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Long-term Strategies for the Central and Eastern European Candidate Countries after their Entry to the EU

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The Inflows of Foreign Direct Investments into Lithuania: Main Determinants, Trends and Developments 1996-2002

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Introduction

Estonia, Lithuania and Latvia are seen as the most advanced countries in the transformation reforms among the ex-Soviet republics, and at the same time they offer the most favorable laws for foreign investors. This is why, even though the absolute value of the FDI[1] inflows into these countries is lower than in Russia or Ukraine, in relative terms[2] it is significantly higher and places these countries among the leaders in the Baltic region. However, there is no existing theory used to calculate the FDI impact on the economy on the scale of gains and losses. We can only estimate the extent to which the FDI inflows meet our expectations in fulfilling insufficient capital inflows, encouraging export growth, decreasing unemployment, intensifying the economic development of the less developed regions, raising the main macroeconomic indices (GDP and GDP per capita) and the country's international economic competitiveness. Lithuania is a small country, which is why every large investment project has an impact on the country's economic development. The fulfillment of these expectations also depends on the main motives and determinants of the foreign investors.

The main objective of this paper is to show the main determinants, trends and developments of FDI inflows into Lithuania from 1996-2002. I will try to identify the positive correlation between the inflow of FDI and the international trade structure as well as GDP and GDP per capita in Lithuania.

1. Inflows of foreign direct investments into Lithuania in comparison with other Baltic States

The total foreign direct investment value for the Baltic States at the beginning of 2000 amounted to 6,2% of such investments in East-Central Europe (ECE). The differences in trends and amounts of flows weren't that significant. Estonia, with some 1728,8 USD of FDI per capita is in second place among the ECE countries, Latvia with 669,7 USD per capita is in fifth place and Lithuania with 560,3 USD is in sixth place (Table I)[3].

Lithuania received the accumulated amount of 2063 millions USD[4] of FDI at the beginning of 2000, which is a high share, considering the symbolic amount of FDI received in 1992-1995. The intense interest from foreign investors is observed from 1996 when this figure doubled in comparison to the previous year, and in 1998 the amount of FDI was the highest among the three Baltic States - at 926 million USD. However, in 1999 there was a decline in inflows compared to the previous year. The capital from the EU amounted to 72 % of the total investment value in 2000. The main investors came from the Scandinavian countries, while US capital amounted to 20%.[5]

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[1] According to the definition of the OECD, foreign investment takes place if the investor achieves or posses a "lasting interest" in the foreign company. To obtain so called ,,interest" is to own 10% of ordinary shares or votes.

[2] the ratio of the per capita to net expenditures for the fixed assets.

[3] A. B. Kisiel-Lowczyc, Baltycka Integracja Ekonomiczna, PWE, Warszawa 2000.

[4] Ibidem

[5] Ibidem, p. 20-45.

Table 1. Foreign direct investments into Lithuania, Estonia and Latvia 1992-2000 (in millions USD)

Country	1992	1993	1994	1995	1996	1997	1998	1999	2000
Baltic States	119	238	460	454	685	1142	1863	1139	1148
Estonia	82	162	215	202	151	267	581	305	398
Latvia	29	45	214	180	382	521	357	347	400
Lithuania	8	30	31	73	152	355	926	486	350

Source: *Economic Survey of Europe 2001*, Geneva 2000.

2. Main economic factors of inflows

2.1. Labor costs and professional qualifications

The labor market, despite other economic and political factors, mainly depends on the demographic situation of the country. In comparison to the West Baltic countries, where there has been some population growth, the East Baltic States have been confronted with a decreasing and ageing population since the early 90s. Nevertheless, the Baltic States have a long-term tradition of investing in education and training, so labor qualifications seem to be especially attractive for foreign investors. Lithuania's spending on research and education increased significantly, from 0,26 % of GDP in 1996 to 5,3% in 2000. The percentage of people with a higher education in 2000 amounted to 22 % and those with a secondary education was 18%, which indicates a growing number of higher educated and qualified people.[6]

However the average monthly salary is still under 300 USD and is approximately only 1/10 of the monthly average in the EU countries. It is also 20%-50% lower than in some Eastern and Central European countries. The unemployment rate is the highest among the Baltic States and is currently 15,3%[7].

2.2. Market size and infrastructure

Lithuania is the biggest market among the Baltic States with a population of 3.7 million[8], Latvia has 2.5 million and Estonia 1.4 million.[9] This explains why most of the investment flows into Lithuania have been motivated by further export production opportunities to CIS, Scandinavia and the Baltic States. One of the greatest economic advantages of Lithuania results from the favorable export environment largely due to the improvement of its transportation infrastructure. The EU's Transport Commission designated Lithuania as the region's transport hub, with 2 out of the 10 priority corridors in Europe intersecting in the country. For example, a network of European-standard 4-lane highways links the major industrial centers. Road construction is currently underway in order to connect with the Trans-European transportation network. It is also a part of the transportation system around the Baltic Sea region and a transportation axis linking Russia and the Baltic Sea.

[6] Statistikos Departamentas, Vilnius 2001.

[7] Ibidem.

[8] Leksykon panstw swiata , PWN, Warszawa 2000.

[9] Ibidem.

The banking infrastructure has been stabilized significantly since the financial crisis in 1996[10]. There are 9 commercial banks, 4 branches of foreign banks and one representative of a foreign bank. The national currency (Litas) had been pegged to the American dollar since 1992 and had a fixed rate, which was an advantage in attracting foreign investors. Since 2001, the Litas has been tied to the Euro.

Lithuania has established favorable institutional frameworks for foreign investors. Since 1999, the government has granted permission to establish branches and representatives of foreign companies. Also, there are no constraints on the movement of capital. However, restrictions are still imposed on the acquisition of agricultural land.

Other factors: service and living costs are among the lowest in Central and Eastern Europe, world class export production[11], multinational investor satisfaction, rapid growth of e-business[12], strong FDI growth, etc.

3. Main political factors of inflows

3.1. Macroeconomic stability

In 2000, economic activity expanded in all three Baltic States for the first time. The GDP of these countries grew by over 4% in 2000. The fastest growth was recorded in Latvia (6.6%) and Estonia (6.4%). Domestic demand also increased, gross domestic investments grew by more than 5 % and household consumption expenditures went up by 3.0%. In 2000, Lithuania and Latvia had the lowest rate of inflation rate among CEE countries -1.4% and 1.8% respectively.[13]

Estonia holds first position in the region regarding the evaluation of the business environment (Table 2). Lithuania has been overtaking Latvia's position in the regional rankings and now has a higher score compared to the period 1996-2000.

Table 2. Business Environment Scores and Ranks

	2001-2005		1996-2000		2001-05/1995-2000	
Country	Total score	Regional rank	Total score	Regional rank	Total score	Regional rank
Estonia	7.40	1	6.86	1	0.54	0
Latvia	6.88	7	5.87	6	1.01	-1
Lithuania	6.95	6	5.74	7	1.21	1
Poland	7.07	3	6.22	3	0.85	0

Source: *Economist Intelligence Unit,* 2001.

[10] due to the banks' insolvency and an impact of the Russian crisis in 1998, which worsen the trade balance with Russia.

[11] Most foreign businesses invest in Lithuania for export production purposes. Many local producers have already achieved ISO 9000 status. Lithuanian exports to Western markets in 2001 were over US$ 3,7 billion and growing.

[12] Lithuania has adopted the Law on Electronic Signature at the same time as the USA. Government policy helps to boost e-commerce and a digital "business-to-business" environment.

[13] Social and economic development in Lithuania, Latvia and Estonia, Department of Statistics, Vilnius 2000.

3.2. Privatization progress

The relatively small FDI inflows in the early stage of transformation (1992-1995) into Lithuania also resulted from more restrictive privatization policies. Privatization or so-called voucher privatization was designed to enable local smaller investors to make gains during the process. Some 15 big manufacturing companies were privatized. Only at the end of 1993, Lithuania organized the first open public bids for foreign investors, with some 14 investors participating. However, the privatization of the main infrastructure companies was postponed until 2002. In 2000, some 951 companies were privatized, 575 of these as long-term assets. The biggest privatization contracts were signed in 2000: the sale of 25% of the shares in Lithuanian Telecom (85), 94 % in JSC ,,Geonafta" and 56,94% JSC in the Lithuanian Development Bank, etc.

In the near future, privatization will continue to attract new FDI inflows into Lithuania, however, the biggest part of the privatization process is expected to be completed.

4. The role of FDI in the process of economic transformation and capital formation in Lithuania

The total accumulated FDI received by Lithuania in 2000 amounted to 2063 million USD[14], whith some 341,7 million USD consisting of long- and short-term loans. The per capita figure in 2000 was 529,0 USD.[15] There are various reasons for the irregular behavior of FDI inflows (see Table 1). From 1994 to 1999 there was a strong correlation between privatization and FDI inflows. Since 2000, FDI inflows have also resulted from the growth of reinvested earnings made by foreign investors. Starting in 1997, stabilization of FDI inflows was expected to occur. In reality, 1998 turned out to be the most successful year for Lithuania in attracting FDI. Similar trends occurred in the other two Baltic countries, which in 1997-1999 ranked particularly high in terms of FDI inflows as a percentage of gross fixed capital formation[16]: Latvia 30.7%, Lithuania 24% and Estonia 27.5%.

4.1. The structure of FDI: branches, sectors and foreign trade in Lithuania

Investments in the manufacturing industries have been decreasing since 1996 (38,3%) and amounted to 31.3% in 2001. A similar trend was observed in trade investments (24.4% in 2001 as compared to 31,3% in 1996), whereas investments in services increased in 2001 in comparison to 1996: telecommunications and postal services - 18% (in 1996 9,6%), financial inter-mediation -11,9 % (in 1996 5.3 %) and other sectors. Among the manufacturing industries the most attractive were food and tobacco, textiles, transport equipment, etc. (Table 3). Nevertheless, these industries also have the most favorable differences in labor productivity, which points to the competitive nature of Lithuanian industry (Table 3). Obviously, these variations in labor productivity can be largely explained by lower living standards, cheaper labor force, etc.

[14] Ibidem.

[15] at the end of 2000, Social and economic development in Lithuania, Latvia and Estonia, Department of Statistics, Vilnius 2000.

[16] World Investment Report 2001, IJNCTAD.

Table 3. FDI in manufacturing in Lithuania and average annual labor productivity growth rates in manufacturing industry in Lithuania and Austria in (%)

FDI in manufacturing in Lithuania, 2001	Average annual labor productivity growth rates in manufacturing industry, 1996-1999	
	Lithuania	Austria
Food products beverages and tobacco 40,87%	0.9	-
Textiles 11,87%	15.7	0.2
Transport Equipment 7,53 %	28.2	5.4
Other non-metalic products 6,81%	26.7	0.7
TV, communication equipment and apparatus 6,10%	45.0	7.6
Refined petroleum and chemical products 4,27 %	7.5	3.2
Wood products 4,22 %	14.3	1.8
Paper products 3,91%	8.9	-2.3

Source: *Department of Statistics,* Vilnius 2001.

One of the major reasons for the economic growth of the Baltic States was an 11.5 % increase in exports (the average was 3.2 % in 1999).[17] The flows of FDI to Lithuanian industries have significantly improved the export volume and international competitiveness of Lithuanian goods and services in world markets. This process has resulted in an increasing share of exports to the EU from the industries in question, which also absorbed the highest amount of FDI (Tables 3 and 4). The increased share of foreign trade in GDP shows that the Lithuanian economy has also become more closely integrated into the global economy. It is important to take note here of the impact of FDI and exports in terms of regional integration, through Lithuanian trade relations with Russia, Germany, Latvia, Poland as well as increasing Estonian investments in Lithuania and Latvia.

Table 4. Winning and losing industries in exports to the EU, 1996-2000

10 biggest winners	Exports ECU millions	Average annual change in %	Market share in the EU in %
Textiles	65.0	26.6	1.38
Furniture	61.8	38.4	0.74
Electrical equipment	45.5	32.6	0.47
Ships and boats	19.5	218.0	0.47
Wood products	18.2	59.8	1.11
Plastic products	17.6	47.6	0.19
TV and communication apparatus	15.5	72.8	0.09
Domestic appliances	18.3	22.4	0.41
Construction materials	13.5	11.3	2.54

Eurostad Comext Database

[17] Social and economic development in Lithuania, Latvia and Estonia, Department of Statistics, Vilnius 2000.

4.2. Geographical distribution of inward FDI stock in Lithuania

The largest number of investment projects - 61,4% - went to the Vilnius area, which created bigger discrepancies with the less developed regions of the country[18]. In terms of the total capital invested in the registered companies, the United States comes in first place with 1.159,8 million USD, followed by Denmark, U.K., Sweden, Germany, Holland, Finland, Norway, Ireland and Estonia. Poland is in 12th position, Russia in 14l and Latvia in 16th.[19] According to the Ministry of Economy the number of registered joint ventures companies with 100% foreign capital amounts to 6.934 in total - some 1.005 with German capital, 1.005 Russian and 735 Polish.[20]

The most active investors in Lithuania come from the Scandinavian countries (Table 5). The Swedish and Finish consortium Telia/Sonera has invested in the Lithuanian telecommunications and holds some 60% of the shares of the company ,,Lietuvos Telekomas". Swedish investors control the biggest bank in Lithuania ,,Vilniaus Bankas", and have also invested in the sales network, production of construction materials and mass media (controlling stock share of the television channels LNK and TV3), and the business daily journal ,,Verslo zinios". Denmark invested into mobile communications (Bite GSM), petrol sales, construction materials, breweries, etc.

Americans hold 33% of the shares in the biggest oil company ,,Mozeikiu Nafta" and have invested in the tobacco industry, non-alcoholic beverages, food industry and chemical industry. German investments are concentrated mainly in textiles, electronics, technology and also hold the controlling share in the biggest exposition center ,,Litexpo".[21]

Table 5. Structure of foreign direct investments by investing countries, 1997-1999 (in % from the total amount of the FDI)

Country	1997	1998	1999	2000	2001
Finland	4.67	4.34	10.67	10.57	6.03
Sweden	11.99	12.18	16.86	17.50	17.33
USA	28.54	25.93	18.67	13.37	9.83
Denmark	5.59	6.24	6.58	9.71	18.25
Germany	12.98	11.24	8.16	7.66	7.38
Estonia	0.93	4.27	4.31	4.14	6.40
Poland	1.02	0.93	1.78	1.97	2.19
Russia	1.83	1.46	1.70	1.39	1.00
WB	8.88	7.85	6.77	7.14	6.68
Switzerland	1.62	1.58	1.67	5.53	4.84
Norway	2.52	3.12	4.19	3.81	4.25

Statistikos Departamentas, Vilnius 2001.

[18] In second place was Klajpeda -10,7% and in third was Kaunas -10,3%, some 17% have been allocated to other regions and cities, B. Wroblewska, M. Starczewski, Litwa 2001, Suwalki-Warszawa.

[19] Ibidem, p.20-30.

[20] Review of the Economy of Lithuania, Vilnius 2000.

[21] Ibidem.

5. Projections of FDI inflows into Lithuania and the Baltic States

The completion of the privatization process has significantly decreased FDI inflows into the Baltic States. The average annual figure of FDI per capita is still the highest in Estonia (Table 6). Progress has also been observed in Latvia, which will attract the biggest annual amount of FDI until 2005 - USD 470 million. The favorable business environment, higher labor productivity, low operational costs will hopefully also attract more Greenfield investments in the near future.

The future dynamics of FDI inflows as well as their impact on the international trade structure of Lithuania will largely depend on the momentum of the economic reforms leading towards EU accession.

Table 6. Projections of FDI inflows from 2001-2005 (in millions USD, annual averages)

Country	2001-2005		
	Total	Percentage of GDP	$ per capita
Estonia	350	4.7	243
Latvia	470	5.5	198
Lithuania	450	3.1	121
Poland	6,900	3.2	178

Source: *Economist Intelligence Unit*, 2001.

Conclusion

Legal improvements for foreign investors, macroeconomic stability, rapid progress in the EU pre-accession reforms together with high labor productivity have been generating the FDI inflows into the Baltic States since the early 90s. Until 2000, a major share of foreign direct investments in Lithuania was through privatization, whereas, levels of Greenfield investments remained fairly low. Investments in services have been overtaking investments in manufacturing industry since 1996. The growth of FDI in Lithuania has enhanced the international competitiveness of Lithuanian exports.

The overall progress achieved by the Baltic States through the inflows of FDI and mutual trade exchanges has resulted in an intensification of the regional integration process. This is expected to lead to a more sustainable regional development and will therefore result in an improved infrastructure for further inflows of FDI in the future.

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