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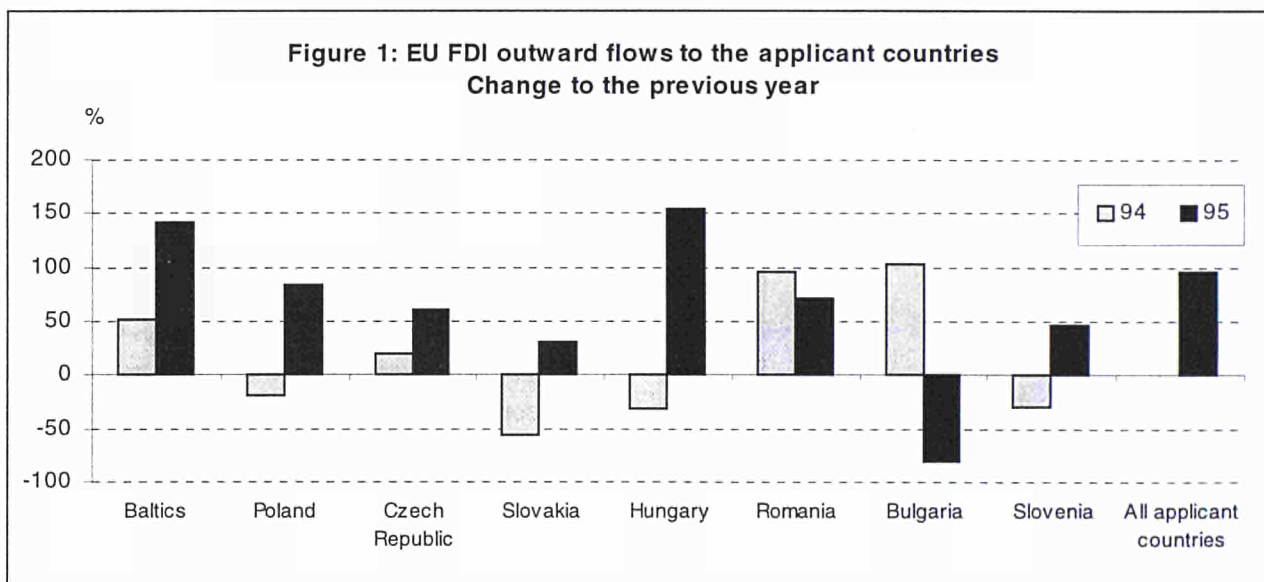
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FOREIGN DIRECT INVESTMENT IN THE BALTIC COUNTRIES

Foreign direct investment (FDI) reflects the objective of obtaining a lasting interest by a resident entity – the direct investor – in an enterprise resident in another economy – the direct investment enterprise. The 'lasting interest' does not necessarily mean control, however it implies the existence of a long-term relationship and a significant degree of influence of the direct investor on the management of the enterprise. The emerging economies of the applicant countries represent an increasingly important 'target region' for EU FDI capital. This article looks at foreign direct investment capital in the three Baltic countries – Estonia, Latvia and Lithuania – and in particular at the FDI relations of the EU with these three countries.

Strong rise of EU FDI flows to the applicant countries and increasing importance of the Baltics



EU FDI capital flows into the applicant countries (the three Baltic countries and Poland, Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Slovenia and Cyprus) experienced a strong rise between 1994 and 1995: flows of equity capital and inter-company loans (other capital) amounted to 5.5 bn ECU in 1995 which is nearly the double of the 1994 value and thus represented 12.4% of total FDI flows out of the EU (1994: 11.7%).

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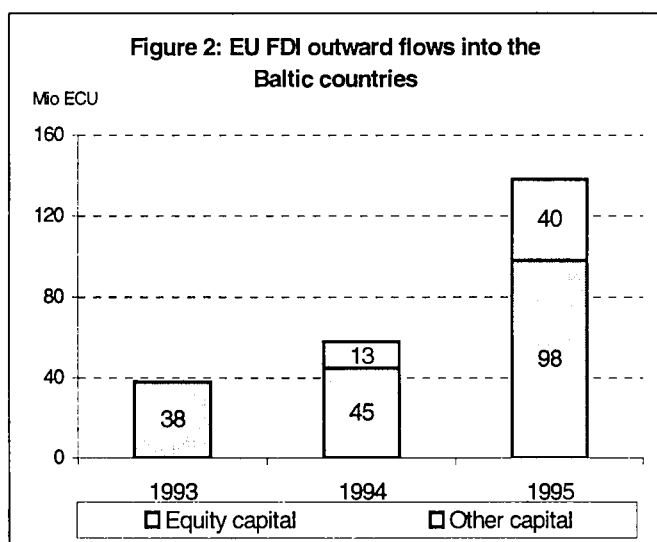
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The strong increase in FDI flows led to a rise in the EU FDI outward position in the applicant countries of more than one quarter. With an increase of the EU FDI assets in China of 41.2%, this country was the only "emerging market" where FDI assets held by EU investors rose even stronger than in the applicant countries (Table 1).

Table 1: EU FDI outward positions in selected emerging markets (million ECU) (end of reference year)

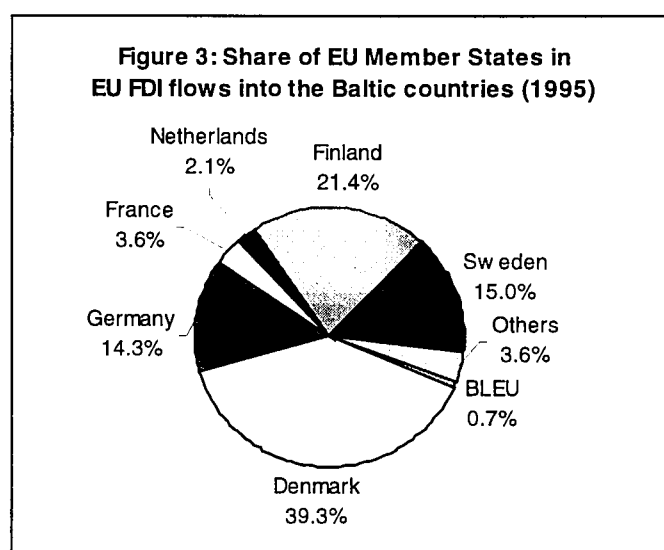
	1994	1995	Variation in %
Applicant countries	11471	14651	27.7
African ACP	8374	9709	15.9
ASEAN	18974	20576	8.4
China	1645	2322	41.2
India	1524	1569	3.0
MERCOSUR	22206	24096	8.5
CIS	891	1033	15.9

In 1995, Estonia, Latvia and Lithuania altogether attracted 2.5% of total EU FDI flows into the group of the applicant countries. The Baltics are of increasing interest for EU investors: FDI capital flows went up from 38 million ECU in 1993 over 58 million in 1994 up to 140 million ECU in 1995 (Figure 2). With EU FDI capital flows to the Baltics being 2.5 times higher in 1995 than in 1994, these three countries, together with Hungary, experienced the strongest increase in EU investment during this period (Figure 1).



Northern EU Member States invest most in the Baltics

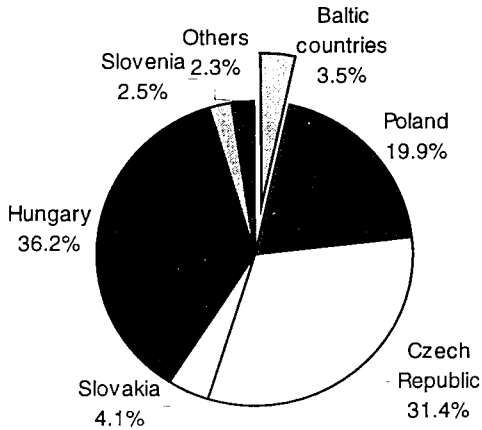
Investing in the Baltic countries is clearly a Nordic affair: by far the largest chunk of EU FDI flows into Baltic companies comes from the Northern Member States (Figure 3). With 39.3% of total EU FDI capital flows into the Baltics in 1995, Denmark accounted for the highest share of EU FDI in these three countries, followed by Finland that accounted for another fifth, and then by Sweden. German FDI flows are relatively important as well, amounting to 14.3% of total EU FDI flows into the Baltics. On the other hand, the FDI engagement of the Mediterranean countries in Estonia, Latvia and Lithuania is of less importance.



In 1995 EU Member States held 0.5 bn ECU of FDI assets in the Baltics

The EU is a net exporter of FDI capital to the Baltic countries: at the end of 1995, EU Member States held 501 million ECU of assets in Estonia, Latvia and Lithuania, exceeding the liabilities by a net direct investment position of 462 million ECU (Table 2). Net EU FDI positions in the Baltic countries account for approximately 3.5% of the total net position in the applicant countries. The biggest chunk of net EU assets in these countries represents investments in Hungarian companies (36.2%), followed by the Czech Republic which accounts for nearly one third, and Poland accounting for another fifth (Figure 4).

Figure 4: EU net FDI position in the applicant countries - Country shares 1995



Between 1994 and 1995, EU Member States increased their net FDI position in the Baltics by a little more than one fifth, which was slightly below the average increase of 26.9% for the applicant countries as a whole.

Table 2: EU net FDI positions in the applicant countries (million ECU) (end of 1995)

	Equity capital	Other capital	Total capital
Baltic countries	373	89	462
Poland	1963	672	2636
Czech Republic	3283	887	4168
Slovakia	444	101	547
Hungary	4007	799	4804
Romania	-12	45	34
Bulgaria	74	-7	67
Slovenia	287	51	338

The Baltic countries attracted 346 million ECU of worldwide FDI capital in 1995

The following part of this article is based on figures coming from the Balance of Payments of Estonia, Latvia and Lithuania.

In 1995, approximately 346 million ECU of FDI capital were invested in enterprises in the Baltic countries; these figures include capital flows between the three countries like eg FDI flows from Estonia to Lithuania (Figures 5,6,7).

Compared to 1994, capital flows decreased on average by 10.8%, but the evolution pattern varied amongst the three countries: while FDI flows to Estonia and Latvia sunk by 15.9% respectively 24%, FDI flows to Lithuania more than doubled in the meantime.

Figure 5: FDI flows to Estonia

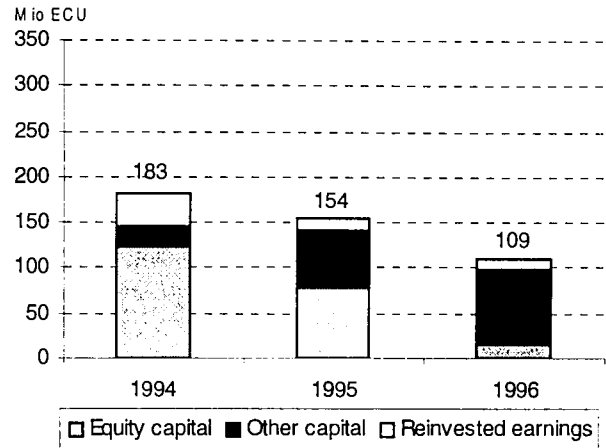


Figure 6: FDI flows to Latvia

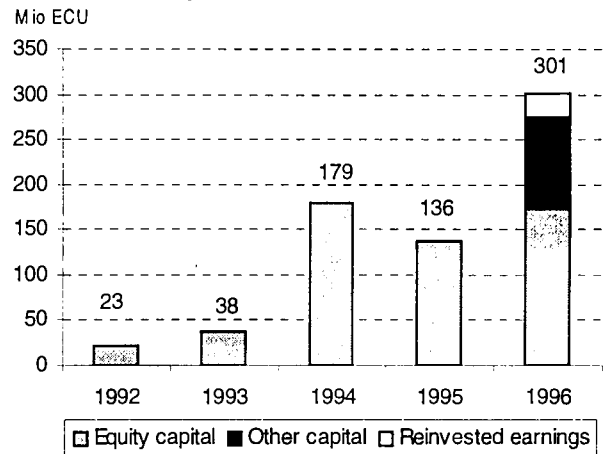
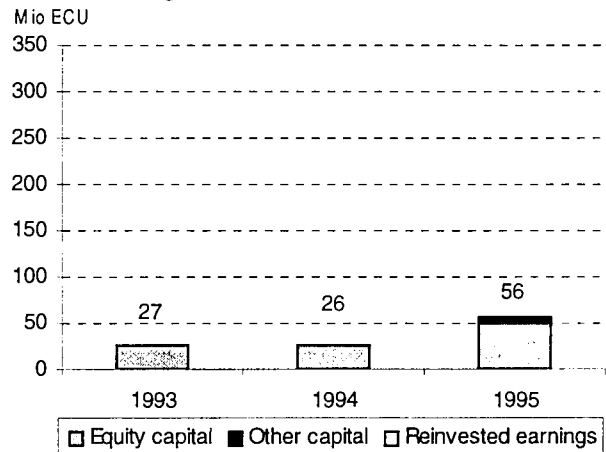


Figure 7: FDI flows to Lithuania



The structure of FDI flows to the Baltics, in particular in Estonia and Latvia, shows a pattern which is typical for 'new' target regions for FDI. Important initial investments in equity stakes of foreign enterprises are reflected in a high share of equity capital in total FDI. Having been in business for a certain time, loans from

the mother company to the foreign affiliate get of major importance, hence the share of 'other capital' in total FDI is rising.

European countries hold the major share of the FDI inward capital position in the Baltics

As reveal the Balance of Payments statistics of the Baltic countries, in 1996 international investors held over 1 450 million ECU of FDI capital engagements in enterprises of this region. European countries, covering the EU Member States, EFTA countries and other European countries like the CEECs and some of the CIS countries (in particular Russia) hold the largest share of this capital, accounting altogether for 79% in Latvia respectively 67% in Lithuania in 1995 (a geographical breakdown of FDI inward positions is not available for Estonia) (Figures 8,9).

Figure 8: Latvia 1995 - breakdown of the position of FDI liabilities by regions

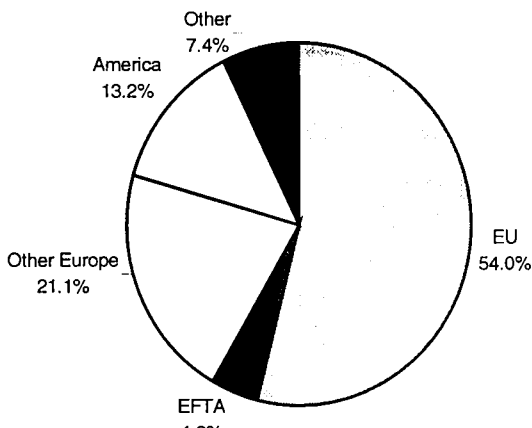
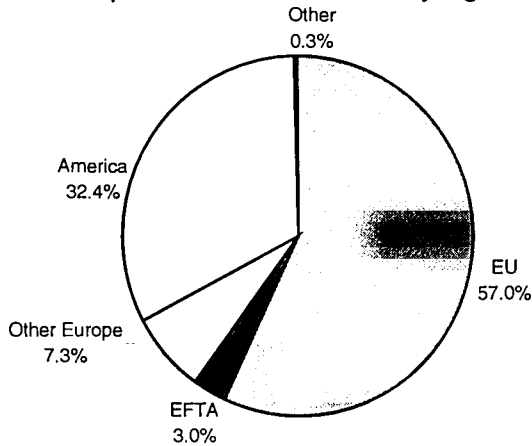


Figure 9: Lithuania 1995 - breakdown of the position of FDI liabilities by regions



In 1995, the major part of FDI capital flows into the Baltics came from the USA, Northern Europe and Russia

The major part of FDI capital invested in the Baltic countries in 1995 came from seven countries: Denmark, Germany, Ireland, Austria, Sweden, the United Kingdom and the United States. These countries can be found amongst the major investing countries of FDI equity capital into Estonia, Latvia and Lithuania (Figures 10,11,12). Finnish investors accounted for nearly 13% of FDI flows to Estonia in 1994, however, after a disinvestment in 1995 capital flows rose again in 1996, then accounting for 3.6% of equity capital flows. The EU Member States amounted to between approximately 50 and 60% of FDI equity capital flows into the Baltics.

Russian equity capital played a very important role for FDI flows into Latvia (43.7%) (Figure 11) and is in the group of the 10 most important countries investing in Lithuania, although accounting for only 1.8% of equity capital flows in 1995 (Figure 12). In Estonia, on the other hand, there could be observed a disinvestment of Russian FDI capital in 1995.

FDI activities from Asian countries were virtually zero in Latvia and Lithuania, while, on the other hand, the group of countries composed of Hong Kong, South Korea, Singapore and Taiwan accounted for more than one fifth of equity capital flows into Estonia in 1995.

In 1995 FDI flows between the three Baltic countries themselves were of minor importance. Such "intra Baltic flows" accounted at the highest for 0.5% of the inflows of equity capital to Estonia, Latvia and Lithuania.

For Latvia, figures for FDI inward flows have been estimated using the difference between the FDI inward position of end of the reference year and the end of the previous year.

Figure 10: The 10 major FD-investors of equity capital in ESTONIA 1995

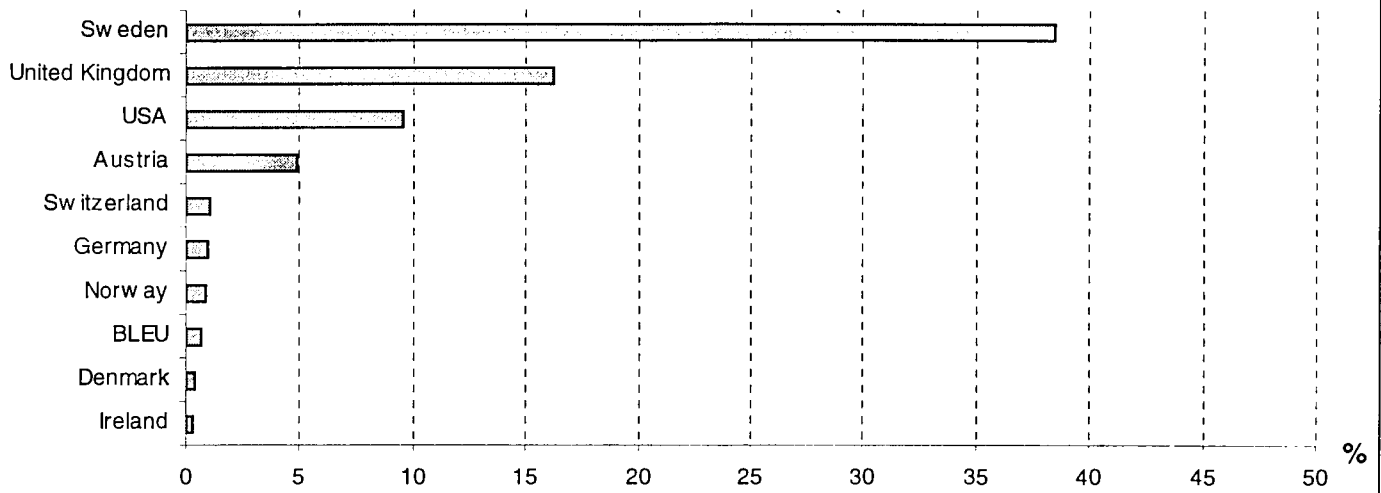


Figure 11: The 10 major FD-investors of equity capital in LATVIA 1995

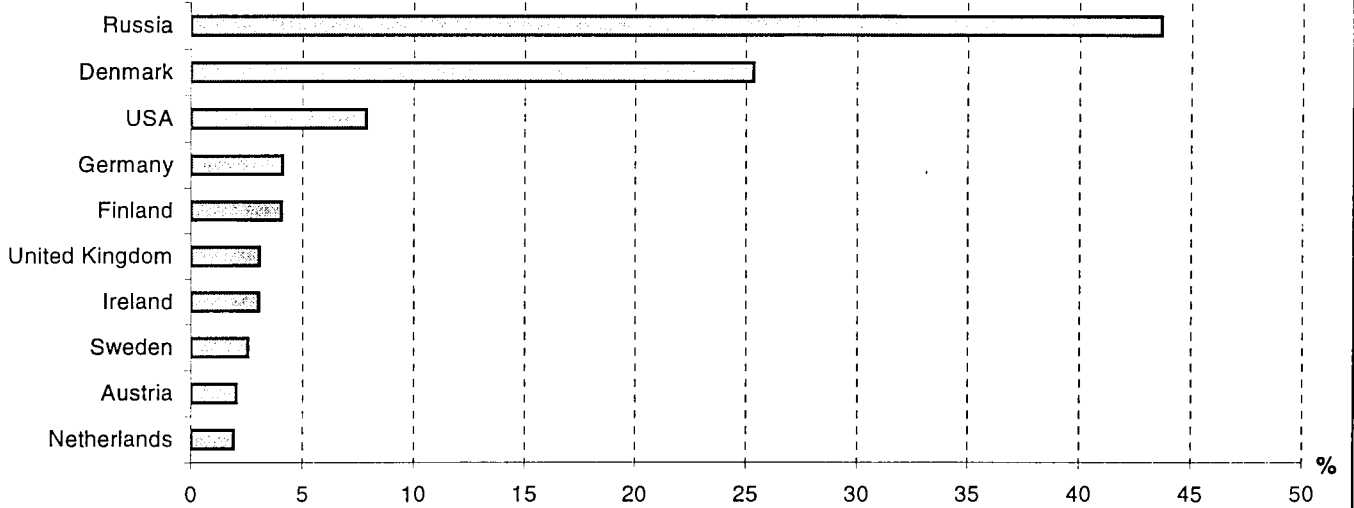
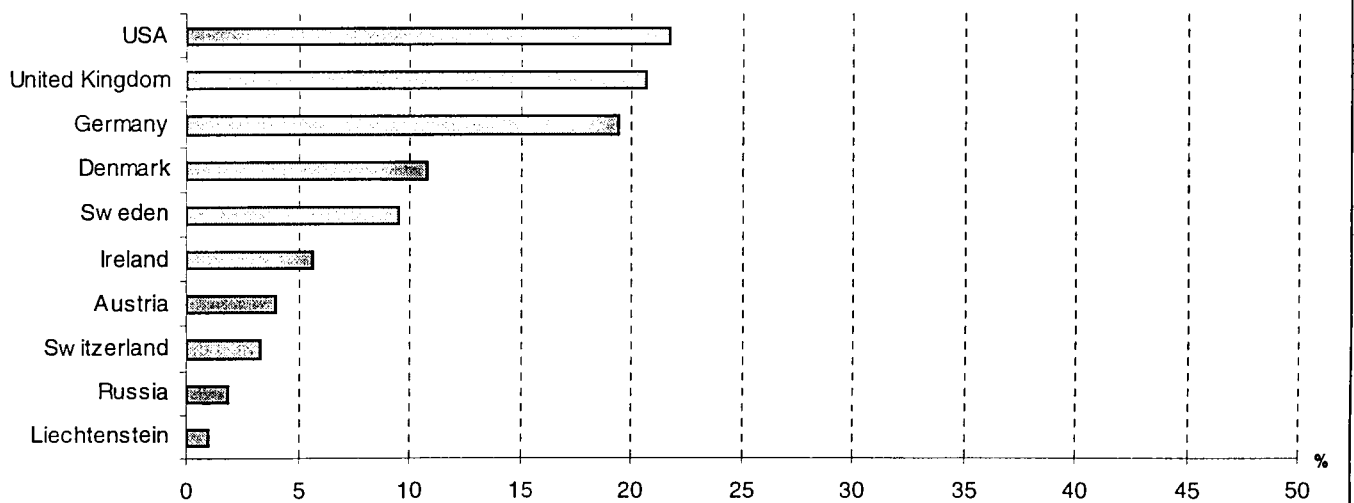


Figure 12: The 10 major FD-investors of equity capital in LITHUANIA 1995



Varying attractiveness of branches for FDI capital

Foreign investors in the economies of Lithuania and Estonia hold the major parts of their stakes in enterprises of the manufacturing sector (between 55 and 65%, *Figure 13**). In Latvia, on the other hand, it's the transport and communication sector that attracted the highest portion of FDI capital over the years 1994-96 (43% of the 1995 FDI position). During this period, FDI

flows into the Latvian industry as well as some of the services branches decreased significantly, with the exception of the trading business where capital flows rose sharply. The downturn of equity capital flows into Estonia, on the other hand, affected all branches in the same way (*Figure 14 and 15*).

* Values for Estonia are based on cumulative flows for 1994-95.

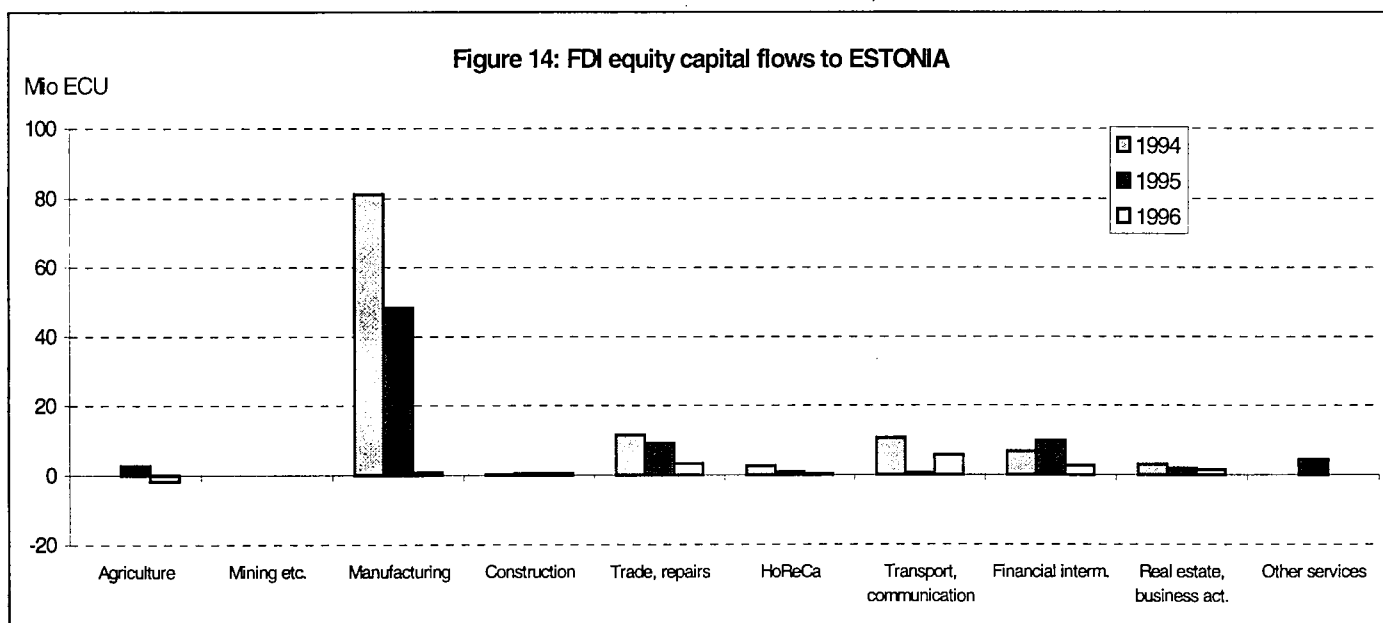
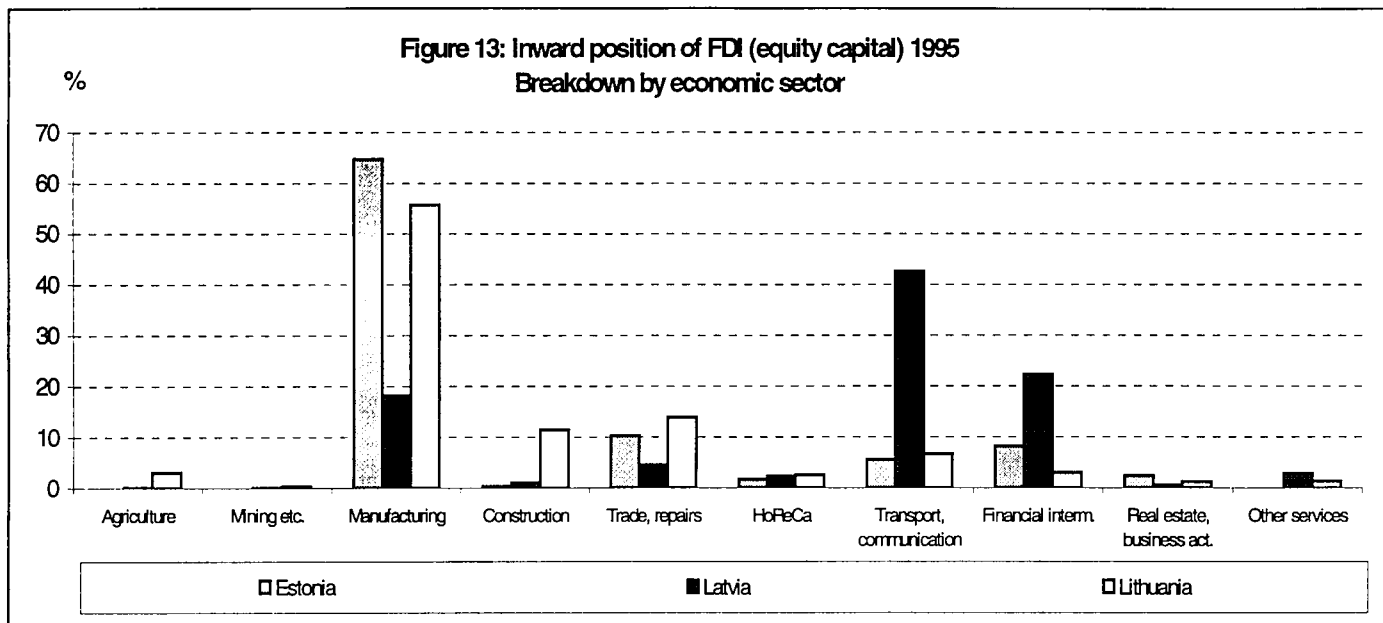
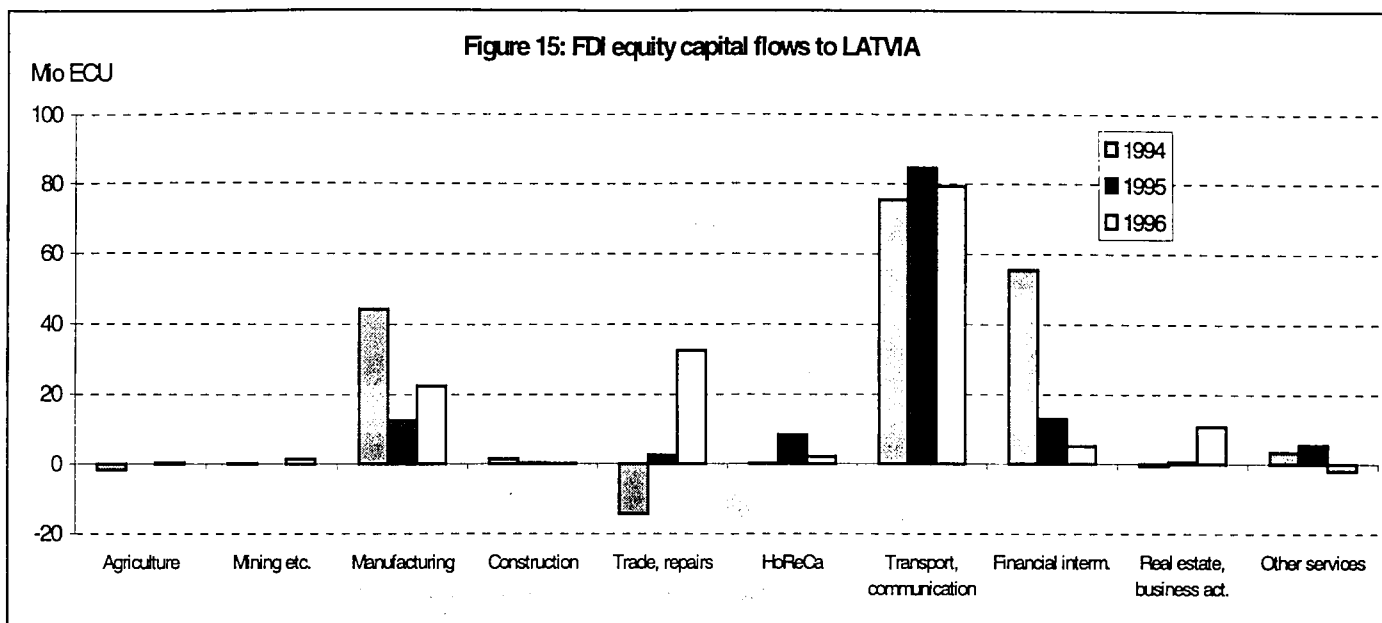


Figure 15: FDI equity capital flows to LATVIA



Foreign direct investment (FDI) is the category of international investment that reflects the objective of obtaining a lasting interest by a resident entity in one economy in an enterprise resident in another economy. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise, and a significant degree of influence by the investor on the management of the enterprise. Formally defined, a direct investment enterprise is an unincorporated or incorporated enterprise in which a direct investor owns 10% or more of the ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated enterprise).

FDI flows and positions

Through direct investment flows, an investor builds up a foreign direct investment position, that features on his balance sheet. This FDI position (sometimes called FDI stock) differs from the accumulated flows because of revaluation (changes in prices or exchange rates, and other adjustments like rescheduling or cancellation of loans, debt forgiveness or debt-equity swaps).

For a more comprehensive and detailed view on EU FDI flows and positions see:
European Union Direct Investment Yearbook 1997

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