Eesti Pank
Bank of Estonia

KROON & ECONOMY

1/2006

SUBSCRIPTION

The quarterly Kroon & Economy can be subscribed by

fax: +372 6680 954
e-mail: publications@epbe.ee
mail: Eesti Pank
Publications Group
Estonia pst 13
15095 Tallinn
Estonia

The quarterly is free of charge to subscribers.

Information about publications of Eesti Pank by phone +372 6680 998.

Publications of the Estonian central bank are available at:
http://www.bankofestonia.info

ISSN 1406-829X

KROON & ECONOMY
Eesti Pank quarterly

Executive editor: Kadri Põdra
Cover design & design: Vincent OÜ
Layout: Kristiina Krüspan

Printed in Tallinna Raamatutrükikoda

CONTENTS

APPENDIX

AUTHORS OF THIS ISSUE

KAUPO POLLISINSKI
Senior Analyst of the International and External Relations Department of Eesti Pank
kaupo.pollisinski@epbe.ee

KÄTLIN KEINAST
Student at the Faculty of Economics of Tartu University,
trainee at the International and External Relations Department of Eesti Pank
katlin.keinast@mail.ee

ANDRES SAARNIIT
Adviser to the Economics Department of Eesti Pank
andres.saarniit@epbe.ee

JAANUS KROON
Head of the Balance of Payments and Economic Statistics Department of Eesti Pank
jaanus.kroon@epbe.ee

REET KIRT
Deputy Head of the Balance of Payments and Economic Statistics Department of Eesti Pank
reet.kirt@epbe.ee

Foreword

This issue of Kroon & Economy gives an overview of the current economic relations between Estonia and Russia. It also describes the main developments in the Russian economic policy and banking sector, and analyses Russian external trade with Estonia as well as with other close neighbours.

After the Russian crisis in 1998, economic growth has been rapid both in Estonia and Russia. Moreover, Estonia's accession to the European Union has given a further boost to the development of economic relations between the two countries.

For historical reasons, domestic savings have been scarce for the past 10 to 15 years in both countries and thus the inflow of Russian capital in Estonia has been modest, given the economic potential of the large neighbour. On the other hand, thanks to the fast development of the Estonian financial sector, capital transfers from Estonia to Russia have increased drastically in recent years, exceeding cash flows in the opposite direction nearly twice. Naturally, it should be taken into account with regard to these data and estimations that in light of the present close economic integration it is nearly impossible to, for instance, determine the amount of Russian capital reaching Estonia via Member States of the European Union, or the volume of investments channelled via Estonia to Russia by third countries.

The situation in trade is quite the contrary – imports from Russia exceed the exports of Estonian goods to Russia by nearly one-and-a-half times. Estonia gets the majority of its raw materials from Russia. The imports of goods also include transit goods. The transit of oil and oil products via the ports of the Baltic Sea to third countries is a whole separate business, comprising a substantial part of the Estonian transport sector. Goods exports to Russia also include transit goods, though to a lesser extent.

Regardless of the tightening economic relations between Estonia and Russia, they still remain quite unvaried and largely rely on Russian natural resources. The ongoing fast development in Estonia as well as in Russia, however, creates preconditions for a more diverse utilisation of opportunities on both sides.

RELATIONS BETWEEN THE EUROPEAN UNION AND RUSSIA

Kaupo Pollisinski

The legal basis for EU-Russian relations was laid down by the Partnership and Cooperation Agreement which was signed in 1994 and entered into force on December 1, 1997. The term of validity of the agreement was initially set at ten years – it will have to be reviewed in 2007. The partnership and cooperation agreement regulates the political, economic and cultural relations between the EU and Russia. The agreement establishes the institutional framework for bilateral contacts, sets the principal common objectives, and calls for activities and dialogue in the following areas:

- Cooperation in trade and economy – with this agreement the most-favoured-nation treatment of the EU was extended to Russia, whereas there are no quantitative restrictions on trade (excl. some steel products)[1]. Moreover, this line of cooperation aims at the harmonisation of legislation;
- Cooperation in science and technology, energy, environment, transport, space, etc;
- Political dialogue – protecting common interests in international issues and cooperating in matters concerning adherence to the principles of democracy and human rights;
- Legal and domestic issues – cooperation in order to prevent crime, drug trafficking, money laundering and organised crime.

The dialogue between Russia and the EU takes place at the following levels:

- The highest form of cooperation is the Summit of Heads of State and Government that takes place twice a year;
- The Permanent Partnership Council founded at the Summit of May 2003 in St. Petersburg in order to strengthen cooperation;
- The Cooperation Committee where senior officials meet; the nine subcommittees deal with technical issues;
- The Parliamentary Cooperation Committee between the European Parliament and the Russian Duma that meets regularly in order to discuss daily matters;
- Troika Meetings (the Presidency of the EU, a high representative of the Common Foreign and Security Policy of the EU, and the incoming EU presidency).

On April 27, 2004 **the EU and Russia signed an extension protocol to the Partnership and Cooperation Agreement and a Joint Statement on EU Enlargement and EU-Russia Relations** which included the "concerns of Russia":

---

[1] Trade relations between the EU and Russia are strong, especially after the last enlargement of the European Union. The EU is the primary trade partner of Russia – trade with the EU amounts to 50% of the total trade. Meanwhile, Russia is the fifth largest trade partner for the EU (approximately 5%) after the US, Switzerland, China and Japan. Russia's main export articles are fuels and raw materials with Russian fuel constituting over 20% of the total fuel imports to the EU. The EU exports industrial products and consumer goods to Russia, also being a major investor and the main exporter of technology and know-how to Russia.

- The level of **customs tariffs** for goods exported from Russia to the EU will increase from an average of 9% to around 4%. Transition periods were established on goods which previously had 0-tariffs (e.g. aluminium exported to Hungary). Russia was promised a 6–7 year transition period for lowering import tariffs from 35% to 20% on the Russian side on cars produced in the EU;
- **The EU will increase steel and crop export quotas for Russia** by the extent to which new Member States have bought steel products and crop until now;
- All **antidumping investigations** initiated against Russian goods after the enlargement of the EU will be terminated; antidumping investigations started in the pre-enlargement EU will gradually be reviewed;
- Disputes concerning the **exports and imports of agricultural products** and veterinary matters are solved (temporarily, for the time being)[2];
- Russia will be providing **nuclear fuel** to those 18 industrial nuclear reactors (nuclear power stations) in the new Member States of the EU, which were built by the Soviet Union;
- The EU will withdraw the strict rule of **liberalising the domestic energy market** in Russia;
- The EU allows to use **planes exceeding noise limits** considering each case separately, i.e. in case of charter flights;
- After May 1, 2004, **visa issuance regime** valid before the EU enlargement will remain in force and negotiations on the general visa issuance regime between the EU and Russia will be launched.

Russia has accomplished much of what was brought out among the concerns.

The EU and Russia reached an **agreement concerning the conditions of joining the World Trade Organisation** at the Summit held on May 21, 2004, which are the following:

- The average customs tariff of Russia on EU goods will be lowered (e.g. in case of industrial goods it must not exceed 7.6% and 13% in case of agricultural products);
- As for services, Russia undertakes to open several sectors of its markets for the EU (e.g. telecommunications, transport); other commitments include providing cross-border services and establishing companies abroad. **Russia retained its right to protect its financial services market** (i.e. Russia does not directly allow EU banks to open branch offices there). Russia may establish export tariffs on natural gas, the elimination of which the EU initially demanded;

---

[2] At the end of May 2004, Russia threatened the EU Member States with an embargo on importing animal products but it was revoked in return for the promise by the EU to impose common veterinary certificates on all EU Member States and allow Russia to perform check-ups on meat industries.

- Russia promised to double its fuel prices by 2010 for its industrial consumers. This was a question of strategic significance for the EU because, firstly, the current low price gives Russian manufacturers an unequal advantage compared to EU manufacturers and secondly, a higher price will stimulate more effective usage of energy resources in Russia (which also supports the objectives of the Kyoto protocol);
- By 2013 at the latest, Russia will change the taxation system for EU planes flying over Siberia so as to make the tax more cost-oriented, transparent and undiscriminating;
- Russia will retain the right to subsidise agriculture to the present extent; initially the EU insisted on abolishing it.

At the St. Petersburg Summit, the EU and Russia agreed to reinforce their cooperation by establishing four “common spaces”[3].

In the matter of organising transit traffic between the district of Kaliningrad and the great Russia[4], the agreement standing as of December 17-18, 2003 remained in force, envisaging a simplification of customs procedures compared to ordinary treatment. The abolishment of transit tariffs between Kaliningrad and the motherland (except costs directly related to the maintenance and administration of transit or transit roads) and minimising customs procedures after the harmonisation of customs regulations on both sides were set as primary goals.

---

[3] The objective of the “common spaces” was set at the Summit of May 31, 2003 with the aim to render bilateral relations more strategic. The common spaces are the following:
- Common economic space – economic integration and harmonisation of legislation in order to increase and diversify trade and investment between the EU and Russia;
- Common Space of Freedom, Security and Justice (this also includes the agreement between Europol and Russia as well as the signing and ratification of border contracts with Estonia and Latvia);
- Common Space on External Security – primarily securing stability in the regions adjacent to the EU and Russia;
- Common Space on Research, Education, Culture (e.g. various exchange programmes).

[4] The transit between Kaliningrad and other areas of Russia goes through Lithuania. – Edit.

RECENT UPGRADE IN RUSSIA'S CREDIT RATING – BACKGROUND ASPECTS

Kaupo Pollisinski

On 15 December 2005, one of the greatest and most renowned rating agencies Standard&Poor's (S&P) announced its decision to upgrade Russia's credit status to a stable "BBB" level instead of the former "BBB-" status.[1] Hence, Russia rose to the second lowest investment grade in the S&P rating table, similarly to its placement by other rating agencies. This is one of the major economic policy aims of (not only) developing countries – to achieve the universally recognized reliability rating, which is an indicator to investors of the financial health of a country that is worth investing in without a threat of losing their money.

The incentive for raising Russia's sovereign rating was the improved (and still improving) monetary status caused by the expectation-exceeding boost of global raw material prices: the trade surplus is increasing, reserves are growing, national debt is diminishing rapidly and the state budget is in considerable surplus. What does it mean? This is the main discussion topic of the article.

Source of wealth

The prices of crude oil and natural gas have increased more than twice during 2004–2005 (see Figure 1). These happen to be Russia's major external trade articles, which comprise approximately 60% of the exports according to the balance of payments compiled by the Bank of Russia (at market prices, i.e. calculated on the basis of the balance of payments methodology).

An important income source for the federal budget is the export customs duties that raw material exporters are obliged to pay to the customs office. The duty on crude oil is calculated every two months on the basis of the average export price of the previous two months. In December 2005 and January 2006 it was 179.6 US dollars per tonne. In the previous period the customs duty rate was 179.9 dollars and as of 1 February 2006 the rate was set at 160.8 dollars per tonne. The decrease of oil prices during the previous reference period lowered the customs duty slightly.

Oil dollars flowing into Russia become roubles through export customs or because exporters have to purchase roubles instead of the dollars earned in order to make their payments in Russia. The greatest foreign currency buyer on Russian currency markets is the central bank, whose reserves are growing as rapidly as oil prices (see Figure 2). The central bank has two goals on currency markets: to regulate the rouble-dollar exchange rate and influence the rate of price increase.

[1] From the rating BBB assets are regarded as belonging to the investment grade.

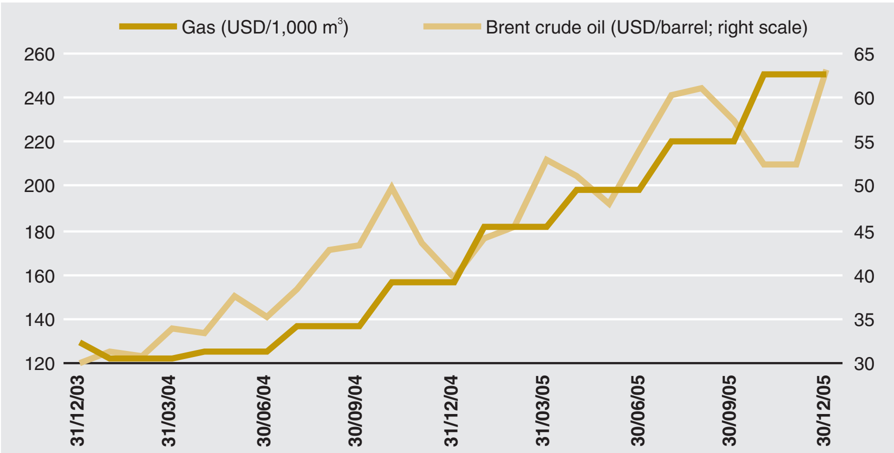

Figure 1. Oil and gas price increase

Source: Reuters

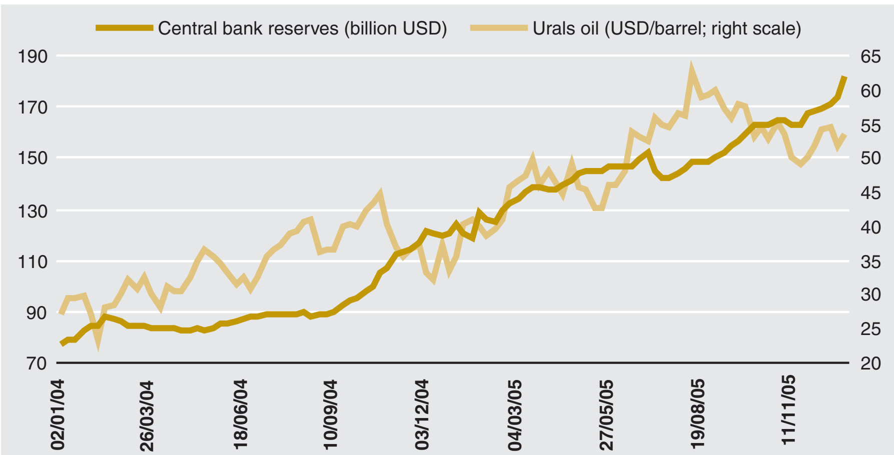

Figure 2. Reserves of the Bank of Russia and oil price increase

Sources: Bank of Russia, Reuters

In 2004, the central bank reserves grew 1.6 times (from 77 billion to 120 billion USD) and in 2005 by 1.5 times (to 182 billion dollars). This means that the volume of the central bank's external assets equals the imports of the past eighteen months. Thus, **within the past two years external**

reserves increased 2.4 times. At the beginning of 2003, central bank reserves amounted to 48 billion dollars.

The Russian federal budget is also well off. In order to prevent too much money from flowing via the state (above all from the federal budget) into daily consumption and the consequent acceleration of inflation, a **stabilisation fund** comprised of the "unforeseen oil income" was established in 2004. For that purpose, every year the Urals crude oil reference price is determined during the compilation of the federal budget and if that limit is exceeded, the respective tax income is channelled into the stabilisation fund. On 1 January 2005 the volume of the stabilisation fund was 522.3 billion roubles, whereas on 1 January 2006 it was already 1,237 billion roubles. Meanwhile, payments from the fund related to the repayment of external debt were made in the sum of 643 billion roubles (approximately 20 billion USD[2]). Hence, at the turn of the year the government reserves stood at nearly 40–43 billion US dollars. Central bank reserves were 182 billion dollars; the total national reserve amounted to approximately 224 billion dollars.

At the end of 2005, the Russian federal budget had a 7.5% surplus in ratio to the expected GDP. The share of customs revenues (both imports and exports) in the federal budget rose to 41% in 2005. The cost side of the 2006 budget is higher compared to previous budgets (see Table 1). The budget includes four so-called national programmes (education, health care, agriculture and housing), which clearly increase national expenses. These four programmes and the newly established state investment fund draw 205 billion roubles from the 2006 budget (nearly 4% of the planned budget for 2006) and this has provoked a heated discussion also in the government. Some

Table 1. Indicators of the Russian federal budget (RUB bn)

	2003	2004	Annual growth	Planned budget for 2005	Budget implementation in 2005	Budget implementation / planned budget	Annual growth	Planned budget for 2006	Annual growth (planned budget for 2006 / budget implementation in 2005
Total income	2,588.34	3,422.3	1.3 times	3,326	5,121	1.68 times	1.5 times	5,046	0,98 times
Income on customs duties	757.6	1,219.3	1.6 times	1,272.9	2,102.2	1.65 times	1.7 times	2,136	1.02 times
Customs duties / total income (%)	30	35.6		38.3	41			42.3	
Total expenses	2,361.5	2,735.7	1.16 times	3,047.9	3,504.5	1.15 times	1.3 times	4,270	1.2 times
Balance (% of GDP)	1.7	4.2		1.5	7.5			3.2	

Source: Russian Ministry of Finance

[2] Calculated on the basis of the central rate of the Bank of Russia in November 2005.

claim that this will boost inflation, whereas others say that it will improve investment efficiency. The actual result will be seen at the end of the fiscal year.

The former head of government Mihhail Kasjanov started his prime minister's career in 2000 with endless arguments with Russian creditors at the Paris Club[3] and also outside of that. By today the repayment of external debt as a process supported by the boost of raw material prices has accelerated remarkably. **Within the first nine months of 2005 government's external debt decreased 25.2 billion US dollars** (see Table 2), of which 20 billion dollars was debt returned ahead of schedule. The business sector, on the other hand, has taken a lot of credit: **companies increased their external debt by 27 billion and banks by 11 billion dollars**.

Table 2. External debt of Russia (USD bn)

	01/01/2005	01/10/2005	Change
Gross external debt	214.5	228.3	13.8
General goverment	97.4	72.2	-25.2
debt of "New Russia"	39.6	35.9	-3.7
debt of former Soviet Union	56.1	34.9	-21.2
Banks' external debt	32.5	43.5	11.0
Corporate debt	76.4	103.4	27.0

Source: Bank of Russia

For 2006 the Russian government has scheduled another round of early repayment of its outstanding obligations. Whether, how and in which amount will be decided during negotiations with creditors to whom Russia is prepared to return the debt ahead of schedule and who are willing to accept it as well. Judging by the conditions of the early repayment of 2005[4], the subject of negotiations may again be the expected interest income of creditors. In February 2006, when meeting with the finance ministers of the G7 countries, Russian finance minister Aleksei Kudrin obtained a prior consent to return up to 12 billion US dollars of external debt to the member states of the Paris Club. All the rest is subject to negotiation.

Comparing the state's reserves (excluding the corporate sector) and debts (224 – 72.2 = 151.8 billion USD) we can see that the **financial assets of the Russian government are considerably greater than liabilities**, and thus Russia is an international net creditor.

However, the perspective is clouded by one small factor. Within the first nine months of 2005 the corporate sector obtained external credit in the amount of nearly 20 billion dollars and

[3] The so-called Paris Club is a consortium of leading industrial countries that provide credit to developing nations. – Edit.
[4] The debt was repaid without interests. – Edit.

observers think that this is primarily related to the takeovers of companies (e.g. Gazprom, Sibneft, Jugansneftegaz) in 2005. The estimates of analysts concerning the volume of external debt are different. The greatest estimates place the debt of state enterprises (hence, indirectly also the state) at 44 billion dollars. As completely reliable information is not available, we cannot foresee how much of the external debt growth of the corporate sector could turn into state's liabilities in case of unfavourable circumstances.

External trade, relying on the exports of energy carriers, is also a large source of income and supports the sovereign rating via foreign trade taxes. Though the surplus of external trade is quite respectable and confidence-inspiring (see Figure 3), some unfavourable developments have been perceived recently. The export growth rate has been declining since mid-2005, also affecting the year-on-year growth of the external trade surplus (see Figure 4). On the other hand, import growth remains steady and tends to accelerate slightly. Nevertheless, the external trade surplus of 2005 at market prices was equal to the imports of eighteen months, comprising quite a hefty reserve.

However, considering Russian external trade from the aspect of national accounting, the situation calls for vigilance. The growth of net exports calculated at constant prices on the basis of the GDP consumption method turned downwards already in the third quarter of 2002, stopped in the third quarter of 2003 and failed to increase also in 2004 (see Figure 5). The data of the Russian Statistical Office confirm the slowdown of growth. In the third quarter of 2005, Russian net exports decreased 54%.

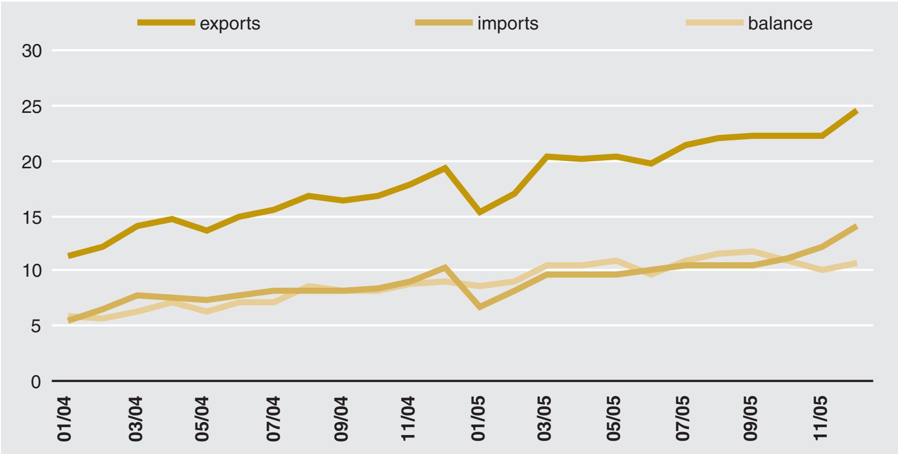

Figure 3. Russian external trade (USD bn)

Source: Bank of Russia

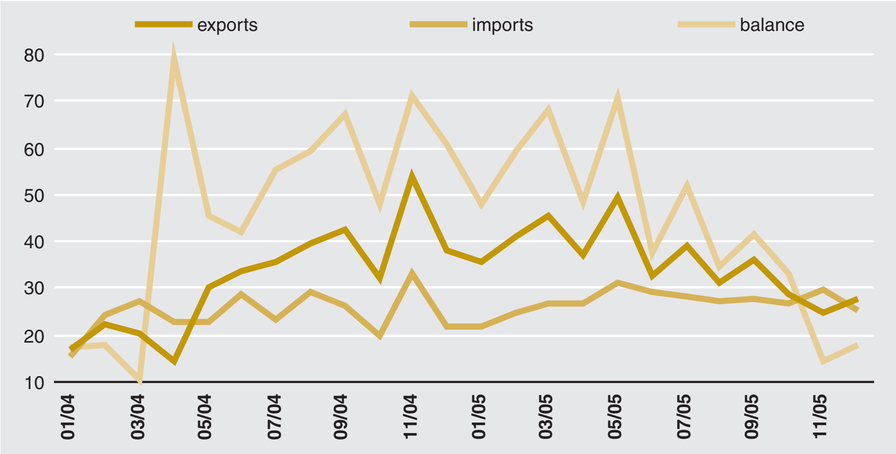

Figure 4. Growth rate of Russian external trade (% year-on-year)

Source: Bank of Russia

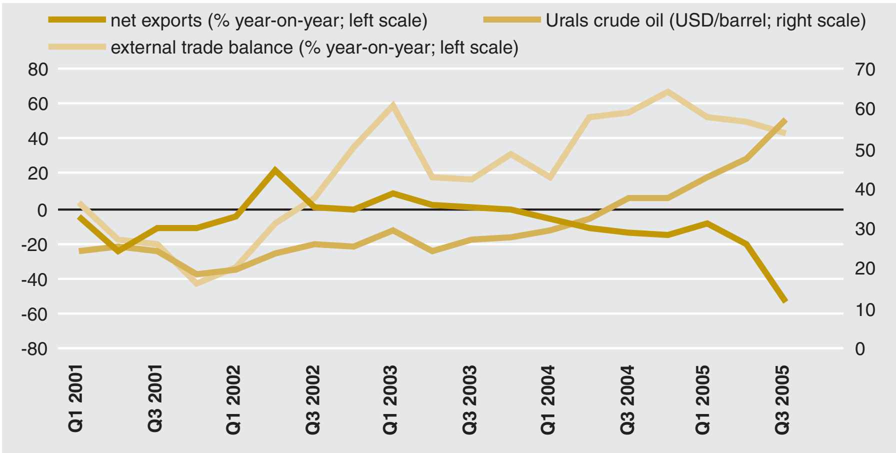

Figure 5. Russian external trade at market prices and constant prices

Source: Russian Statistical Office, Bank of Russia, Reuters

This difference in export results calculated at market and constant prices which, on the one hand, demonstrates massive success and growth of national wealth but, on the other hand, indicates a deterioration of the situation, is figuratively speaking the "oil hook" which the Russian economy is stuck to.

Nevertheless, there is quite a clear explanation to the unfavourable development of export growth. The Ministry of Industry and Energetics of Russia announced at the beginning of January 2006 that **in 2005 a record amount of crude oil was produced in Russia – 470.2 million tonnes**. This exceeds the amount of 2004 only by 2.2%. In earlier years the growth reached almost 7%, whereas the exported 251 million tonnes of oil in 2005 was 1% less than in 2004. Meanwhile, Russian oil producers earned 72 billion US dollars in the first eleven months of 2005, i.e. 44% more, year-on-year.

Therefore, 60% of the Russian export volume depends (financially) on the world market price of crude oil. According to the data of the Russian Statistical Office, the price of Urals crude oil in the world grew 1.55 times by November 2005 compared to January the same year. What did it look like in yearly comparison? Excluding short-term fluctuations, **in 2005 the average barrel price of Urals was 15 US dollars higher than in 2004** (see Figure 6). The year 2006 began with an even greater spread compared to 2005 – nearly 20 dollars per barrel. If this year the price remains at the current level, i.e. 55–60 dollars per barrel as optimists in general are hoping, the oil price will be an accelerating factor for the Russian export growth until the middle of the year (if the export volume does not shrink significantly). In order to maintain their role as the force driving growth, the dynamics of oil prices on world markets should follow pessimistic forecasts, which do not take even 80 dollars per barrel as an utmost limit. Naturally, oil-consuming countries hope for the realisation of the first scenario.

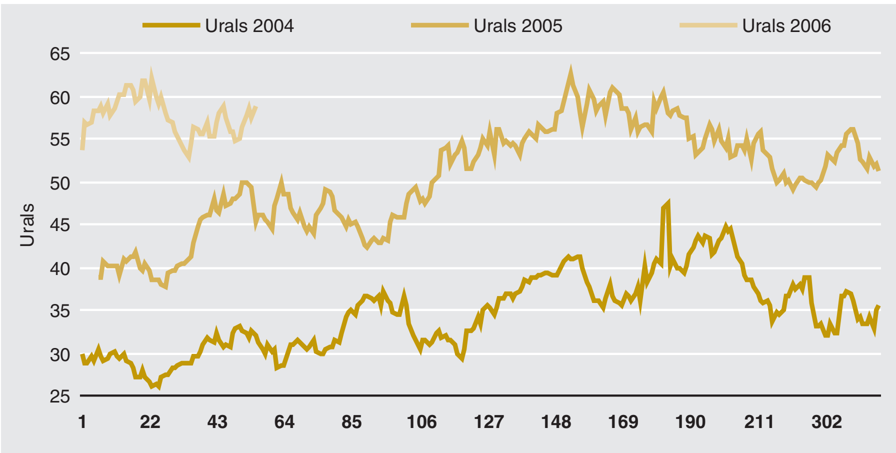

Figure 6. Urals crude oil price in 2004–2006 (closing price at London Stock Market; USD/barrel)

Source: Reuters

RUSSIAN BANKING SYSTEM

Kaupo Pollisinski

The following article analyses the Russian banking sector, which is the fastest developing part of the Russian economy. However, it is also a controversial sector. There are many banks and they are mostly small. The banking sector is dominated by some very large and state-owned banks; the state's share in the banking market exceeds 40%. Nonetheless, the Russian banking system does not meet the needs of the rapidly developing Russian economy due to its fragmentation and the smallness of banks.

At the end of 2005, there were 1,258 banks in Russia. Although the number of banks[1] was decreasing considerably, the banking sector development remained fast. Within a year (from October 2004 until October 2005) banks' assets increased 36%, the total volume of credit granted to the private sector grew 47% and household loans nearly doubled. Banks' growth trend could also be discerned – the number of smaller banks decreased but that of larger banks increased (see Table 1).

Table 1. Breakdown of Russian banks by the amount of fixed capital in 2005 (EUR m*)

	Below 0.08		**0.08–0.26**		**0.26–0.79**		**0.79–1.59**	
	Number	**Share (%)**	**Number**	**Share (%)**	**Number**	**Share (%)**	**Number**	**Share (%)**
1 January	73	5.6	133	10.2	232	17.9	225	17.3
1 December	56	4.5	108	8.6	208	16.5	212	16.9
	1.59–3.96		**3.96–7.93**		**Over 7.93**		**Total**	
	Number	**Share (%)**	**Number**	**Share (%)**	**Number**	**Share (%)**		
1 January	211	16.2	191	14.7	234	18.0	1,299	
1 December	226	18.0	205	16.3	243	19.3	1,258	

* Calculated on the basis of the monthly average RUB/EUR exchange rate of the Bank of Russia.
Source: Bank of Russia

Despite fast growth and great profitability the **capitalisation of the banking sector is still low** – in 2004 it reached 6% of GDP. The equity of about a third of the banks exceeds 4 million euros, but the minimum EU requirement for banks' capital is 5 million euros.

The weakness of the Russian banking sector as a financial intermediator also reveals when comparing its domestic impact in relation to other transitional economies (see Table 2).

[1] 1,299 credit institutions were registered in Russia as at 1 January 2005 and 1,258 as at 1 December 2005.

Table 2. Russian banking indicators in ratio to GDP in 2004

	Assets	Deposits	Loans	M2
Belarus	29.6	17.2	15.5	20.3
Czech Republic	89.9	67.0	35.2	46.8
Estonia	104.2	40.5	48.2	46.8
Hungary	71.4	41.4	47.0	48.1
Latvia	120.1	37.1	53.3	47.6
Lithuania	47.1	28.2	27.2	36.9
Poland	53.9	36.8	28.6	43.4
Russia	**44.0**	**24.1**	**26.6**	**34.3**
Ukraine	43.9	30.3	31.4	45.8

Source: International Monetary Fund

Single major banks dominate the fragmented and decentralised Russian banking sector. By the end of 2004 state banks owned 41% of the banking sector in terms of the volume of assets (incl. Sberbank 28%, Vneshtorgbank 6%, Gazprombank 5% and Vneshekonombank 2%). The share of the remaining 1,295 banks reached a total of 59% of the market. The latter are dominated by banks owned by large financial and industrial groups, such as Alfa-Bank (Alfa), Rosbank (Interros), Sobinbank, Petrokommertsbank and URALSIB (LUKOIL), MDM-Bank (MDM), Trust & Investment Bank and Menatep (Menatep[2]).

The Russian banking system is regionally concentrated. About 60% of operating credit institutions are situated in the Central Federal District of Russia, whereas 50% of all credit institutions are located in the city of Moscow (see Table 3). The territorial distribution of credit institutions generally shows the economic success of the respective areas. It is also noteworthy that credit institutions with headquarters in Moscow are expanding to other cities, whereas no opposite tendency can be detected.

The concentration of Russian banking is high also in terms of ownership (see Table 4). Four major state banks are the largest creditors as well as the greatest depositors. All in all, the state controls 21 banks through federal/regional authorities or state enterprises. These banks are holding 70% of the population's deposits and 40% of loans to the economy. Several regional banks are monopolists in their region. The most old-standing bank in the Russian banking market is Sberbank (Savings Bank), which has 500 times more branches than the next largest Russian retail bank.

Sberbank's share in the private deposits market decreased from 75% in 2000 to 60% in 2004 mainly due to the invasion of other state banks into the market. In the current economic-political

[2] Major shareholder of YUKOS.

Table 3. Regional distribution of credit institutions in Russia (as at 1 September 2005)

	Credit institutions	Share of the total number (%)	Operating branches	Share of branches (%)	Total	Share of the total sum (%)
Russian Federation	1,270	100.0	3,283	100.0	4,553	100.0
Central District	724	57.0	728	22.2	1,452	31.9
Moscow	639	50.3	135	4.1	774	17.0
North-West District	84	6.6	374	11.4	458	10.0
St. Petersburg	42	3.3	129	3.9	171	3.8
South District	128	10.1	470	14.3	598	13.1
Volga District	150	11.8	662	20.2	812	17.8
The Urals	67	5.3	385	11.7	452	9.9
Siberia	74	5.8	446	13.6	520	11.4
Far-East	43	3.4	218	6.6	261	5.7

Source: Bank of Russia

Table 4. Ownership structure of Russian banking at the end of 2004 (% of total banking structure)

	Sberbank	4 largest state banks*	5 largest banks**	30 largest banks
Assets	28	40	43	66
Credit to economy	30	38	44	
Deposits	42	52	54	72
residents' deposits	60	67	68	79

* Sberbank, Vneshtorgbank, Gazprombank, Vneshekonombank
** The abovementioned four and Alfa-Bank
Source: International Monetary Fund on the basis of the Bank of Russia's data

situation where the state has started to increase its control over key economic sectors, it is rather difficult to predict whether this will also take place in the banking sector.

The state (without regional governments) has determined its share and position in the banking market rather clearly through six banks: Sberbank shall generally prevail in retail banking, Vneshtorgbank shall control external economic activities, Gazprombank[3] shall mostly control the raw material sector (through Gazprom), Vneshekonombank shall be officially servicing the national debt, Development Bank shall be financing national strategic development programmes, and the Agricultural Development Bank shall finance agriculture.

[3] Though the privatisation plan of Gazprombank has not been officially cancelled, the state's activity in developing Gazprom hints at the possibility that it might be done.

By the end of 2004, 131 Russian banks had foreign shareholders, whereas 33 banks were fully foreign-owned. Three of the banks fully owned by foreign investors are among 30 largest Russian banks. Still, the share of non-residents in Russian banking remains modest: in 2000 it stood at 10.7%, dropping to 5.2% in 2003 and rising to 6.2% in 2004. Nevertheless, **foreign-owned banks are significant competitors on the Russian banking market** – better access to foreign financing through parent banks[4] enables them to provide more favourable and a wider variety of bank services than Russian "domestic banks". 50% of total foreign capital that Russian banks attracted from abroad in 2004 went to foreign-owned banks[5].

As at 1 November 2005, Russian banks were holding deposits worth about 3,446 billion roubles (approximately 101 billion euros). Slightly over 73% were deposits of households and self-employed persons (see Figure 1). The dramatic change in deposit sums in 2004 denotes a great leap in indexing wages, pensions, etc. in January 2004. As to the general deposit structure, a constant increase in the share of corporate deposits can be perceived, which stabilised in June 2005. However, given the growth of production costs (incl. raw material prices, wage costs) the corporate deposit volume may start shrinking again. Approximately a third of all deposits in the given period consists of foreign currency deposits which are experiencing a slight downward trend (i.e. the rouble is strenghtening).

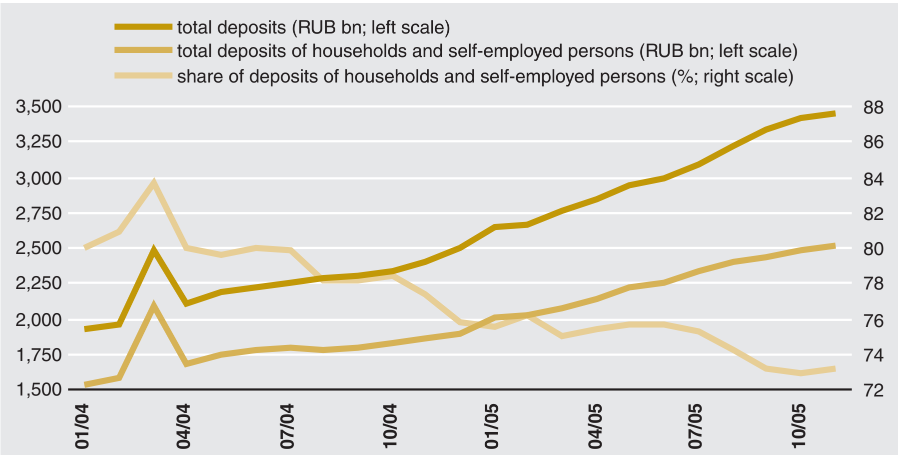

Figure 1. Deposits with Russian banks

Source: Bank of Russia

[4] Only subsidiaries of foreign banks, not branches, are allowed to operate in Russia.

[5] According to the Bank of Russia, Russian banks attracted external funds in the amount of 7.6 billion USD in 2004.

The deposit volume growth in roubles is nonetheless a little deceptive. The annual growth of deposits has remained near 40% since March 2004 which, however, cannot be considered slow (see Figure 2). The different dynamics of rouble and foreign currency deposits indicate depositors' confidence in one or the other. No acceleration of deposit growth is to be expected in the near future. Russian residents enjoy consuming.

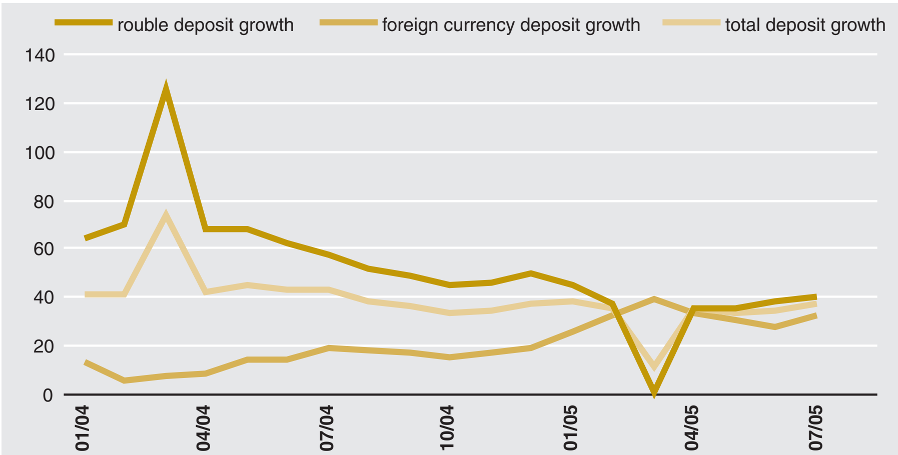

Figure 2. Deposit growth (% year-on-year)

Source: Bank of Russia

The **deposit insurance system** of Russia was completed in September 2005: the central bank approved 1,150 out of 1,183 banks that had applied for joining the system. Three of the applications rejected had been submitted by financial institutions belonging among the 200 largest banks in Russia. Therefore, 150 institutions who have thus far called themselves banks have to renounce that title and end their operations or continue operating as some other kind of financial institution. This is prescribed by the current rules.

Russians' consumption readiness and needs are so great that household loans are growing nearly twice as fast as deposits (see Figure 3). This has been brought on by the generally rapid increase of real income in 2005.

Though the loan growth is slightly slowing down, it still remains relatively high (see Figure 4). Household loan growth is almost twice as high as the corporate loan growth. At the end of October 2005, the loan volume of residents amounted to 18.5% of the total loan volume.

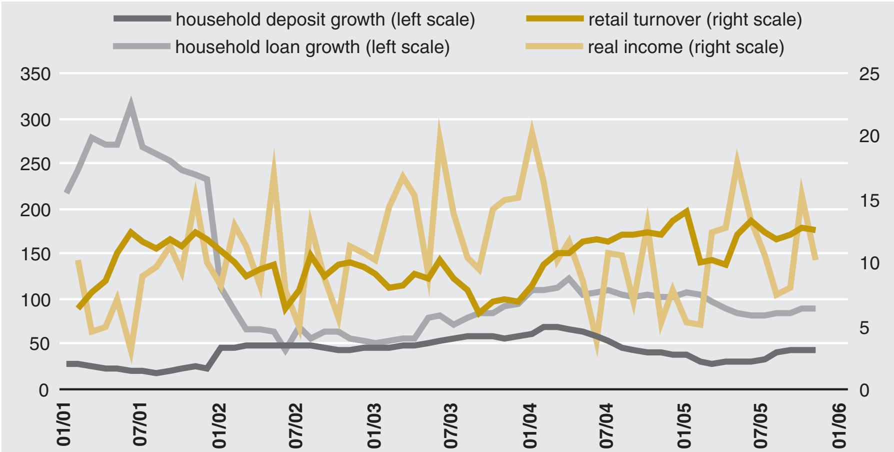

Figure 3. Household deposits, loans and consumption (% year-on-year)

Source: Bank of Russia

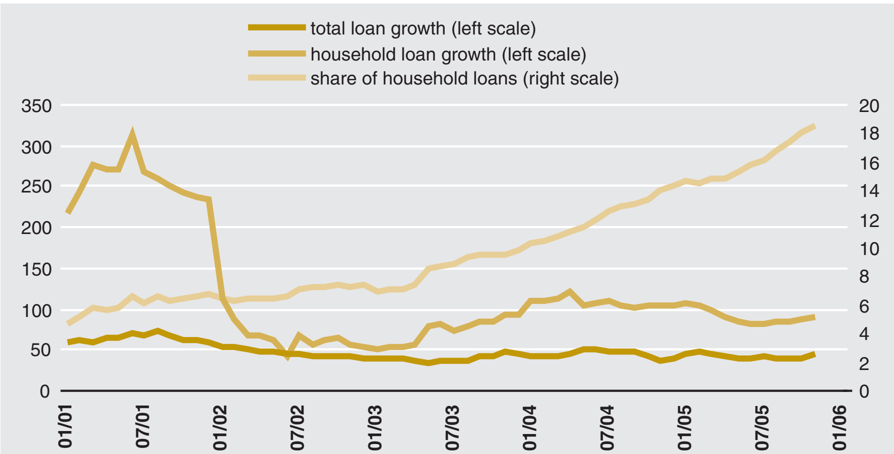

Figure 4. Loan growth (% year-on-year)

Source: Bank of Russia

The corporate sector is still a greater borrower (see Figure 5). Corporate loans[6] account for 70% (3,948 billion roubles, i.e. 116 billion euros) of all loans (5,609 billion roubles, i.e. 165 billion euros). However, the borrowing activity of households, which is mainly related to purchasing housing, is increasing almost 2.6 times faster than corporate loan growth (see Figure 6). The 35% year-on-year corporate loan growth in October 2005 is rather high, but its downward trend indicates the decreasing share of banks in corporate investment activities and in financing generally. This might also be a sign of increasing business passivity.

The largest and still growing concern of Russian banking is the **great gap between domestic loan resources and loans issued** (see Figure 7). At the end of October 2005, credit volume exceeded deposit volume by 1.63 times, which at that moment indicated a resource shortage of 2,163 billion roubles (64 billion euros). At least part of that had to be borrowed from abroad. Twelve months earlier the gap was 1,071 billion roubles (29 billion euros[7]), i.e. 2.2 times smaller. **If the economic situation turns unfavourable for Russia and borrowers can no longer meet their commitments, this may become one of the greatest threats to the Russian bank system.**

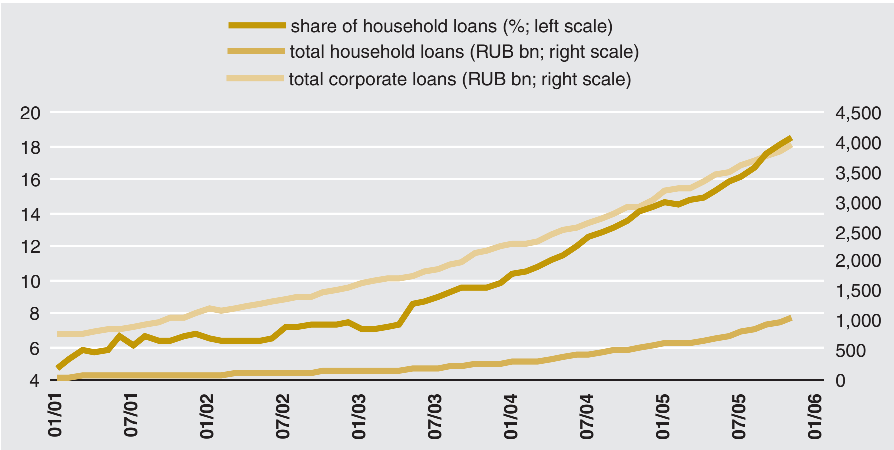

Figure 5. Household and corporate loans (RUB bn)

Source: Bank of Russia

[6] As at 1 November 2005.

[7] Calculated on the basis of the average RUB/EUR exchange rate of the Bank of Russia in November 2004.

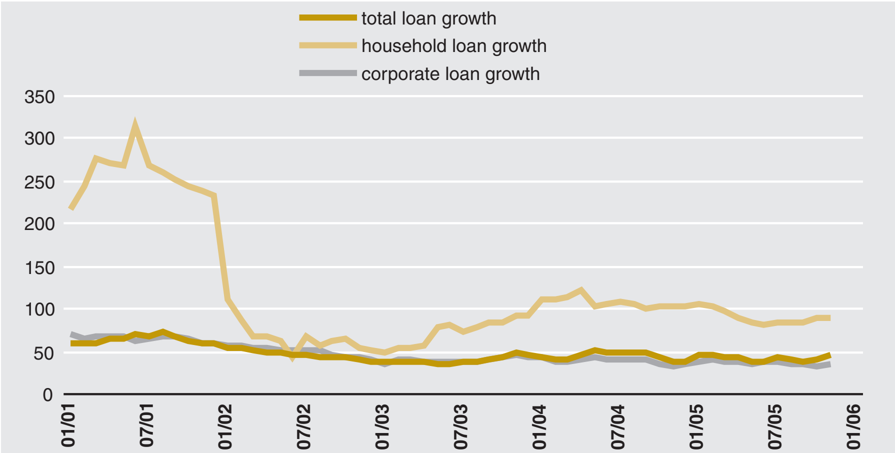

Figure 6. Household and corporate loan growth (% year-on-year)

Source: Bank of Russia

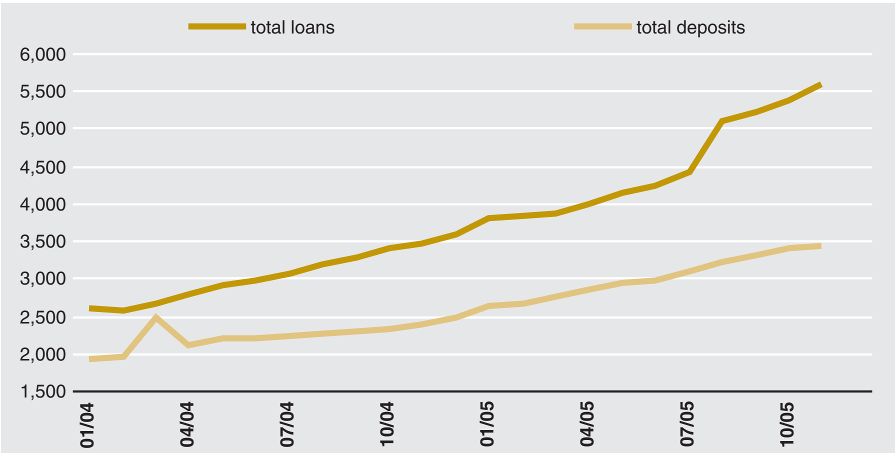

Figure 7. Loans and deposits (RUB bn)

Source: Bank of Russia

Banks cover approximately 15% of their credit needs by external loans. It is remarkable that the external loans taken by companies (non-financial sector) accounted for 40% of the volume of loans issued by banks (see Table 5). The major borrowers of the Russian economy are simply so great that the Russian banking system is unable to service them, but they are free to borrow from international money markets. This mainly applies to the raw material sector which is currently the backbone of the Russian economy.

Table 5. Loan growth in Russia (EUR bn*)

	01/01/05	01/10/2005	Growth
Loans from banks	102.0	154.8	1.52 times
Foreign loans of banks	14.8	23.3	1.57 times
Foreign loans of companies	43.7	63.7	1.46 times

* Calculated on the basis of the Bank of Russia's average rates of respective months.
Source: Bank of Russia

RUSSIAN TRADE WITH FINLAND, ESTONIA, LATVIA AND LITHUANIA

Kätlin Keinast

A common link between the three Baltic States and Finland is their historical connection with the great eastern neighbour. While Finland and Russia share a border already since 90 years ago, the border between the Baltic States and Russia was restored only 15 years ago. Nevertheless, we can find many common features in the development of trade relations between the small countries belonging to the European Union and the great neighbouring country. These common characteristics as well as differences in the trade relations of Estonia, Latvia, Lithuania and Finland with Russia shall be discussed in the following article.

Trade between Finland and Russia

From January to November 2005, 10.9% of Finnish goods were exported to Russia and Russia was the source of 14.2% of imports to Finland. In November, goods were exported to Russia approximately in the sum of 557 million euros; Finland imported goods from Russia in the sum of 524 million euros.

Finland has long imported more from Russia than exported there. However, as of October 2005 the trade balance between the two countries has been in surplus for Finland, i.e. **Finland has exported more to Russia than imported from there** (see Figure 1). In November, the trade surplus concerning Russia made up about 4% of the trade balance surplus.

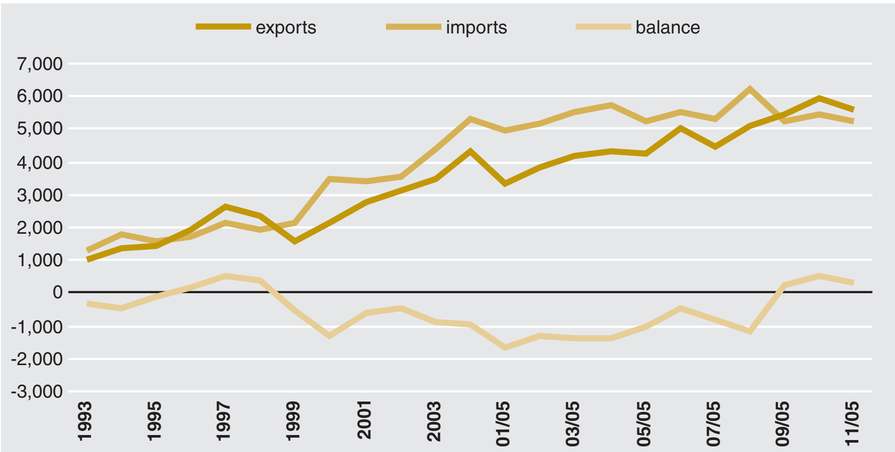

Figure 1. Finnish trade with Russia (EUR m)

Source: Finnish Customs

The trade between the two countries is not only important for Finland. From January to November 2005, Finnish-Russian trade grew almost as fast as Russian trade in general (31.2% and 32.8%, respectively). Trade with Finland constituted 3.2% in that period. Finland remains among the ten most important trading partners of Russia.

Primary export articles channelled from Finland to Russia (see Figure 2) are **machinery and transport vehicles**, which comprised 55% of the goods exported from Finland to Russia based on the data of 2004. Other major export articles are **chemicals** and chemical products. While food accounts for a large share of the goods exported from the Baltic States to Russia, its share in case of Finland remains only at 4%.

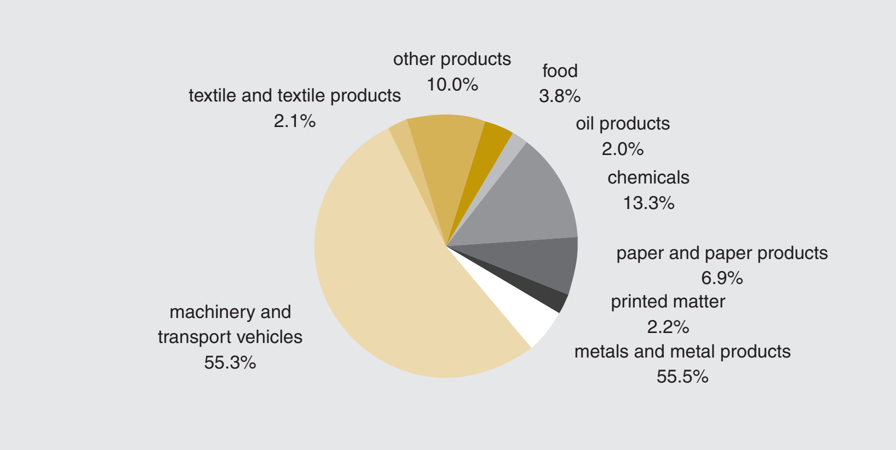

Figure 2. Main articles exported from Finland to Russia in 2004

Source: Finnish Customs

Similarly to exports, Russia is also one of the major import partners of Finland, competing for the first position with Germany (see Table 1).

Finland mainly imports oil from Russia, which comprises 46% of the total amount of goods bought from Russia. The second greatest import article besides oil is timber (see Figure 3).

Although since the 1990s no major changes have occurred in the exported or imported goods groups, it appears that **high technology goods** (mainly electronic and telecommunications equipment) **have gained significance in Finnish exports**. In 2004 their exports formed approximately 18% of total exports from Finland and their imports comprised 14% of total imports to Finland. Finland expects strong export growth of these goods.[1] This reflects in the export boost in recent years. While in 2002 high technology goods were exported to Russia in the amount of 593.4 million euros, then in 2004 the respective indicator had risen to 1,225 million euros (year-on-year growth was 47%).

Table 1. Finland's major trading partners (January–November 2005)

	Exports			Imports	
	EUR m	%		EUR m	%
Sweden	5,221.2	11.0	Germany	6,239.8	14.7
Russia	5,178.3	10.9	Russia	6,014.8	14.2
Germany	5,016.1	10.5	Sweden	4,452.6	10.5
United Kingdom	3,214.3	6.7	United Kingdom	1,859.9	4.4
USA	2,824.0	5.9	USA	1,793.7	4.2

Source: Finnish Customs

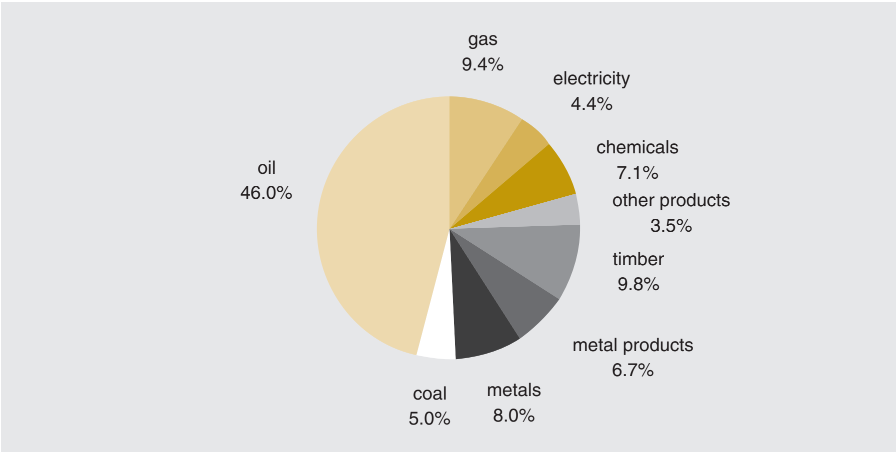

Figure 3. Main articles imported from Russia to Finland in 2004

Source: Finnish Customs

[1] Source: High Technology Finland [http://2002.hightechfinland.com/index.php].

Trade between Estonia and Russia[2]

During the whole independence period Estonia has imported more goods from Russia than exported there. The difference between exports and imports started to increase significantly since 1998. Later the difference decreased but grew again in 2004. The trade between Estonia and Russia declined most in 1998–2000. According to the Statistical Office of Estonia, last year the exports of goods channelled to Russia increased 32.8% and imports grew 7.8% (see Figure 4). The trade balance with Russia is negative.

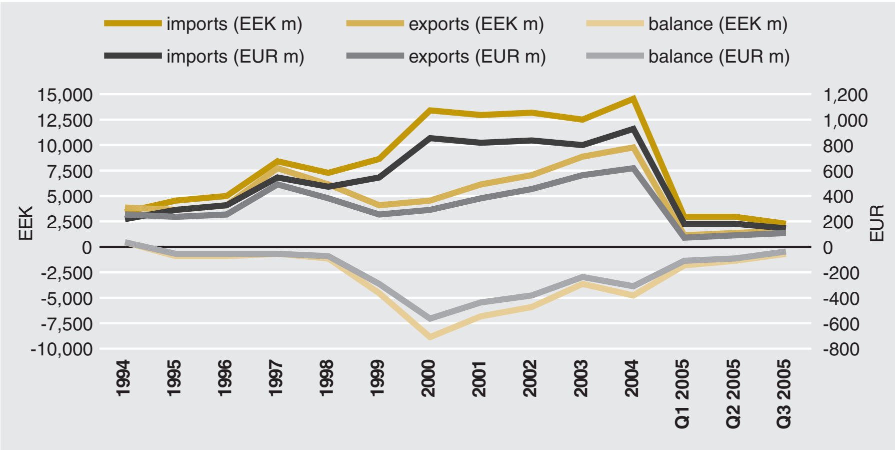

Figure 4. Estonian trade with Russia

Source: Eesti Pank

Analysing the share of trade between Estonia and Russia in the total exports and imports of Estonia, it appears that the share of both exports to and imports from Russia in total trade turnover has been declining since 1994 (see Figure 5). The share of goods imports from Russia in the total imports of Estonia has remained relatively stable, but since 2000 it has started to shrink slightly.

The primary goods groups transported to Russia in 2005 were **machinery, vehicles, textile products and food** (see Figure 6). The exports of machinery and mechanical equipment (mainly electrical machinery and equipment) comprised 22% of the total flow of goods to Russia. Vehicles and other transport means (the majority was formed by means of land transport and railway and tram locomotives) accounted for 13.2%, textile products formed 10.2% and food 9.7%. In 2003,

[2] Data on Estonia concern the first eleven months of 2005, unless otherwise indicated.

food exports declined considerably but have been recovering slightly in recent years. The exports of textile products have been increasing year by year, whereas the exports of transport vehicles has been decreasing.

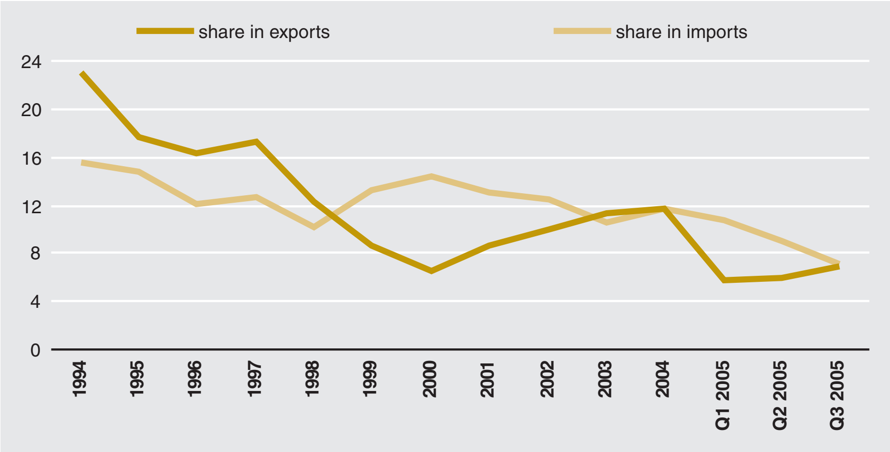

Figure 5. Share of Estonian-Russian trade (%)

Source: Eesti Pank

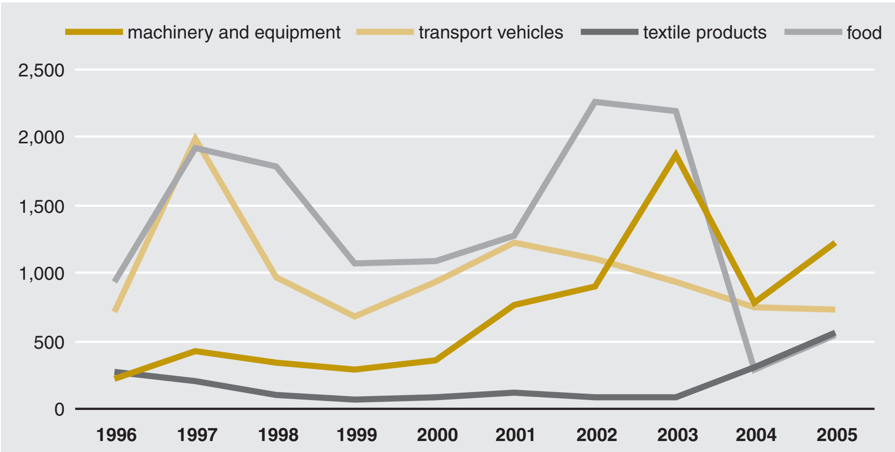

Figure 6. Main export articles of Estonia (EEK m)

Source: Statistical Office of Estonia

The main import articles are mineral products[3], timber and timber products as well as **metals and metal products** (see Figure 7). The most significant of them are mineral products, whose share amounted to 45% of all goods imported from Russia in 2005. Timber and timber products made up 21.9% and metal products comprised 13.8%. The share of all other goods groups remained smaller than 10% of total imports. The imports of timber and timber products from Russia have increased year by year. The imports of mineral products fell quite sharply in 2002–2004, but rose again nearly twice in 2005. The imports of metals and metal products have been declining since 2000 but still retain a large share in total imports.

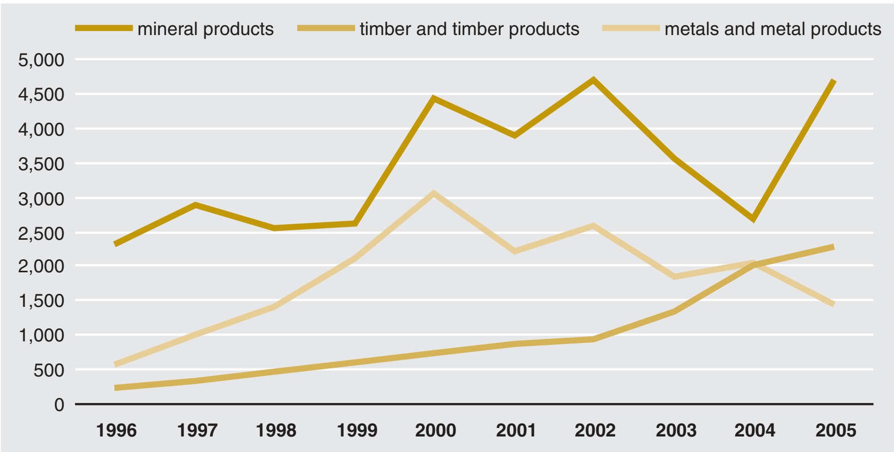

Figure 7. Main import articles of Estonia (EEK m)

Source: Statistical Office of Estonia

Trade between Latvia and Russia

Contrary to Estonia, **Russia remained the main export market for Latvia also throughout the 1990s**. In 1996 exports to Russia comprised nearly 25% of Latvia's total exports. The share of goods imported from Russia remained slightly smaller, staying near 20%.

Since 1996, however, the importance of Russia as Latvia's trade partner has been constantly decreasing. Exports to Russia dropped fast until 2000, when Russia received less than 5% of total exports. Later on this indicator has been increasing modestly, remaining within the range of 5–10%.

[3] Mineral products primarily include mineral fuel and natural gas.

Last year, Russia was only the fifth major export partner for Latvia after Lithuania, Estonia, Germany, and the United Kingdom.

Contrary to the exports channelled to Russia, imports has not fluctuated that much. The share of Russia in Latvia's imports has decreased every year (except for a slight rise in 2000), currently being below 10% of total imports (see Figure 8). With 8.6% Russia ranks third among Latvia's major import partners.

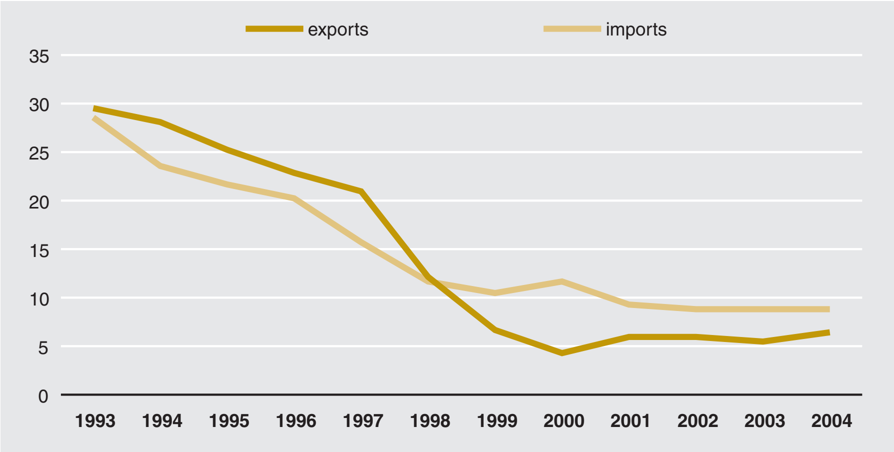

Figure 8. Share of Latvian-Russian trade (%)

Source: Statistical Office of Latvia

Latvia's trade balance with Russia has been negative since 1993. The deficit has been increasing remarkably since 1997. **In 2004, the trade deficit between Latvia and Russia was 8.5 times greater than the deficit of Latvia's total external trade** (the large deficit is offset by the relatively great trade surpluses with the United Kingdom, Ireland, and Japan).

Latvian trade with Russia has been rather stable (see Figure 9).

Latvia exports food, textile products, machinery, equipment and chemical products to Russia (see Figure 10). According to the data of 2004, the share of food was 22.4%, machinery and equipment comprised 20.2%, chemical products 12.3% and textile products 9.2%. After the decline in 1999–2000 food exports to Russia has recovered the fastest, but improvement in other goods groups has also been quite noticeable.

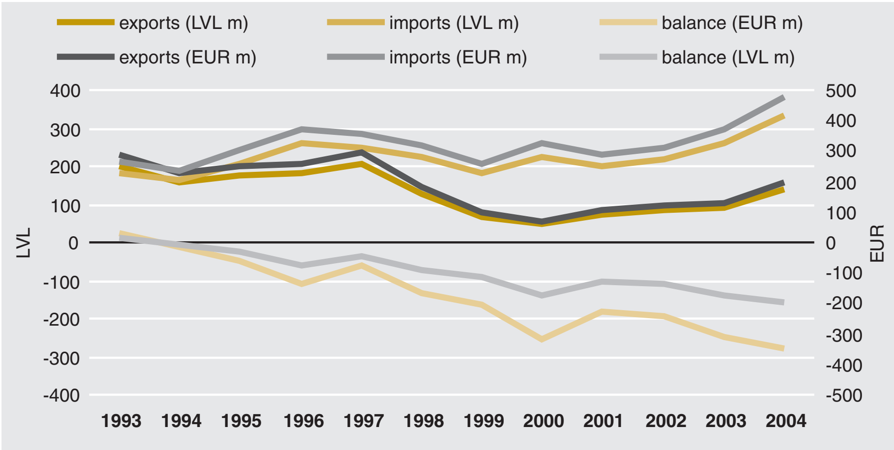

Figure 9. Latvian trade with Russia

Source: Statistical Office of Latvia

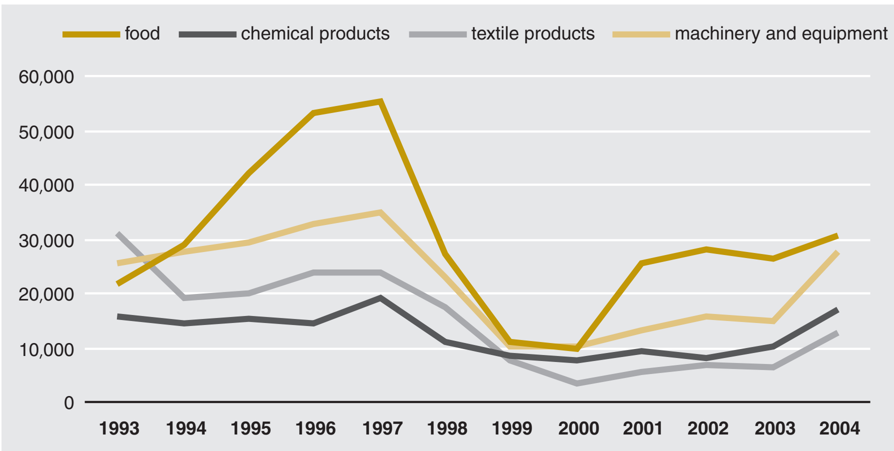

Figure 10. Main export articles of Latvia (LVL thousand)

Source: Statistical Office of Latvia

From Russia, Latvia mainly imports mineral and chemical products, timber and metal products. The share of mineral products stood at 37.6%, metals and metals products amounted to 21.7%, timber to 14.3% and chemical products to 7.9%. Similarly to Estonia, the imports of timber and timber products from Russia to Latvia have started to increase in recent years. The imports of chemical products have remained relatively stable throughout the years (see Figure 11).

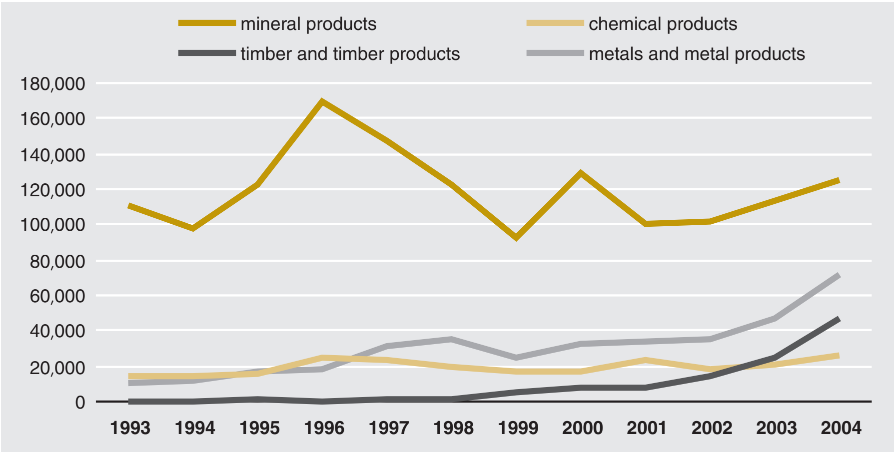

Figure 11. Main import articles of Latvia (LVL thousand)

Source: Statistical Office of Latvia

Trade between Lithuania and Russia

Last year, the volume of Lithuanian exports to Russia amounted to 3.4 billion LTL (nearly 1 billion euros). Compared to 2004, exports increased almost 44%, which indicates that **Lithuanian trade with Russia grew faster than Lithuanian trade in general**. Altogether, Lithuania imported goods from Russia in the sum of 11.9 billion litas (3.4 billion euros). Within a year, imports grew 51.3%. In comparison with previous years, Russia's share in Lithuanian imports has been rising steadily, almost reaching the 1996 level in 2005 (29%).

The great difference between export and import volumes has also brought about extensive trade deficit (from Lithuania's perspective). At the end of 2005, it reached 8.5 billion litas (2.5 billion euros), which exceeds total trade deficit by nearly 8.4 times (the deficit is offset by relatively positive trade balances with France, Latvia, Canada, and Singapore). Figure 12 shows the constantly growing trade deficit of the two countries.

Lithuania's main export articles are mineral products (mineral fuels, mineral oils), the share of which in total exports comprises about a third. The second most popular articles are (excluding the

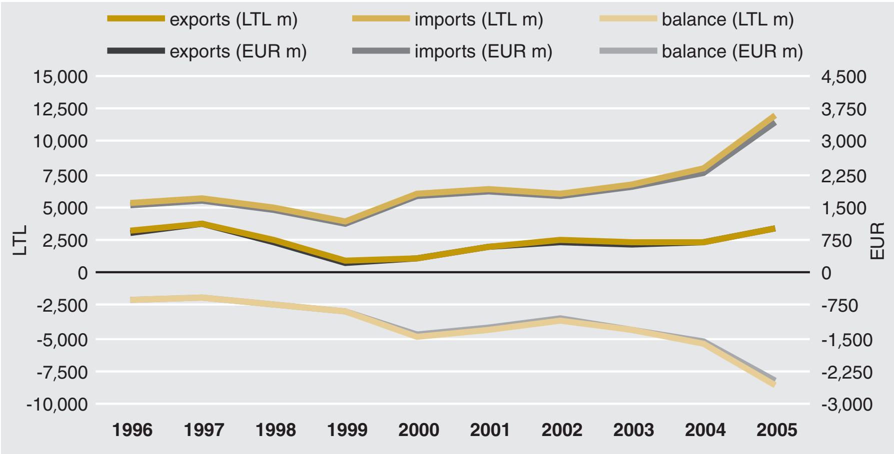

Figure 12. Lithuanian trade with Russia

Source: Statistical Office of Lithuania

group "other products") machinery and equipment (12.4%). The share of all other articles remains below 10% (see Figure 13). Therefore, Lithuanian exports differ by goods groups from the exports of other Baltic States but are similar to Finland.

Similarly to exports, mineral products were also the primary import goods for Lithuania, comprising 25.6% of total imports (see Figure 14). Other significant goods groups imported to Lithuania were machinery and equipment (17.9%) and transport vehicles (11.7%; see Figure 14). While Lithuanian export articles were similar to those of Finland, imports in all Baltic States is dominated by mineral products and by goods groups Lithuanian imports are quite similar to those of Estonia and Latvia.

Comparing the four small countries analysed in this article, in concludes that according to the data of 2004 trade with Russia is the least important for Latvia (6.4% of exports, 8.7% of imports). For Estonia, Russia was equally important both in terms of exports and imports in 2004 (11.7%). For Finland and Lithuania, however, Russia's share in exports is quite significant, being the most important trade partner for both countries.

As to imports, the role of Russia is especially great in Lithuanian imports, comprising nearly one-third.

In 2005, the situation slightly differed from 2004 – the data are presented in Table 2 (Estonia's data as at the third quarter of 2005).

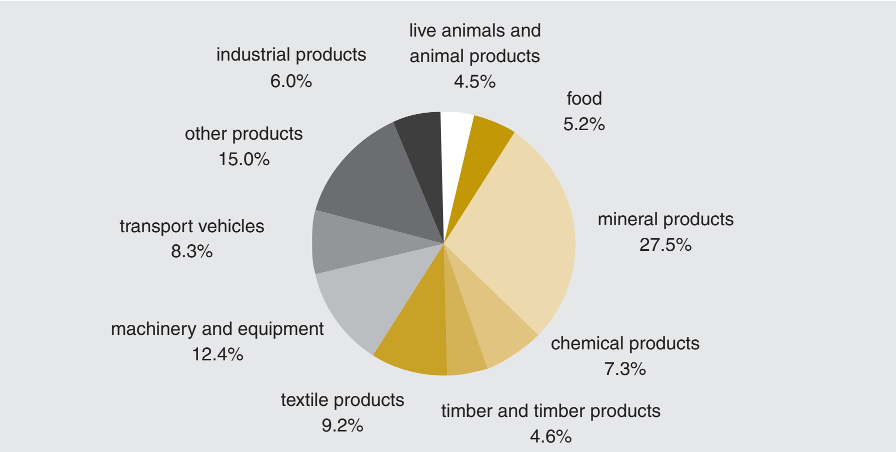

Figure 13. Main export articles of Lithuania in 2005 (% of total exports)

Source: Statistical Office of Lithuania

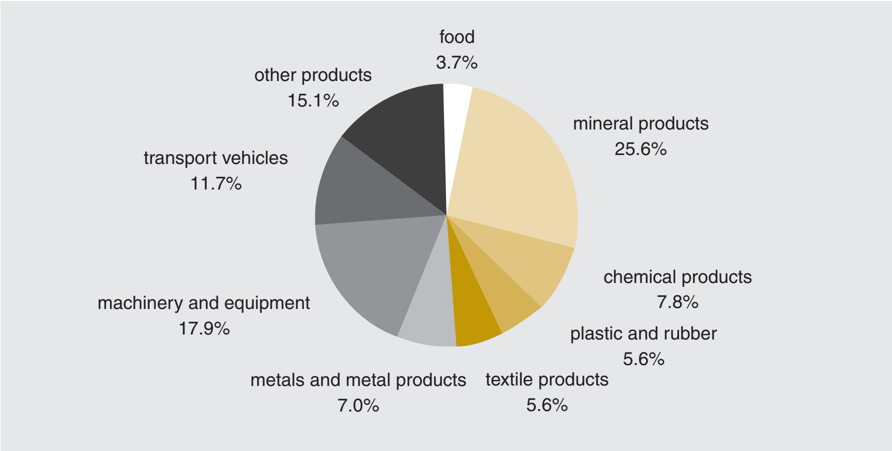

Figure 14. Main import articles of Lithuania in 2005 (% of total imports)

Source: Statistical Office of Lithuania

Table 2. Russia's share in the external trade of Finland and the Baltic States in 2005

	Exports		Imports		Share for Russia**
	EUR m	%	EUR m	%	
Finland	5,178.3	10.9	6,014.8	14.2	3.2%
Estonia*	109.5	6.9	135.8	7.0	0.7%
Latvia	328.1	8.0	594.5	8.6	0.4%
Lithuania	991.3	10.4	3,463.3	27.8	1.3%

* Third quarter of 2005
** From January to November 2005
Source: Finnish Customs, Eesti Pank, Statistical Office of Latvia, Statistical Office of Lithuania

The trade relations of all three Baltic States as well as Finland are definitely clouded by their **strong dependence on fuel imported from Russia** (see Table 3).

Table 3. Dependence on oil and gas imports from Russia (%)

	Oil	Gas
Baltic States	90	100
Poland	100	99
Czech Republic	65	82
Slovakia	100	100
Slovenia	0	62
Hungary	100	81
Romania	55	100
Bulgaria	5	94

Source: The Economist

Table 4 reflects Russia's share in the energy market of other Baltic States and Central European countries. Apparently, Russia has the smallest share in the Estonian market: Gazprom owns 37% of Eesti Gaas. Neither is the Latvian market severely dominated by Russia. In Lithuania, however, the situation is the opposite. In Bulgaria, Russian companies have majority shares in all gas and fuel related companies.

As to goods, the goods groups circulating in Russian trade are quite similar in case of all four countries. Exports to Russia are dominated by transport vehicles and other machinery, food (especially in the exports of the Baltic States) and textile products. The main import articles from Russia are mineral and chemical products (this group mainly includes mineral fuels and gas), timber and metals. Only time can tell what the future trade developments of Finland and the Baltic States with Russia will be like. Nevertheless, exports to Russia are expected to increase – its market is great and full of opportunities. The export growth is additionally boosted by the rapid economic

Table 4. Holdings of Russian enteprises in Central and Eastern European energy companies

Country	Company	Company operations	Owner/investor	Holding (%)
Bulgaria	Lukoil-Neftokhim	Oil processing, oil products	Lukoil	58
	Topenergy	Gas supply and channeling	Gazprom	100
	Overgas	Gas supply	Gazprom	50
Estonia	Eesti gaas	Gas supply	Gazprom	37
Hungary	BorsodChem	Chemical production	Gazprom	
	Panrusgas	Gas imports	Gazprom	50
Latvia	Latvijas Gaze	Gas supply	Gazprom	34
	LatRos Trans	Exports of oil via pipeline	Transnefteprodukt	34
Lithuania	Lukoil Baltija	Fuel supply, filling fuel stations	Lukoil	100
	Lietuvos Dujos	Gas supply	Gazprom	34
	Mazheikiu Nafta	Oil processing, export terminal	Yukos	54
Poland	Europol Gaz	Exports of gas via pipeline	Gazprom	48
	Gas Trading	Gas imports	Gazprom	35
Romania	Petrotel-Lukoil	Oil processing	Lukoil	93
Slovakia	Slovrusgaz	Gas trading	Gazprom	50
	SPP	Gas supply	Gazprom	up to 16.3
	Transpetrol	Oil pipeline	RussNeft	49

Source: Austrian Energy Agency, company reports, Linklaters

growth of Russia. Continuous import growth can also be anticipated. However, evidently the future of trade largely depends on the development of the countries' relations in other areas.

Summary

Russian trade with Finland and the Baltic States has increased quite rapidly in recent years. The outlook for successful trade relationships has never been as favourable over the last 15 years as it is now. Nevertheless, problems still occur and they can probably be expected in the future as well.

Finnish external trade in 2005[4]

In 2005, Finnish trade with other countries increased. Compared to 2004 goods exports from Finland grew 7%; goods were exported in the total sum of 52.4 billion euros. Imports grew more than twice as fast as exports. Last year goods were imported to Finland in the amount of 46.7 billion euros, i.e. 15% more compared to 2004. At the end of the year, the trade balance surplus reached 5.7 billion euros, which is 2.8 billion less than in 2004.

29% of Finnish exports went to euro area countries, 28% to other Member States of the European Union and 43% to non-EU countries. From among partner states trade increased the most with Russia and the Near and Middle Eastern countries. By the end of 2005, Russia was one of the most important export partners of Finland (see Table 1).

As to import partners, the significance of Russia and Asian countries increased the most – imports from these areas grew 25% in 2005.

Estonian external trade during the first 11 months of 2005[5]

According to the Statistical Office of Estonia, within the first 11 months of 2005 (incl. November) exports from Estonia increased 30.2% compared to the first 11 months of 2004. Goods were exported in the total value of 88.5 billion kroons (5.7 billion euros). Imports increased 22.6%; during the first 11 months goods were imported in Estonia in the amount of 116.5 billion kroons (7.4 billion euros). By the end of the period, the trade balance deficit stood at 28 billion kroons (1.8 billion euros), which is 7.3% less than in 2004.

In the third quarter of 2005, the most important trade partner of Estonia was the European Union, receiving 77.2% of exported goods. The greatest export partners by countries are Finland, Sweden, Latvia and Russia (see Table 5). The European Union is also Estonia's major import partner – its share in total goods imports is 77%. As to countries, the largest import partners are Finland, Germany, Sweden and Russia. The share of Russia, however, decreased to 7% in the third quarter compared to 9% in the previous period.

For Russia, Estonia is a considerably less important trade partner. In the past two years, the share of Estonia among Russian trade partners has remained steadily near 0.7%. Thus, Estonia belongs among 30 most important trade partners of Russia.

---

[4] According to the Finnish Customs.
[5] According to the Statistical Office of Estonia.

Table 5. Estonian major trade partners in the third quarter of 2005

	Exports				Imports		
	EEK m	EUR m	%		EEK m	EUR m	%
Finland	6,931.6	443.0	28.1	Finland	6,109.7	390.5	20.1
Sweden	2,893.1	184.9	11.7	Germany	4,442.0	283.9	14.6
Latvia	2,331.9	149.0	9.4	Sweden	2,552.3	163.1	8.4
Russia	1,713.0	109.5	6.9	Russia	2,125.0	135.8	7.0
Germany	1,371.8	87.7	5.6	Lithuania	1,940.6	124.0	6.4

Source: Eesti Pank

Latvian external trade in 2005[6]

Latvian trade with other countries thrived in 2005. Exports increased 33.6% compared to 2004. Imports grew 27.1%. The goods account deficit amounted to 1.96 billion lats (2.8 billion euros). The main trade area where Latvia channelled its exports was the European Union – it was the target for 76.2% of all exported goods. 12.3% of total exports went to CIS countries.

Latvia imports goods primarily from Germany, Lithuania and Russia. The latter's share in total imports accounts for nearly 8.6% (see Table 6).

According to Russian customs statistics the share of Latvia among Russian trade partners was 0.4%, which thus makes Latvia the least important trade partner of the three Baltic States for Russia.

Table 6. Latvian major trade partners in 2005

	Exports				Imports		
	LVL m	EUR m	%		LVL m	EUR m	%
Lithuania	311.5	447.6	10.8	Germany	669.3	961.6	13.8
Estonia	309.3	444.4	10.8	Lithuania	662.5	951.8	13.7
Germany	294.5	423.1	10.3	Russia	413.8	594.5	8.6
United Kingdom	290.3	417.1	10.1	Estonia	381.0	547.4	7.9
Russia	228.3	328.1	8.0	Poland	307.0	441.1	6.3

Source: Statistical Office of Latvia

[6] According to the Staistical Office of Latvia.

Lithuanian external trade in 2005[7]

In 2005, exports from Lithuania to other countries grew 27% and imports 24.9%. The trade balance deficit amounted to 10.2 billion litas (2.9 billion euros). Similarly to other Baltic States, the main trading partner of Lithuania is the European Union, though its share in trade with Lithuania remained slightly smaller compared to trade with Latvia and Estonia. 65.8% of Lithuania's total exports are channelled to the European Union and 58.9% of total imports come from the EU. Last year the most important export partner of Lithuania was Russia, its share reaching 10.4%; Latvia (10.3%) and Germany followed (9.4%; see Table 7). Russia was also the greatest import partner (27.8%) preceding Germany (15.2%) and Poland (8.3%).

The importance of Lithuania among Russian trade partners remained near 1.3% during the period from January to November 2005.

Table 7. Lithuanian major trade partners in 2005

	Exports				Imports		
	LTL m	EUR m	%		LTL m	EUR m	%
Russia	3,422.8	991.3	10.4	Russia	11,961.5	3,464.3	27.8
Latvia	3,370.9	976.3	10.3	Germany	6,522.2	1,889.0	15.2
Germany	3,076.1	890.9	9.4	Poland	3,563.5	1,032.1	8.3
France	2,299.0	665.8	7.0	Latvia	1,685.9	488.3	3.9
Estonia	1,934.3	560.2	5.9	Netherlands	1,594.4	461.8	3.7

Source: Statistical Office of Lithuania

[7] According to the Statistical Office of Lithuania.

SHARE OF TRANSIT IN ESTONIAN ECONOMY

Andres Saarniit

Due to its geographical situation, Estonia has acted as an intermediate country in trade relations with Russia already for centuries. Estimates on the share of the transit sector in the Estonian economy are very different. According to various sources the transit sector constitutes 4–10% of the Estonian gross domestic product (GDP) or even more. At the end of the 1990s, some foreign experts estimated the contribution of transit in the GDP of the Baltic States at nearly 30% and predicted its growth even to 50% by the end of the century[1]. Considering these various estimations it is not always clear what is meant – is it the measure of the value added created by the transit business in GDP formation, the ratio of the cost of transported goods and GDP, or something else. As official national accounts do not specifically identify the transit sector, the aim of this article is to test the existing estimations on the volume and share of transit in GDP formation.

The role of the transport sector in the Estonian economy is relatively important. The official national accounts distinguish 16 fields of activity on the production side of the gross domestic product. The value added created in transport is included under "transport, storage and communications", which formed 14.4% of GDP in 2003 (see Table 1). Approximately 70% of that is ascribed to transport and storage, which thus contribute about 10% to the value added. The transit business (i.e. the transport of goods through Estonia) is undoubtedly one of the reasons for the large share of the transport and storage sector.

Specifics of the Estonian transit business

It is possible that the current role of Estonia in trade between Russia and the rest of the world is more clear-cut than ever. Namely, Estonia represents the typical **Baltic transit model, which is based on the transport of Russian oil and oil products to the ports of the Baltic Sea**. While in Estonia and Latvia the first link in the chain is the railway, in Lithuania the rail transport is replaced by transport through pipelines. Similarly to Estonia and Latvia, rail transport is the first and most important link also in the Finnish transit model for handling goods arriving from Russia.

Among other things, the statistics of rail transport also display transit separately and according to that data approximately **80% of transit goods are crude oil and oil products** (see Figure 1). The completion of a coal terminal at the port of Tallinn in 2005 and the launch of the Sillamäe port may change that situation already in the near future. However, at least until now the rail transport of oil products has also determined the flow of transit goods in Estonian ports (see Figure 2).

[1] U. Tooming. *Eesti peab võitlema oma transiidituru eest* (Estonia Has to Fight for Its Transit Market). – The *Postimees*, 11 April 1996.

Table 1. GDP by fields of activity in 2003 (at current prices)

	EEK m	%
Manufacturing	20,205.8	17.9
Real estate, renting and business activities	18,805.7	16.7
Transport, storage and communications	16,189.6	14.4
Wholesale and retail trade	14,680.3	13.0
Construction	7,205.0	6.4
Public administration, national defence and social insurance	6,802.2	6.0
Education	5,712.3	5.1
Other public, social and personal services	4,784.5	4.2
Financial intermediation	4,268.0	3.8
Electricity, gas and water supply	3,384.9	3.0
Health care and social welfare	3,225.1	2.9
Agriculture and hunting	2,773.7	2.5
Forestry	1,845.8	1.6
Hotels and restaurants	1,610.1	1.4
Mining industry	1,144.2	1.0
Fishing	126.0	0.1
Total value added*	112,763.2	100.0

* Excl. net product taxes that have not been distributed among fields of activity (see ESA database)

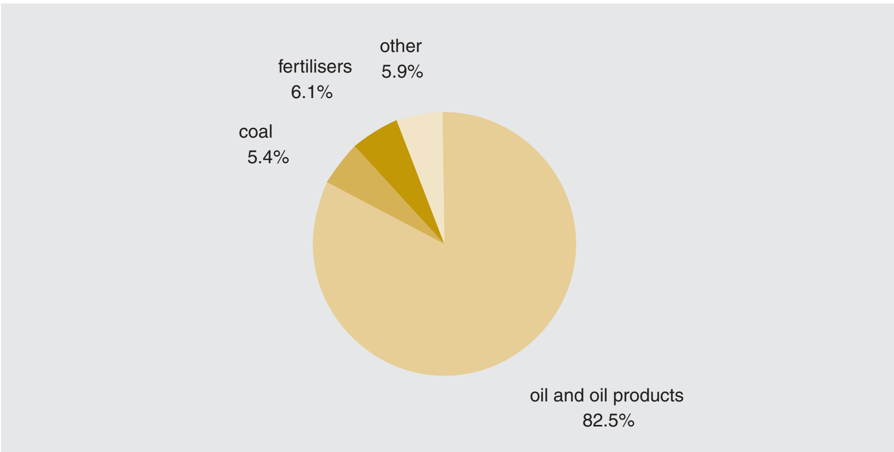

Figure 1. Breakdown of rail transit by goods groups in 2003

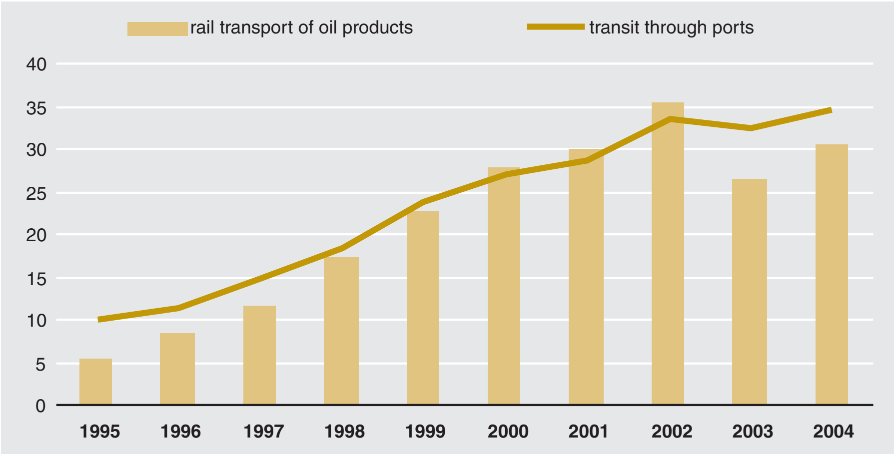

Figure 2. Rail transport of oil products and transit through ports (m tonnes)

As the volume of goods transported through Estonia is remarkable and their cost is high given the scope of economy, this has raised concerns that resources might excessively concentrate in the transit business, thus making Estonia vulnerable to adverse shocks arising from that field of activity. This matter is undoubtedly also one of the reasons for forming an additional estimation described in the present article.

Definition of the sector

Given the specifics of Estonia, the whole transit sector has been defined as railway and port-based. This was done on the premises that the exclusion of road freight transport – and why not also air transport – is set off by the classification of the whole business activity of railways and ports as transit business. In 2003, the turnover of goods transport (i.e. transport in Estonia and out of Estonia) via air did not exceed 100 million kroons according to the balance of payments data and the volume of road transport stood at approximately 250 million kroons. In the same year, the value added created by Eesti Raudtee (Estonian Railways) and Tallinna Sadam (the Port of Tallinn) alone constituted about 1.5 billion kroons.

These two major corporations do not merely handle transit goods (for instance, the 2003 annual report of Tallinna Sadam indicates the share of transit goods in the general trade flow to be about 75% and the 2003 annual report of Eesti Raudtee displays 83%). Therefore, the current approach is more likely to overestimate than underestimate the transit sector (see the more technical description in the background information “Methods of estimation”).

Estimation results

Summing up the data of enterprises classified as transit companies, it turned out that the transit sector accounted for nearly 3.5% on the production side of the GDP of 2003. By components the share of these enterprises in the operating surplus and mixed income was considerable, comprising 7%, whereas labour input proved to be lower than average (see Table 2).

Table 2. Transit sector indicators on the GDP revenue side (estimation based on the indicators of 2003)

	Total economy	Transit sector (% of total economy)
GDP (EEK m)	127,334	4,445 (3.5%)
labour costs	59,745	1,305 (2.2%)
depreciation	17,981	890 (4.9%)
profit	34,233	2,430 (7.1%)

This outcome is similar to some earlier estimations. In particular, the materials of a transport conference held in Pärnu in autumn 2003 mention 5–7% of the GDP, referring to all the Baltic States. Thanks to the improvement of calculation methods and the collection of up-to-date data, the GDP of 2003 is now estimated to be approximately 10% bigger than it was thought at the beginning of 2004, for example. The difference may be even greater compared to the time of preparing the conference materials.

As to external trade, the large impact of transit on the volume of services exports and its essential role in improving the external balance is clearly evident. For example, from 2000 to 2003 the positive balance of freight transport services comprised an average of 3.5% of GDP, which happened to be equal with the value added created in the transit business (see also Table 1).

Can the influence of the transit business be greater on economy than indicated by the GDP production side?

The role of a field of activity in the national economy is often attempted to describe not only on the basis of the GDP created within that field but also through purchases from the other sectors. A typical case in point is manufacturing, which in developed countries usually accounts for slightly below or above 20% on the production side of GDP. Therefore, some experts claim that the role of manufacturing is underestimated, as it is allegedly the largest customer of the services sector (more precise estimations on that topic, however, are difficult to find in literature).

In principle, the same train of thought can also be applied to the transit business. For instance, **in 2003 transit companies purchased services in the total amount of approximately 6 billion kroons, which comprised 4.7% of GDP**.[2] The value added created in other Estonian enterprises included in the price of these purchases is recorded as the contribution of other fields of activity in traditional national accounts, be it “construction”, “real estate development” or some other sphere. Indeed, under other equal conditions without the transit business this value added would not have been created. Unfortunately, it is not really possible to determine the share of imports in the purchases of transit companies. This would require analysing every single transaction. Therefore, **it is impossible to assess the contribution of the transit business in GDP formation on a larger scale**, considering also the input of companies servicing the transit sector.[3]

Summary

Hence, size-wise the transit business is a predominant field of activity, which yielded an estimated 3.5% of GDP according to the data of 2003. The contribution of Estonian companies that service the transit sector can be added to this, though their role could not be clearly identified. As to external trade, we can clearly perceive transit’s defining impact on the volume of services exports and its essential role in improving the external balance.

The outlook for the transit business depends on how effective the recent investments in the development of ports prove to be. The advancement of infrastructure will definitely stimulate changes in the structure of transit goods by diversifying it.

[2] The estimation is rough due to the lack of respective data in the Commercial Register.
[3] In addition, one should distinguish investments unrelated to transit (for instance, in case of Tallinna Sadam docks for cruise ships, etc.).

Methods of estimation

In technical terms, the estimation consisted of two stages: a) determining the sample of companies which make up the transit sector; b) calculating indicators characteristic of the whole sector on the basis of the economic indicators of transit companies.[4]

In order to perform the necessary calculations on the whole sector it proved expedient to define the transit sector based on the bottom-up approach, distinguishing transit companies from other business associations. As mentioned in the article above, the sample included companies dealing with railways and ports on the presupposition that the income of these companies on other than transit business are as large as the value added of the transit companies not related to railways or ports and excluded from the sample. The sample was drawn in cooperation with the experts of the Transit Association and finally about 90 business associations were chosen.[5]

From among databases, only EKOMAR (national comprehensive statistical report for calendar year) administered by the Statistical Office of Estonia met the requirements, including all necessary initial data (e.g. labour costs, profit, depreciation) for calculating the GDP by companies. As data about all the companies in the sample could not be found in the database, information had to be acquired also from the Commercial Register. Compared to the ESA database, data about companies in the Commercial Register was inconsistent. For instance, in case of some business associations the Commercial Register had information about labour costs and profit but lacked data on depreciation, or exceptional profit could not be differentiated from overall profit. Therefore, the so-called expansion method had to be used in order to obtain the missing data.

[4] The abovementioned estimation was carried out only thanks to the cooperation of the experts of the Statistical Office of Estonia and in the Balance of Payments and Economic Statistics Department at Eesti Pank. Many thanks to Natalja Viilmann from the Economics Department of Eesti Pank for research assistance in preparing the article.

[5] After joining the European Union new transit channels have emerged, but their scope is not comparable to the transit from railways to ports.

INVESTMENTS BETWEEN ESTONIA AND RUSSIA

Jaanus Kroon

In recent years the inflow of Russian capital into Estonia has become an increasingly popular topic, having picked up pace after Estonia's accession to the European Union. This is true, but **Estonia's capital transfers to Russia have been far more extensive**, exceeding the volume of Russian investments in Estonia almost twice.

Within the first nine months of 2005, the financial liabilities of Estonian residents to Russia amounted to approximately 5.5 billion kroons. At the same time, the claims of Estonian residents on the eastern neighbour amounted to almost 10 billion kroons (see Table 1).

Table 1. Estonian-Russian foreign investment as at end of third quarter of 2005

	Claims			Liabilities			Balance	
	Total	of which Russia		Total	of which Russia		Total	of which Russia
	EEK bn	EEK bn	%	EEK bn	EEK bn	%	EEK bn	EEK bn
Direct investment	22.1	3.1	14.0	163.0	3.2	2.0	-140.9	-0.1
Portfolio investment	36.6	1.3	3.6	40.0	0.1	0.3	-3.4	1.2
Financial derivatives	0.4	0.0	0.0	0.2	0.0	0.0	0.2	0.0
Other investment	46.3	5.5	11.9	86.5	2.2	2.5	-40.2	3.3
Reserve assets	22.1						22.1	0.0
Total	**127.5**	**9.9**	**7.8**	**289.7**	**5.5**	**1.9**	**-162.2**	**4.4**

In absolute terms, economic cooperation between Estonia and Russia has not been that significant compared to other countries' investment in Estonia. Russian capital constitutes only 2% (approximately 3.5% compared to Estonia's annual GDP) of foreign investment in Estonia, whereas Russia is the target of 8% of Estonian investment abroad (about 6.3% compared to Estonia's annual GDP).

The following analyses the investment structure by types of capital (see also Figure 1).

Within the first nine months of 2005, the volume of Russian **direct investment** in Estonia related to acquiring qualifying holding in businesses and voting rights and the volume of Estonian direct investment in Russia were comparable – in both cases over 3 billion kroons. While Estonian direct investment in Russia constitutes 14% of the total Estonian direct investment capital channelled abroad, Russia's respective share in Estonia remains near 2%. The dynamics of direct investment since 1994 (see Figure 2) testify to the rapid growth of reciprocal investment, especially in 2005.

The majority (70%) of Estonian direct investment in Russia is related to financial intermediation and 17% to wholesale and retail trade (see Table 2). A third of Russian direct investment in Estonia is channelled to the transit sector (transport, storage and communications), a quarter to wholesale and retail trade and 14% to companies in the industrial sector.

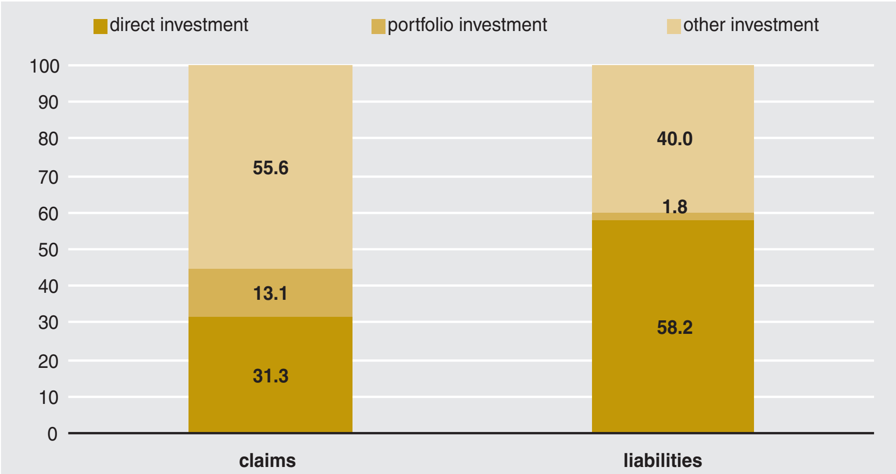

Figure 1. Structure of Estonian-Russian foreign investment as at end of third quarter of 2005 (%)

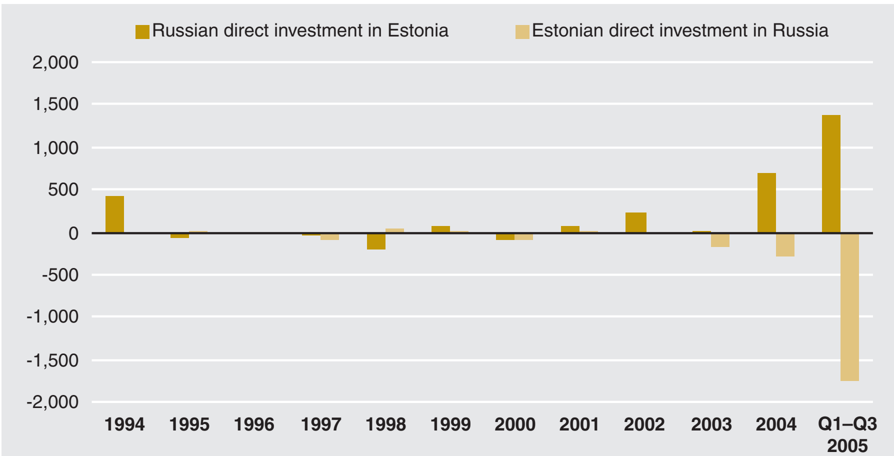

Figure 2. Direct investment flows between Estonian and Russia in 1994–2005 (EEK m)

Table 2. Estonian-Russian direct investment by main fields of activity (EEK thousand)

Direction	Field of activity	Inflow*			Status	
		2003	2004	Q1–Q3 2005	30/09/2005	%
in Estonia	Transport, storage and communications	-347,120	285,024	1,038,773	947,797	30.0
	Wholesale and retail trade; repair	-23,270	240,303	224,083	773,477	24.5
	Manufacturing	101,813	43,930	3,596	429,973	13.6
	Real estate, renting and business activities	188,211	-104,226	49,147	324,276	10.3
	Financial intermediation	5,452	7,364	23,517	43,820	1.4
	Other	99,118	231,811	23,695	637,278	20.2
	Total	**24,204**	**704,206**	**1,362,811**	**3,156,621**	**100.0**
in Russia	Financial intermediation	-5,456	-166,485	-1,388,995	2,213,098	70.5
	Wholesale and retail trade; repair	-63,472	-93,829	-234,644	536,768	17.1
	Transport, storage and communications	-62,998	17,248	-54,451	141,294	4.5
	Manufacturing	1,555	-878	-13,644	88,512	2.8
	Other	-36,259	-36,389	-55,751	158,089	5.0
	Total	**-166,630**	**-280,333**	**-1,747,485**	**3,137,761**	**100.0**

* Capital inflow indicated with a positive sign (+), outflow with a negative sign (-).

The structure of direct investment related to Russia somewhat differs from the average structure of Estonian direct investment. The share of loan capital is smaller, while that of equity (equity capital and reinvested earnings) is greater (see Figure 3).

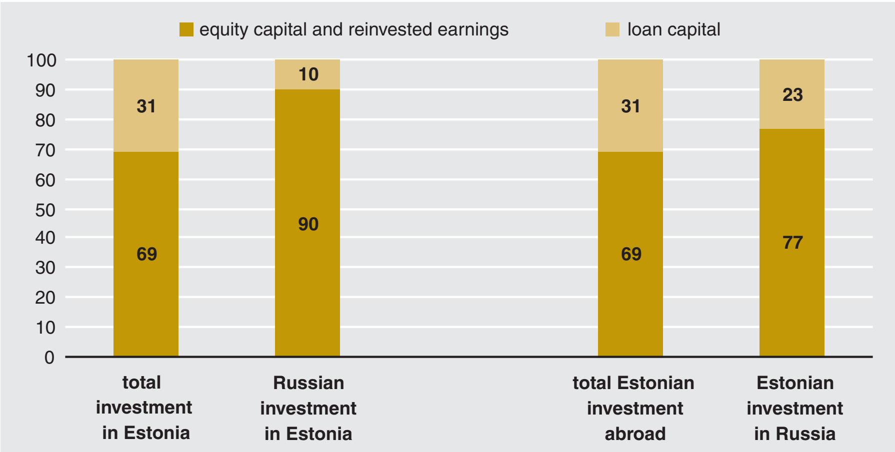

Figure 3. Comparison of Estonian-Russian direct investment capital structure as at end of third quarter of 2005 (%)

Modest volumes of **portfolio investment** indicate relatively high-risk expectations concerning reciprocal investment in securities. Although Estonian residents' investment in Russian securities exceed the sums invested from Russia in Estonian securities more than ten-fold, their volume still remains below 1.4 billion kroons, which accounts for about 1% of Estonian investment abroad (incl. reserve assets).

Financial intermediation largely dominates among fields of activity, whereas in relations with Russia, contrary to the usual, equity securities are preferred to debt securities (see Table 3 and Figure 4).

As regards the structure of foreign investment in relations with Russia, **other investment** capital encompassing trade credit, deposits and loans plays an important role. Estonian residents' claims on Russian natural and legal persons amounted to 5.5 billion kroons after the first nine months of 2005, reaching more than a tenth of Estonia's total other investment claims. Two thirds of it was related to loans and a quarter to trade credit claims, which does not substantially differ from the structure of Estonian capital invested abroad. The situation is quite the opposite for Estonian investment liabilities to Russia, which reached 2.2 billion kroons, constituting 40% of Estonian liabilities to Russia and 2.5% of total other investment liabilities. As one of the specifics of trade with Russia is receiving advance payments for goods and services in order to reduce trade risks, trade credit liabilities make up more than 40% of total liabilities. The volume of Russian residents' deposits held with Estonian credit institutions also remains within the same range, indicating eastern neighbours' confidence in Estonian banks.

Table 3. Estonian-Russian portfolio investment by main instruments and fields of activity (EEK thousand)

Direction	Field of activity	Inflow*			Status	
		2003	2004	Q1–Q3 2005	30/09/2005	%
in Estonia (liabilities)	Financial intermediation	46,418	218,557	5,451	91,574	72.1
	Manufacturing	-60	1,804	16	14,820	11.7
	Wholesale and retail trade; repair		194	1,037	8,160	6.4
	Real estate, renting and business activities	77	3,070	2,435	4,784	3.8
	Other	-479	17	1,477	7,600	6.0
	Total	**45,956**	**223,642**	**10,416**	**126,938**	**100.0**
in Russia (claims)	Financial intermediation	-114,448	-179,414	-364,781	1,158,779	86.3
	Wholesale and retail trade; repair	-225	7,394	-39,210	44,600	3.3
	Other	-9,275	3,089	-123,532	140,111	10.4
	Total	**-123,948**	**-168,931**	**-527,523**	**1,343,490**	**100.0**

* Capital inflow indicated with a positive sign (+), outflow with a negative sign (-).

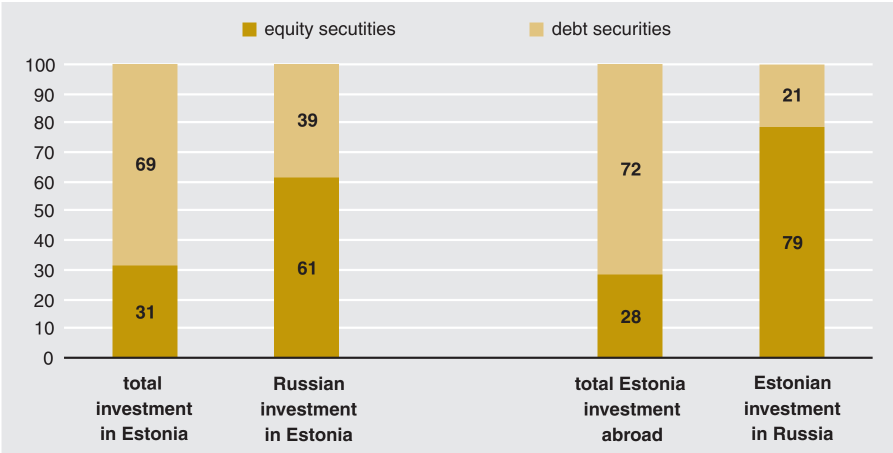

Figure 4. Comparison of Estonian-Russian portfolio investment capital as at end of third quarter of 2005 (%)

Other investment between Estonia and Russia by major fields of activity as well as the comparison of other investment capital structure have been outlined in Table 4 and Figure 5.

Table 4. Estonian-Russian other investment by main fields of activity (EEK thousand)

Direction	Field of activity	Inflow*			Status	
		2003	2004	**Status**	30/09/2005	%
in Estonia (liabilities)	Financial intermediation	-145,590	333,276	228,693	1,122,771	51.1
	Construction	7,019	151,880	233,396	391,283	17.8
	Manufacturing	-18,270	296,427	16,594	331,149	15.1
	Wholesale and retail trade; repair	-19,411	15,784	54,020	331,820	15.1
	Other	-71,832	27,828	-48,246	20,683	0.9
	Total	**-248,084**	**825,195**	**484,457**	**2,197,706**	**100.0**
in Russia (claims)	Financial intermediation	24,432	-1,609,873	-2,079,716	3,709,849	67.7
	Wholesale and retail trade; repair	-975	102,293	-536,644	1,133,689	20.7
	Manufacturing	-25,286	-98,548	-138,392	426,023	7.8
	Transport, storage and communications	-138,312	-19,534	28,978	317,264	5.8
	Other	-227,807	22,217	-66,603	-109,551	-2.0
	Total	**-367,948**	**-1,603,445**	**-2,792,377**	**5,477,274**	**100.0**

* Capital inflow indicated with a positive sign (+), outflow with a negative sign (-).

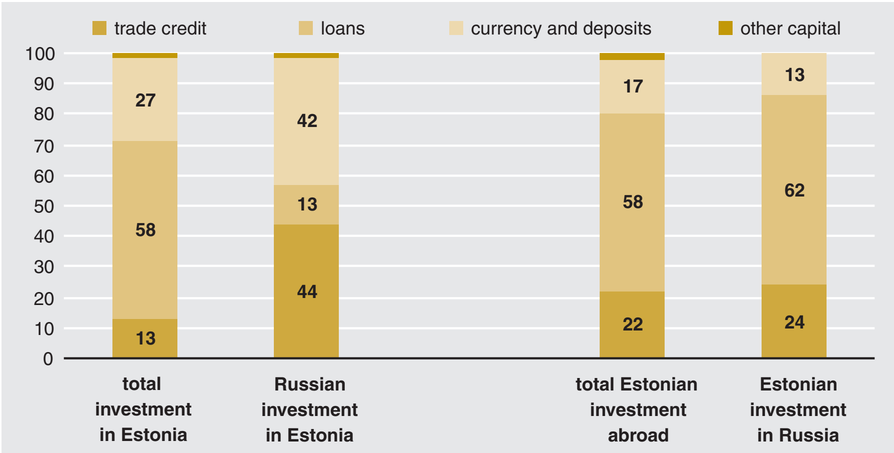

Figure 5. Comparison of Estonian-Russian other investment capital structure as at end of third quarter of 2005 (%)

Summary

Given the size and proximity of our neighbouring country, the investment activities between Estonia and Russia remain modest. There is room for improvement without having to worry about too high a dependence on eastern investment. However, in interpreting the given statistical data it should be taken into account that all investments made with Russian capital need not reach Estonia directly but through international companies. The same applies for Estonian capital reaching Russia.

BALANCE OF PAYMENTS BETWEEN ESTONIA AND RUSSIA IN 2003–2005

Reet Kirt

From the beginning of 2003 until the third quarter[1] of 2005, the **Estonian balance of payments current account with Russia was constantly in deficit**. However, this changed in the third quarter of 2005 (see Table 1). With nearly three years the credit turnover of the Estonian-Russian current account has increased much faster than the debit turnover – while the latter grew by a *third*, credit turnover rose almost *three times*. Turnover growth has been favoured by Estonia's accession to the European Union and the consequent abolishment of double customs tariffs by Russia on goods imported from Estonia. Traditionally, the deficit has been greater in the first quarter when the import of fuels from Russia picks up.

Table 1. Estonian-Russian current account (EEK m)

	Credit	Change* (%)	Debit	Change* (%)	Balance
Q1 2003	1,172.3	100.0	-2,272.8	100.0	-1,100.5
Q2 2003	1,544.3	31.7	-2,189.0	-3.7	-644.7
Q3 2003	1,547.5	0.2	-2,121.9	-3.1	-574.4
Q4 2003	1,539.1	-0.5	-2,528.0	19.1	-989.0
Q1 2004	1,602.1	4.1	-2,728.4	7.9	-1,126.3
Q2 2004	1,834.9	14.5	-2,824.9	3.5	-990.1
Q3 2004	2,660.8	45.0	-2,737.1	-3.1	-76.3
Q4 2004	2,731.8	2.7	-3,223.1	17.8	-491.3
Q1 2005	2,279.5	-16.6	-3,305.6	2.6	-1,026.1
Q2 2005	2,628.5	15.3	-3,396.1	2.7	-767.6
Q3 2005	3,210.1	22.1	-2,967.8	-12.6	242.3

* Compared to previous period, unless stated otherwise.

The Estonian current account deficit with Russia (see Figure 1) is primarily caused by the foreign trade balance deficit – goods imports from Russia to Estonia considerably exceeded their exports to Russia. The services account remained in surplus, even experiencing an increase: Estonia sold more services to Russia than bought from there. Current transfers[2] also had a surplus, but their share in the balance of payments between the two countries was relatively marginal. The share of the income account[3], which was negative, remained even smaller.

[1] This article analyses the period from the first quarter of 2003 until the third quarter of 2005, because balance of payments statistics by all entries and countries are available since 2003.

[2] The current transfers account includes all remaining transactions related to the accumulation of residents' disposable income but not recorded elsewhere under the current account. Current transfers are usually related to taxes, fines, subsidies, donations, inheritance, membership fees, insurance premiums, and indemnities.

[3] The income account reflects income related to the use and render for use of production factors (capital and labour). Respectively, income falls into two categories: compensation of employees and investment income.

Purchase and sale of goods had an important role in the structure of foreign trade turnover between Estonia and Russia (see Table 2). Year-on-year, their share in the credit turnover grew by nearly 12 percentage points, making up 54% in 2005. The share of goods in the debit turnover remained stable, constituting over three quarters of the turnover. Services also played an important role, especially in the credit turnover, although their share decreased by 10 percentage points and amounted to 39% in 2005. In the debit turnover, services accounted for 18–19%.

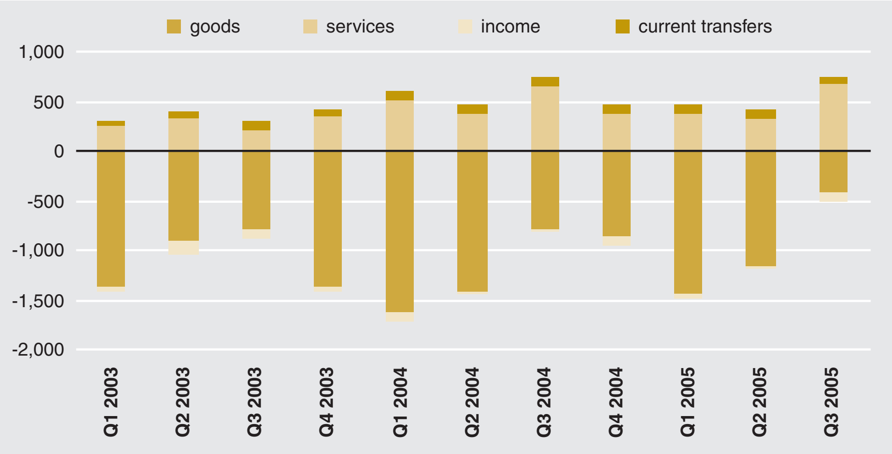

Figure 1. Structure of Estonian-Russian current account deficit (EEK m)

Table 2. Estonian-Russian current account structure (%)

	Credit turnover			Debit turnover		
	2003	2004	Q1–Q3 2005	2003	2004	Q1–Q3 2005
Goods	42.5	47.8	54.4	75.6	77.6	76.9
Services	49.8	45.4	39.0	19.3	18.3	18.7
Income	1.6	1.9	2.6	4.5	3.6	3.9
Current transfers	6.1	4.9	4.0	0.6	0.5	0.5
Kokku	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

The following gives a more detailed overview of the sub-accounts of the current account.

Goods[4]

While at the beginning of the given period the volume of goods exported from Estonia to Russia remained relatively modest, **accession to the European Union and the abolishment of double customs tariffs have greatly facilitated export growth** – in the third quarter of 2005 the volume of goods exported from Estonia to Russia quadrupled compared to the first quarter of 2003 (see Table 3). The volume of goods imported from Russia increased more modestly, growing only by a fifth.

Table 3. Estonian-Russian foreign trade*

	Exports	Change (%)	Imports	Change (%)	Balance
Q1 2003	418.9	100.0	1,893.9	100.0	-1,475.0
Q2 2003	659.5	57.5	1,613.7	-14.8	-954.2
Q3 2003	725.5	10.0	1,569.9	-2.7	-844.4
Q4 2003	636.3	-12.3	2,127.4	35.5	-1,491.1
Q1 2004	560.7	-11.9	2,370.7	11.4	-1,810.0
Q2 2004	746.1	33.1	2,337.5	-1.4	-1,591.4
Q3 2004	1,261.3	69.1	2,223.2	-4.9	-961.9
Q4 2004	1,611.9	27.8	2,726.1	22.6	-1,114.1
Q1 2005	1,229.4	-23.7	2,964.2	8.7	-1,734.9
Q2 2005	1,400.0	13.9	2,847.0	-4.0	-1,447.0
Q3 2005	1,682.4	20.2	2,316.7	-18.6	-634.3

* Exports in f.o.b. prices, imports in c.i.f. prices.

The structure of foreign trade changed significantly as well, especially in terms of exports (see Table 4). Hence, the share of machinery and equipment in exports rose from 6.6% in 2003 to 21.7% in 2005 and that of food products increased from 7.5% to 17%. At the same time, the share of chemical products, transport vehicles and mineral products shrunk considerably. The greatest change experienced by the import structure was the rapid growth of the share of mineral products (in case of Russia, that product group mainly comprises mineral fuels and gas) in 2005, which mainly stemmed from the oil price hike on global markets. Accordingly, the Estonian-Russian foreign trade deficit was primarily brought about by the large imports of mineral products. Also, the share of timber and paper products imported from Russia increased, whereas that of transport vehicles decreased.

[4] As external trade balance is the most important component of Estonian-Russian balance of payments and the present issue includes a separate article on the foreign trade between Estonia and Russia (see page 30), goods are analysed here only generally.

Table 4. Estonian-Russian foreign trade structure (%)

	Exports			Imports		
	2003	2004	Q1–Q3 2005	2003	2004	Q1–Q3 2005
Food	7.5	12.9	17.0	4.2	3.3	2.8
Mineral products	11.6	9.2	5.3	29.2	27.9	42.4
Chemical products	31.3	16.4	12.0	11.1	8.2	7.4
Clothing, footwear and headgear	3.3	7.8	11.0	1.3	1.0	0.7
Timber, paper and products	7.4	5.5	5.2	19.4	22.3	25.1
Metals and metal products	4.8	5.2	7.3	16.3	21.0	14.7
Machinery and equipment	6.6	18.6	21.7	4.2	2.5	2.7
Transport vehicles	20.6	17.8	13.8	12.4	11.9	2.2
Furniture, toys and sporting goods	2.4	2.0	2.3	0.7	0.7	0.6
Other	4.5	4.6	4.5	1.2	1.2	1.2
Kokku	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Services

The Estonian services account[5] with Russia remained positive throughout all the quarters of the given period (see Table 5). The surplus ranged from 300 to 400 million kroons, except during the summer months of recent years when the most active sale of travel services to Russian residents also increased the positive balance of services. The exports of services to Russia grew considerably faster than their imports from there.

Table 5. Estonian-Russian services account turnover (EEK m)

	Exports	Change (%)	Imports	Change (%)	Balance
Q1 2003	649.7	100.0	-401.8	100.0	247.9
Q2 2003	782.5	20.4	-459.4	14.3	323.1
Q3 2003	683.6	-12.6	-472.6	2.9	211.0
Q4 2003	776.3	13.6	-424.9	-10.1	351.4
Q1 2004	902.2	16.2	-393.6	-7.4	508.6
Q2 2004	952.6	5.6	-581.3	47.7	371.2
Q3 2004	1,221.3	28.2	-569.5	-2.0	651.8
Q4 2004	932.1	-23.7	-560.6	-1.6	371.5
Q1 2005	841.5	-9.7	-479.6	-14.5	361.9
Q2 2005	1,034.8	23.0	-708.4	47.7	326.4
Q3 2005	1,288.8	24.5	-621.0	-12.3	667.8

[5] The services account reflects the services sold to and purchased from non-residents by Estonian residents.

Both in the structure of exports as well as imports of services (just as in the total services account of Estonian balance of payments) the majority was formed by two types of services – **transport and travel services** (see Tables 6 and 7). Although the sales volume of transport services increased,

Table 6. Estonian-Russian services account (EEK m)

	Exports			Imports			Balance		
	2003	2004	Q1–Q3 2005	2003	2004	Q1–Q3 2005	2003	2004	Q1–Q3 2005
Transport services	1,435.1	1,690.2	1,156.7	-799.5	-1,107.1	-961.4	635.5	583.0	195.3
Travel services	931.5	1,523.4	1,500.6	-472.1	-484.7	-450.4	459.4	1,038.7	1,050.2
Communication services	46.7	93.8	72.5	-44.5	-67.6	-56.3	2.2	26.2	16.2
Construction services	58.9	98.5	47.6	-52.6	-70.5	-71.2	6.3	28.1	-5.3
Insurance services	1.0	2.1	1.2	-0.9	-1.1	-0.6	0.1	0.9	0.6
Financial services (other than insurance)	5.1	8.6	2.5	-5.0	-15.9	-37.9	0.1	-7.3	-35.4
Computer and information services	9.7	7.1	4.6	-4.3	-3.9	-1.8	5.4	3.2	2.8
Royalties and licence fees	1.1	3.0	10.6	-1.5	-1.7	-3.8	-0.4	1.2	6.9
Other business services	299.4	468.5	264.4	-336.2	-323.6	-205.5	-36.8	144.9	58.8
Personal, cultural and recreational services	0.4	0.3	3.0	-0.8	-0.5	-0.8	-0.5	-0.2	2.3
Government services	103.3	112.8	82.9	-41.2	-28.3	-19.3	62.0	84.5	63.6
Total	**2,892.1**	**4,008.2**	**3,165.1**	**-1,758.7**	**-2,105.0**	**-1,809.0**	**1,133.4**	**1,903.2**	**1,356.1**

Table 7. Estonian-Russian services account structure (%)

	Credit			Debit		
	2003	2004	Q1–Q3 2005	2003	2004	Q1–Q3 2005
Transport services	49.6	42.2	36.5	45.5	52.6	53.1
Travel services	32.2	38.0	47.4	26.8	23.0	24.9
Communication services	1.6	2.3	2.3	2.5	3.2	3.1
Construction services	2.0	2.5	1.5	3.0	3.3	3.9
Insurance services	0.0	0.1	0.0	0.0	0.1	0.0
Financial services (other than insurance)	0.2	0.2	0.1	0.3	0.8	2.1
Computer and information services	0.3	0.2	0.1	0.2	0.2	0.1
Royalties and licence fees	0.0	0.1	0.3	0.1	0.1	0.2
Other business services	10.4	11.7	8.4	19.1	15.4	11.4
Personal, cultural and recreational services	0.0	0.0	0.1	0.0	0.0	0.0
Government services	3.6	2.8	2.6	2.3	1.3	1.1
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

their share in the services exports diminished considerably, comprising 36.5% in 2005. At the same time, the export volume of travel services grew briskly in absolute as well as relative terms, even reaching 47.4% of the services exports in 2005. The growth was mainly supported by private travel. The share of transport services in the structure of services purchased from Russia somewhat rose, making up 53% of the services imports in 2004–2005. The volume and share of travel services purchased from Russia remained relatively stable, accounting for a quarter of the services imports. As to the imports of travel services, the share of business trips rose slightly, reaching 35% in 2005.

In the structure of the most important type of services in the Estonian-Russian services turnover – transport services – the **main transport type was rail transport**. Its share in both exports and imports ranged from 50–60% during the given period (see Table 8). Maritime transport formed nearly a quarter of the transport services exports, although its share in the imports remained smaller (11–14%). Road transport comprised a fifth of both the exports and imports of transport services in 2005.

Table 8. Estonian-Russian transport services structure (%)

	Exports			Imports		
	2003	2004	Q1–Q3 2005	2003	2004	Q1–Q3 2005
Maritime transport	21.3	25.4	23.9	10.8	13.9	10.9
Air transport	2.7	4.4	5.0	7.4	6.1	6.0
Rail transport	57.9	52.6	50.1	54.2	53.7	57.0
Road transport	12.6	16.2	20.6	18.5	16.3	18.3
Transport through pipelines	0.7	0.7	0.2	5.5	4.0	4.3
Other	4.8	0.7	0.1	3.6	6.1	3.6
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Transport services were mainly provided for transporting goods and their share in the given period increased substantially, amounting to 86% of the exports as well as the imports of transport services in 2005. The share of goods transport grew on the account of the decrease of other transport services. Passenger transport remained merely within 3–5%.

The third most important component in the Estonian-Russian services turnover was other business services[6]; their share shrunk in both exports and imports, comprising 8.4% and 11.4% in 2005, respectively. As to other business services, operational lease (wagons) prevailed, reaching 60–70% of the exports and imports of business services in 2003. By 2005 this indicator dropped to 40–50%. The rest of other business services were various services related to business and professional activities.

[6] Other business services include e.g. services related to consulting (legal assistance, accounting, audit, management consulting, etc.).

Income

The share of income in the current account between Estonia and Russia remained relatively modest, especially the income of residents on investment in Russia (see Tables 9 and 10). Nevertheless, it has increased rapidly, reaching 2.6% of the current account credit turnover in 2005. While in 2003, three quarters of Estonian residents' income earned in Russia was made up of labour income and the rest was investment income, a significant change took place in 2004 and 2005 – the majority of income earned consisted of investment income, mainly income on other investment. Moreover, 60 million kroons of direct investment income was received in 2005.

Table 9. Estonian-Russian income account credit turnover

	Volume (EEK m)			Share (%)		
	2003	2004	Q1–Q3 005	2003	2004	Q1–Q3 005
Labour income	71.2	49.6	21.6	74.7	29.9	10.3
Investment income	24.1	116.3	188.1	25.3	70.1	89.7
Income on direct investment	-3.2	-0.1	58.8	-3.3	0.0	28.0
income on equity capital	-6.1	-1.1	38.6	-6.4	-0.7	18.4
dividens	0.0	0.1	0.0	0.0	0.1	0.0
reinvested earnings	-6.1	-1.2	38.5	-6.4	-0.7	18.4
income on debt (interests)	2.9	1.1	20.2	3.0	0.6	9.6
other sectors	2.9	1.1	2.6	3.0	0.6	1.2
Income on portfolio investment	1.5	4.6	11.3	1.5	2.8	5.4
Income on other investment	25.9	111.7	118.1	27.1	67.4	56.3
Total	**95.4**	**165.8**	**209.7**	**100.0**	**100.0**	**100.0**

Table 10. Estonian-Russian income account debit turnover

	Volume (EEK m)			Share (%)		
	2003	2004	Q1–Q3 2005	2003	2004	Q1–Q3 2005
Labour income	-69.2	-36.6	-17.3	16.9	8.8	4.6
Investment income	-340.5	-377.7	-355.6	83.1	91.2	95.4
Income on direct investment	-327.5	-371.1	-293.6	79.9	89.6	78.7
income on equity capital	-324.9	-369.7	-293.6	79.3	89.2	78.7
dividens	-11.7	-19.6	-46.6	2.9	4.7	12.5
reinvested earnings	-313.2	-350.0	-246.9	76.4	84.5	66.2
income on debt (interests)	-2.6	-1.4	0.0	0.6	0.3	0.0
Income on portfolio investment	-0.1	-0.8	-0.5	0.0	0.2	0.1
Income on other investment	-13.0	-5.8	-61.5	3.2	1.4	16.5
Total	**-409.8**	**-414.3**	**-372.8**	**100.0**	**100.0**	**100.0**

Although Estonia has invested considerably more in Russia than vice versa, the income of Russian investors earned in Estonia is much larger, amounting to 4–5% of the current account debit turnover. This can be explained by the fact that investment in Russia has only picked up in recent years and has not yet earned significant income. The absolute volume of income has been relatively stable during the past three years, i.e. slightly over 400 million kroons. Similarly to the credit turnover of income, the share of labour income dropped also in the debit turnover of income. Meanwhile, Russia mainly earned on direct investment in Estonia (approximately 90% of the total income), which in turn was almost fully reinvested earnings.

Current transfers

The current transfers account of Estonia's balance of payments with Russia had a surplus throughout all the quarters of the given period. The share of current transfers in the current account credit turnover decreased from 6% in 2003 to 4% in 2005. They were almost exclusively other current transfers made by the general government, which mainly consisted of pension transfers for retired Russian soldiers living in Estonia. The share of outgoing current transfers to Russia amounted to 0.5% in the current account debit turnover and they were mainly related to other current transfers of other sectors (insurance benefits, compensations, fines).

APPENDIX

MAIN QUARTELY INDICATORS OF THE ESTONIAN ECONOMY as at 13 April 2006

	Unit	Period	Indicator	Change compared to the previous period (%)	Change compared to the same period last year (%)	Source
Gross domestic product						
Current prices	EEK m	Q4 05	42,694.8			ESA
Constant prices	EEK m	Q4 05	35,682.6	4.8	11.1	ESA
Production						
Volume index of industrial production (at constant prices, 2000=100)	%	Q4 05			8.4	ESA
Agriculture						
Meat (live weight)	thousand tons	Q4 05	27.8	20.9	-5.1	ESA
Milk	thousand tons	Q4 05	159.5	-12.5	3.0	ESA
Eggs	m pieces	Q4 05	50.1	-2.7	-13.2	ESA
Investments in fixed assets (at current prices)	EEK m	Q4 05	8,872.9	16.5	42.8	ESA
Construction						
Construction activities of construction enterprises (at current prices)	EEK m	Q4 05	11,413	5.3	34.0	ESA
Usable floor area of completed dwellings	thousand m^2	Q4 05	108.5	69.8	30.3	ESA
Usable floor area of non-residential buildings	thousand m^2	Q4 05	279.7	66.1	50.0	ESA
Consumption						
Retail sales volume index (at constant prices, 2000=100)	%	Q4 05		6	11	ESA
New registration of passenger cars	pieces	Q1 06	14,477	-2.1	24.1	ARK
Prices						
Consumer price index	%	Q1 06		1.1	4.4	ESA
Producer price index	%	Q4 05		1.0	2.0	ESA
Export price index	%	Q4 05		1.3	2.8	ESA
Import price index	%	Q4 05		0.8	4.2	ESA
Construction price index	%	Q4 05		2.1	7.4	ESA
Real effective exchange rate (REER) of the Estonian kroon	%	Q4 05		-0.5		EP
Labour market and wages						
Employment rate (based on the Labour Force Survey)*	%	Q4 05	58.6	58.3	57.4	ESA
Unemployment rate (based on the Labour Force Survey)*	%	Q4 05	7.0	7.0	8.5	ESA
Registered unemployed	persons per month	Q1 06	20,620	-8.4	-31.7	TTA
% of population between 16 years old and pension age*	%	Q4 05	2.8	3.0	4.0	TTA
Average monthly gross wages and salaries (health insurance benefits excluded)	EEK	Q4 05	8,690	11.6	12.8	ESA

* Indicators of the period, not changes.

	Unit	Period	Indicator	Change compared to the previous period (%)	Change compared to the same period last year (%)	Source
General government budget (net borrowing not included here)						
Revenue	EEK m	Q4 05	17,240.5	1.3	11.1	RM
Expenditure	EEK m	Q4 05	18,660.4	27.7	11.4	RM
Balance (+/-)*	EEK m	Q4 05	-1,419.9	2,404.6	-1,218.7	RM
Period's revenue to the planned annual revenue*	%	Q4 05	27.8	27.4	27.9	RM
Transport						
Carriage of passengers	thousand	Q4 05	55,465	7.3	-4.8	ESA
Carriage of goods	thousand tons	Q4 05	25,261	0.4	4.2	ESA
Tourism and accommodation						
Visitors from foreign countries received by Estonian travel agencies	thousand	Q4 05	439.4	-51.4	9.9	ESA
Visitors sent to foreign tours by Estonian travel agencies	thousand	Q4 05	106	-16.9	16	ESA
Accommodated visitors	thousand	Q4 05	427.2	-43	4.6	ESA
o/w foreign visitors	thousand	Q4 05	279.4	-48.9	-3.6	ESA
Confidence indicators*						
of industrial enterprises	%	Q1 06	22	10	21	EKI
of construction enterprises	%	Q1 06	42	35	27	EKI
of trade enterprises	%	Q1 06	27	12	22	EKI
of consumers	%	Q1 06	8	3	-5	EKI
Foreign trade (special trade system)						
Exports	EEK m	Q4 05	27,648.3	11.3	35.1	EP
Imports	EEK m	Q4 05	36,196,9	9.0	26.4	EP
Balance*	EEK m	Q4 05	-8,548.6	-8,343.6	-8,172.7	EP
Foreign trade balance/exports*	%	Q4 05	-30.9	-33.6	-39.9	EP
Balance of payments*						
Current account balance	EEK m	Q4 05	-4,628.1	-3,775.6	-6,194.9	EP
Current account balance to GDP	%	Q4 05		-8.7	-17.2	EP
Foreign direct investment inflow	EEK m	Q4 05	-586.1	3,875.2	4,661.6	EP
Foreign direct investment outflow	EEK m	Q4 05	-2,470.4	-1,642.0	-557.3	EP
International investment position						
Net international investment position	EEK m	31/12/05	-163,979	1.9	25.4	EP
Direct investment in Estonia	EEK m	31/12/05	162,275	-1.3	40.5	EP
Net external debt	EEK m	31/12/05	148,239	5.6	29.1	EP
o/w goverment	EEK m	31/12/05	3,852.8	-5.7	-1.0	EP
EEK/USD average quarterly exchange rate	EEK	Q1 06	13.005		9.0	EP

Statistical Office of Estonia (ESA)
Motor Vehicle Registration Centre (ARK)
Eesti Pank (EP)
Labour Market Board (TTA)
Ministry of Finance (RM)
Estonian Institute of Economic Research (EKI)