Business Eastern Europe

A WEEKLY REPORT: BUSINESS, FINANCE & INVESTMENT

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The Economist Intelligence Unit

February 28, 1994

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Management issues

Wrestling with the trade unions

Companies are paying closer attention to union issues in Eastern Europe. *BEE* looks at how Kmart approached labour relations in the Czech Republic and Slovakia

As the post-socialist transition continues, companies must pay much closer attention to union issues. The need for corporate labour relations planning in Eastern Europe is growing in significance, and foreign companies must be prepared for unpleasant as well as pleasant surprises.

The situation in both the Czech Republic and Slovakia is fairly typical of what companies now face. By law companies must either have a union agreement or have formulated an internal policy that provides minimum employment standards. If dealing with a union, companies must create an umbrella agreement with the relevant trade union association with addenda for each individual operation.

While not a model for all countries or companies, the example of the American retail chain Kmart demonstrates how one company's management has been forced to react to differing labour circumstances at its separate Czech and Slovak operations. Kmart purchased 13 department stores in Czechoslovakia, including the Prior chain, in May 1992. In the ensuing 20 months, the company has invested more than $100m, mainly for an extensive renovation programme at its stores in Bratislava and Prague. In addition to the premises, Kmart also inherited a workforce of 5,500 employees, evenly split between the Czech Republic and Slovakia. The company began to negotiate a collective agreement with the trade unions in both republics in August 1993. But this is where the similarity between Kmart's labour relations in the two republics ends.

Smooth sailing in the Czech Republic

Negotiations went smoothly in the Czech Republic, and the company was able to sign an agreement after just three weeks and three rounds of negotiations. According to Imrich Gombar, Kmart director of human resources and training for the Czech Republic and Slovakia, the Czech negotiations were so problem-free that he scarcely remembers the details.

The main points of the Czech agreement are straightforward. Under the agreement, the company must publish performance trends in an annual report, allow union representation at all company-employee meetings, provide an office and conference room for union meetings, enable fee collection and discuss safety conditions with the union. The company also has agreed to provide subsidised meals at the employee restaurant, supply uniforms, allow for two paid days of leave per year for union conferences and cover the fee for initial physical examinations. As an extra negotiated point, Kmart took over union coverage of 50% of summer camp costs for the children of company employees. The firm also promised to maintain a clearly stated wage structure and offer financial bonuses for significant periods of service (which carried over from the workers' Prior employment).

A different story in Slovakia

Although the company took the same negotiating stance with its Slovak department stores, workers there also demanded a 13th and 14th monthly payment at the middle and end of the year. While this practice is common in Germany and Austria (which deliver the pay package in 14 instalments), the company preferred to tie these

Note to readers

We've received more than 100 responses to our 1994 readership survey, and we would like to thank all of our readers who took the time to answer. In the coming weeks and months, you'll notice some changes in *BEE* as we seek to incorporate your suggestions into the publication. Your ideas and comments are highly valued and always welcome.

JOHN REED

Kmart offers incentives to enhance employee relations at its Bratislava store

extra payments to a performance-related bonus. The union also demanded the same starting salary for similar positions at each of its stores in Slovakia. The company felt this was unrealistic considering the cost-of-living differences between various regions. According to Mr Gombar, this demand was a relic of socialist thinking—that on paper everyone should be equal regardless of actual economic circumstances.

Negotiations in Bratislava ended in failure in November 1993 after nine rounds, and the company reportedly has no plans to resume them. Instead, Kmart has formulated an internal policy which meets minimum state requirements and, in fact, is as liberal as the agreement that was signed with the trade union in neighbouring Czech Republic.

Illustrating the growing unpredictability between unions in two different countries, Mr Gombar says that negotiators perceived a clear difference between the Czech and Slovak negotiators. "The Czech unions have really changed their economic thinking," he notes. "In Slovakia, the unions are still extremely socialistic. They want to have capitalism with all its advantages, but at the same time hold on to the security of the socialist system." In December Kmart negotiators asked all its Slovak store managers to explain the status of the union negotiations to workers via public meetings. "Somehow it doesn't seem that our employees are frustrated or angry," Mr Gombar says. "They realise that the trade unions cannot help them much." He says that workers understand that to have a secure job with Kmart, they must do everything possible to contribute to the store's success.

The company says that its Bratislava store, which employs 750 full-time and 100 part-time workers, is one of its most difficult stores to manage because of low unemployment in the city (4.5%) and the proximity of union headquarters, with the potential for agitation. Kmart has decided to enhance employee relations by offering store managers a comprehensive training programme, including a two-week management course in the USA. The company also offers free English classes to all employees. As an extra incentive, Kmart bestows a monthly Master of Sales award on a selected outstanding employee at the firm.

Although only a handful of Western companies actually have a workforce in Slovakia, Kmart is not alone in paying close attention to union issues. The German carmaker Volkswagen, which employs 400 workers in Slovakia, signed its first agreement with a Czechoslovak trade union in 1991. It then renegotiated its collective agreement, which took effect on January 1, 1994. The company says that it has a positive relationship with the union. Rhône Poulenc (France), which employs nearly 3,400 workers at its Chemlon Humenne joint venture in east Slovakia, signed an agreement with a trade union in December 1993, less than one year after it began production. The company, which produces synthetic fibres and polymers, says it had "no serious problems" with the negotiations.

CAROLINE SMRSTIK

Kravchuk not seeking re-election

President Leonid Kravchuk's announcement last week that he will not stand in Ukraine's June presidential election comes as no surprise with his popularity now at rock-bottom. He has been blamed (and rightly so) for the country's catastrophic economic performance, which saw monthly inflation at 80% in December and 1994 annual inflation set to reach 10,000%.

The four most likely candidates to succeed him are all divisive figures. Rukh leader Vyacheslav Chornovil will not gain much support beyond the nationalists. Russian Vladimir Griniov has taken the New Ukraine party so far down the anti-reform path that his party is unviable even in Ukraine. Former prime minister Leonid Kuchma will gain support among the Russian dominated eastern regions and military-industrial complexes, but he will alienate the nationalist west. A possible dark horse could be former defence minister General Konstyantyn Morozov, a native Russian speaker with nationalist credentials. He may prove to be the attractive "strong man" sought by many Ukrainians. In any case, the vote could be close, with no candidate likely to gain a sweeping majority at the first ballot.

The March parliamentary elections are likely to result in a parliament with a large block of independents drawn from the former conservative political apparatus. Reformist parties will probably be squeezed out by western nationalist and eastern anti-reform parties, with the re-legalised Communist Party and various socialist groups gaining some 20-25% of the vote.

Any new president of Ukraine will have his work cut out for him as he tries to maintain a balancing act between parliament, economic pressures, secessionist Crimea and "Big Brother" Russia, to which Ukraine owes some $2.6bn in outstanding energy debts.

DANIEL THORNILEY

Estonia

Go west

A nimble local retailer is dominating the home market—and looking west for new opportunities

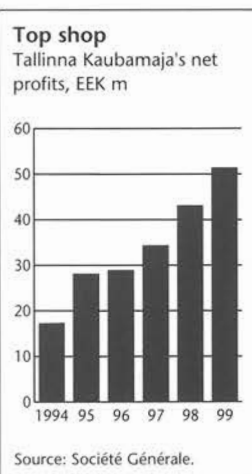
Kaubamaja is trying to break Estonians' corner-shop habit

Pretty quick off the mark, the Estonians. Take Tallinna Kaubamaja, a Tallinn-based retailer, which is pushing itself to the forefront of modern shopping. Starting with refurbishing its flagship department store in Tallinn's "magic triangle" retailing district, the company has expanded to Tartu, the second city, and even to Helsinki—thus becoming the only East European retailer to turn the tables on the West. And it's expanding sideways, too: A-Selver, its wholly owned grocery division, is now moving to establish a foothold in Estonia's undeveloped foods sector.

Tallinna Kaubamaja's success represents a missed opportunity for Stockmann (Finland), whose two-year-old Tallinn store gave Estonians their first taste of retail sophistication. But Stockmann's upmarket goods appeal more to well-heeled locals and foreigners. Responding nimbly, Tallinna Kaubamaja packed its main store and Punane Selver (A-Selver's food supermarket in the Lasnamae suburb) with Estonian foodstuffs and keenly priced bulk packaging. This pulls in not only Estonia's growing middle class, but also caters to the bargain-hunting Finnish tourists looking for cheap cheese.

Punane Selver is not just pandering to local tastes—it's shaping them too. The supermarket is targeted at shoppers who drive and stock up once a week—a novelty for Estonians, who like other Europeans were used to frequent runs to the little shop at the corner. But Punane Selver has proved a hit. Tallinna Kaubamaja is negotiating on two more suburban sites in Tallinn for the beginnings of a grocery chain. And moving outside the capital should be a cinch, the company says: Estonia is particularly poorly served by quality retailers, with Tartu the only provincial town to boast a big international-standard store (and one owned by Kaubamaja at that).

Top shop
Tallinna Kaubamaja's net profits, EEK m



Source: Société Générale.

Home building

While seizing prime position in the supermarket race is top priority, the Kaubamaja group has a number of other projects on its wish list for the next year. Dominating Tallinn, where the money is, must come first. Most of the EEK30m ($2m) invested in renovations in 1997 went into the flagship store, which in February unveiled a flashy new glass elevator as part of its façade, the first of its kind in Tallinn. It's not just for decoration: the store plans to open its top storey—currently used for storage—as another 1,500 sq metres of retail space in the autumn.

But the major investment in the main store this year may well be the store itself. Like other top real-estate properties in Tallinn (such as the four-star Hotel Olympia), the business is fully private, but the physical building is still owned by the state. An auction of the Tallinna Kaubamaja property has been promised for April with a starting price of EEK40m. Kaubamaja intends to bid but there may well be counterbidders.

The worm turns

The company's most daring move so far has been to reverse the usual foreign investment flow and open a EEK30m store in pricey downtown Helsinki. The clothing-only shop celebrates its first birthday in April, confounding predictions that Kaubamaja was overreaching itself. Unlike other East European products in other West European countries, Estonian goods enjoy a sound reputation for low prices and high quality in Finland. Negotiations are under way for a second shop in the Finnish capital, which should be cheaper as the first outlet has all the warehouse capacity Kaubamaja needs. This year, Kaubamaja hopes to capture 1% of retail clothing sales in Helsinki and turn a profit locally.

Tying the whole empire together is the Kaubamaja loyalty card, valid in all company stores. For a EEK500 annual fee, cardholders are entitled to a 5% standard discount on all purchases, receive special offers and even get an hour's free parking at the Tallinna Kaubamaja car park. The fairly hefty fee seems to encourage cardholders to shop even more: the company estimates that the 8,000 cardholders account for 10% of total sales.

Regional expansion is a natural move for the self-assured retailer. Baltic neighbours Latvia and Lithuania both lack a modern, full-service department store. The major obstacle to a Baltic expansion is the need to establish separate legal entities to carry out business in Latvia or Lithuania. The company is not yet sure which might get a taste of shopping Kaubamaja-style first, but the active Estonians are keeping an eye out for prime-location high-street premises in Vilnius and Riga. Over the longer term, Estonia's free-trade agreement with Ukraine and that country's 50m consumers will make Kiev tempting as well, Kaubamaja managers say.

CAROLINE SMRSTIK

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Baltic-Russian relations

Wolf at the door?

Political tension hasn't slowed trade between the Baltic states and Russia

Estonia, Latvia and Lithuania may be knocking hard on the door of the big Western clubs. They may have made remarkable strides in orientating their trade towards Western Europe. But they cannot escape their past. The trio's single biggest trade partner remains the one with the prickliest attitude—Russia. Just how important is the state of each country's ties with Moscow?

Glacial relations have not prevented Latvia from exploiting its historic role as a trade crossroads

If they do have an impact, **Latvia** should be suffering. The country is Russia's current Baltic whipping-boy. Latvian police used rubber truncheons to break up a protest by Russian-speaking pensioners in Riga in March. Incendiary reports from the Russian-language media, and unfortunate remarks by Guntars Krasts, the Latvian prime minister, combined to raise hackles in the Moscow Duma. Unexplained bomb blasts at a synagogue and outside the Russian embassy led Russia to warn that "fascists" were on the march in Latvia. Threats of economic sanctions were issued. In comments which have since cost him his job, Atis Sausnitis, the minister of economy, alleged that Russian customs officials were already holding back $300m-worth of goods at the border.

Mr Krasts is belatedly trying to play down the row, but substantive improvements in political ties between Moscow and Riga look unlikely. The issue of Latvia's ethnic Russian population won't go away. A sign-off on a border treaty between the two remains unscheduled. The fragility of Latvia's ruling coalition, and the prospect of general elections in October, gives nationalist Latvian politicians plenty of opportunity to make mischief.

Rumours abound of Estonian goods bearing "made in Finland" labels flowing into St Petersburg

Sound and fury

But glacial relations have not prevented Latvia from exploiting its historic role as a trade crossroads. Negotiators of a 1994 agreement on Russian troop withdrawal managed to include a clause which gave Latvia most-favoured nation/MFN status and eliminated the double tariff system which still plagues Estonian exporters. Exports to Russia constituted 6.1% of Latvian GDP last year.

Chart topper

Baltic trade with Russia 1997; $ m

	Imports	Rank	Exports	Rank
Estonia	604.1	2[a]	517.4	1
Latvia	411.6	1	339.3	1
Lithuania	1,409.6	1	939.8	1

[a] Finland is Estonia's largest source of imports.

Sources: Latvian Development Agency; Lithuanian Development Agency; State Statistical Office of Estonia.

Investors have proved willing to bet on Latvia as an export base: Corpora Tres Montes (Chile) established a $15m soft-drinks powder factory in 1995, whose entire output is sold in Russia. Kellogg's (US) may have ceased production at its Latvian factory this year, but it maintains a distribution centre for the Baltics and Russia just outside Riga.

The potential impact of sour relations with Russia on the country's lucrative oil transit trade is more worrying. Ventspils port moved 36.7m tonnes of goods in 1997, far more than St Petersburg, its nearest Baltic Sea rival with 20.5m tonnes. East-west transit trade makes up a thumping 20% of Latvia's GDP. But there's no immediate danger of traffic shrivelling. Russia moves 45% of its transit trade through Baltic ports, and will continue to do so as long as big investments in Russian ports fail to materialise. Ventspils is indisputably the best port in the Baltics, and ongoing modernisation should keep it ahead of the field.

Hard to port

Lithuania would beg to differ, especially if Lukoil, a Russian oil giant, follows through on plans to invest in the country's Butinge terminal and Mazheikiu refinery. But it's still difficult to argue that Lithuania's relatively untroubled relations with the Kremlin have given it a real boost in commercial terms. Lukoil's professed interest in Lithuania's oil infrastructure could turn out to be a ruse to batten down Ventspils's high transit charges. And Lithuania's cosy ties with Russia haven't yet won it exemption from the latter's protectionist textiles trading regime.

Estonia is the most disadvantaged by its trading relations with Russia. Although it has made better progress than Latvia in its treatment of the ethnic Russian population, the country does not yet enjoy MFN status. Exports are consequently uncompetitive: Estonian food products cost three times as much on a Russian grocery shelf than they do at home. Estonian dairy and tinned fish products had a reputation for high quality in Soviet days but are now virtually luxury products. Rumours abound of Estonian goods bearing "made in Finland" labels flowing into St Petersburg. Might these problems reflect tetchy political relations between the two countries? They might, but Russia still absorbs more Estonian exports than any other market. Spats between Baltic and Russian governments haven't yet got in the way of making money.

Caroline Smrstik

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Baltic states

Northern fights

Quick-thinking Estonian companies are venturing abroad

Not content with cornering the most foreign direct investment in the Baltics, Estonian executives are doing some empire-building of their own. Sure-footed Estonian companies, well-schooled in the dark arts of mergers and acquisitions, have started scouring the region for opportunities. Estonian investment in Lithuania, a cumulative total of $30.1m at the end of 1997, accounts for over 3% of all foreign investment there, propelling Estonia into the top ten sources of Lithuania's foreign capital.

Financial deals have soaked up most of the recent publicity

Estonian investors are advancing on a number of fronts, but deals in the financial industry have soaked up the bulk of recent publicity. Hansapank has led the charge into the region, starting with its 1996 purchase of the foundering Deutsche-Lettische Bank in Riga, now turning a profit as Hansabank Latvija. Hansapank is also slated to open a subsidiary in Vilnius this autumn, joining Kredyt Bank (Poland), Société Générale (France) and Norddeutsche Landesbank (Germany) as the fourth foreign bank in Lithuania.

That's not all. Tallinna Pank's share swap merger with Saules Bank (Latvia), Hoiupank's purchase of a controlling stake in Latvijas Zemes Banka (Latvia) and a co-operation agreement between Uhispank, Unibanka (Latvia) and Vilniaus Bank (Lithuania) are further evidence of Estonian-led consolidation of fragmented Baltic financial markets. A fight-back is starting: a merger between Lithuania's Vilniaus and Hermis banks is on the cards (see page 9) as a means of warding off Estonian advances.

Smaller enterprises escape the attention of Western investors

Acquisition addiction

The Estonians aren't just interested in banks. The ETFC holding group, using no-mercy management techniques copied from Philip Morris (US), has expanded its profitable 24-company food empire throughout the Baltics. Hard decisions haven't been shirked: the purchase of a majority stake in Rigas Miesnieks, Latvia's biggest meat producer, in the spring of 1997 was swiftly followed by the sacking of the Miesnieks management. Synergy between ETFC's Rakvere Meat Plant in Estonia and Miesnieks will force further job losses, with Latvian packers being used primarily to help Estonian products avoid double tariffs at the Russian border.

A takeover in the pharmaceuticals industry has also riled the neighbours. Grindex (Latvia) bought 55% of Tallinna Farmaatsiatehas (Estonia) in March as a first step towards the creation of a pan-Baltic holding company. But Grindex is itself owned by an Estonian bank, prompting complaints from Latvian producers that the Estonians are carving up market share through obscure mergers.

Regional dreams

All this crossborder activity has breathed fresh life into the idea of the pan-Baltic market. But foreign investors shouldn't get too excited:

- Baltic investors are using local contacts and Soviet-era networks to weave multinational empires. Outsiders can't match up. Much of the wheeler-dealing involves small and medium-sized companies, where the Baltic region's major growth potential lies; but these enterprises tend to slip beneath the radar of most Western investors.

  The hope is, however, that mergers will eventually build companies large enough to warrant foreign attention. The burst of activity in the banking sector looks especially promising: Scandinavian banks in particular are said to be pricking up their ears.
- As the cases of ETFC and Grindex show, even fellow-Balts aren't always welcome investors. That goes double for large-scale projects in politically sensitive areas such as infrastructure. Take the attempts by Levicom, an Estonian telecoms group, to purchase a stake in Lintel, a Lithuanian-US joint venture which manages Lithuania's international telephone connections and owns a chunk of the country's second cellular phone network. Although US West, the American partner in Lintel, was keen to sell its shares, Lithuanian officials balked at letting the Estonians gain a toehold in telephony. The incident sparked a nasty row in February, with Vytautas Landsbergis, the speaker of the Lithuanian parliament, even accusing Estonia of trying to damage Lithuania's chances of EU accession.
- As many a Western company can testify, mergers and acquisitions are easy to conceive, tricky to pull off. The postponement of merger talks between Hansapank and Hoiupank shows that such deals are tough enough to broker within borders: the political sensitivities and cultural differences of crossborder negotiations make things triply troublesome. Throw in the potential impact of early Estonian membership of the EU on Baltic trading arrangements, and the regional market still seems a long way off.

Caroline Smrstik

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Baltic states

Read all about it

Estonian investors are shaking up the news kiosk trade in Latvia

Kiosk retailing can be a murky business—the traditional East European battleground for shady traders of contraband cigarettes and alcohol. But Meediakorp, an Estonian media conglomerate, is helping to take the Latvian kiosk upmarket, and making waves as a result.

Plus Punkts takes Scandinavian news kiosks as its model

Meediakorp has an impressive pedigree. The firm encompasses Estonia's top weekly newspaper, *Eesti Express*, majority stakes in two dailies, a magazine group and the Estonian news kiosk chain Plusspunkt—enough tasty morsels to persuade Marieberg International (Sweden) to purchase a 50% stake in Meediakorp last month. With 55 Plusspunkt kiosks in Tallinn, and small networks in Parnu, Tartu and Voru county, Meediakorp controls about 65% of the Estonian kiosk market. Its home territory under the thumb, Latvia was the obvious target for further expansion.

The Plus Punkts joint venture, which is 74%-owned by Meediakorp and 26%-owned by *Diena*, Latvia's leading daily paper, opened the first of its stripey orange and violet kiosks in Riga in January 1997; the chain has since expanded to 11 kiosks and 60 wholesaler locations. Meediakorp's Gunnar Kobin estimates that a good two or three years are needed to reach the 50-location saturation rate in the capital, but Plus Punkts is already doing well: the operation turned a profit of EEK150,000 ($10,500) on an EEK70m turnover in 1997.

Plus points

Lithuania offers even more of a challenge than Latvia

Meediakorp has quickly improved industry standards. When the firm first set up shop in Latvia, newspapers were sold out of tiny, wooden Soviet-era kiosks. Plus Punkts, by contrast, takes Scandinavian news kiosks as its model, and sells newspapers, magazines, drinks and pre-packaged snacks displayed in an orderly fashion in clean, well-lit kiosks. So great was the change that at first bureaucrats and city architects didn't understand what the Estonians were driving at: "We think of Plus Punkts as a small shop, not a kiosk—a petrol station without the petrol," says Mr Kobin.

The prefabricated structures are manufactured in Riga, gaining a few points with the locals. But the boxes don't come cheap: with windows that lock securely at night and refrigeration units, costs run at about $20,000 per kiosk. New bookkeeping software for the computerised tracking system, already in use in Estonia, should be in place in Riga by the autumn.

But if local customers are taken with the new-look kiosks, the path into Latvia hasn't been easy for Meediakorp. Red tape and vested interests clog up the Latvian market far more than they do the Estonian one. Game-playing is still required to get a piece of the action in Riga.

The Estonians had anticipated obstacles of this kind—the selection of *Diena* as a partner in the venture was designed to help smooth the way with Riga's notoriously fief-like city and neighbourhood councils. But bureaucracy hasn't been the biggest problem: Mr Kobin says that cronies of Vilis Kristopans, the Latvian transport minister, have blocked Plus Punkts's attempts to gain prime kiosk locations.

Mr Kristopans is in charge of the state's 60% slice in Preses Apvieniba, a Latvian kiosk company. But his alleged opposition to Meediakorp may not just be about protecting Preses Apvieniba, but also about shoring up control of media distribution networks prior to Latvian general elections scheduled for September. A dislike of *Diena*, which has spent years sniffing around the transport minister's impressive personal fortune, could also be behind Mr Kristopans's interest in the kiosk trade.

Costly kiosks

Whatever Mr Kristopans's motives, Meediakorp is being forced to work hard for its kiosk sites. Where Riga district governments have to give the go-ahead for structures on municipal property, Plus Punkts has tried approaching local council members directly with its application. This direct approach has had some success. A box of chocolates or a small cognac can help; lack of a rate card means fixing rents is often a matter of how many cognacs. In addition, many potential locations are privately owned, which often requires Meediakorp to dig deep. Monthly rent for private locations in Riga reaches LVL350 ($600), considerably higher than anything in Tallinn, where there are no privately owned pavement locations.

If Latvia is tough going, Lithuania, with its network of grubby chaotic kiosks offering everything from vodka to newspapers to nylon stockings, is even more of a challenge. Developing a news kiosk and distribution system would need heavy investment at the outset. And as Mr Kobin says, the Lithuanians are often less than keen on foreign investment: "With an Estonian company and Estonian director, you can be pretty sure you can't do anything." Until it's clear how the Latvian operation is running, Plus Punkts will not be appearing in the southernmost Baltic state.

CAROLINE SMRSTIK, RIGA

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Latvia

A Daug's life

Daugavpils, Latvia's second-largest city, has so far been left to its own devices. But a big textiles investment heralds change

Riga can be casual in its disregard for Daugavpils

It is difficult to attract talented employees to the city

Daugavpils, Latvia's second city, is a world away from Riga, the bustling capital. The city, perched on the Duna river, has all the typical hallmarks of a Soviet metropolis: the buildings, the inhabitants—even the weather—are grey. In Soviet times the city was an important industrial base and rail hub; tankers carrying Russian oil to the port at Ventspils still pass through Daugavpils' switching yard and the state-owned railway is one of the town's major employers.

The city was always more Russian than Latvian: two-thirds of the population is Russian-speaking and there are nearly as many Poles as Latvians. This multicultural environment has not endeared the city to hard-core nationalists elsewhere in Latvia. Alexei Vidauski, the popular mayor and a former Communist functionary, was re-elected in March 1997 and has survived several lawsuits filed by Riga-based nationalists charging that he was still an active member of the Communist party after the party was declared illegal in January 1991.

Sidelined

Decision-makers in Riga can be casual in their disregard for Daugavpils. The auction of a majority stake in Lokomotive Daugavpils, a rolling-stock manufacturer and repair factory, was cancelled by the Latvian Privatisation Agency/LPA in May 1998, ostensibly because of lack of investor interest. Hardly surprising, given that promotional materials for investors avoid talking about the city. Further privatisation plans have been pushed to the back of the LPA's agenda, even though Lokomotive is the city's largest employer with 3,600 workers, and continues to pull in contracts for repair work from Russia, other former Soviet republics and Germany.

Other local firms have fared better. Flotation on the Riga Stock Exchange in 1996 turned the Daugavpils Motor Chain Factory into one of the bourse's ten blue chips. Originally linked to the Volga car factory in Russia, the 1,600-worker factory is now producing drive chains, motor tools and bicycles, and exports 29% of its output to OECD countries.

Daug days

Population	116,530
Ethnicity (%)	58.5 Russian; 14 Latvian; 13 Polish
Latvian citizenship (%)	70
Unemployment (%)	7.8
Average monthly income (LVL)	91
Telephones per 100 people	34

Source: *Business Eastern Europe*.

The city got another big boost in January 1998 when the Tolaram Group (Singapore) took the plunge and acquired the Dauteks textile factory. At the same time, the Development Bank of Singapore and the IFC took 5% stakes in Dauteks. The task of modernising the factory as an integrated nylon plant and reorientating exports from CIS to European markets is expected to cost the Singaporeans $14m over three years.

Tolerant Tolaram

It hasn't been plain sailing for Tolaram. "Daugavpils is attractive, but you have to be able to sustain your interest—it's a very long-term perspective," says Sonny Aswani, who oversees Tolaram's Baltic investments from the relative luxury of Tallinn in Estonia. The deal took nearly two years to close and involved protracted haggling with the Riga authorities over debt acquisition.

Local barons were more concerned about keeping jobs for the 3,600 employees of the factory. Tolaram refused to offer any employment guarantees, and about 300 workers were let go immediately—mostly those with alcohol problems or those already at retirement age. Over the next two years, the factory should pare its workforce down to 2,000. A one-time "social tax" of about $650 per head for "retraining" dismissed workers seemed to pacify the Daugavpils authorities.

Mr Aswani admits it is difficult to attract talent to Daugavpils. Tolaram managers from Singapore, India and South Africa are set to take charge for the crucial initial phase, but no one expects to stay in Daugavpils longer than two or three years. The lack of any Western infrastructure bothers all but the most adventurous. To avoid frightening visiting clients, Dauteks now has a small guest house (which is also used by expat employees). Advisers from the German Bundesbank helping the Latvian central bank to modernise its Daugavpils vault refuse to overnight there, insisting instead on the three-and-a-half-hour trip to Riga.

Yet the Tolaram investment augurs well. Spending power in the city will increase thanks to secondary employment from the Dauteks turnaround, reckons Laila Svelpe in the Riga office of Ober Haus, an Estonian estate agent; the firm hopes to open a Daugavpils office by early 1999.

CAROLINE SMRSTIK, RIGA

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Latvia

Don't pass the port

Ventspils contains the Baltic Sea's most dynamic port. Local barons are jealous of their success

Ventspils is Latvia's success story, thriving off the former Soviet Union's most modern port. The impressive and efficient facilities of Ventspils Nafta moved 24.2m tonnes of Russian crude and oil products in 1997; another terminal handles one-fifth of the world's potassium fertilisers. Transit is the only thing that pushes Latvia's GDP growth rate into the black, boasts local boss Aivars Lembergs. He would know—as mayor since 1992, chairman of the board of Ventspils Port Authority/VOP and president of the Latvian Transit Business Association, Mr Lembergs has the money-spinner firmly under his thumb.

Ventspils

Population	46,600
Ethnicity (%)	46.9 Latvian
	37.2 Russian
	5.3 Belarusian
	5.3 Ukrainian
Unemployment (%)	3.9
Av. monthly income (LVL)	173
Telephones per 100	32

Source: *Business Eastern Europe*.

He also does his best to keep greedy Riga fingers out of the pie. The city had to transfer over half its income to the central government last year to feed the national equalisation fund designed to subsidise poorer regions. Ventspils is the largest municipal contributor to the state budget and complains bitterly at the ever increasing payments—from 31% of local revenues in 1995 to over 60% in 1997.

Hands off

The hands-off approach extends to planning for the port's future: the Latvian Development Agency admits that the proud Mr Lembergs would not consider coming to them for help. The agency promotes the port and does some joint marketing, but concrete projects are dealt with by the city itself. VOP landed an Ecu20m ($22m) credit from the European Investment Bank, for instance, to dredge the main channel to allow larger vessels to dock—the results should show up in this year's turnover. Ventspils Nafta is currently negotiating with the EBRD about financing for a new pipeline to bring more Russian oil directly to the city, doubling current pipeline capacity and undermining competitors in Lithuania.

Strategic foreign investors won't get a look at the port

And the long-awaited privatisation of Ventspils Nafta, which has had Riga bureaucrats and foreign investors salivating for several years, is proceeding at a pace set by the town and not by the Latvian Privatisation Agency. A local consortium already speaks for 40% of the port's shares, although Janis Naglis, head of the privatisation agency, is still hoping that a share offering will hit the Riga bourse this year, with up to 7% of shares earmarked for sale as Global Depositary Receipts.

Strategic foreign investors won't get a look in at the port, however. What little domestic capital there is in Latvia is drawn to the country's top money-maker, and the Ventspils bosses like it like that. Mr Lembergs and his friends, who include cronies from big Russian firms such as Lukoil, don't need to look for strategic investors.

Shiny city

That sounds more sinister than it actually is. Mr Lembergs is a benevolent ruler who seems genuinely to care about improving the lot of his people; the Ventspils brand of crony capitalism is simply more successful than that practised at the national level, as is the interaction between Latvian and Russian business elites.

VOP, the not-for-profit overseer of commercial port activities, rakes in around $15m in port fees annually; Ventspils is a free port, so this amount is exempt from Latvia's 18% value-added tax, excises and customs. The rent and property taxes paid to the city also fatten Mr Lembergs's coffers nicely, and the results are clearly visible. Whereas Riga has a disintegrating infrastructure dotted by shiny Western shops, Ventspils boasts immaculately tended small parks, new bus stops and a pleasant brick-lined quayside promenade. The pothole-free streets are swept spotless twice daily. Some things are familiar, though: the few shops in town offer the usual chaotic assortment of cheap and cheerful imports sold by unsmiling clerks.

The city is well enough off to offer a programme of credits for facade renovations to owners of historic buildings; if the work is completed within three years, the city forgives half the loan. Another innovative municipal project put new toilets in every public school in the city. City-funded projects start and finish on time: another gift to the populace is a spanking new sports complex next to the soccer arena which features indoor tennis and cycling, boxing rings, and a sauna. Rounding off the picture is an internationally accredited college, funded by the city and local businesses, which opened its doors in September 1997 to 100 selected students.

Might events in Russia take the shine off the Ventspils story? Not immediately: Russian oil exporters are about the only businesses to have applauded rouble devaluation. But longer term, a stagnant Russian economy is clearly not in the port's best interests; Mr Lembergs cannot rest in his bed.

Caroline Smrstik, Riga

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18 October 1996

Mild-mannered professor quests for power

Vilnius (dpa) - His modest, rumpled exterior notwithstanding, Vytautis Landsbergis knows how to play Lithuania's power game.

The chairman of the national right Conservatives (Fatherland Union) is anticipating leading his party to victory in Sunday's general elections and is already consolidating his Lithuania-first, right-wing coalition.

The 64 year-old pianist, composer and music history professor came to prominence in the late 1980s as a leader in Sajudis, Lithuania's nationalist independence movement.

From 1990 to 1992, Landsbergis was president of Lithuania and became globally known for his frank pronouncements on everything under the sun.

As leader of the parliamentary opposition in the last four years, Landsbergis hasn't stopped his tirades against the left, or anyone he perceives as against Lithuania's interests.

He dismisses current president Algirdas Brazauskas as "not a person you could trust" and prefers to gloss over the looming reality that a Conservative-led government will have to co-operate with the leftist president until his term expires in 1998.

As for his own role after the elections, Landsbergis modestly admitted in an interview with dpa that "it could happen that I am called to become speaker of parliament."

This largely ceremonial post is acknowledged by seasoned observers to be no more than a waiting room for the presidency, an office that Landsbergis still covets.

But whether a coalition of Conservatives, Christian Democrats and the populist Centre Union could hold long enough for "the professor" to land back in the limelight he loves is questionable.

Pre-election promises from the Conservatives like channeling 50 per cent of all foreign loans received to assist Lithuanian industry sound good at home but have alarmed international lenders.

In comparison, the austere reforms adhered to by the demonised ruling left Labour Party (LDDP) are models of economic sanity.

And Landsbergis' tendency to spy a conspiracy round every corner hardly bodes well for stability in a ruling coalition.

"There are secret loyalties in every party," Landsbergis told dpa. "I will know who is against us."

14 February 1997

Violinist Gidon Kremer returns to his roots in Riga, Latvia

By Caroline Smrstik, dpa

Riga (dpa) - In an 11-month world tour to celebrate his fiftieth birthday, one stop is especially meaningful for the violinist Gidon Kremer.

"There is a certain sympathy toward me here, which I feel is a kind of reconciliation for me with my home country," Kremer told dpa in Riga, the city where he was born February 27, 1947.

Kremer spent his childhood in Riga, then part of the Soviet Union, before moving to Moscow at 18 to study at the Tschaikovky Conservatory.

He has returned to Riga a number of times since Latvia gained its independence in 1991, including playing at the re-opening of the National Opera in 1995.

But his "birthday" concert, complete with tributes from Latvian President Guntis Ulmanis and an award as cultural ambassador for Latvia, marked the start of a new project for the restless violinist.

The chamber orchestra Kremerata Baltica, comprised of 30 young musicians from Latvia, Estonia and Lithuania made its debut in Riga.

The orchestra was chosen by Kremer by audition in Vilnius in November and will be the centerpiece of his established festival in Lockenhaus, Austria this summer, which will also offer a number of Baltic composers in residence.

The young orchestra will also feature at the Menuhin Festival in Gstaad, Switzerland and in Salzburg, Austria.

"I don't feel old, but somehow one has to admit aging. With age you tend to go back to your roots," Kremer explained his desire to start a Baltic project.

Because he is constantly in demand as a soloist, Kremer has never taught in a conservatory or summer academy. He saw this as his chance to be in touch with young musicians in training.

"He is wonderful to work with, very intelligent and a natural teacher," enthused Ula Zebriunaite, a 22 year-old violist from Vilnius who soloed alongside her idol in Alfred Schnittke's Concerto for Three, a piece originally written for Kremer.

Kremer's insistence that his new orchestra debut in Riga brought back a number of bittersweet memories about his own life as a music student in Riga.

"I felt like an alien," Kremer said. "By my roots or blood or whatever counted, I wasn't considered a Latvian."

His mother was German and grandfather from Sweden. And his Riga-born father was Jewish.

"My father survived the Nazi period in cellars and was one of the few survivors," Kremer said, noting ironically "but he was not a real Latvian."

The young Kremer was admitted to the Russian section of the music school, not the Latvian, and upon winning a competition to represent Latvia at a Moscow festival was eliminated for being the wrong ethnicity.

"The logic of this for a grown-up is one thing, but for an 8-year-old boy it was an emotional issue," Kremer recalls.

He struggled against his "incorrect" image, learning the Latvian language and seeking out Latvian composers to play as a teenager.

But since independence, Latvia has been happy to claim the gifted violinist as one of their own. Kremer has since received Latvian citizenship and returns with enthusiasm to his childhood home.

Following the wildly successful debut concert of Kremerata Baltica, Kremer admitted to childhood flashbacks in the PhilharmoniaHall.

He reminisced about seeing the legendary American pianist Van Cliburn in concert, standing in the wings in awe "because he was so romantic and my whole dream of being a musician was projected onto him."

"Now I am here myself and being celebrated almost like him," the virtuoso concluded with obvious delight.

9 April 1997

Latvia's only school for Romany children thrives on love

By Caroline Smrstik, dpa

Ventspils, Latvia (dpa) - The neat rows of desks and colourful pictures on the wall in the Ventspils school are typical enough. But the quiet alertness of the eleven children, ranging from the diminutive 10-year-old boy to the awkwardly-hunched 14-year-old girl, betrays a difference.

The second-year students are all Romanies (Gypsies), proudly struggling through lessons in the Latvian language they have been learning over the last two years.

Latvia's only school for Romany children is located in the Baltic Sea port city of Ventspils, 180 kilometers west of the capital Riga.

Local authorities noticed a problem in 1987, when local Romany youth who turned up for their required military service could neither read nor write, explained Gunita Grinvalde, head teacher at the school.

The young men were sent to the existing remedial evening school, but brought their younger siblings. Since that improvised beginning, more children have entered the school and classes were moved to the daytime.

This year, 45 children ranging in age from 6 to 17 are being taught in five classes. Several are regular students who return year after year. But the four teachers who work exclusively with Romany children don't expect such regularity.

"The parents are indifferent to what's going on with their children," Grinvalde said.

Around 2,000 of Latvia's nearly 8,000 registered Romany live in Ventspils and neighbouring districts. But human rights and Romany cultural activists estimate the number of Romany in Latvia to be nearly double the official count.

The school receives no special recognition or support from the state. A one-time grant of 100 lats (200 dollars) was received this year to help pay for school supplies through the justice ministry's minorities programme.

"When the ministry figured out the money was for gypsies, that was the end of that," Grinvalde said ruefully.

Some Romany children attend their neighbourhood Latvian school, which is ultimately the goal of the special school. But the children who don't make it in the regular classroom have found their home.

Lita Sprugevica, 24, has spent her entire six-year teaching career at the Romany school, initially because there were no other places open. Now she can't imagine leaving.

"We have all received many offers from other schools but the children here are so dear, and different," Sprugevica said.

The children have formed personal bonds with their teachers and have difficulty accepting new teachers, she explained.

"They value us, and you don't find this kind of relationship in a Latvian school," the young teacher said.

The Latvian teachers have all learned some Romany, and extra language lessons are taught at all levels with a Romany language childrens' book published by the Soros Foundation for use in Eastern Europe.

The teachers keep a meticulous scrapbook of the children's activities. Photos of each class from the last decade are in the thick book, as well as photos and drawings from school festivals.

The school sponsors a music and dance troupe which performs traditional Romany as well as Latvian programmes at folk festivals around the country. Costumes are fitted by the teachers and everything is documented.

The shy children preferred to gather around the scrapbook during their break, pointing out photos and whispering excitedly, than to go outside and play in the spring sun.

"All we can do is release the talent that's hidden," said Grinvalde. "For these children, school is their centre and everything around that works," she told dpa.

16 July 1997

Estonia's possible headstart on EU talks not euphorically welcomed

By Caroline Smrstik, dpa

Tallinn (dpa) - Estonia's recognition as ready to begin European Union accession talks has not released an outburst of enthusiasm in the Baltic states.

The European Commission's opinion on enlargement talks, unveiled Wednesday in Strasbourg, deemed Estonia ready but Latvia and Lithuania not quite there.

Lithuania's reliance on the Soviet-era Ignalina nuclear power plant, weak banking sector and need for administrative reform to combat official corruption were all mentioned as areas needing more attention.

Latvia's undeveloped judicial system, weak public administration and not-yet-competitive market economy were judged to hold the country back from early negotiation rounds.

"These countries make their own policy decisions," Estonian Foreign Minister Toomas Hendrik Ilves said in an interview with dpa.

One such notable decision was Lithuania's declaration at the end of 1996 that it allied itself with central Europe, especially neighbouring Poland, and not with fellow former Soviet republics Latvia and Estonia when seeking EU and NATO membership.

The strategy fooled no decision-makers in Brussels. Poland has been invited to join NATO and is one of the five eastern Europeans declared ripe for EU accession talks.

Lithuania, which has grown louder in its insistence on a common start line for accession talks since its central European gambit failed, declined official comment on the commission's avis Wednesday.

The game is not over in Latvia, where foreign ministry officials expressed "serious doubts" that up-to-date economic data were used to evaluate their country's progress.

The final decision taken by the EU member states in Luxembourg in December could well be in Latvia's favour, foreign ministry spokesman Andrejs Pildegovichs told dpa.

"The difference between Latvia and Estonia is not so big," he said, hastening to point out that the commission's recommendation of Estonia is a welcome signal that the unification of Europe is really happening.

Whether singling out one of the three states throws a wrench into regional co-operation remains to be seen. The Baltics' proudest trilateral achievement to date is a free-trade agreement that includes agricultural products since January this year.

But implementation problems still exist. Non-tariff barriers need to be broken down, according to Estonia's Ilves, and free trade in services is still to be introduced.

"Estonia is ready and willing to move ahead," Ilves told dpa. "This would make all countries more acceptable to the EU," he noted.

16 July 1997

Estonia begins serious battle for EU membership - at home

By Caroline Smrstik, dpa

Tallinn (dpa) - The European Commission's decision to recommend Estonia as one of five eastern European countries ready to begin talks on entrance to the European Union has fallen on skeptical ears.

Aside from convincing EU member countries to support the commission's recommendation at the Luxembourg summit in December, Estonia has some work to do at home.

Estonian Foreign Minister Toomas Hendrik Ilves attributed the relative lack of domestic reaction to the natural reservedness of the Estonian people.

"People don't go wild here, but I think the commission's decision will dramatically increase support for the EU," he said in an interview with dpa.

It will have to do so, since according to a telephone poll conducted in mid-June by the EMOR agency, only 43 per cent of Estonians support their country's entrance into the EU.

The nationwide survey showed 40 per cent of the 511 respondents have no opinion yet, while 17 per cent expressed outright opposition.

Fear of losing their treasured independence, regained from the Soviet Union in 1991, was the main reason those polled were reluctant to endorse EU membership.

Gaining a centralised bureaucracy and a higher tax burden were other top reasons to be at least skeptical, the poll found.

Aarne Otter, head of the Estonian European Research Group, understands these concerns.

"Brussels has no interest in small countries and regional politics," Otter told dpa. "For Estonia, it's very important to maintain our sovereignty," he added.

The founder of Estonia's only Euroskeptic NGO labels himself a "Euro-realist." Rather than spreading reactionary propaganda, Otter says his organisation wants to be sure that Estonians have the possibility to evaluate the positive and negative sides of EU membership.

Even the European Commission itself admits that the public information flow in Estonia has been lacking.

Niall Leonard at the EC delegation in Tallinn characterised the average Estonian's knowledge of the EU quite simply: "not much."

When accession talks are nearly complete -official Estonian estimates say five to seven years of preparation are still needed- Otter's group naturally favours a referendum.

But local opinion-makers, such as the Postimees independent daily, warn that Estonia lacks both the oil wealth and the NATO membership which enabled Norway to refuse the EU's offer in a referendum.

18 November 1997

Latvian Holocaust survivors hope for more than a Swiss gesture

By Caroline Smrstik, dpa

Riga (dpa) - The 80 members of the Latvian Jewish Society of Former Prisoners of Ghetto and Concentration Camps stood in the spotlight briefly Tuesday in Riga, when they became the first Holocaust survivors in the world to receive promised money from a special Swiss fund.

"Today I am the top model, but it doesn't bring me much," shrugged Yevgenia (Jane) Borovska. Her 400 dollar cheque from the fund, the first payment of a promised 1,000 dollars, will cover her rent for four months.

The bright-eyed retired English teacher in her mid-70s supplements her tiny Latvian pension by continuing to teach English privately.

"We don't want Swiss money, we need something from Germany," Borovska insisted.

Unlike Holocaust survivors in Western Europe, the United States and Israel, those behind the Iron Curtain for 40 years never received any reparation payments from the German government.

Representatives of the Swiss Fund for Needy Victims of the Holocaust, created in March 1997 by the Swiss government in reponse to international criticism over the neutral country's role in the second World War, stress that their action is charity for the poor and not intended to compensate Holocaust victims.

Swiss banks and businesses have so far put nearly 280 million Swiss francs (200 million dollars) into the fund. The decision to offer payments to the Latvian group first resulted from the organisational efforts of Alexander Bergman, chairman of the Latvian Jewish group.

Bergman is also active in current negotiations between survivors' groups and the German government about compensation. Though the talks may be close to bearing fruit, potential recipients are dying out.

Six years ago there were 140 eligible survivors in Latvia, nearly double the 80 elderly men and women who proudly gathered for the Swiss ceremony.

Memories flew like ghosts through the peeling auditorium where the ceremony took place.

"I spent four years not being a human creature," recalls Jane Borovska. "We were worse than dogs- people liked dogs," she said.

She was imprisoned in the Daugavpils ghetto in 1941 and a year later returned from her forced labour detail to find her family gone.

Borovska survived transfers to the Riga Ghetto and to the Stutthof concentration camp. Her gift for languages saved her when she escaped in 1944 and fled east thorough German-occupied Poland until meeting Soviet troops.

She worked as an interpreter between Russian and German troops until returning to Riga in 1946.

Riva Schefere, another retired teacher and the first to receive a cheque, agreed with Borovska.

"This money is only a symbol that the West has finally heard us," said the sprightly white-haired 75-year-old.

"After the German occupation we were different -not even human- and it has taken me my whole life into my old age to recover from this," said Schefere.

The money designated as a "significant" sum by the World Jewish Restitution Organisation does not go far in expensive Riga.

Schefere, who survived a year of forced labour in the Riga Ghetto and two years in hiding, confessed that she had hoped to buy an automatic washing machine with her payment but the amount turned out to be not enough.

10 September 1997

After 50 years, Torah scrolls laid to rest in Lithuanian cemetery

By Caroline Smrstik, dpa

Vilnius (dpa) - The mourners gathered outside the parliament building in Vilnius, their small knot dwarfed by the grandiose Soviet-era block building. Five black-hatted rabbis emerged from the entrance usually used by members of parliament, bearing a small white box at shoulder height.

Upon placing the box gently into a waiting Lithuanian hearse, the rabbis started chanting a traditional funeral prayer from the first book of psalms.

So began the ritual burial of four fragments of the Torah, the prayer scrolls used in Jewish religious services. A Torah is the most treasured possession of every community and is considered a living being, Rabbi Gershon Gewirtz explained to dpa.

The funeral service accorded a torn or irreparable Torah is the same as that for a dead person. "It is a mitzvah, the fulfillment of a divine obligation," the visiting rabbi from the United States said.

The fragments buried on this blustery early autumn afternoon in the Jewish cemetery in Vilnius were damaged during the Nazi German occupation of Lithuania in the second World War. The ceremony was the first of its kind held in eastern Europe and also marked the first time that any eastern European government gave its consent to the proper burial of Torah fragments.

More than 90 per cent of Lithuania's 250,000-strong Jewish community was killed in the Holocaust. In the six years since the country regained independence from the Soviet Union, religious scholars from the United States and Israel have been able to examine gathered relics of Lithuania's once-rich Jewish heritage.

The American rabbis have viewed nearly 200 Torah fragments catalogued by the Lithuanian national library and plan to repair and restore about 50 Torahs that are still complete. Ideally, the holy books should be returned to Jewish congregations for active use in worship.

According to Jewish custom, incomplete fragments should be buried properly. "These are not cultural treasures but a spiritual lifeline for the community," said Rabbi Eliezer Sandler, one of the officiating rabbis from the United States.

The first Torah burial in Vilnius was attended by about ten elderly Lithuanian Jewish men, huddled together in the brisk wind. Parliament President Vytautas Landsbergis, cushioned by two tall bodyguards, stood slightly apart from the slow-moving mourners.

As the rabbis chanted psalms, the aged and tiring bearers of the small coffin swapped places. The weak thready voices of the old men were nearly drowned out as the wind whistled through the pines in the cemetery.

In Yiddish mixed with English, the rabbis called out to the Jews of Vilnius (Vilna in Yiddish) and blessed their suffering and survival. "The wound does not heal and our souls do grieve," cried Sandler.

The small coffin, encased in a linen sack, was lowered into a waiting grave accompanied by the grieved sobs of the rabbis leading their tiny congregation in mourning.

The first echoing thud as earth landed on the coffin faded quickly as mourners took turns filling in the grave. Some shoveled in slow sadness, some in manic anger. Then the uncertain voices of the last Jews of Vilna found their strength to recite the Kaddish, the traditional prayer for the dead.

E·I·U

The Economist Intelligence Unit

Business operations report

Estonia
Latvia
Lithuania

2nd quarter 1998

Business environment

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Chapter 1 The business environment

Politics: implications for business

The scene calms down in the first quarter—

Following a turbulent 1997 in which strikes and scandals shook the government, the political scene in Estonia has become much calmer. Since the passing of the 1998 state budget, incentives and opportunities to score populist points have diminished greatly. The prime minister, Mart Siimann, has warned that the current government will not last out the year (see *Business operations report*, 1st quarter 1998, pages 8-9), and the EIU sees the debate over the 1999 budget as the probable cause of its demise, although the prime minister has said in press interviews that the next budget debate should be less contentious.

Mr Siimann heads a minority coalition (it holds 37 seats in parliament out of a total of 101) that takes a basically free-market approach to the economy, although it has been buffeted by the demands of interest groups such as teachers and farmers. The latter have been the most potentially dangerous to business operations, as they have sought the imposition of protectionist tariffs against food imports. While their pressure has pushed the government to take on the power to apply such tariffs, officials have yet to do so. In an apparent effort to expand the coalition's support base and reduce the chances of it splintering before parliament's term ends in March 1999, the prime minister started holding talks with other parties in the first quarter of 1998. However, he was evasive about both the purpose of the talks and their outcome.

—as officials become preoccupied with EU negotiations

Any break-up of the coalition, or a major defeat of the government in parliament, would come about only if one faction considered an early general election to be in its interest. At the moment, none of them do. Although the government was defeated in a budget-related parliamentary vote on the allocation of teachers' salaries, it was not brought down. This was partly because the teachers had put forward a strong case for a raise (and had staged a short strike in November 1997); it was also the result of concern across the political spectrum that Estonia appear politically stable as it enters negotiations to join the EU. The negotiations officially started at the end of March, as did those between the EU and five other candidate countries. Estonia's largely free-market policies give it a paradoxical status in the talks: it is a front-runner for early entry, but may have to reverse course in some policies before it will be allowed to join. A major problem may be its free-trade agreements with neighbouring Latvia and Lithuania, countries which were not invited to take part in the first round of negotiations because their economies are still too subject to state control. Estonian officials are known to want to bring the other Baltic states into the EU as early as possible and this will be a subtext for much of their negotiating strategy.

EEK8:DM1
April 1998 rate

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Key factors driving the economy

High growth needs to be cooled off

Estonia's blistering growth rate for 1997—now estimated at 9%, one percentage point higher than the figure revised at the beginning of 1998—is raising hackles among most observers, especially in light of the performance of the East Asian economies that enjoyed similar rates of growth until the 1997 crises. The high rate of economic growth is particularly worrying when coupled with the 1997 current-account deficit, which was 13% of GDP (when the share rises above 5% of GDP, economists become concerned). The authorities are aware of the risks and have been taking steps to slow growth. The Bank of Estonia, the central bank, has been raising banks' prudential- and capital-adequacy ratios, which has pushed up lending interest rates. Officials at the bank say that the economy appeared to cool off somewhat in the second half of 1997 as a result of these actions. Meanwhile, the 1998 budget should produce a EEK54m ($3.8m) surplus, which will be placed in an IMF-sponsored stabilisation fund. The fund, which is projected to hold EEK1.2bn by the end of 1998, will both help to suck cash out of the economy and enable the government to repel attacks on the kroon. The currency is tied to the D-mark by means of a currency board system in which EEK4 must be backed by DM1 in reserves. The currency board is a constitutional arrangement that Estonians are eager to retain. While the system can protect the kroon from speculators' attacks, it is far from invulnerable.

Table 1.1
Economic indicators

	1993	1994	1995	1996	1997[a]
GDP at current prices (EEK m)	22,060	30,268	41,279	52,379	63,438
GDP at exchange rate ($ m)	1,668	2,331	3,601	4,353	4,573
GDP at purchasing power parity ($ m)[a]	5,781	5,813	6,214	6,612	7,317
Real GDP growth (% change)	–8.5	–1.8	4.2	4.0	9.0
Consumer price inflation (% change; av)	89.4	47.7	28.9	23.1	11.1

[a] Estimates.

Source: EIU.

Table 1.2
Forecast summary
(% change year on year, unless otherwise indicated)

	1996	1997[a]	1998[b]	1999[b]
Real GDP	4.0	9.0[c]	4.1	4.0
Industrial production	–1.0	1.5	1.0	1.0
Consumer prices (av)	23.1	11.1	9.6	7.7
Trade balance ($ m)	–1,057	–1,322	–1,287	–1,373
Current-account balance ($ m)	–441	–595	–423	–234

[a] EIU estimates. [b] EIU forecasts. [c] Official estimate.

Source: EIU.

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Grey economy

The Estonian grey economy seems destined to remain in shadow. Figures from economists, businessmen and the government agree that there is a substantial unregistered economy, yet officials don't seem to be too keen on looking more closely at the matter. Dimitri Demekas, the IMF resident representative in Estonia, gently chides Estonian officials for neglecting the issue. Not only should the tax authorities pay more attention to the grey economy, Mr Demekas says, but government planners need to do so as well. The more unofficial activity is underestimated, the farther off-the-mark are all other economic estimates.

The Estonian Socioeconomic Institute, together with the state statistical office, ran a first-time study in 1996 with the goal of creating a model for future measurements of unregistered economic activity in the country. According to results released in April 1997, the grey economy accounted for 13.6% of Estonia's GDP in 1996 and an estimated EEK2.1bn in total tax revenue was lost. However, observers in Tallinn generally agree that the estimate is on the low side; most economists think that the grey economy accounts for around 25% of GDP.

The 1996 study compared known tax intake with labour statistics and family budget surveys in an attempt to fill the gap between reported income and purchasing power. Researchers concluded that 240,000 workers, or 34% of the country's nearly 708,000 workers, received "envelope salaries" of untaxed, unreported income in addition to their declared salaries. As well as looking at untaxed services, the study estimated losses in value-added tax and excise taxes from unregistered trade in goods at EEK600m, or over 28% of EEK2.1bn total.

Although the study was designed to set a benchmark, the Socioeconomic Institute has not received further instructions to continue its investigation of the problem. "It depends on the will of our government and how much they really want to know about this," admits institute director Juhan Sillaste.

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Chapter 2 Infrastructure and key sectors

General developments in key sectors

The telecommunications sector and the oil and gas industry are the special topics of this quarter's *Business operations report*. The 1st quarter 1997 edition looked at education. What follows is an outline of some of the main developments in the country's more important industries.

Banking

Hansapank, which has been aggressively expanding through a series of mergers, was rebuffed in an effort to take over Estonia's fourth-largest bank, Tallinna, in late March. Tallinna management instead recommended a merger with Uhispank, Estonia's largest commercial financial institution. Hansapank is currently the country's third-largest bank but has been trying to arrange a merger with Hoiupank, which would create both an institution bigger than Uhispank and the largest financial institution in the Baltics. The Hansa-Hoiu merger, however, will now be subject to a new round of negotiations after an initial set of talks fell through early in the first quarter of 1998.

Construction

- Lemminkainen, a Finnish construction company, is enlarging its presence in Estonia. For some time the firm has had a loose agreement with NCC, a Swedish builder, concerning joint efforts in the market. Now it has bought three asphalt companies—Talter, Harbet and Tasfil—in partnership with NCC. Once merged, the three enterprises will have a clear market-leading position in Estonia, and will focus on winning the country's numerous road-construction contracts.

- Merko and EMV, two Estonian construction companies, have announced plans to merge. If the deal goes ahead on the terms announced in mid-March, Merko will have a 59% stake and EMV 41%.

Telecommunications

The fixed network is improving and expanding rapidly—

Telecommunications have developed rapidly in Estonia. A joint venture between the Estonian, Swedish and Finnish state telephone operators, Eesti Telekom, is currently modernising the fixed network, Eesti Telefon. Active competition is driving the development of the mobile telephone network faster than in the rest of Central and Eastern Europe.

EEK8:DM1
April 1998 rate

The Estonian telecommunications landscape is dominated by Eesti Telekom (Estonian Telecom), a holding company wholly owned by the government. The fixed network is operated by a joint venture, Eesti Telefon (Estonian Telephone),

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which is 51%-owned by Eesti Telekom and 49%-owned by the Swedish and Finnish state-owned telephone operators, Telia and Telekom Finland, which each hold a 24.5% stake. There is also a tiny independent fixed-line operator, Eleks, which serves 400 people in a rural area.

The state has granted a monopoly to Eesti Telefon in both domestic and international fixed-network calls until 2001, in return for investing in the network infrastructure. Eesti Telefon is obliged to submit an annual business plan to the government for discussion each spring. Topics of frequent debate—and disagreement—include the costs of timed calls and the scheduled levels of investment, especially those needed to expand services in rural areas. While the government does not control the price of calls directly, it does so indirectly by having to approve the business plan, under which the telephone company seeks to maximise return on investment. Eesti Telekom has pledged to take deputies' concerns about higher telephone rates into consideration in drafting its plan for 1998. The authorities, meanwhile, have accepted the idea of equalising the rate for all calls at EEK0.6 a minute from the current ones of EEK0.25 for local calls and EEK1.05 for long distance.

Eesti Telefon was formed in 1992 and there has been strong growth in the fixed network since then. In 1992 the fixed-line network's penetration was 22 connections per 100 residents. At the end of 1996 the figure was 30 per 100, and by the end of 1997 it was estimated to have reached 34 per 100, with the 165,000 new digital lines installed that year bringing the total number of fixed-network lines to 455,000. The joint venture's monopoly in this area of operations will be phased out by 2001, as the telecommunications sector will thereafter be subject to EU rules.

Earlier in 1997 the government made a decision in principle to privatise the Eesti Telekom holding company in 1998. The initial privatisation plan includes listing a 49% stake, divided between the Tallinn Stock Exchange and a foreign stock exchange.

—as are cellular services

The cellular telephone sector is booming and has been fuelled by the entry in 1997 of a third operator. As of August 1997 it is estimated that 7% of Estonians had a mobile telephone. The three cellular network operators include Eesti Mobiiltelefon (Estonian Mobile Telephone), a joint venture that is separate from Eesti Telefon but which has the same shareholder structure; Radiolinja Eesti, a subsidiary of Finland's Radiolinja cellular service operator; and Ritabell, the latest licence recipient and a joint venture between Millicom International (UK) and Levicom, a private local company.

Eesti Mobiiltelefon has dominated the market, having been launched first and achieved the widest geographical coverage. It operates an NMT analogue network that serves most of the country and also provides "roaming" capabilities in the Nordic countries, the other Baltic states and parts of Russia. The company also operates Estonia's widest digital GSM network, encompassing all major centres and motorways and providing roaming capabilities throughout much of Europe. As of August 1997 Eesti Mobiiltelefon had 79,000 subscribers.

Radiolinja, which has been operating a GSM system for two years, has the second-largest network that stretches to most major towns and along major

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motorways. It also offers international roaming capabilities. Radiolinja currently has 20,000 subscribers.

A newcomer to mobile services is Ritabell, which has been operating a GSM network under the brand-name of Q since April 1997. The company held a licence for two years before beginning operations. It describes its move into Estonia as a strategic action to take advantage of the growing popularity of mobile telephony in the country. The company has built up a clientele of about 9,000 subscribers since starting operations. It covers only the major population centres and has not sought to cover the motorway network, although it does have some international roaming capacity.

Both the fixed network and mobile networks are regulated by the Inspectorate of Telecommunications. The inspectorate can shut down a mobile operator if it breaches frequency guidelines, as happened early in 1997 when Q-GSM was shut-down as punishment for breaking the guidelines during its test phase.

Beyond this strict attention to frequency regulations, there does not appear to be much official desire to regulate competition in the mobile phone network. However, an official at the Ministry of Transport and Communications said that no more than three licences will be granted for mobile networks due to the limited number of frequencies available.

Oil and gas

Oil shale is the country's biggest resource—

Stubborn Estonia continues to rely on its own resource, oil shale, for a large portion of its hydrocarbon fuel needs—in particular, to power its electric supply. Supplies of gas and petroleum products come from Russia. Given the continuation of popular resentment concerning Russian control of Estonia in the Soviet era—combined with a reasonable fear of over-dependency on a single supplier of fuel—patterns of fuel use will not change substantially over the next few years, even as a result of the government's desire to reduce energy-related pollution.

Table 2.1
Energy consumption
(in Terajoules)

	1990	1995	1996
Solid fuels (coal, coke, oil shale, peat, firewood, wood waste)	21,689	13,649	14,465
Liquid fuels (heavy fuel oil, light fuel oil, petrol)	66,071	30,014	28,644
Gaseous fuels (natural gas, liquefied gas)	9,504	4,586	3,891
Electric energy	26,277	17,785	19,022
Heat energy	89,895	40,309	42,168
Total	**213,436**	**106,343**	**108,190**

Source: Estonian Statistical Office.

An estimated 3.8bn tonnes of oil shale lie underground in north-east Estonia. The majority of the output is used to fuel Eesti Energia's two power plants. Oil

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shale of different qualities are used by a privatised chemicals factory, Kiviter, and Kunda-Nordic Cement plant, which is owned by a consortium of Estonian and Scandinavian partners. Altogether, oil shale feeds 62% of Estonia's energy needs.

Table 2.2
The structure of energy consumption
(%)

	1990	1995	1996
Solid fuels (coal, coke, oil shale, peat, firewood, wood waste)	10.2	12.9	13.3
Liquid fuels (heavy fuel oil, light fuel oil, petrol)	30.9	28.2	26.5
Gaseous fuels (natural gas, liquefied gas)	4.5	4.3	3.6
Electric energy	12.3	16.7	17.6
Heat energy	42.1	37.9	39.0
Total	**100.0**	**100.0**	**100.0**

Source: Estonian Statistical Office.

—as Estonians seek to limit reliance on fuels from Russia

The natural gas used in Estonia comes exclusively from Russia, which has hampered its use as a cheap, clean-burning fuel source. Mistrust of Russia still rules the popular imagination: more than one newly renovated home in Tallinn continues to rely on wood-burning fireplaces and expensive electric radiators rather than turning to the new gas-fired heating system built into the house. The three Baltic states all have strong memories of the threats to cut off gas supplies that followed the build-up of massive debts to Russia in 1993.

Gas accounts for only 11% of Estonia's fuel usage. Even so, the government's long-term energy plan foresees this rising to 20% by 2010. The main supplier, Gazprom (Russia), has a 31% stake in Estonia's distribution monopoly, Eesti Gaas; Ruhrgas (Germany) has bought another 15% to provide technical upgrades in storage and distribution; the state still holds 10%; and the remainder is owned by investment funds and small shareholders. At the end of March 1998 Neste (Finland) was reported to be considering taking a 10% stake in the company, although this has yet to be approved by Gazprom and Ruhrgas. Analysts said that Neste's stake might mean it is committing to building a pipeline across the Baltic from Finland to Estonia, providing another potential non-Russian source of gas to the country.

The policy of seeking independence from foreign (ie Russian) but cleaner-burning fuel sources has led to the development of huge mountains of environmentally hazardous waste ash. The government has pledged to reduce the use of oil shale as a fuel for power stations to less than 50% by 2010. Observers say that a larger shift away from oil shale is unlikely since continued mining keeps thousands miners, most of them ethnic Russians, in work.

Shale industry's privatisation depends on break-up

The state-owned shale mining concern Eesti Polevkivi is up for privatisation, yet because of its links to the also-to-be-privatised Eesti Energia and Kiviter, it will probably be sold to the new owners of those enterprises since they are dependent on oil shale. Polevkivi will be broken up into daughter companies, each running one of the nine oil-shale mines, but an actual ownership shift is

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not expected before the end of 1998. A Polevkivi subsidiary which awards concessions for oil-shale sales at a government-fixed price (now EEK73 per tonne) will remain in state hands. Although the benzoic acid production unit of Kiviter was fairly quickly privatised (see *Business operations report*, 1st quarter 1997), the remainder had been unattractive to investors because of the environmental liabilities involved. In November another Estonian company, Erioli, bought the remainder for EEK120m and promised to invest a further EEK350m. One project under consideration is the construction of an oil refinery, but additional investors will have to be found to finance 80% of the estimated $100m cost.

Table 2.3
Fuel consumption by type
('000 tonnes, unless otherwise indicated)

	1990	1995	1996
Coal & coke	396	85	97
Oil shale	25,699	15,420	16,032
Peat	533	516	554
Peat briquette	205	92	66
Firewood ('000 cu metres)	945	1,431	1,543
Wood chips & waste ('000 cu metres)	120	390	544
Petrol	523	245	250
Diesel oil	604	352	334
Aviation fuel	35	18	16
Heavy fuel oil	1,838	405	391
Shale oil	n/a	195	156
Light fuel oil	118	23	45
Natural gas (m cu metres)	1,516	723	799
Liquefied gas	34	7	5
Other fuels ('000 tonnes of oil equivalent)	256	178	207

Source: Estonian Statistical Office.

Refined petroleum products come from either Norway or Russia. Russian crude oil, meanwhile, is transshipped through Estonia; very little is processed for use in Estonia itself. Baltica Finance (Netherlands) and Coastal Oil (US) founded Estonian Oil Services (EOS) in 1994 to take advantage of the oil-transit industry. EOS made a successful bid for the state distributor Esoil to get hold of storage tanks and terminals at Maardu port near Tallinn in 1996 and has invested $35m to modernise existing tanks and construct new ones. The company moved 1.3m tonnes of light fuel and crude oil thorough its terminal in 1997 for shipment to the US and Europe. EOS's managing director, Arnout Lugtmeijer, says the venture started out with the goal of purchasing oil from Russia and marketing the product from its own terminal. But over the last two years, Russian oil firms have moved their representation so aggressively into Europe that it leaves little scope for a middleman. EOS has reoriented its operations as a through-put service for Russian companies moving their own oil. A terminal expansion is scheduled for the second half of 1998, increasing EOS storage capacity from the present 100,000 cu metres to 120,000 cu metres.

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Pakterminal (Netherlands/Estonia) is the other big transit player, loading 15 oil products through a 170,000-cu-metre storage facility at Muuga port. Western oil executives agree that the Estonian port is the least financially risky in the Baltic states since daily operations do not require the pay-offs that are routine in Latvia or Lithuania.

The biggest obstacle to expansion of the oil transit trade is Eesti Raudtee, the state-owned railroad. Also, there is no pipeline to bring oil in from Russia. Meanwhile, bottlenecks in rail service have limited operations at all loading facilities to well below capacity. The authorities have tentatively planned to begin privatising the railroad towards the end of 1998, but that all depends on a large amount of regulatory legislation being written and passed in time. Instead of offering a standard price list for services, with discounts for higher volumes, Eesti Raudtee still operates on an ad hoc basis. Oil companies must negotiate separate contracts with it, although they are attempting to band together to send a single negotiator in 1999. Eesti Raudtee imposed rate increases of 20% across the board at the start of 1998, although this is probably more of a negotiating strategy than anything else. Some terminals may not agree to the new prices, reasoning that service can't get any worse; at the same time, Eesti Raudtee is unlikely actually to cut off service since it needs the cash flow and will probably settle for lower fees.

Through the Esoil purchase, EOS became the owner of the EK petrol retail chain. Discussions to sell the chain to competitors Hydro Texaco (Norway-US) and Neste (Finland) were inconclusive in 1997. However, permission to build new petrol stations becomes increasingly difficult and development more expensive as companies have to meet more stringent planning rules. As a result, EK's network of 33 established stations could increase considerably in value to any of the players now in Estonia. Both Neste and Statoil (Norway) want to expand their chains and Hydro Texaco and Royal Dutch Shell (UK/Netherlands) are looking for a way in. LUKoil (Russia) also has retail stations in Estonia but suffers from an image problem. Partly because of the jazzier image Western firms and partly because of resentment of many Estonians towards anything Russian, ethnic Russians make up the bulk of customers at LUKoil stations. Upwardly mobile Estonians gravitate towards the brightly lit stations of Neste and Statoil with their attached 24-hour shops.

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Chapter 3 Investment

General developments

Foreign direct investment (FDI) in Estonia in 1997 was EEK3.6bn, a record. Official figures published in early April 1998 indicated that Finland continued to be the leading source of foreign capital in 1997, contributing 28% of the total. In second-place was Sweden, with 21%. In 1996 Norway had been the second most important source of FDI for Latvia.

The lion's share of Estonian investment abroad went to Cyprus (41%), imitating a pattern seen throughout the former Soviet Union. The next-largest recipients were neighbouring Latvia (36%) and Lithuania (17%).

Sources of finance

Foreign sources are best for large amounts

As in many emerging markets, financing a company's operations requires flexibility when it comes to handling the changing financial environment. Companies in Estonia have sought various local and foreign sources of capital, including commercial paper, local and foreign stock-exchange listings and foreign loans. Of the factors that determine how a company raises funds, the most important are the amount to be borrowed, the level of local interest rates and the stability of the currency.

The small size of Estonia's capital market makes local borrowing quite difficult for larger companies. Smaller companies with foreign owners find that their financing requirements can often be met using sources in their home countries. The need for flexibility in the Estonian market is also reflected in the high interest rates imposed by the Bank of Estonia, the central bank, in an attempt to restrict the growth of the money supply and slow a credit-fuelled boom in the economy (see also Chapter 1). The bank raised overnight interbank money-market rates to highs of 18% in late 1997 and early 1998; in contrast, they were only 3-4% during the first three quarters of 1997. Average overnight rates came down to 12.9% in early April 1998.

EEK8:DM1
April 1998 rate

Eesti Telefon (Estonian Telephone, see box below), jointly owned by Telia (Sweden) and Telekom Finland (a combined 49% stake) and the state-owned holding company Eesti Telekom (51%), has said that it cannot borrow on the local market because there are insufficient funds available for its needs. Meanwhile, in 1997 Tartu Brewery—at the time partly-owned by Finland's Olvi brewery and Estonia's Magnum Consumer Group, before Olvi took full control in 1998—considered obtaining a listing on the Tallinn Stock Exchange. How-

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ever, it dropped the idea after Olvi said that it could meet the financing needs from its own listing on the Helsinki bourse.

Commercial paper tides firms over until foreign sources are tapped

Commercial paper has been a useful stop-gap for large local companies including local water utilities, shipping companies, and Eesti Telefon. Ulo Kallas of Hansapank (Estonia), who organises most of the issues, said that the majority of larger companies issued commercial paper to cover short-term cash flow and to tide them over until they were able to secure longer-term loans from abroad. Most of the companies that issued commercial paper have now redeemed these securities after taking funds from foreign sources.

Concerns about currency stability also caused some worry for those involved in commercial-paper deals. In the second half of 1997, when the Asian currencies came under pressure and Estonia's kroon was subject to an increasing number of forwards and swaps, the sum total of possible clients interested in commercial paper dropped sharply.

Currency stability fears are overdone

Foreigners operating in Estonia have also limited their financing because of a fairly erroneous perception that the local currency, the kroon, may be unstable. Foreign investors are often very quick to ask banks in their home countries to hedge against a fall in the kroon following any rumour that the EEK8:DM1 peg, managed by the country's currency board, may be altered. Devaluation of the kroon would make it harder for companies to repay locally raised loans in foreign currencies such as the D-mark. The majority of loans—whether for consumer spending, home-buying or business—are denominated in German marks or dollars, and as such expose the borrower to increased risk.

However, despite the scare in late 1997, there is little actual probability that Estonia's currency board can be overwhelmed by speculators. The main reason is that only one foreign bank is actually operating in Estonia, so any trading would have to be conducted via Estonian banks, whose currency dealings are strictly limited under the currency board system; such trading would also be subject to limits in the speculators' home countries on dealing with banks based in developing markets.

EBRD is beginning to widen its financing

Estonia's small size has apparently prompted the EBRD, a multilateral lender, to revise the way it operates in the country. Until 1998 the EBRD lent only to Estonia's banking sector, and its internal guidelines ruled out making loans to, or taking equity in, the relatively small companies that are Estonia's largest firms. However, early this year, the bank's policy changed and loans to larger local companies are now on the books. One project which may benefit is an export-oriented sawmill, partly owned by a Canadian firm. Another project, still under review at the time of writing, could provide financing to Norma, a locally owned car seatbelt manufacturer which is almost wholly export-oriented and is listed on the local stock exchange. Diplomatic sources admit that some pressure was applied to encourage support for the sawmill project.

In addition to the EBRD, which is financed largely by the EU, a number of foreign-government-supported funds exist to encourage investment in Estonia: Swedfund (Sweden), Finfund, the Finnish Export Bank (both Finland) and the Baltic-American Enterprise Fund (US), to name but a few. Several high-profile

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companies have taken investment support from Finland's Finfund, including Elcoteq (Finland), an electronic components assembler. Finfund takes an equity position—one of its conditions for helping with the financing of a project—but limits itself to funding one-third of a project and works in co-operation with Finnish financial companies.

The Baltic-American Enterprise Fund (BAEF) has earmarked $50m for the Baltic states and currently has $3m invested in Estonia. It provides direct equity investment, five- to seven-year loans to medium and large companies, and real estate mortgage loans to private individuals. The BAEF is now aiming to increase its equity investment in companies, but has up to now mostly supported loans of EEK2m-8m for both local and foreign companies operating in Estonia. The interest rates are based on the US prime rate and have been steady at 10-12%. Andres Trink, who heads the local office, said that the fund hopes to support strategic investment projects, and to increase the number of equity-investment projects over the straight lending of funds.

Private investment funds outside of Estonia—the Baltic Republics Fund (BRF), the Baltic Investment Fund and the Baltic Fund—are also a source of capital. The London-based BRF has the highest profile, with holdings across the Baltic republics and investments in both listed and unlisted companies. Hansapank's investment banking arm said that contact with the private funds is generally made through the arranger, but direct contact is possible.

The initial public offer is only now becoming a means of raising funds, whereas for much of 1997 it was really up to owners to find out how much their companies were valued at and to sell part of their stake. In 1998 only Uhispank has completed an issue and this was a global depositary receipt (GDR) issue launched internationally. Hansapank, which also needs further funds to support its Baltic expansion plans, will be launching a GDR offer before the end of the first half of 1998.

Listing an enterprise on the Estonian stock market is much less cumbersome than doing so on US markets. Several investment banks said that some of the companies listed in Estonia would never have received a listing in most other regulatory systems, including in Germany or London, because the information requirements in Estonia gave the firms greater leeway.

One factor that has made funds easier and cheaper to obtain was Estonia's taking a credit rating in 1997. The government and central bank had previously held off seeking a rating for the country, arguing that A-ratings would make it too easy for banks to obtain foreign-currency loans and so fuel a credit boom. The central bank relented and Estonia received what was considered to be a good rating for an emerging market (see Table 3.1).

Table 3.1
Estonia's credit ratings, Apr 1998

Agency	Long-term foreign-currency rating
Standard & Poor's	BBB+
Moody's	Baa1
IBCA	BBB

Source: EIU.

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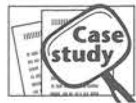
Sovereign or state guarantees are not given very often. The Ministry of Finance says that only five loans have been issued with government guarantees. These have involved infrastructure projects, such as the renovation of Tallinn Airport, the central bank's currency support programme and water-treatment plant renovations.

Phare, an EU aid agency, supports a variety of projects in Estonia which have been selected as being within the government's and the EU's stated guidelines. The Phare programme for 1998/99 is allocating Ecu21m for both the national programme and an additional programme to improve the legislative and administrative system in the country as part of Estonia's EU accession plan.



Eesti Telefon

Eesti Telefon (Estonian Telephone) is the fixed-line telephone operator in Estonia which has monopoly status until 2000. Its policy for seeking finance reflects a need for flexibility in changing financial macroeconomic conditions. Eesti Telefon was formed in 1992 with 51% participation by the Estonian state and the remaining 49% stake jointly owned by Telia (Sweden) and Telekom Finland.

Jaan Mannik, the company's chief executive, said that in its five years of existence, his firm had taken funds from several different channels to meet its investment needs but has used commercial paper to handle shorter-term cash flow.

The company has a high level of investment in basic infrastructure requirements and was Estonia's largest direct investor in 1996, when investment totalled EEK500m. Its ten-year business plan states that it will increase investment to EEK750m over the next two years. However, the company says that to maintain the level of investment it has not really had a consistent policy for finding funds.

Mr Mannik said that his firm has never had to go looking for ways to raise funds because it regularly has companies contacting it to offer financing. Deals are decided on a case-by-case basis.

The company followed a strong programme of commercial paper issues and by the end of 1997 had issued or renewed over seven lots of commercial paper. Most of the paper was issued with a term of three months and a yield of over 10% in 1995. The yield had declined to 7.48% in 1997. However, as with other companies in Estonia, Eesti Telefon redeemed most of its commercial paper as of early 1998. Mr Mannik said that they do not have any concrete plans to issue new paper.

Other sources for funding in 1997 included several syndicated loans, with the most recent being for EEK320m for a term of five years with an interest rate in D-marks of LIBOR plus 0.45%. Mr Mannik said that they have not yet decided how they will raise the funds for the investment.

Overall, the company said that they chose to make use of commercial paper or foreign borrowing for much of 1996 and 1997 because the Estonian money market was very small. If Eesti Telefon had borrowed all its needs locally, its executives believe, there would have been no funds left for anyone else.

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Chapter 4 Property, labour, business services

Salaries and benefits

Salaries in Estonia are often supplemented by benefits that are eligible for tax deductions and which, when applied correctly, help to reduce a company's social-tax bill. The employer's usual social-tax contribution is 30% of the employee's gross wage and is one of the most criticised taxes.

Foreigners and locals take a different approach

However, the responses by foreign and local companies are very different. Foreign firms tend to provide higher wages and do not consider the social tax a significant problem, whereas local ones rely on benefits to attract new recruits and to retain their employees.

The first, and probably largest, benefit offered to salaried staff and executives is a company car, which is generally leased. The monthly cost of leasing can vary from EEK2,000 to EEK4,000 per month, depending on the car's purchase cost.

However, one large foreign company with a sales network said that it pays higher wages and treats cars as a work tool, so that if an employee wishes to use the car for private purposes then he or she must pay 1% of the value of the car. This company also stresses that a mobile telephone is a work tool and not a benefit.

In contrast, a local company observed that mobile phones were viewed as a benefit by employees and considered to be part of the remuneration package. The initial cost for a mobile phone can range between EEK2,000 and EEK12,000, with additional costs for the calls themselves and administration fees to the service provider.

Another benefit is the so-called 13th-month wage or Christmas bonus. This bonus is usually equal to a month's salary. Two larger foreign companies said that they do not pay Christmas bonuses, but the majority of local firms report that they pay the bonus not only to salaried staff but also to staff on hourly wages.

Local companies also said that they provide some EEK1,000 a year towards medical expenses, including the cost of medicines. One manufacturer with a staff of 250 said that it provided a doctor on-site for employees. This medical benefit, together with the provision of free lunches, cost a total of EEK50,000 per month. The same company also provides insurance coverage for employees who have to travel a great deal and for those whose occupation is considered dangerous.

EEK8:DM1
April 1998 rate

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There is no current provision in Estonian legislation for the establishment of private health insurance or pension funds, but this situation could change in the near future. Two companies interest said that they might be interested in participating in such schemes.

Employee absenteeism

Policies tend to prevent much shirking

Both local and multinational companies say that employee absenteeism is not a particular problem in Estonia. There are, however, no official statistics to indicate adequately the number of working days lost to the economy as a result of absences when employees are not actually ill.

Existing government policy does not encourage employees in either the private or government sectors to shirk. If staff are absent due to illness for more than a day, they are required to produce a doctor's certificate. The national health fund will then cover 80% of the employee's wage for the days in question. If the employee has to be admitted to hospital, which happens more often in Estonia than in West European countries—a function of hospitals' receiving funding based on in-patient traffic—the health fund will pay only 60% of the employee's wage.

Companies often give some leeway to workers—

In practice, several companies reported that they usually require a doctor's certificate only after two days, meaning that an employee may still be on a full wage for the first work day lost due to illness. Most companies do not keep statistics on the number of working days lost in this way.

Paulig Baltic (Finland), a coffee and spice packaging company, said that there is some attempt by production staff to take extra days off when they are not sick, but noted that there are little or no problems with administrative staff. A Paulig executive said that one of the main reasons for employee absenteeism was a lack of motivation and that this should be addressed as part of the general responsibility of the personnel department.

Norma (Estonia), a diversified industrial company whose main product is car and lorry safety belts, says that it does not consider absenteeism to be a major worry. Norma requires an employee to submit a doctor's certificate if they are away for longer than one day.

A department store, Stockmann's (Finland), said flatly that absenteeism was not a problem. The company says it does not even usually require a doctor's certificate, since the incidence of reported sick leave is very low. Stockmann also pays above-average salaries for its sales clerks—a wage of around EEK4,000 a month—which probably encourages staff to show up for work, since full pay is much better than the 60% paid for sick leave.

—and most find the "doctor's excuse" system trustworthy

Personnel officers with several companies were shocked at the suggestion that doctors' certificates could be forged, or gained from doctors even if the employee was not ill, although one officer conceded that an employee could stay away longer than necessary, especially if he or she had a hard-to-detect illness such as lumbago.

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Several cafés and restaurants said that staff absenteeism was not a particular problem, but one restaurant manager did complain that casual staff sometimes did not advise that they would not be coming into work if they had secured a new position.

Employees in several sectors said that employers are often flexible if a parent must stay home to take care of a sick school-age child, for example. Employers also seemed prepared to allow employees some time off during the day if they needed to complete administrative procedures, such as those involving public utilities, that can only be sorted out during the working day. Several employees who worked for foreign companies said that, because of this flexibility, they did not feel the need to take a full day off unnecessarily. Equally, they did not feel that they could abuse their managers' goodwill by requesting too much time off.

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Chapter 5 Importing and distribution

Import agents and freight companies

Shipping companies act as import agents as well

In Estonia companies do not use firms that function as import agents alone. Instead, most depend on the combined services offered by their shipping companies or freight forwarders. Importers and exporters also say that they use their shipping agents or wholesalers to handle customs and selected freight companies according to requirements.

The process for importing goods has two alternative procedures:

- a shipping company handles the customs paperwork and brings the goods in and the importer/exporter will then find a distributor; or
- a producer arranges for a wholesaler/importer to import the goods and the latter will then handle both the customs and distribution of the goods.

Most firms are chosen based on their speciality—

The main determining factor in choosing either a shipping agent or a wholesaler appears to be the nature of the goods imported and whether an import licence is required, as is the case with alcohol. Food and alcohol are often brought into the country through wholesalers, while most other goods are usually handled by shipping agents. Chris Mclean of Baltic Connection, which organises contact meetings for exporters from the UK, said that this is the usual way of doing business. Although his company has attempted to introduce clients to import agents, almost nobody uses them. Instead, the services of shippers like Icelandic and UK-owned MGH were often used.

—and clients find them competent

David Coutts of Highland Marketing, a local company founded on British capital which runs two bars in Tallinn, has been involved in importing into Estonia and re-exporting to the CIS. Highland has used MGH to bring in its alcohol supplies and found that the company did what was required within the time required.

A subsidiary of an international news agency said that it had used Beweship to import computer hardware. Beweship had also handled customs clearance and delivery without problems.

Wholesalers can act as import agents. Multinationals say the choice of wholesaler will depend on the client's need for promotion of particular products and how exclusive a relationship it requires. The bigger names given for wholesalers were Dunker (Estonia), which handles alcohol; Kesko (Finland), which specialises in food; and Smarten (Estonia) which handles a range of fast-moving consumer goods, primarily for Procter and Gamble.

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April 1998 rate

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Wholesalers' use of separate freight companies varies. Some, such as Kesko, have their own drivers; others rely on either contractors or use a combination of their own vehicles to serve Estonia's main towns and contracted transport to smaller villages.

Many freight and forwarding companies offer transport services into neighbouring countries. Multinationals say they have tended to use Beweship, MGH and Scansped (Sweden) for international shipments. Highland Marketing, for example, has used Beweship and Kaubaekspress for deliveries within Estonia and found the service reliable. Kaubaekspress is operated by owner-drivers who used GSM digital mobile phones to keep in touch with the dispatchers. However, Kaubaekspress operates lorries of 5 tonnes or more which are not suitable for smaller deliveries.

Contacts

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Chapter 6 Sales and marketing

Sales techniques

The service culture needs to be nurtured

Developing a strong service culture in Estonia is one area that company owners say will take time. The issue of good service is becoming a major topic in business. The main business publications regularly publish reviews of service establishments. Many retailers find the reviews to be a positive way of monitoring their reputation in the marketplace and often carry out improvements based on the reviews.

Even so, many company owners in the service sector have only an ad hoc training policy. Exceptions are the larger multinationals, which can draw on their training experience in their home markets, adapting it to local needs.

By far the most significant factor influencing staff service training is whether companies believe the employees will stay with them after the training period is over. Firms of every size fret that head-hunters will poach newly trained and highly productive employees. Some companies now require employees to sign a contract to ensure that they remain with the company for at least a year after the training.

Finnish customers have started the honing process

Several companies operating throughout Eastern Europe say that Estonia's close contacts with Finland, and the part of its service sector aimed at the Finnish tourist, have fostered an improvement in service culture, especially in Tallinn. Estonian establishments take note of reviews in Finnish guidebooks to the city in addition to those in the local press.

Most banks in Estonia run induction courses in which much attention is devoted to customer service. Small companies stay with on-the-job training, with understandably mixed results.

Service training seems to be strongest in stores with strong foreign ties, such as the Stockmann department store and the hardware goods store K-Raua (both Finland). These stores are keen on customer feedback and have set up complaints systems or suggestion boxes.

K-Raua, for example, teaches its staff to assist and advise customers in their purchases and to remain polite and responsive. Stockmann initially brought in trainers from Finland and sent key salespeople to Finland to develop customer responsiveness. However, some Stockmann employees have said that service training needs to be varied in order to help them handle the typically very independent and fairly unresponsive Estonian client, who often prefers no sales assistance. Meanwhile, Statoil (Norway) uses trainers and programmes brought in from Norway to foster a service culture in both salespeople and service-station attendants.

EEK8:DM1
April 1998 rate

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Hotel Olympia, the largest business-class hotel in Estonia, has opted for a strong multilevel service training programme. Initially, the company used foreign consultants to run courses. These were followed later by local training companies, such as Merco International, and its own trainers. The hotel did not find the out-sourced service training to be sufficient, so in-house training ensured that the hotel's particular requirements were met.

Restaurant training focuses on language and cash registers

Bars, cafés and restaurants take a very different approach to service training. Highland Marketing (UK), in its popular Bar With No Name, does not offer special training (except for language courses), which reflects its concern about spending money on new employees who may leave shortly after. The company finds that all employees need to speak Estonian, English, Russian and some Finnish.

Ruby Tuesday, another bar owned by expatriates, was also cautious about training employees who may leave after the investment had been made, although the owners do provide basic training to enable new employees to operate the restaurant's computerised ordering system.

As part of the reforms carried out in the vocational school system, it is now possible to train young people specifically for the hospitality industry. The new curriculum includes one year of class work, which covers all aspects of the industry from food preparation to service provision. This is followed by one year of practical experience.

The students are either placed by the school, if the school has co-operation agreements with particular companies, or the students themselves find a placement. There is no difficulty in finding companies to take the students, since many students keep working in the same companies after graduation. The hospitality and tourism courses themselves are hugely popular.

Several private training companies also offer service courses based on core material from the parent companies and tailored to suit the Estonian market.

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