and Uzbek railways about unified freight rates for container transportation to Central Asia through Kazakhstan and Russia. The Riga free port is ready to build in its territory a terminal for reloading cargos from Kazakhstan.

Delegation from northwestern Latvian port city Ventspils was the biggest in the Latvian business delegation at the forum in Kazakhstan. *Noord Natie Ventspils terminals*, *Ventbunkers* and Ventspils free port have been already cooperating with Kazakhstan for a long time. A Latvian-Kazakh joint venture has started construction of *Ventspils Grain Terminal*. On March 24, Kazakh vice-premier and agriculture minister **Akhmetzhan Yesimov** attended the ground-breaking ceremony. It is planned that the terminal will start operations in July 2005.

Latvia is interested in handling Kazakh foreign trade shipments. Kazakhstan itself does not have direct access to international maritime routes, and Latvia can offer attractive transit services through its territory. In this way both countries have common interests and Latvia hopes that Kazakhstan, more actively developing its interests, could facilitate a dialogue with Russia as regards transit transport.

BY JOINT EFFORTS

Latvian business delegation to Kazakhstan, apart from transit businesses, included also representatives from energy and metal-processing companies, food industry, wood-processing industry, IT and telecommunications, financial sector, pharmaceutical industry, tourism, construction, education, trade, etc. Some of these economy sectors already have representation offices or joint ventures in Kazakhstan, for example, *BTA* insurance company, *KazBalttTrans* (cargo transit), *KazBaltGroup* (construction investments), *KazDitton* (representation of the Daugavpils motor chain plant), *Olainfarm* (pharmaceuticals), *Parex Bank* and *Trasta Komercbanka* banks.

In the first quarter of 2004, Kazakh investments in the companies registered in Latvia amounted to USD 6.38 million. By September this year, 38 joint Latvian-Kazakh ventures have been registered in Latvia. •

Reaching for heart of Asia

By Mikhail Tuzhikov

A large Latvian delegation headed by Latvian President Vaira Vike-Freiberga visited the Kazakh capital Astana on October 7-9. *Latvijas Dzelzcels* (*LDz*) railway company board chairman Andris Zorgevics agreed to tell the *BC* about results of this visit and possible future cooperation with "the heart of Asia".

LIDA

ASTANA: Zorgevics receives Honorary Badge of Kazakh Railway.

"The Baltic railway transport system is the final stretch of the CIS railway network, ending at Latvian, Lithuanian and Estonian port terminals, said Mr. Zorgevics. This is a quite advantageous position because vast mineral deposits in Kazakhstan represent, on one hand, huge opportunities for European business and, on the other hand, new ways for Kazakhstan and Russia to reach the European population of half a billion. After all, Russia and Kazakhstan are great transit territories leading to the gigantic South East Asian market with huge human and raw materials resources (the population of China, Japan, Korea and India makes up 2.5 billion people or 42% of the total world population). This is why *LDz* has to "stake out a claim" already today, making the company feel more confident about the future.

Few years ago we started working on a project called the Baltic Product that envisaged cooperation between the three Baltic states and Russia's Kaliningrad region in offering their services on the East-West transit route. Then we developed another project, the Asian Product, which immediately drew interest of Central Asian countries — Uzbekistan and Kazakhstan. As a result, our countries made an agreement about a joint strategy for container transportation from the Baltics to Central Asia via Russia and Kazakhstan, and the last signature under this document was put during the visit to Astana.

Speaking about container freight, we look with optimism at new opportunities opening up with development of a railway transport system through Afghanistan and Pakistan to India. We could create in Riga an pan-European logistics center and provide services in the entire region, especially considering Latvia's advantage of being close to Russian and Belarus borders.

In future transits will continue to growth both along the Trans-Siberian route and in the southern direction. One only has to have a clear idea of economic benefits to the Latvian state from cooperation with eastern neighbors. Latvia's accession to the EU and NATO has eliminated the danger of foreign invasion and now all thoughts should be turned to ways for strengthening mutually profitable economic relations with neighbors". •

VOLUMES OF TRANSPORTATIONS OF CARGOES ON THE LATVIAN RAILWAY FOR 10 MONTHS 2004, THOU. TONS

	October, 2003	October, 2004	% 2004 to 2003	10 months 2003	10 months 2004	% 2004 to 2003
Total cargoes	3269	4195	128.3	39691	42872	108.0
Import	2518	3375	134.0	32659	35390	108.4
Incl. through port terminals	2140	3003	140.3	29333	31784	108.4
Export	220	144	65.5	2408	1822	75.7
Incl. through port terminals	120	40	33.3	1622	918	56.6
Internal transportation	273	312	114.3	1931	1991	103.1
Overland transit	258	364	141.1	2693	3669	136.2
By kinds of cargoes:						
Oil	1145	1519	132.7	19272	17737	92.0
Coal	592	1218	205.7	5670	11202	197.6
Mineral fertilizers	578	548	94.8	5939	5644	95.0
Mineral raw materials	232	196	84.5	1545	1615	104.5
Ferrous metals	131	155	118.3	1686	1456	86.4
Wood	91	128	140.7	997	1305	130.9
Chemicals	115	102	88.7	925	995	107.6
Sugar	66	8	12.1	958	455	47.5
Grain and flour	36	55	152.8	625	330	52.8
Others	283	266	94.0	2071	2133	103.0

Source: LDz.

KAZAKHSTAN TODAY MEANS:

- a population of 15 million;
- good relations with Russia, China and the EU (Brussels introduced "special terms of market economy" in respect of Kazakhstan as of October 12, 2000) as well as with the League of Arab States;
- US investments in excess of USD 4 billion;
- a 40-year contract with the US company *Chevron* for development of the Tengiz oil field worth USD 20 billion;
- prospective oil deposits containing over 13 billion tons (the second largest in the world after the Saudi Arabia);
- first place in the world by prospected resources of zinc, wolfram and barytes, second place by silver, lead and chromites, third place by copper and fluorspars, fourth by molybdenum, sixth by gold;
- exports of coal, rolled alloyed and non-corrosive steel and other steel products, cast-iron pipes and ferrous alloys, grain.

Time “to play” in Russia

By Olga Pavuk

While Russian and Latvian politicians are busy defining their attitude towards each other, those in charge of economic affairs are helping businessmen “to build bridges”. Latvian Economics Minister Juris Lujans made a two-day visit to Moscow in October. During this visit Latvian officials succeeded in laying down foundations for cooperation with two largest and most influential business associations in Russia — the International Congress of Industrialists and Entrepreneurs and the Moscow Chamber of Commerce and Industry.


Ministry of Economics

FRIENDLY HANDSHAKE: Juris Lujans (on the right) and Suren Vardanyan.

For the first time since restoration of Latvia’s independence in 1991 Latvian government officials succeeded in reaching an agreement on close cooperation with the most serious Russian business organizations. As Mr. Lujans said, this is a signal to business people of both countries to start taking decisive actions: “Let’s stop sizing each other up, trying to make out detailed rules of the game. It is time to play!”.

FIRST LEGAL ACT

The International Congress of Industrialists and Entrepreneurs (ICIE) was founded in 1992 by **Arkady Volsky,** currently its honorary president. The ICIE now consists of members from 24 national business unions from the CIS countries, Baltic states, India, China, Hungary, the Czech Republic, Poland, Moldova, Bulgaria, Romania, Slovakia. The Congress has many functions, including lobbying for business interests, organization of negotiations about cooperation, presentations and fairs, consultations on all types of business activities, etc.

During the three-hour long roundtable talks at the ICIE, Mr. Lujans, accompanied by the Latvian Economics Ministry officials and the Latvian Investment and Development Agency (LIDA) director **Juris Kanels,** business and media representatives, talked to the ICIE officials, scholars and other interested parties.

The ICIE vice-president **Vladimir Kolmogorov** set the positive note to the meeting from the start saying: “I’m sure that this meeting will create an impetus for Latvian and Russian businessmen willing to carry out joint projects, make mutual investments, organize new companies. Today we are fully at your service and ready to answer any questions about future partnership.”

Mr. Lujans said in his turn that Russia had always been an important trade partner for Latvia. Last year the Russian Federation occupied the seventh place in the list of countries importing Latvian goods and services, and the third place by exports to Latvia. “Our country exported to our Eastern neighbors goods totaling USD 170 million and we received from Russians about USD 950 million worth of goods, he said. Total goods turnover growth in 2003 was around 35% and topped one billion US dollars”.

As one of the options for further cooperation the Latvian economics minister suggested participation of Russian businessmen in organizing industrial, scientific and technological parks in Latvia, first of all in the eastern region of Latgale bordering with Russia.

The roundtable meeting resulted in signing of the Framework Agreement on Cooperation between ICIE and LIDA. Mr. Kolmogorov described the agreement as a unique document. He said that for the first time a government-private partnership between two organizations has been created taking the form of a legal act. “And this is just the beginning. In future joint informational and marketing portal may be organized to help businessmen from both countries in trade and new contacts”, he said.

Some Latvian business people received practical assistance; thus, **Vitaly Kozlovsky**, director of the Latvian company *KRES,* got a promise from the economics minister to assist in sorting out obstacles connected to trade across the border.

COMMON INTERESTS

The Latvian delegation’s visit to the Moscow Chamber of Commerce and Industry (MCCI) was fruitful as well. **Suren Vardanyan**, the head of the Foreign Economic Affairs Directorate, received Latvian guests. There are over 5,000 companies working under the auspices of the MCCI that has close ties with the Moscow city government and Russian federal ministries. The main objectives of the Moscow Chamber (there are as many as 162 chambers of commerce and industry throughout Russia) for most part are the same as those of similar foreign organizations. The MCCI represents interests of business people in relations with the state authorities, creates conditions for building a socially oriented market economy, and helps to build legal background for business environment and its infrastructure.

The Moscow Chamber also has some unique authorities, i.e. according to the Russian law it has the right to suspend any unauthorized and unmotivated interference by any government agency into affairs of a business company, an MCCI member. In other words, the MCCI protects businesses from arbitrary actions by state officials.

During the meeting, it was agreed to set up a commission for trade and economic cooperation with the Baltic states. Mr. Vardanyan invited LIDA to participate in the commission. The Latvian economics minister was very enthusiastic about the offer: “We have common interests. And at the same time we are looking for the best and fastest channels to speed up cooperation between business people, and I think we have found it”.

LIDA director Juris Kanels explained to the *BC* that the MCCI is ready to organize on a commercial basis meetings between Latvian and Russian companies, as well as business visits and business forums. “The MCCI has among its partners all leading organizers of Russian trade-fairs, e.g. *Expocenter, VDNH, Sokolniki,* etc. It means that our companies will have the broadest opportunities to advertise their products. From Latvian part, we will try to involve the Russian side into activities by our *Euro Info Center*, supplying all sort of information about business in the EU, as well as in Latvia.” •

"It's trying to break free, it wants to get outside..."

By Olga Pavuk

Anna Kalnish is 24. Born in the Latvian capital Riga, she has graduated one of the leading European business schools with a degree in business administration. She got married and moved to Canada. She was lucky to find a prestigious job quickly... Out of the blue, in spring of this year Anna started writing poems — both in English and Russian. One of Anna's Russian poems is called "My Beloved City", which is about Anna's most favorite and dear to her heart city. Although Anna was born in Riga, this poem turned out to be about ...Toronto...

- Anna got her secondary education in Riga. She managed to complete two final years of the high school program in just one year, and graduated with distinctions. Every summer since the age of 13, Anna attended summer language schools in England.
- After finishing the high school, Anna was adamant to pursue her higher education in England. She successfully passed the required English language qualification tests at the British Council in Riga, and got accepted to the Oxford Brooks University to a Business Administration, Management and Law undergraduate program in September 1997. Anna graduated with Honors in 2001. Her theses' theme was "Applicability of Motivation Theories and Practices in Eastern Europe".
- In October 2001, Anna and her husband moved to Toronto, Canada. Shortly thereafter, Anna found a job as a management secretary in the *Maple Leaf Foods Inc.* central office. This spring Anna's dream came true when she got Human Resources Manager position in one of *Maple Leaf Foods* company branches. •

MISSING

You talk, but none seems to listen,
You walk, but none sees your steps,
Even your shadow's always missing,
You don't exist, and yet you live.
You try to scream at people's faces,
You try to touch somebody's hand,
You're like a ghost that travels places,
But cannot find its dear land.
When woken up by early sunrise,
You think, "thank god, the day has come"
You hope today will stop the races,
Today, today you will be found!
Sunset is like a million gunshots
That tear apart your gentle soul,
There is not doubt you're one of hundreds,
That never ever find their home.

A STRUGGLE OF THE SEED

A little Asian seed was trying to break free,
To loosen all the walls and stop its misery.
It did not seem so bad, when it was very small,
But now the shell somehow restricts its healthy grow.
It's trying to break free, it wants to get outside,
To stretch towards the sun, and to enjoy its light;
It wants to see the sky, to listen to the birds,
The seed's growing fast; the shell is tight and hurts.
The happy day is near, the shell is almost past,
The seed will reach outside, and will be free at last.
It focuses so hard on strengthening its core,
One day it'll be a tree on a Muskoka shore.

ON THE STREETS OF SWITZERLAND

Narrow streets and low-rise houses,
Shiny lake and bright-white swan,
This is where your spirit raises,
This is where you feel like home.
Filling up your lungs with fresh air,
Breathing in ecstatic mood,
This will cure past despair,
Once again you will feel good!
Just relax, enjoy the brightness,
Take a walk and feel the breeze,
Let sun hug you with its kindness
It will help your heart unfreeze!
You'll wish you'd come more often,
Even though it's not homeland!
Wounds will heal; your heart will soften,
On the streets of Switzerland

HOPE FOR ANOTHER DAY

Today is tough,
It's windy and it's wet,
Today I am alone,
Today I'm very sad.

Along with tears, sadness,
Trouble finding way,
Hope lives in me,
Hope for another day.

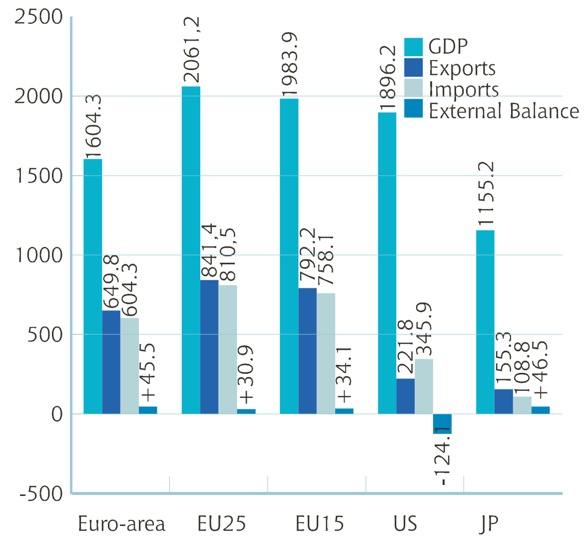
Hope for another sun,
Hope for another wind,
I hope that everyone,
Will change for different.

I hope for better day,
I hope for bluer sky,
I hope God stays with me,
I hope I will know "why?".

I hope I'll know for sure,
That future will be bright,
My family secure,
My living path is right.

I hope for happiness,
Although the sky is gray,
I'll keep my hope with me,
Hope for another day!

EUROPE AND THE WORLD, Q2 2004, BLN EUR



Source: Eurostat.

GENERAL GOVERNMENT DEBT (at the end of quarter)

	Latvia	Lithuania	Estonia
Total, mln EUR			
Q1 2004	1275.0	2598.0	395.0
Q1 2003	1276.0	2950.0	361.0
Per capita, EUR			
Q1 2004	551.0	755.0	n.a.
Q1 2003	548.0	852	n.a.

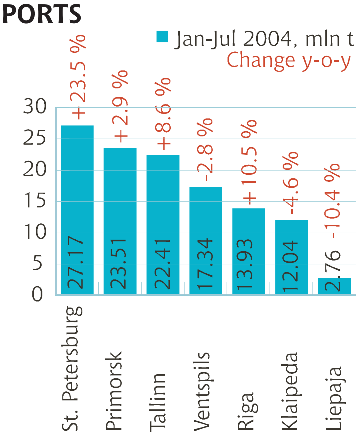
Source: Latvian Central Statistics Office.

FOREIGN TRADE, Q2 2004, MLN EUR

	Latvia	Lithuania	Estonia
Exports (FOB):			
Total	800.0	1737.0	1157.0
to EU25	635.0	1109.0	951.0
% of total	79.0	64.0	82.0
Imports (CIF):			
Total	1411.0	2441.0	1934.0
from EU25	1056.0	1624.0	1552.0
% of total	75	67.0	80.0
Foreign trade deficit	-611.0	-705.0	-777.0

Source: Latvian Central Statistics Office.

CARGO TURNOVER IN BALTIC PORTS



Source: BNS, port information.

AVERAGE PRICES FOR GOODS AND SERVICES, EUR PER KG

	Latvia		Lithuania		Estonia	
	April	July	April	July	April	July
Pork	2.57	2.60	2.43	2.83	3.21	3.13
Chicken	1.98	1.92	1.58	1.80	2.39	2.39
Boiled sausage	2.66	2.61	2.46	2.63	2.43	2.56
Butter	2.92	3.00	3.40	3.49	3.36	3.58
Milk, 2.5% of fat, 1l	0.46	0.47	0.47	0.47	0.45	0.44
Eggs, 10 pcs	0.93	0.90	0.76	0.64	0.91	0.88
Rye bread	0.67	0.68	0.62	0.66	0.80	0.81
Wheat bread	0.82	0.84	0.81	0.85	0.91	0.93
Sugar	1.00	0.99	0.94	0.98	0.46	1.03
Potatos	0.21	0.27	0.19	0.41	0.34	0.51
Vodka 40% alc. vol., 1l	7.98	7.75	6.96	6.97	8.36	8.34
Petrol A-95, 1l	0.64	0.69	0.73	0.78	0.62	0.69
Electricity, per 100 kWh	6.85	6.76	8.40	8.40	7.00	7.00

Source: The Latvian Central Statistics Office.

INDUSTRIAL OUTPUT GROWTH IN CONSTANT PRICES, H1 2004

	Latvia	Lithuania	Estonia
% over the same period, 2003	107.9	113.4	107.4

Source: The Latvian Central Statistics Office.

INFLATION, JULY 2004

	Latvia	Lithuania	Estonia
% over June 2004	0.2	0.0	0.3
% over July 2003	6.7	1.9	4.1

Source: The Latvian Central Statistics Office.

WAGES, EUR

	Latvia	Lithuania	Estonia
Monthly average, Q2 2004			
Old-age pension	102.0	100.0	136.0
% over Q2 2003	109.6	109.0	108.5
Gross wage	316.0	354.0	474.0
% over Q2 2003	109.0	106.6	107.3
Minimum wage, July 2004	120.0	145.0	159.0
% over July 2003	114.3	116.3	114.8

Source: The Latvian Central Statistics Office.

GDP AND GROSS VALUE ADDED BY INDUSTRY, Q2 2004, MLN EUR (based on seasonally adjusted data, at constant prices 1995)

	GDP	Agriculture, hunting and fishing	Industry, incl. energy	Construction	Trade, transport, communication services	Financial services and business activities	Other services	Total Gross Value Added	FISIM*
Euro-area	1 604 329.2	38 033.2	344 773.3	77 549.9	333 136.5	405 580.3	319 216.9	1 518 290.0	67 030.7
EU25	2 061 199.7	45 570.7	441 925.5	97 383.1	435 544.5	508 004.5	403 428.4	1 931 856.7	82 991.2
EU15	1 983 852.1	43 216.1	420 939.4	93 563.3	416 430.3	498 537.7	391 828.4	1 864 515.1	81 412.3

* *Financial Intermediation Services Indirectly Measured.*

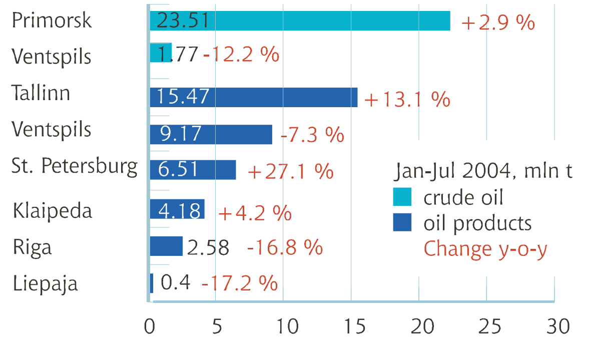
Source: Eurostat.

FOREIGN DIRECT INVESTMENTS

At the end of quarter	Latvia	Lithuania	Estonia
FDI, stock, total, mln EUR			
Q1 2004	3011.0	4116.0	5539.0
Q1 2003	2687.0	3992.0	4119.0
Per capita, EUR			
Q1 2004	1300.0	1196.0	4085.0
Q1 2003	1154.0	1154.0	3038.0
FDI, flows, mln EUR			
Q1 2004	110.0	186.0	162.0
Q1 2003	106.0	151.0	294.0
% of GDP			
Q1 2004	4.6	4.9	8.9
Q1 2003	4.7	4.2	15.6

Source: The Latvian Central Statistics Office.

OIL AND OIL PRODUCTS HANDLING IN BALTIC PORTS



Source: BNS, port information.

GDP VOLUME GROWTH (based on seasonally adjusted data)

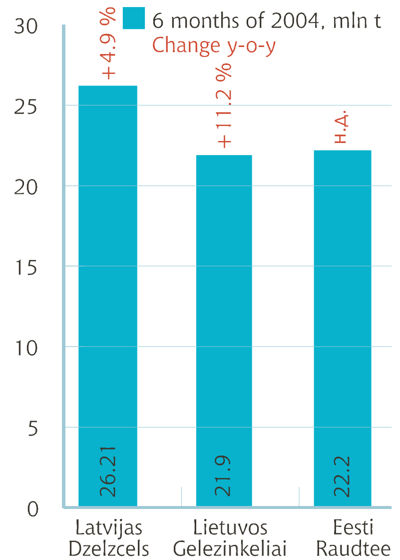
	Change in % q-o-q						Change in % y-o-y	
	2003	2004	2003				2004	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Euro-area	0.5	0.4	0.6	0.5	0.3	0.7	1.3	2.0
EU25	0.6	0.5	0.7	0.6	0.7	1.1	1.7	2.3
EU15	0.5	0.5	0.7	0.6	0.6	1.0	1.6	2.3
EU Member States								
Belgium	0.6	0.7	0.7	0.8	0.8	1.3	2.0	2.8
Czech Republic**	0.7	0.7	n.a.	n.a.	3.3	3.3	3.1	n.a.
Denmark	0.8	0.5	1.0	0.2	0.4	1.4	1.5	2.5
Germany	0.3	0.3	0.4	0.5	-0.3	0.0	0.8	1.5
Estonia	2.2	1.1	1.2	n.a.	5.0	6.1	7.0	n.a.
Greece	1.9	-0.3	2.9	-0.6	4.3	4.3	4.0	3.9
Spain	0.6	0.7	0.7	0.5	2.6	2.8	2.7	2.6
France	0.8	0.5	0.8	0.8	0.4	1.0	1.7	3.0
Ireland	-2.4	5.6	0.6	n.a.	0.6	5.1	6.0	n.a
Italy	0.4	0.0	0.4	0.3	0.4	0.1	0.7	1.1
Cyprus**	1.2	1.7	0.2	n.a.	1.8	2.6	3.2	n.a.
Latvia*	n.a.	n.a.	n.a.	n.a.	7.3	7.5	8.8	n.a.
Lithuania**	2.5	2.2	1.4	n.a.	8.8	10.6	7.7	6.9
Luxembourg	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Hungary	1.0	1.1	1.1	n.a.	2.9	3.3	4.1	n.a.
Malta*	n.a.	n.a.	n.a.	n.a.	-0.4	1.5	2.3	n.a.
Netherlands	0.1	0.5	0.6	-0.2	-1.4	-0.5	0.6	1.1
Austria	0.2	0.2	0.2	n.a.	0.6	0.8	0.5	n.a.
Poland*	n.a.	n.a.	n.a.	n.a.	4.0	4.7	6.9	n.a.
Portugal	-0.5	-0.1	0.6	n.a.	-0.9	-0.4	0.1	n.a.
Slovenia**	1.0	0.5	n.a	n.a.	2.3	2.5	3.7	n.a.
Slovakia*	n.a.	n.a.	n.a.	n.a.	4.2	4.7	5.5	n.a.
Finland	0.6	0.3	0.8	1.0	2.4	1.7	2.5	2.8
Sweden	0.7	0.8	0.8	0.9	1.7	2.3	2.6	3.3
United Kingdom	0.9	1.0	0.7	0.9	2.2	2.9	3.4	3.7
EFTA								
Norway**	1.2	0.5	1.0	n.a.	1.5	0.7	3.2	n.a.
Switzerland**	0.5	0.5	0.4	n.a.	-0.6	0.0	1.5	n.a.
Main Partners								
United States	1.8	1.0	1.1	0.7	3.5	4.4	5.0	4.7
Japan	0.6	1.8	1.6	0.4	1.8	3.5	5.2	4.5
Canada	0.3	0.8	0.7	1.1	1.3	1.7	1.7	3.0

** Non-seasonally adjusted data.*

*** Change in % year-on-year calculated from non-seasonally adjusted data.*

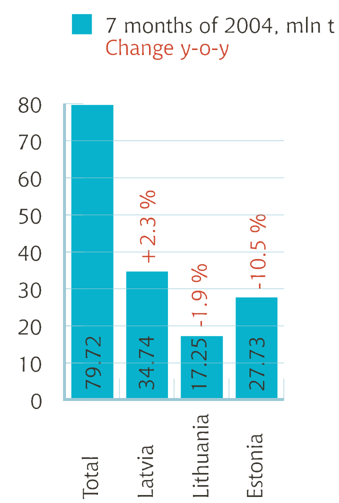
Source: Eurostat.

CARGO TURNOVER OF BALTIC RAILWAYS



Source: BNS.

CARGO TURNOVER IN BALTIC PORTS



Source: The Latvian Central Statistics Office.

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