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Lithuania: Foreign Direct Investment Impact and Policy Analysis

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LITHUANIA: FOREIGN DIRECT INVESTMENT IMPACT AND POLICY ANALYSIS

July 2000

This study has been prepared within the framework of the OECD Co-operation Programme with the Baltic States.

Organisation for Economic Co-operation and Development 2000

FOREWORD

As Lithuania has evolved into a market economy, the OECD Centre for Co-operation with Non-Members (CCNM) has actively promoted the development of the country's framework conditions for foreign direct investment. In 1998, the CCNM published an *Investment Guide for Lithuania*. Lithuania has been active as an observer in the discussions on international investment, held in the OECD's Committee on International Investment and Multinational Enterprises (CIME). Since 1998, the CCNM's co-operation with Lithuania, together with Estonia and Latvia, has taken place within the context of a Baltic Regional Programme.[1] This Programme promotes the adoption by the Baltic countries of the OECD members' best practices in the field of foreign investment and many related areas, such as entrepreneurship, competition policy, taxation, financial and capital markets, education policy and others.

Cumulative net inflows of foreign investment to Lithuania amounted to US$2.1 billion by the end of 1999, or US$558 per capita. Despite its volatile economic conditions, Lithuania has recently deployed considerable efforts to create favourable conditions for foreign direct investment. It recorded the best FDI performance among the Baltic States in 1998. Lithuania has enacted legislation to promote and protect foreign investment and accords national treatment, with few exceptions. Future membership of the EU is a national priority and current energies are focussed on fulfilling membership criteria in all areas, including those affecting the business and investment regime in the country. In December 1999, Lithuania was accepted into EU accession negotiations and negotiations on its membership of the World Trade Organisation are well advanced.

As in other transition economies, the main factor behind recent FDI inflows has been the privatisation of former state-owned companies. However, the country has proved attractive on account of its location and well-developed transport infrastructure, offering market access within the extended Baltic region. It also has a well-educated workforce and competitive labour costs, combined with an active investment promotion strategy. Engineering, research-related sectors, energy, services, textiles and furniture should attract greenfield investment. Barriers to investment remain, and challenges for the future are seen in the completion of privatisation, the development of the capital market and bureaucratic administrative and customs structures.

This working paper on foreign direct investment in Lithuania, and the evolution of the underlying institutional framework, examines the main policy changes made to create a hospitable business environment in the country. It also traces the most visible economic benefits that Lithuania has derived from foreign direct investment. The final part of the study examines some policy challenges for the future to sustain inflows of foreign direct investment and encourage reinvestment to enhance its impact on the Lithuanian economy.

This working paper has been prepared by Ms Inkeri Hirvensalo, Director of the Centre for Markets in Transition at the Helsinki School of Economics and Business Administration, and Ms Tuuli Juurikkala, of this School's Department of Economics, under the direction of Ms Marie-France Houde, OECD Outreach Co-ordinator for Foreign Direct Investment. It is an updated and expanded version of a study prepared for a Conference on Foreign Direct Investment (FDI) Policy and Private Sector

Development in the Baltic States organised in November 1999.[2] The conference was organised by the OECD Committee on International Investment and International Enterprises (CIME) under the auspices of the OECD Centre for Co-operation with Non-Members and with the support of the Estonian Investment Agency. This paper is based on statistical material and other reports and studies available up to the second quarter of 2000.

The authors are grateful for the assistance provided by the Lithuanian Government in preparing this paper. The opinions expressed herein are their sole responsibility and do not necessarily reflect those of the OECD or of the governments of its Member countries.

Foreign Direct Investment Impact and Policy Survey

Lithuania

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FOREIGN DIRECT INVESTMENT IMPACT AND POLICY ANALYSIS

LITHUANIA

Executive summary

The present study was prepared in the third quarter of 1999 as a background study to a Conference organised by the OECD Committee on International Investment and Multinational Enterprises (CIME), in collaboration with the Centre for Co-operation with Non-Members and with the support of the Estonian Investment Agency, on the subject of "Foreign Direct Investment Policy and Private Sector Development in the Baltic States". This event took place in Tallinn on 17 November 1999. Its objective was to provide an overall assessment of the contribution of foreign direct investment (FDI) to the economic transformation of the three Baltic states since their independence in 1991-1992.

The conference was one of the main activities organised in 1999 under the auspices of the OECD Baltic Regional Programme. Within the framework of the same programme, it was followed up by a Conference on Fiscal Incentives and Competition for Foreign Direct Investment in Vilnius in Spring 2000 organised in collaboration with the Government of Lithuania. The objectives of the OECD Baltic Regional Programme are (i) to assist in the completion of the three Baltic states' transition to a market economy; (ii) to promote the stable integration of the Baltic region into the global economy; and (iii) to encourage the use of best OECD practices in developing policies and strategies in the Baltic region, in order to promote long-term sustainable economic growth an political stability.[3]

The main conclusions of the conference were that foreign direct investment has played a determining role in the economic progress of the Baltic States towards market-based economies and their integration into the global economy. Liberalisation of trade and investment together with sound macro-economic policy were the best investment incentives that could have been provided to foreign investors. In the future, openness to FDI as well as efforts to remove regulatory and administrative barriers and constraints, should continue to be pursued to achieve a *de facto* as well as a *de jure* hospitable business environment. The OECD will continue to work with the Baltic countries in a number of specific areas related to FDI policies and private sector development.

With regard to Lithuania, the major findings of the study[4] are as follows:

FDI inflows into Lithuania have grown constantly since the country regained its independence in the early 1990s. Although the FDI inflows to Lithuania gained momentum later than those to Estonia and Latvia, the growth was faster than in the other two Baltic countries.

Geographically close to Lithuania, the Nordic countries have an increasingly strong presence as investors in the country, together with the United States, which has accounted for a large share of the FDI throughout the 1990s. Most FDI has gone into the manufacturing sector, especially in the food, beverages and tobacco industry. The trade, financial services and telecommunications sectors have

also benefited most from foreign capital, with the latter growing in importance due to the partial privatisation of the national telecommunications company Lietuvos Telekomas in 1998. Of all the regions in the country, Vilnius has attracted the most FDI, although the share of other urban centres is also relatively high.

In general, the share of FDI in the gross fixed capital formation has increased considerably since 1995, which indicates that its significance for the economic development of the country has also increased since the middle of the 1990s.

By far the main factor behind the FDI inflows into Lithuania has been the privatisation of former state-owned companies. The fact that this process has been slower and started later for major infrastructure projects is one of the main reasons why the FDI inflows to Lithuania lag somewhat behind those of the other Baltic states. Lithuania is still in the process of large-scale privatisation and it is most likely that this will continue to dominate the FDI figures for the next few years to come.

Not all of the FDI inflows have, however, been motivated by privatisation initiatives. Among the other main reasons why foreign companies decide to invest in Lithuania are the moderate wage costs and skilled workforce, growing market potential, geographic location and economic and political stability. The major barriers to investment are seen as bureaucratic structures and practices and the unstable legislative framework underlying the business climate.

There is still potential for more FDI in Lithuania, although the size of inflows will continue to be affected by the small size of the Lithuanian market in general.

With regard to the economic impact of FDI, research indicates that positive effects include improved quality standards and delivery performances and are strongest in the backward linkages between local suppliers and the foreign-owned companies. It is important therefore that FDI policy should continue to place an emphasis not only on attracting FDI but also on the integration of the local companies into the supplier network of the foreign-owned enterprises. Furthermore, as the major motivations for choosing local subcontractors – assuming adequate quality standards – have been production capacities and transportation costs, there is a need to develop and increase information about the more specific competitive advantages of the Lithuanian industries.

In more general terms, it is a commonly recognised fact that one of the major challenges for investment policy will be to attract more greenfield investment into the country, especially on completion of the large-scale infrastructure privatisation process. The growing international competition for FDI forms another important challenge for Lithuanian policymakers. Against this background, the first requirement for any country wishing to attract FDI is to have the necessary regulatory, administrative and general institutional framework in place – an area which still requires considerable efforts on the part of the Lithuanian authorities.

As a host country for FDI, Lithuania has many attributes in common with a number of other Central and Eastern European countries and must therefore differentiate itself in terms of the attractive sectoral investment opportunities it offers. Such sectors of potential interest in Lithuania include:

- Engineering, notably electrical engineering;

- Research-related sectors in general and some very narrow areas of specialisation, such as multicoloured lasers in particular;

- Service sectors, especially banking and insurance which have only developed since the implementation of economic reforms;

- Textiles, furniture and software;

- Energy and oil sectors – among the most interesting targets for FDI through privatisation opportunities.

Integration into the European Union and progressive harmonisation of laws and regulations will also enhance Lithuania's attractiveness for investors. Outside the context of EU enlargement, international co-operation has not been sufficient to offset the problem of growing international competition for FDI. Co-operation among the three Baltic states to promote the Baltic states as a region could be strengthened further.

In Lithuania, membership of the European Union is seen as one of the most important conditions for the implementation of economic and social policy objectives. The Medium Term Economic Strategy of Lithuania, prepared in 1999, is largely oriented towards EU membership. FDI policy has been integrated into the general economic policy of Lithuania through the pre-accession harmonisation process which is in progress.

CHAPTER 1

FOREIGN DIRECT INVESTMENT TRENDS, FACTORS AND PROSPECTS

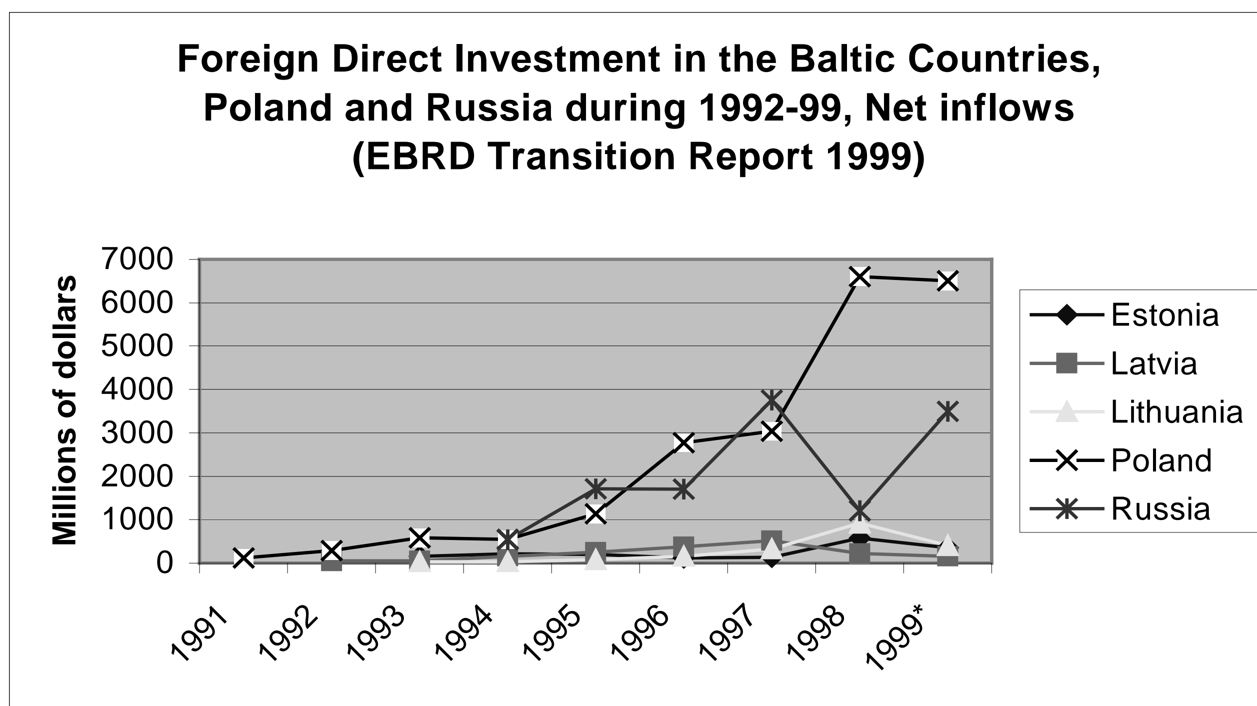
This chapter first provides an overview of the increase in and main characteristics of FDI since 1991. It then proceeds to identify the main factors behind FDI trends and presents findings on the investment climate in Lithuania relative to the other Baltic countries. The chapter ends with an assessment of statistical sources on FDI in Lithuania up to date.[5]

1.1 Foreign direct investment facts and figures

Development of FDI during the period 1992-1999: comparison of Baltic states, Russia and Poland

Figure 1.1 depicts the development of FDI in the Baltic countries, Poland and Russia as reported in the EBRD Transition Report 1999. Among the five Baltic Sea region transition economies, Poland has attracted the largest inflows of FDI in absolute terms. Up to 1997, FDI in Russia grew at almost the same high rate as in Poland, but fell dramatically in 1998 as a result of the Russian economic crisis. The net inflows to Latvia and Lithuania started to grow about two years later than those of Estonia, although the pace of growth in both countries has been faster. In yearly inflow volumes, both countries had caught up with Estonia by 1996 and, in cumulative inflows, by 1997. According to Table 1.1 Latvia was first, Lithuania second, and Estonia third among the three Baltic countries in terms of the cumulative net FDI inflow volumes by 1998. The FDI inflow to Lithuania peaked in that same year and exceeded the inflows in both Estonia and Latvia. In relative terms, FDI has been considerably more significant in the Baltic countries than in Poland and Russia. According to Table 1.1, which summarises the key indicators of FDI in the region, the cumulative net inflows of FDI per capita over the years 1992-1998 were highest in Estonia and lowest in Russia. FDI in Estonia amounted to more than ten times the per capita level in Russia in the same period. Among the Baltic countries, the cumulative net inflows of FDI per capita were second highest in Latvia, followed by Lithuania and reached a higher lever than in Poland. Likewise, the inflows of FDI in comparison to GDP were higher in all three Baltic countries than in Poland or Russia during 1997 and 1998.

Figure 1.1



* estimate
Source: EBRD Transition Report 1999

Table 1.1 FDI inflows to the Baltic countries – key indicators, in million US$ and percentage

(Net inflows recorded in the balance of payments)

	Cumulative FDI net inflows as of 1989-98	Cumulative FDI net inflows per capita 1989-98	FDI net inflows per capita 1997	FDI net inflows per capita 1998	FDI net inflows as a % of GDP 1997	FDI net inflows as a % of GDP 1998
Estonia	1,382	953	89	396	2.8	10.6
Latvia	1,604	642	206	88	9.3	3.5
Lithuania	2,063*	558*	89	250	3.4	8.6
Russia	8,901	61	25	8	0.8	0.4
Poland	15,066	389	79	171	2.2	4.5

* Figures as of 1 January 2000;
Source: EBRD Transition Report 1999; Bank of Lithuania

Inward and outward flows and stocks

Information from the register of joint ventures and foreign capital companies run by the Ministry of Economy was the basis for calculation of foreign direct investment data up to 1995. Since then, the Lithuanian Department of Statistics has started collecting information on foreign direct investment, following OECD recommendations. FDI statistics are published as part of the balance of payments statistics. The survey basis used in 1996 was revised in 1997. Thus, the data is only directly comparable from 1997 onwards.[6]

Table 1.2 FDI inflows to Lithuania, US$ million, 1993-1999[7]

	1 Q	2 Q	3 Q	4 Q	Total
1999	105.72	156.10	101.25	123.40	486.47
1998	83.01	140.42	584.39	117.70	925.52
1997	69.07	67.77	151.65	66.02	354.51
1996	15.68	26.16	45.24	65.35	152.43
1995	12.72	17.28	18.55	24.01	72.56
1994	6.28	8.50	10.26	6.26	31.30
1993	1.22	13.81	10.37	4.78	30.18

Source: Economic and Social Development in Lithuania 3/2000, balance of payments data provided by the Bank of Lithuania; Bank of Lithuania at *www.lbank.lt*

Table 1.2 and Figure 1.2 show the development of FDI in Lithuania during the 1990s. It has grown constantly over the last five years largely due to the mass privatisation programme that has taken place in the country. The growth of FDI accelerated after the second phase of privatisation involving the sale of large enterprises started in 1995. From 1996 to 1997, the accumulated stock of FDI in Lithuania grew by 50 per cent.

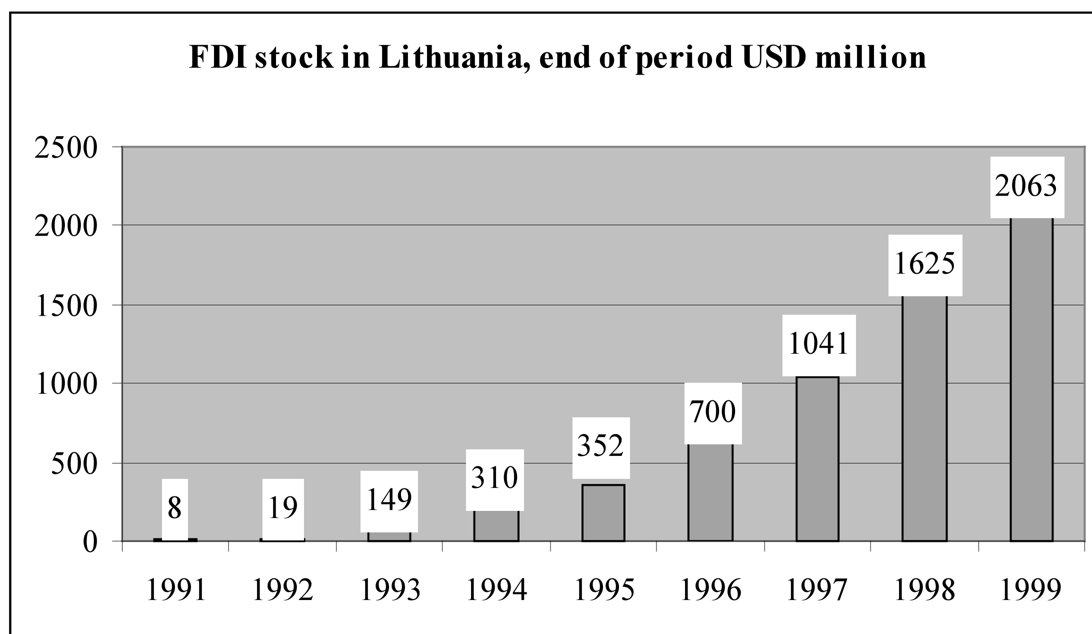
During 1998 FDI in Lithuania experienced an even higher growth, reaching a level of US$1 625 million by the end of the year. The substantial increase in FDI during 1998 was mainly due to the third-quarter figures. During this period, Lietuvos Telekomas was privatised and FDI increased 3.8 times compared to the corresponding period a year earlier. In the fourth quarter, FDI decreased from the third quarter, but was still almost 80 per cent higher than the previous year.

The flow of foreign direct investment into Lithuania reached the level of US$486 million in 1999, which represented a significant decline from 1998. However, excluding the receipts from the privatisation of the telecommunications joint-stock company, *Lietuvos Telekomas,* the FDI flow expanded by 17.1 per cent. This expansion resulted mainly from the privatisation of the major companies *Mazeikiu Nafta* (energy) and *Lietuvos Draudimas* (insurance) and the growth of reinvested earnings. These totalled LTL 589.9 million accounting for 30.1 per cent of the FDI flow. In 1991, the receipts from equity privatisation to non-residents amounted to LTL 127.1 million or 6.5 per cent of the overall FDI flow. The positive growth of FDI (including reinvested earnings) in 1999 shows that, despite the current economic recession, foreign investors' assessment of the long-term prospects for Lithuania's economic development has been favourable. As of 1 January 2000, FDI in Lithuania totalled US$2 063 million. The stock of FDI per capita was US$558 million (see Figure 1.3).[8]

In 1999, major investments (including reinvestments) flowed into the production of refined petroleum products (16 per cent). 14.4 per cent of the FDI was invested in long-distance telecommunications

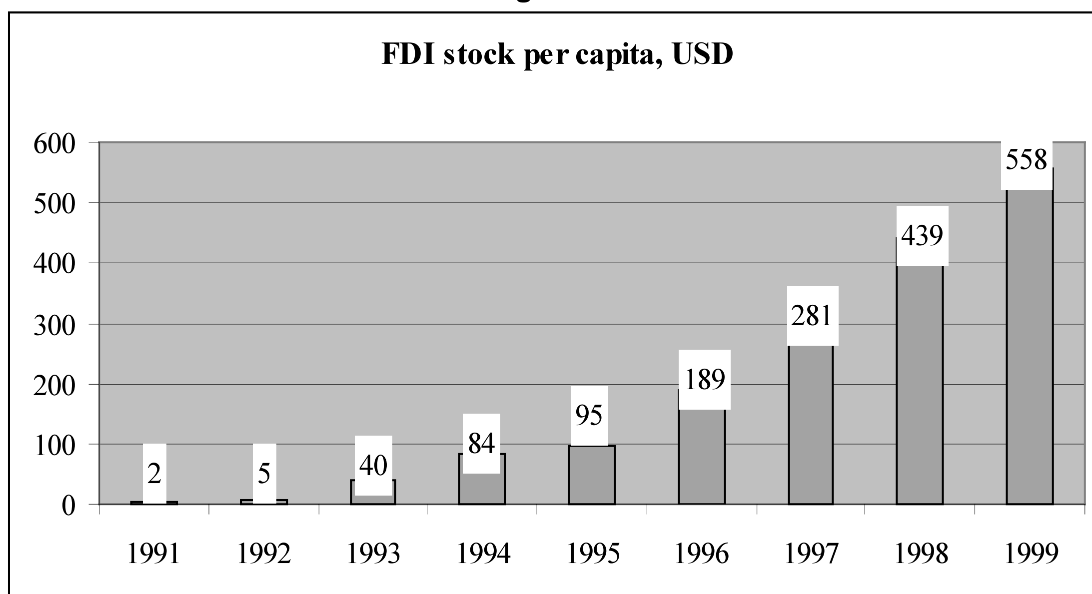
facilities, 14 per cent in the manufacture of food products, beverages and tobacco, 9.3 per cent in the retail and commission trade, 7.7 per cent in financial services and 7.3 per cent in insurance activities. Among the countries to have made the largest investments are Denmark (LTL 372.4 million or 19.1 per cent of the FDI flow), Switzerland (LTL 354.7 or 18.2 per cent), and Sweden (LTL 308.5 or 15.9 per cent).

Figure 1.2[9]



Sources: Survey of Lithuanian Economy, November 1998, Statistics Lithuania;
Foreign Direct Investment in Lithuania 2000 01 01, Statistics Lithuania B413

Figure 1.3



Source: Foreign Direct Investment in Lithuania 2000 01 01, Statistics Lithuania B413

Outflows of direct investment from Lithuania have been negligible compared to inflows, as indicated in Table 1.3 and, in 1997 for instance, were over 13 times lower than inflows.

Table 1.3 Flows of Lithuania's direct investment abroad, US$ million, 1995-1999

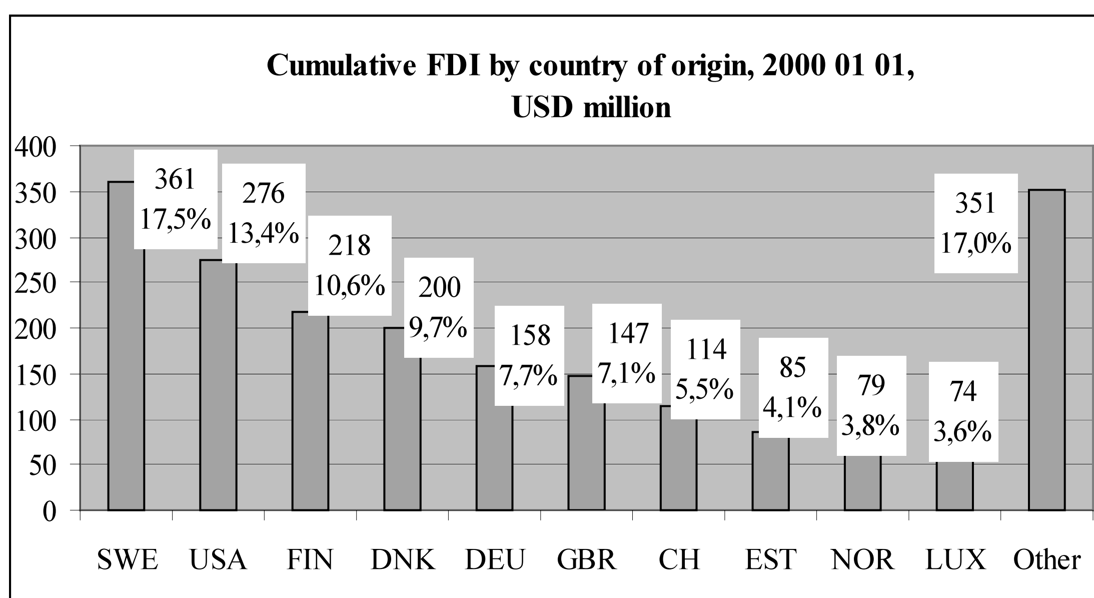
1995	1996	1997	1998	1999
1.00	0.11	26.98	4.17	8.63

Source: Bank of Lithuania balance of payments statistics

Countries of origin

The United States dominated the direct investment inflows to Lithuania, until Sweden became the largest investing country after the first quarter of 1999. At the beginning of 1997, the United States accounted for 28.5 per cent of cumulative FDI in the country, whereas in January 2000, it had a 13.4 per cent share of the total. Details of the major country investors are provided in Figure 1.4 and Table 1.4.

Figure 1.4



Source: Foreign Direct Investment in Lithuania 2000 01 01, Statistics Lithuania B413

Sweden, Finland and Denmark, already the first, third and fourth sources of FDI, and Norway, have recently shown an increased interest in investment opportunities in Lithuania. In general, the importance of EU countries as investors in the country has been growing constantly and they have accounted for 63.1 per cent of the FDI in the country since the first half of 1999.

Among the EU countries, the FDI share in Lithuania of the larger countries, such as Germany and the United Kingdom, has diminished, whereas the role of the smaller and, in particular the neighbouring Scandinavian countries, has been growing during the last few years. At the beginning of 1996, Germany occupied the first position in the cumulative FDI by country of origin with a 19.4 per cent share of the total and the United Kingdom accounted for 11.5 per cent. By the beginning of the year 2000, Germany's share had dropped to 7.7 per cent and that of the United Kingdom to below 7.1 per cent.

Table 1.4 Major investing countries

	FDI, US$ million									
	1996 01 01		1997 01 01		1998 01 01		1999 01 01		2000 01 01	
	Total	%	Total	%	Total	%	Total	%	Total	%
TOTAL	352	100	700	100	1041	100	1625	100	2063	100
Sweden	30	8.5	84	12.0	127	12.2	274	16.9	361	17.5
United States	60	17.2	200	28.5	270	25.9	304	18.7	276	13.4
Finland	14	3.9	33	4.7	45	4.3	173	10.7	218	10.6
Denmark	16	4.5	39	5.6	65	6.2	107	6.6	200	9.7
Germany	68	19.4	91	13.0	117	11.2	133	8.2	158	7.7
United Kingdom	41	11.5	62	8.9	82	7.9	110	6.8	147	7.1
Switzerland	9	2.5	11	1.6	16	1.6	27	1.7	114	5.5
Estonia	3	1.0	6	0.9	44	4.3	70	4.3	85	4.1
Norway	6	1.7	18	2.5	33	3.1	68	4.2	79	3.8
Luxembourg	5	1.3	30	4.3	40	3.9	75	4.6	74	3.6
Other	100	28.5	126	18.0	202	19.4	284	17.3	351	17.0

Source: Foreign Direct Investment in Lithuania 2000 01 01, Statistics Lithuania B413

The importance of the CIS countries as investors is marginal and, as of 1 January 2000, they together had a 1.9 per cent share of the total. At the beginning of 1996, Russia alone accounted for 6.5 per cent of the total FDI in Lithuania and this share had declined to below 1.4 per cent by 1 January 2000.

Estonian investors have shown an increasing interest in Lithuania over the last three years. Currently it is the eighth biggest investor country with a share of approximately 4 per cent. At the start of the year 2000, Latvia was behind Estonia with its 0.9 per cent share in FDI in Lithuania. Among the other neighbouring countries, some investment has come from Poland and this accounted for about 2 per cent of the accumulated FDI inflows in Lithuania at the beginning of 2000.

In terms of the number of enterprises, Germany occupies first place among foreign investors in Lithuania with 371 companies with German capital operating in the country, thus accounting for 19.6 per cent of all 1 893 operating joint ventures and companies with foreign capital. The second place is occupied by the United States with 157 companies, followed by Sweden with 133.

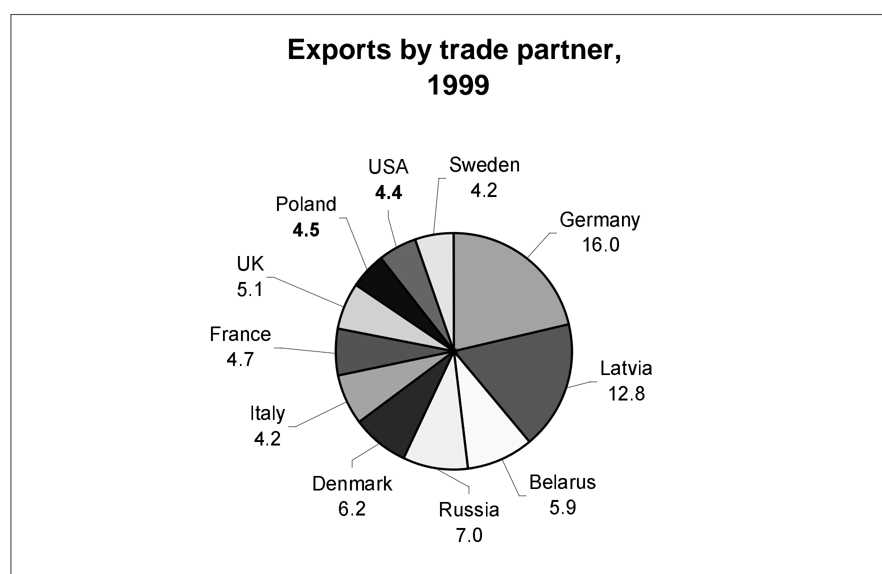
Comparing the FDI by country of origin to trade statistics indicates that, in line with the trends in the FDI flows, the share of trade with EU countries is on the increase. In 1999, Lithuanian foreign trade amounted to US$7 838 million, of which the EU accounted for 47.9 per cent. Lithuania's exports to the EU in 1999 amounted to 50.1 per cent (US$1 505 million) of the country's total exports of US$3 004 million. Compared to 1998, exports to the EU increased by 6.8 per cent. In 1999, imports from the EU were US$2 248 million or equivalent to 46.5 per cent of the total imports (US$4 834 million).[10]

Despite their modest share in FDI in the country, the CIS countries still remain important trading partners for Lithuania. The export volume to CIS countries in 1999 amounted to 18.2 per cent (US$547 million) of the total exports. Due to the economic crisis in Russia, Lithuania's exports to Russia decreased, however, by 58.7 per cent in 1999 compared to 1998, and amounted to US$778 million. Although imports from the CIS countries are dropping, they are still the most important suppliers of raw materials to Lithuania, with a share of 24.4 per cent (US$1 182 million) of total imports by the country. Altogether, CIS countries accounted for approximately 22 per cent of Lithuania's total foreign trade in 1999, Germany has become Lithuania's main trading partner, followed by Russia and Latvia. The major investor countries for Lithuania, namely Sweden, the

United States and Finland in that order, are not among the seven most important trading partners, whereas countries such as Italy, France, United Kingdom and the neighbouring countries to Lithuania were at the top of the list of trading partners, but not among the top ten investors.

Figure 1.5 shows Lithuanian exports by trading partner in 1999. Germany accounted for 16 per cent of the exports, compared to the 8.6 per cent of both Sweden and the United States. Of the Nordic countries, only Denmark occupied a somewhat similar place both among investing countries and export destinations.

Figure 1.5



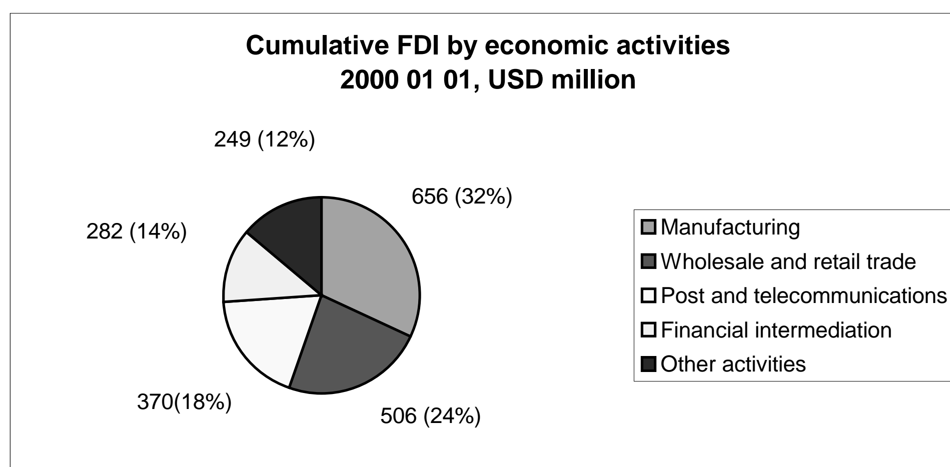
Other countries – 25 per cent
Source: Statistics Department of Lithuania.

Before turning to the sectoral distribution of FDI, it should be noted that the statistics reflecting the origin of FDI can be misleading, as the source of investment capital and project control may be different from that of the country of origin of the investor. For example, Statoil of Norway invested in Lithuania through its Swedish subsidiary.[11]

Distribution by economic activity[12]

The manufacturing sector attracted the most FDI in Lithuania throughout the 1990s, followed by the wholesale and retail sectors. There was a surge of foreign investment in the post and telecommunications sector in 1998, mostly as a result of the Telekomas privatisation deal. Figure 1.6 shows the distribution of the cumulative FDI by economic activities as of 1 January 1999. Table 1.5 shows the percentage FDI shares of all sectors of the economy between the end of 1995 and beginning of 2000.

Figure 1.6



Source: Foreign Direct Investment in Lithuania 2000 01 01, Statistics Lithuania B413

At the beginning of 2000, foreign capital totalling US$656 million or 31.8 per cent of total FDI was invested in 358 manufacturing enterprises.[13] The major manufacturing sector or approx. US$244 million in value of all manufacturing investment. This was followed by the textiles and leather industry and the refined petroleum and chemical industries, with FDI levels of US$89 million and US$76 million, respectively. Fourth and fifth in order of importance as recipients of FDI were the transport equipment and electrical and optical instruments industries.

After manufacturing, the second major target for investors is the wholesale and retail trade, including repair services for vehicles, motorcycles and household appliances. At the beginning of 2000, almost 50 per cent of all 1 718 operational joint ventures and foreign capital companies were engaged in these activities. As of 1 January 2000, the wholesale and retail sector accounted for US$506 million or 24.5 per cent of all investment and a total of 834 enterprises.

The field of postal and telecommunications technologies has also attracted considerable foreign investment. From the beginning of 1997 to January 2000, FDI into postal and telecommunications services increased from US$72 million to US$370 million. As of 1 January 2000, investment in this sector accounted for 17.9 per cent of all FDI.

Although the percentage share of FDI in financial services has remained under 15 per cent, the sector has experienced fast growth in absolute terms. At the beginning of 1998, this sector had an accumulated FDI of US$67 million, which rose to US$282 million by January 2000. The impact of FDI on the development of the financial sector will be discussed in more detail in Chapter 2.

Table 1.5 Trends of FDI by economic activity, 1995-1999

Foreign Direct Investment by economic activity, per cent, end of period					
	1995	1996	1997	1998	1999
Total	100	100	100	100	100
Agriculture, fisheries, forestry	2.06	0.66	1.18	0.86	0.51
Mining	1.94	2.50	2.02	1.04	0.96
Manufacturing	44.13	41.17	36.64	32.39	31.81
Construction	1.18	0.36	0.35	0.50	0.70
Wholesale and retail trade, repair services for personal and household goods	29.35	32.50	29.91	25.10	24.53
Hotels and restaurants	1.85	2.38	3.93	3.27	2.53
Transportation and warehousing	1.30	0.89	3.34	3.43	2.42
Post and telecommunications	4.14	10.29	8.45	17.43	17.94
Financial services	6.74	5.45	6.42	9.84	13.65
Real estate, rent and lease of property and commercial activity	1.77	1.73	4.41	3.82	2.58
Education, health, recreation and culture	1.80	0.96	2.26	0.82	0.87
Other activities	3.74	1.11	1.09	1.50	1.50

Source: Foreign Direct Investment in Lithuania 2000 01 01, Statistics Lithuania B413

In 1998, investment flows were dominated by the largest single privatisation deal in Lithuania to date, the sale of Lietuvos Telekomas. The trade and repair services sector attracted the second largest inflow of foreign capital after telecommunications, financial services the third and food production the fourth. As the amount of FDI into Lithuania has been comparatively low to date in international terms, the figures for an individual year, and even the figures for the accumulated stock of FDI, may be easily dominated by a few large, usually privatisation-related investments.

Of the five major investing countries, Sweden, the United States, Finland, Denmark and Germany, Sweden and Finland have invested the most in the post and, more particularly the telecommunications sector as well as considerable amounts in trading activities and food production. Sweden has also specialised in financial services (see Table 1.6). In January 2000, Denmark was the leading source of investment in the post and telecommunications sectors and in production of transport equipment in particular. Germany was the most active of the main investor countries in the textiles and leather sector, as was the United States regarding investment in food, beverages and tobacco production. The overall level investment in the manufacture of wood and paper products is low.

Table 1.6 Major investing countries by economic activity as of 1 January 2000, US$ thousand

	Sweden	United States	Finland	Denmark	Germany
Total	360 973	275 807	218 034	200 250	158 012
Manufacturing	60 859	85 741	35 447	93 982	67 853
Food, beverages and tobacco	39 239	53 574	12 644	31 942	5 494
Textiles and leather products	659	11 570	44	5 958	23 391
Wood and paper products	3 985	6 400	12 383	5 436	1 534
Refined petroleum and chemical products	9 072	10 356	6 438	9 009	
Transport equipment	=	=	=	33 550	10 313
Other manufactured goods	7 904	3 841	3 938	8 087	27 121
Wholesale and retail trade, repair services for personal and household goods	43 950	64 717	72 586	14 878	57 703
Hotels and restaurants	8 487	16 440	=	630	1 909
Transport and warehousing	10 885	7 455	405	1 275	7 395
Post and telecommunications	146 227	45 295	101 237	54 352	40
Financial services	78 713	33 682	4 918	21 518	13 515
Other activities	11 852	22 477	3 441	13 615	9 597

4 LTL = 1 US$
Source: Foreign Direct Investment in Lithuania 2000 01 01, Statistics Lithuania B413

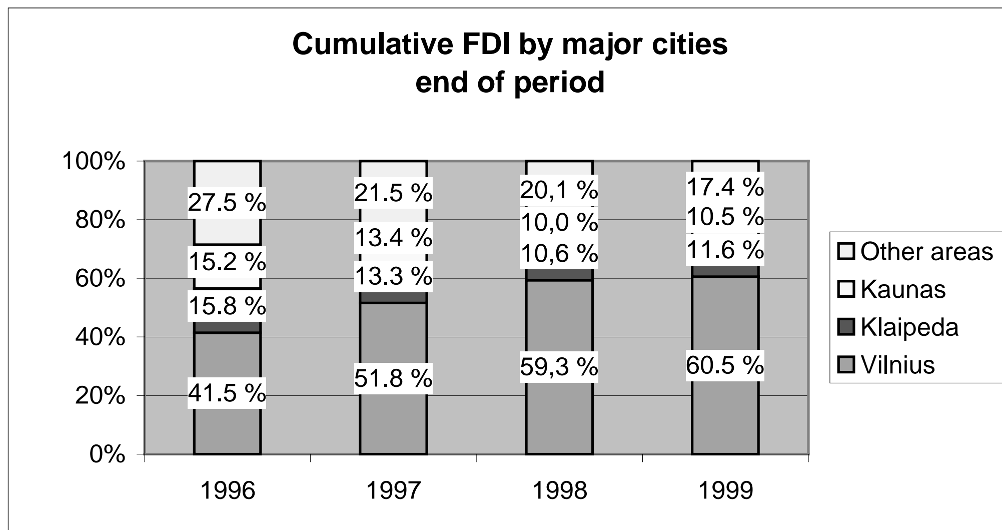
Geographic distribution

In Lithuania, the population, production activities and GDP are concentrated in three cities: Vilnius, Kaunas and Klaipeda, which have also benefited from the highest levels of FDI. During the last few years, Vilnius has gradually increased its share of the total FDI in Lithuania to reach 60.5 per cent at the beginning of 2000. At the same time, the shares of both Kaunas and Klaipeda have declined from approximately 15 per cent at the end of 1996 to 10.5 per cent in Kaunas and 11.6 per cent in Klaipeda in 2000 (see Figure 1.7).

The largest Western enterprises have typically set up trading subsidiaries in Vilnius. At the beginning of 2000, 28 per cent or US$350 million of the total FDI of US$1 248 million in Vilnius was in the wholesale and retail trade. Another 30 per cent, US$370 million, was invested in the post and telecommunications sector. Manufacturing accounted for only 10 per cent or US$126 million of the FDI in Vilnius.

In contrast with Vilnius, the foreign investment in Kaunas (US$216 million in total) and Klaipeda (US$240 million in total) had gone mostly into the manufacturing industry, with shares of 51 and 71 per cent, respectively at the beginning of 2000. In Kaunas, the production of food, beverages and tobacco attracted most FDI within manufacturing, accounting for almost 41 per cent of the total within the sector. In Klaipeda, over 50 per cent of foreign capital in manufacturing was invested in the production of food, beverages and tobacco, whilst the second most favoured sector in the city, production of transport equipment, attracted 25 per cent of the FDI inflows.

Figure 1.7



Source: Foreign Direct Investment in Lithuania 2000 01 01, Statistics Lithuania B413

Enterprise structures

In Lithuania, most companies with foreign capital are either totally or majority foreign-owned. At the beginning of 2000, just over 35 per cent of enterprises were wholly foreign-owned and, in the case of an additional 32.8 per cent of the companies, over 50 per cent of the capital was foreign-owned. Only 31.5 per cent were joint ventures with foreign capital shares of 10–50 per cent.

Table 1.7 presents the number of companies by capital ownership structure and the relative importance of these categories in terms of the amount of capital invested. Not surprisingly, the companies with less than 50 per cent of foreign capital account for just over one-fifth of the FDI, even though they represent almost one-third of the number of companies with foreign participation.

Table 1.7 Foreign direct investment by foreign capital share, as of 1 January 2000

	Foreign capital share			
	10%-50%	Over 50%	100%	Total
Number of enterprises	541	563	614	1 718
Per cent	31.5%	32.8%	35.7%	100%
Amount of FDI, US$ million	475	947	641	2 063
Per cent	23.0%	45.9%	31.1%	100%

Source: Foreign Direct Investment in Lithuania, Statistics Lithuania B413

When analysing the breakdown of enterprises by the number of employees, it was found that, at the beginning of 2000, almost 76.1 per cent of enterprises with foreign participation had under 50 employees. This vast majority of companies accounted for only 23.9 per cent of the total foreign capital invested. Table 1.8 provides more details on the employee structure of companies.

Table 1.8 Foreign direct investment by number of employees, as of 1 January 2000

	Enterprises by number of employees						
	0-9	10-19	20-49	50-99	100-499	Over 500	Total
Number of enterprises	820	318	295	125	132	28	1 718
Per cent	47.7	18.5	17.2	7.3	7.7	1.6	100.0
Amount of FDI, LTL million	125	155	213	159	736	675	8 252
Per cent	6.1	7.5	10.3	7.7	35.7	32.7	100.0

Source: Foreign Direct Investment in Lithuania 2000 01 01, Statistics Lithuania B413.

As indicated in the previous table, small companies account for a relatively low share of FDI. Some small and medium-sized enterprises (SMEs) have invested in the processes of their Lithuanian suppliers, providing equipment and other supplies, although the amount of equity investments by SMEs in Lithuanian companies is not fully known.

FDI has been dominated by the privatisation of large companies. At the end of 1998, US$582 million or 34 per cent of the total FDI stock of US$1 625 million in Lithuania originated from the sale of

privatised firms. An additional US$300 million, or 18 per cent of total FDI, was granted as investment guarantees.[14]

Major investors

In the early 1990s, many of the first investors who came to Lithuania were large multinational corporations, such as McDonalds, Philip Morris and Coca Cola.

The United States industrial giants were undoubtedly among the first investors to enter Lithuania when it regained its independence in the early 1990s. These were followed by major European companies such as the Swedish-Finnish concern Amber Teleholdings Consortium, the Danish brewery Carlsberg, Norwegian Statoil and the United Kingdom and Dutch corporation Shell.

Table 1.9 lists the largest investments in Lithuania according to a survey carried out by the Lithuanian Development Agency in January 2000. American and Nordic companies are well represented. Other interesting groups are large international oil-related businesses from various countries of origin, as well as producers of food, beverages and tobacco. The average volume of all foreign direct investments made in Lithuania up to 1 January 2000 was US$1.1 million. The corresponding figure was US$2.7 and 2.5 million for Sweden and Finland, respectively, US$1.8 million for the United States and 1.7 million for Denmark, compared to, for example, the average German investment of US$0.4 million.

Table 1.9 The largest foreign investors in Lithuania as at January 2000

	Investor	**Origin**	**Joint Venture/ Investment**	**Activities**	**US$ mil lion**
1.	Amber Teleholdings Consortium (Telia/Sonera)	Sweden/Finland	Lietuvos Telekomas	Tele-communications	510 comm. 210
2.	Williams International	United States	Mazeikiu Nafta	Oil Refinery, Pipelines, Sea Terminal	150 comm. 75
3.	Telia/Sonera	Sweden/Finland	Omnitel	Tele-communications	66
4.	Philips Morris International Finance Corporation	United States	Philips Morris Lietuva	Tobacco products	62
5.	SEB-Skandinaviska Enskilda Banken AB	Sweden	Vilniaus Bankas	Banking	57
6.	Tele Denmark A/S Millicom East Holding B.V.	Denmark/ Luxembourg	Bite GSM	Tele-communications	49
7.	Carlsberg	Denmark	Svyturys	Brewery	45
8.	Den Norske Stats Oljeselskap	Norway	Lietuva Statoil	Petroleum products	38
9.	Danisco Sugar A/S	Denmark	Sugar Factories	Sugar production	34
10.	The Coca-Cola Corporation	United States	Coca-Cola Bottlers Lietuva	Soft drinks	32
11.	Shell Overseas Holdings Ltd	Great Britain /The Netherlands	Shell Lietuva	Petroleum products	29
12.	Codan Insurance Ltd., A/S	Denmark	Lietuvos Draudimas	Insurance	27
13.	AS Hansa Liising	Estonia	Hanza Lizingas	Financial services	26
14.	Euro Oil Invest S.A.	Luxembourg	Lukoil Baltija	Petroleum products	25
15.	Henley Trading Ltd. Private person	Ireland/Switzerland	Ekranas	Electronics	25
16.	Neste OY	Finland	Neste Lietuva	Petroleum products	25
17.	Baltic Beverages Holding (Pripps-Hartwall company)	Sweden/Finland	Kalnapilis and Utena	Brewery	24
18.	Kraft Food International	United States	Kraft Foods Lietuva	Confectionery	24

Table 1.9 The largest foreign investors in Lithuania as at January 2000 *(cont.)*

	Investor	Origin	Joint Venture/ Investment	Activities	US$ mil lion
19.	Partec Insulation; Finnfund; NEFCO	Sweden/Finland	Partek Paroc	Construction materials	20
20.	Odense Steel Shipyard Ltd.	Denmark	Baltijos Laivu Statykla	Ship building	18
21.	Osman Trading AB; Woodison Trading AB; Ferrous Investment Ltd; Duboil Ltd.	Sweden / Ireland / Great Britain	Klaipedos Nafta	Oil terminal	17
22.	EFFEM, Inc.	United States	Masterfoods Lietuva	Pet food	15
23.	Tuch Fabrik Wilhelm Becker	Germany	Eurotextil	Textiles	15
24.	Svenska Petroleum Exploration AB	Sweden	Genciu Nafta	Oil extraction	14
25.	Cargill, Inc.	United States	Lifosa	Fertilisers	14
26.	Siemens AG	Germany	Baltijos Automobiliu Technika	Electronics	14
27.	AGA AB	Sweden	AGA	Trade in gas for technical and medical purposes	13
28.	Huta Szakla Warta P.S.	Poland	Panevezio stiklas	Glassware	13
29.	Icelandic Health Company Limited; Swedfund International AB	Iceland/Sweden	Ilsanta	Pharmaceuticals	12
30.	Indutech s.p.a.	Italy	Lifosa	Chemical products	10

Source: Informal survey by the Lithuanian Development Agency;

1.2 Main explanatory factors behind FDI

Typically, the main factors encouraging FDI are linked to the specific characteristics of the target country, such as natural resources endowment, infrastructure and human competitive advantages, geographic location, soundness and quality of economic policies and performance, level of sophistication of the institutional framework and future growth prospects. This section discusses the relevance of these issues for investments in Lithuania.

As previously discussed, the main factor behind the FDI inflows into Lithuania has been the successive privatisation of former state-owned companies. One of the main reasons for the FDI figures to lag somewhat behind those of other Baltic states has simply been the slower pace of privatisation, particularly in the case of large infrastructure projects (see Chapter 4).

The Lithuanian Development Agency lists the general factors presented below as the "10 reasons to invest in Lithuania". The following sections comment briefly on these arguments.

1) Excellent infrastructure

"A network of European-standard 4-lane highways links all major industrial centres. Klaipeda port is the major ice-free port on the Eastern Baltic. It is also the only one in the region to receive EBRD and European Investment Bank funding for a $200 million expansion. Zokniai airport in the Siauliai Free Economic Zone is a CAT 1[15] cargo airport with one of the longest runways in Europe."

This point refers mainly to the transportation infrastructure in Lithuania which is discussed briefly below. The 1999 EBRD transition report, "Ten years of transition", states that, within the context of infrastructural development, private sector participation in district heating has begun but little progress has been made in unbundling the electricity sector. Government plans to split up and privatise Lithuanian Energy's electric power generation and transmission facilities remain to be implemented. According to the EBRD report, increasing the operational efficiencies in this area would significantly enhance the potential for trade in electricity within the entire Baltic region and thus the interest of potential foreign investors in the area.

2) Low operating costs

"Utilities, rent, building, overhead and service costs are among the lowest in Central and Eastern Europe."

Despite this advantage, the fact remains that transactions in real estate are perceived to be very difficult by international investors. Procedures for obtaining the necessary land and/or buildings lack clarity and are time-consuming. This has been one of the most important *de facto* barriers to entry to Lithuania in the past.

3) Highly-educated, cost-effective workforce

"The yearly number of university graduates per 1000 inhabitants is the highest in the region, while the cost of labour (with an average salary of $253 per month in 1999) is among the lowest. All five major cities have their own universities."

Lithuania has traditionally had high standards in the field of mathematics and applied sciences. It was a centre for high technology during Soviet times. The production of certain high-tech niche products is still thriving in the country. Engineering-related fields may be among the sectors offering a competitive advantage for Lithuania in the future.

Lithuanian wages have grown at a fairly rapid pace for some years. In 1998, this growth rate was 19.5 per cent. In 1999 the wage growth dropped by half the level to 8.9 per cent. In the medium- or long-term the advantage of competitive wage costs may be lost, especially after Lithuania joins the EU.

4) Unmatched opportunities in free economic zones and Industrial Parks

"Lithuania's three free economic zones and industrial parks boast unparalleled infrastructure and transhipment facilities, highly qualified workforces and offer investors extremely attractive incentives. There is also plenty of industrial land available with direct access to ports, railways and highways. In the case of investments exceeding US$1 million, a corporation tax holiday is granted for the first 5 years and 50 per cent tax reduction for the following 10 years (effective rate 14.5 per cent). If the investment is under US$1 million – there is a corporation tax reduction of 80 per cent for the first 5 years (effective rate 5.8 per cent) and 50 per cent tax reduction for the following 5 years (effective rate 14.5 per cent). There is exemption from VAT and customs duties; free repatriation of profits and a 50 per cent reduction on land lease."

In practice, the free economic zones are not yet fully operational and it is uncertain how long they will be able to maintain their status, given the international trend away from special treatment of foreign investment in Europe. With Lithuania's accession to the EU, this question is most likely to be raised.

5) Lithuania: a new leader in economic growth

"Foreign investment in Lithuania has been increasing fastest in Central and Eastern Europe for two consecutive years with its cumulative total doubling in 1997 and reaching US$2.4 billion in 1999. In 1999, inflation was 0.3 per cent. In the first 9 months of 1998, GDP grew by 5.7 per cent, but slowed down and reached 5.1 per cent at the end of the year as a result of the economic crisis in Russia."

In reality, FDI grew at a record high pace. The officially recorded stock of FDI reached US$2 063 million in 1999 (see section 1.4 on assessment of statistical sources).

The year 1999 saw a 4.1 per cent drop in GDP due largely to the Russian crisis. Of all the Baltic states, Lithuania has the most extensive trade ties with the CIS countries. As in the other Baltic countries, industrial production slumped after the Russian crisis and in 1999, was down 9.9 per cent compared with 1998. In mid-November, the Ministry of Economy revised its forecast of GDP decline from 1 to approximately 2 per cent for 1999.[16]

The events after the Russian crisis in 1998 could not have been foreseen. It is only natural that growth aspirations have had to be downscaled somewhat, at least for 1999, and thus economic growth cannot act as a major driving force for FDI in the near future, at least not to an extent that it would be a differentiating factor for Lithuania in competing for investors with some other countries in the region or further afield.

6) Multinational investor satisfaction

"Siemens, Telia, Philips, Motorola, Masterfoods/Mars, Sonera, Kraft Food International, Festo, Lancaster Steel, Partec, Kemira, Philip Morris, Danisco, SEB, Carlsberg, Cargill, Codan and Tolaram are among the multinationals that have chosen to locate production facilities and/or invest in Lithuania."

Multinationals have undoubtedly established a presence as investors in Lithuania, and the trend is expected to continue with major infrastructure privatisations still ahead. The situation is, however, more complex for smaller companies, as will be discussed in Chapter 3. Recently, efforts have been made by the government to create level playing field for all investors, regardless of their country of origin or the size of the company. Thus, investor satisfaction may improve further in the future. In a 2000 survey on the investment climate by the Lithuanian Development Agency, respondents evaluated it as satisfactory and it was expected to remain that way in the near future.

7) World-standard export production

"Most foreign businesses invest in Lithuania for export production purposes. Many local producers have already achieved ISO 9000 status."

The reasons for investing in production in Lithuania and the resulting experience of a number of companies are illustrated in a section on spillover effects in Chapter 2. According to the EBRD Transition Report for 1998, enterprise restructuring has varied across sectors. Investment levels and profit margins also differ across sectors, with food processing, apparel and chemicals recording the best performance up to the publication of the report in late 1998. The superior performance of labour-intensive sectors reflects the reorientation of exports in line with the country's comparative advantage. From Section 1.1 we recall that, apart from infrastructure projects, food processing has been one of the sectors of the economy that has attracted the most FDI.

8) Lithuania: the regional transport hub

"The EU's Transport Commission designated Lithuania as the region's transport hub, with 2 out of the 10 priority corridors in Europe intersecting in Lithuania. The country offers 4 international airports and an ice-free port on the Eastern Baltic."

According to the OECD Investment Guide of 1998, Lithuania is taking an active part in the implementation of the balanced trans-European network development plan, with a view to gradually adapting the rest of its own transport infrastructure to western standards.

Transit freight levels are already high in Lithuania due to the flows between east-west trading partners through the seaports of Klaipeda and Kaliningrad. Hence, one of the most important priorities is to improve the infrastructural and operating conditions within these international corridors. The EBRD Transition Report for 1999 states that limited progress has been made in the reorganisation of railways. The transport ministry is currently working on a draft of a new railway law that would initiate the restructuring of the sector.

9) Excellent Location

Lithuania is a candidate for membership of the EU and is centrally located among other future members. Its strong trade relations with Russia and the CIS make it a logical location for accessing this huge potential market. Companies based in Lithuania are also well positioned to service the "just in time" needs of customers from Sweden to Spain.

10) Political and ethnic stability

"With a strong, pro-business government, excellent external relations and harmonious minority relations internally, Lithuania is an oasis of political and ethnic stability in the region. It has a stable currency, strong banking sector, and offers unrestricted movement of capital and dividends."

As to the political stability, there are indications of increased coherence in the country's economic policies despite the two government changes in 1999. A clear manifestation of this is the Medium Term Economic Strategy by the Ministry of Economy, which is discussed below and focuses on developing and sustaining co-ordinated policies during the pre-accession period to the EU.[17] With regard to openness of the economy in general, there are various areas for improvement.

In sum, Lithuania has many sustainable advantages in attracting FDI, just as there are also areas to be improved. The 10 reasons to invest in Lithuania above did not cover certain country-specific aspects that are usually perceived as important for the development of FDI in a certain country. These include natural resources endowment and the level of sophistication of the institutional framework.

The main natural resource in Lithuania is timber, since forests cover about 40 per cent of the country. Other resources include gypsum, quartz sand, dolomite, clay, limestone, brick clay, gravel, construction grade sand, peat and mineral water. Amber is found along the Baltic coast.

To date, these natural resources have not been a major factor influencing the sectors receiving the most FDI in Lithuania. In practice, oil-related fields of economy have received considerably more attention, as major oil deposits are known to lie just off the Lithuanian and Latvian Baltic coast. Lithuania does not have major fossil fuel reserves of its own but, despite this, there is a large petrochemical refinery, Mazeikiu Nafta in the country. So far the production at the refinery has been mostly dependent on Russian crude oil. A major oil terminal has been built at Butinge near the Baltic Sea, with the aim of having alternative oil supplies from sources other than Russia.

In conclusion, FDI related to natural resources is expected to flow mostly to the oil and energy sectors, in line with the pace of future privatisation projects.

The level of sophistication of the institutional framework has been a major obstacle to FDI expansion in Lithuania. Surveys among investors reveal consistent complaints of rapid changes in laws and regulations, their implementation falling short of western standards and slow, burdensome bureaucracy.

One reason for the initially slow development of FDI in Lithuania was the generally low profile of the country internationally. The association with the former USSR has been considered a particular obstacle to investment, despite the fact that administrative and other barriers are not as problematic in Lithuania as in the CIS. However, the association with the other former USSR states has not deterred investors from the Nordic countries for whom proximity to home markets is a major factor behind

their investment flows into Lithuania. In addition, many large companies in the region have developed strategic Baltic Rim plans. Breweries are an excellent example of this trend.

Although there is some potential for more FDI in Lithuania, the level of inflows will be influenced by the small size of the market in general.

1.3 How does the international business community view the investment climate in the Baltic countries?

The Lithuanian Development Agency has conducted surveys of how the investment climate is regarded among the largest investors in the country.[18] Of the companies – respondents to the spring 2000 investment survey, 94 per cent were prepared to invest in Lithuania again, a 4 percentage point rise from the 90 per cent in the survey a year earlier. The investors were generally satisfied with the business environment in Lithuania. Estonia was perceived to have a more favourable investment climate than Lithuania, which was considered to have similar conditions to those prevailing in Latvia.

The government's efforts in 1999 to manage Lithuania's economy were rated neutrally. Foreign investors hoped for an improvement of the general situation in their sectors in the course of the year 2000.

The four main reasons why companies decided to invest in Lithuania were:

- geographic location with a well-developed transport and telecommunications infrastructure;
- highly educated, low-cost workforce;
- historical connections with Eastern markets (*i.e.* post communist countries);
- potential market access.

Among the barriers to investment, the following were found to be of an above-average significance:

- bureaucratic difficulties;
- unstable and fast changing legislation;
- complex tax and duty structure.

Foreign investors express the hope that Lithuania is aligning its policies to those of other European countries as a result of the new government policies in place since the summer of 1999.

In the prevailing economic situation, foreign investors were a rather small group among the clients of an international professional services company interviewed in July 1999. The quiet business situation might have indicated that there were little or no new foreign investment activities taking place in the market. This may in turn support the view that the main factor promoting the FDI inflow has been the general economic development. Lithuania's problems could be considered as typical of a "normally working economy" and therefore less a cause for concern than those prevalent in some of the other parts of the former Soviet Union.

1.4 Assessment of statistical sources[19]

During the period 1991-1994, FDI statistics were collected and published by the Ministry of Economy. In 1995, the responsibility for the FDI statistics was transferred to the Statistics Department. In 1996, Lithuania designed a new questionnaire, which was tested during that year. Since 1997, the present more comprehensive survey method has been used and FDI data are compiled in compliance with the OECD, IMF and World Bank requirements.

A commercial register was established by the Law on the Register of Enterprises in 1990. The Ministry of Economy was responsible for the register until February 1995, when its management the was transferred to the Statistics Department of Lithuania. The list of enterprises used in FDI data compilation is based on the commercial register and includes wholly and partly foreign-owned enterprises. Information on newly-created units or new acquisitions is updated constantly as fully as possible. For this purpose, a variety of sources are used, including:

- administrative registers;
- various questionnaires by sections and divisions of the Statistics Department of Lithuania, which are not directly involved in FDI data compilation;
- data from external registers, such as one maintained by the Ministry of Economy, in which foreign capital is registered;
- press sources.

The compilation of official FDI is the joint responsibility of the Statistics Department of Lithuania and the Bank of Lithuania. Firstly, a list of companies, which have reported having foreign capital, is compiled on the basis of the commercial register. Secondly, a questionnaire is sent to all relevant companies. The department responsible for collecting the information on FDI sends out a questionnaire to all those companies, in which foreign investment exceeds the level of 10 per cent. Other companies provide information for the unit, which collects data on portfolio investment. Thirdly, the Statistics Department analyses the information provided by the companies and sends the results to the Central Bank. Fourthly, the Central Bank adds information concerning the banking sector, this being mainly data on commercial banks produced by the banking supervisory authority, and checks against other balance of payments items. It also receives some information on privatised companies from the Privatisation Fund. The Bank checks certain information with the Ministry of Economy (joint ventures and wholly foreign-owned companies) and, finally, sends its complete set of the FDI statistics to the Statistics Department of Lithuania to be published as part of the balance of payments information.[20]

Most of the balance of payments information is collected quarterly, including the FDI data. About 2000 questionnaires are sent out four times a year and the number of respondent companies is about 1600. The difference is explained by companies where the foreign shares have been bought by domestic owners or which have ceased operations.

Before 1997 the major differences in the data collected by the Statistics Department and the Central Bank were due to the modifications in the shareholdings that had changed hands on the Lithuanian Stock Exchange. Since 1997 the Statistics Department and the Central Bank publish the same figures.

During the period 1995-1996, there were major discrepancies between the various information sources due in part to treating registered investment commitments as actual FDI for statistical purposes. In

reality, some of these registered investment commitments are never realised in the country. The actual status has to be checked on the basis of the balance of payments statistics.

It is not easy to get all the necessary information from companies, in particular from those that are 100 per cent foreign-owned. Companies with some Lithuanian ownership comply more easily with the information requirements. Companies are believed to be rather honest in their answers in general, partly due to the fact that the Central Bank has a possibility to verify the information.

EU membership should not make any significant difference to the collection of FDI statistics in Lithuania, since it already complies with the EU directives. To reach this level of quality, Statistics Lithuania has co-operated to some extent with foreign specialists, especially Swedish and Danish officials.

In sum, the FDI statistics generated in Lithuania can be considered as reliable from 1997 onwards. With older data it should be remembered that the current process was not in place at that time and thus figures from different sources vary.[21]

CHAPTER 2

ECONOMIC IMPACT OF FEDERAL DIRECT INVESTMENT

The economic impact of FDI can be assessed, among others, by the share of FDI in domestic fixed capital formation, impact on the capital account, the development of the financial sector, contribution to privatisation or by the spillover effects of the investments. The role of FDI in the Lithuanian privatisation process is discussed in more detail in Chapters 1, 3 and 4. This chapter assesses the other four areas of interest, as well as the financial structure of FDI in Lithuania.

2.1 FDI and fixed capital formation

The recorded gross fixed capital formation has grown at approximately the same rate as gross domestic product since the middle of the 1990s in Lithuania. The share of gross fixed capital formation fluctuated between 23 and 25 per cent of the gross domestic product between 1995 and 1999. The development of foreign direct investment has, however, been much more rapid and, as a result, its share in the gross fixed capital formation increased considerably from five per cent in 1995 to about one-third in 1998 (see Table 2.1). In 1999, as a result of the Russian crisis, gross fixed capital formation decreased at a higher rate than GDP and the FDI inflow was lower. Even though the share fell to twenty per cent in 1999, this indicates that the significance of FDI in the economic development of the country has also increased considerably since the middle of 1990s.

Table 2.1 Foreign direct investment and gross fixed capital formation in Lithuania during the period 1995-1999.

	Gross fixed capital formation (GFCF), US$ million	Foreign direct investment (FDI), US$ million	FDI as per cent of GFCF
1995	1 388.5	72.6	5.2
1996	1 817.3	152.4	8.4
1997	2 334.2	354.5	15.2
1998	2 615.8	925.5	35.4
1999/ I-VI	2 395.2	486.5	20.3

Source: Economic and Social Development in Lithuania, Statistics Lithuania 3/00, B 111

2.2 FDI and the balance of payments

The foreign direct investment in Lithuania has also grown in significance when compared to the current account development. Between 1993 and 1997 foreign direct investments provided finance for an average of 27 per cent of the current account deficit. In 1998, as a result of the large privatisation deal of Lietuvos Telekomas, this share was as high as 71 per cent (see Table 2.2) and remained at

41 per cent in 1999 indicating that it has proved a significant source of financing for the widening current account deficit particularly since 1997.

Table 2.2 FDI and current account development during the period 1993-1999, in US$ million

	1993	1994	1995	1996	1997	1998	1999
Current account credit	2 351.92	2 534.22	3 354.54	4 411.97	5 541.37	5 435.70	4 520.58
Current account debit	-2 437.63	-2 628.21	-3 968.97	-5 134.58	-6 522.77	-6 733.84	-5 714.68
Current account balance	-85.71	-93.99	-614.43	-722.61	-981.40	-1 298.14	-1 194.10
FDI	30.18	31.30	72.56	152.43	354.51	925.52	486.47
FDI in comparison with the current account balance	35.2%	33.3%	11.8%	21.1%	36.1%	71.3%	40.7%

Source: Lithuanian balance of payments, Bank of Lithuania 1999

2.3 Sources of financing of FDI

Foreign direct investors have financed the bulk of their investments in Lithuania through equity capital (see Table 2.3). Financing through reinvested earnings was first recorded in 1995. Thereafter, it only increased moderately until the end of 1998, when it accounted for slightly over 10 per cent of the total FDI. In 1999, however, the share of reinvested earnings as a source of FDI financing increased to about 30 per cent. Financing through other forms of capital, such as short-term and long-term loans, was first recorded in 1997 and accounted then for one-quarter of the total FDI. The large equity investment in Lietuvos Telekomas in 1998, however, is behind the dominant position of equity capital in that year.

Table 2.3 Sources of financing of FDI flows to Lithuania during the period 1993-1999, US$ million

	1993	1994	1995	1996	1997	1998	1999
Foreign direct investment	30.18	31.30	72.56	152.43	354.51	925.52	486.47
Equity capital	30.18	31.30	65.37	127.79	217.63	772.12	371.66
Re-invested earnings			7.19	24.64	43.35	99.76	146.47
Other capital					93.53	53.64	-31.66

Source: Lithuanian balance of payments, Bank of Lithuania 1999

Table 2.4 illustrates the sources of financing of FDI on the basis of the international investment position or stock of FDI. During the three years covered by the statistics, the share of other capital,

which includes short and long-term loans decreased by 20 percentage points while the share of equity capital and reinvested earnings increased correspondingly. The information in Table 2.4 is not fully comparable to that in Table 2.3 even though both are based on balance of payments statistics, due to a different breakdown of the items. However, they both testify to an increased significance of equity capital as a source of financing for FDI for the last few years, partly explained by the large share of privatisation deals involved.

Table 2.4 Sources of financing of FDI position in Lithuania during the period 1997-2000, US$ million

	Total FDI US$ million	Equity capital and reinvested earnings, US$ million	Share of equity capital and reinvested earnings in total, per cent	Other capital, including short-term and long-term loans, US$ million	Share of other capital in total, per cent
1.1.1997	700.31	412.65	58.9	287.66	41.1
1.1.1998	1 040.61	666.74	64.1	373.87	35.9
1.1.1999	1 625.30	1 133.71	69.8	491.59	30.2
1.1.2000	2 063.03	1 626.63	78.8	436.40	21.2

Source: Lithuanian balance of payments, Bank of Lithuania 1999

About half of FDI in Lithuania is related to the privatisation of state-owned companies. In order to acquire partial or full ownership of privatised companies it has been necessary to first purchase the shares which give title to voting rights in the acquired companies. Secondly, the Lithuanian Privatisation Fund has been able to record equity sales as direct income to the fund, whereas loan arrangements would not have allowed this.

2.4 FDI and financial markets

The preference of equity capital over loans noted above is also an indication of the lacking efficiency of the local banking sector and relatively high real interest rates, which is why financing has generally not been sought from the local banks. It should be noted that, of all investments made into tangible fixed assets and construction in Lithuania in 1999, approximately 70 per cent were financed from investors' own sources. Only about 8 per cent of these sources were foreign. The share of foreign loans in the financing of all fixed investments was in turn about 13 per cent in 1999.[22]

Over 12 per cent of the FDI in Lithuania has gone into the banking sector or financial services. At the end of September 1999, there was one subsidiary of a foreign bank, the joint-stock company Hansabank, operating in Lithuania. In addition, the Vilnius branches of Polish Kredit Bank S.A. and the French Bank Société Générale as well as four representative offices of foreign banks were carrying out banking operations in Lithuania.[23] International competition was expected to increase even further in the Lithuanian banking sector and lead to increased efficiency.

In the private banking sector, approximately 70 to 80 per cent of shares were held by foreign companies in July 1999. With the efforts deployed to restructure and strengthen the Lithuanian financial sector and to change state's role from owner to regulator, plans to privatise two large state-owned banks, the Savings Bank and the Agricultural Bank, were made. The Savings Bank is likely to be an interesting target for potential investors. Privatisation of the Agricultural Bank was originally planned in 1998, but delayed due to the Russian economic crisis in autumn of that year. The new tender for the privatisation was launched in April 2000 and it aroused some interest on the part of

potential investors and it is expected that the privatisation process will be completed by September 2000.

In addition to increasing the operational efficiency of the banking sector, the foreign financial organisations, particularly in new fields such as leasing, factoring and related financial services, have provided technical expertise for the formulation of relevant legislation for these areas.

The influence of FDI on the capital market is also marked. At the end of 1998 the market capitalisation of the Lithuanian National Stock Exchange (LNSE) amounted to US$3 billion. By the end of that year investments made by non-residents in the traded companies, amounting to US$170 million, accounted for about 40 per cent of investments recorded by the Central Securities Depository of Lithuania. The foreign investors, who in this case include both direct and portfolio investors, were predominantly private companies and commercial banks. Unlike local investors, the foreign investors mainly bought shares of listed companies, whereas the resident investors concentrated on non-listed companies. As the information requirements are much stricter for the listed companies, the foreign investors shy away from the much less transparent[24] non-listed companies, thus providing a clear signal for the latter that the situation must be improved to attract foreign capital.

2.5 Spillover effects

There are not many empirical studies available which analyse the transfer of technology to Lithuania or its spillover effects on local industry in particular. Among the few that have been carried out, a survey by the Economic Research Centre in 1998 investigated various spillover effects of FDI in the Lithuanian textile, electronics and optical instruments industries. The survey covered nine companies, which had a strategic foreign investor in each case, and 3 local subcontractors.[25]

Among the surveyed companies, the share of foreign customers exceeded 50 per cent. Another common feature of almost all the companies was that they were involved in international cross-border production co-operations, which implies that they were also likely vehicles/channels for technological spillover effects to local suppliers and/or subcontractors.

According to the surveyed companies, the main motivations for starting business in Lithuania were relatively cheap and skilled labour and access to other countries of the region. The size of the market and liberalised trade regime were of less importance. The main criteria used when choosing subcontractors among the interviewed companies were quality of production and price. On the other hand, the main motivations of the local subcontractors to start working with foreign-owned companies were entry to international markets and the ensuing growth in income and increased skills in marketing.

The main requirements that the foreign-owned companies interviewed were facing from their predominantly foreign customers concerned quality and terms of delivery, sometimes also design and packaging of their products. Such requirements were then put to the local subcontractors, who as a result of increased competition, were facing similar demands also from other sources in the markets. Thus the demands for increased quality and prompt delivery terms result both from direct and indirect linkages to foreign-owned companies and their customers. However, the direct international linkages seem to be the main channel of technology transfer in the surveyed industries.

As to the features of linkages between the foreign-owned companies and their subcontractors, it was found that there was no systematic, continuous or planned co-operation in the field of research and development. However, the more important the local subcontractors, the more frequent the cases of

co-operation in the research and development process. The most frequent types of linkages were technical and information exchanges. Among the main factors that contributed to the increase in the quality level of the local suppliers' production were the increased use of high-quality raw materials and improvement of equipment and related technologies as well as the implementation of production systems based on certification.

Concerning the prospects of using the Lithuanian market as a stepping stone to the other Baltic and CIS markets, all of the surveyed companies were of the opinion that the Baltic countries should create a common market as, individually, each of them is relatively small. Moreover, companies particularly in the electronics and textile sectors, considered the CIS market to offer the most potential.

When the results of the survey were compared to similar surveys carried out in Latvia and Estonia, it emerged there were no obvious differences between the three countries or between the surveyed industries. These findings imply, first, that the environment encountered by the companies is quite similar in the three countries. Second, it is the environment and the general economic framework, which influences the attitudes, experiences, and behaviour of companies in their relationships towards local suppliers, rather than specific features of the represented industries.

Both in Estonia and Latvia the major customers of the foreign-owned companies are also foreign parent companies or other large customers abroad. Local customers include wholesale organisations or large department stores. This reflects the general situation in industries chosen for the survey, particularly the textile and electronics industries, which manufacture consumer products.

The suppliers of the surveyed companies in all three Baltic countries were also mostly foreign companies. The reasons for not using local suppliers were twofold. On the one hand, local suppliers were not available or the quality of the local supplies was not considered adequate. On the other hand, there is often no need for local supplies due to the operating strategy followed, involving the use of components or raw materials supplied or bought by the parent company. For companies with local subcontractors, the local suppliers had been found either on the basis of earlier contacts or as a result of a new search conducted in the host country and motivated mostly by price and transportation considerations.

In Estonia and Latvia the quality of products also seems to be the major concern and requirement for the local suppliers. The resulting spillover effect, pressure for quality, also seems stronger in the subcontractor relationship than in a more loose business arrangement. The relative importance attached to a supplier's compliance with payments terms reflects, most likely, the general liquidity problems faced by companies. The companies are compelled to require relatively long payment periods in order not to tie working capital funds before they themselves receive payment from customers.

About one half of all surveyed Baltic companies reported having co-operation in research and development and about the same number of companies had given some kind of assistance to their subcontractors. Companies, who act as subcontractors to foreign investors, have benefited very much from the business relationships. They all claimed, firstly, that they had been forced to become more efficient and, secondly, that most of them had higher sales and lower costs as a result of the subcontracting activities. Comparison to other local producers is, however, made difficult by the fact, that many of the companies were producing goods, which were not otherwise manufactured locally. Most of the competitors in these cases were foreign companies, which, at least in the West European countries, generally implies a higher cost level.

About one half of the surveyed Baltic companies without local subcontractors, had considered another Baltic country as a host country before making the final decision. However, only one-fifth of the companies with local subcontractors had done so. This implies that the companies, who engaged subcontractors, were more committed to the country in question than those who did not. In their decision-making, the companies did not consider the Baltic countries predominantly as a single market.

According to the surveyed companies, the exchange rate regime in the Baltic countries did not play a major role in the decision-making of the foreign investors and a change in it would not have a significant influence on the companies' strategies. Most companies claimed to be prepared to adjust activities accordingly. As most expectations are that the Baltic currencies will be devalued rather than appreciate, companies realise that they, as major exporters, are likely to become net beneficiaries of devaluation. On the other hand, a few companies stated that they would consider moving to another market, if the wages in the host country were raised significantly or if import tariffs or local content requirements were introduced. This implies that the local cost level and/or other administrative barriers could have a higher significance for the investors than the exchange rate regime in the Baltic environment

The implications for FDI policy on the basis of these surveys are:

Firstly, as the major motivations of foreign investors to enter the Lithuanian and other Baltic markets have been the low-cost level of the skilled labour force, the decreasing cost advantages make the significance of the regional market aspect even more significant in the future.

Secondly, the clearly identifiable positive spillover effects of FDI, predominantly upward pressure on quality and improved delivery performance, support the general policy of attracting FDI into the country.

Thirdly, the spillover effects are strongest in the subcontractor relationships of local suppliers with the foreign-owned companies. This suggests that the FDI policy should place emphasis not only on attracting FDI but also on the opportunities for backward linkages with local industries to become subcontractors to the foreign-owned companies.

Fourthly, as the major motivations for choosing local subcontractors, assuming an adequate level of quality, are both low production and transportation costs, there is a need to develop and increase knowledge about more specific competitive advantages of the Lithuanian industries.

CHAPTER 3

THE ROLE OF FOREIGN DIRECT INVESTMENT IN ECONOMIC STRATEGY

This chapter discusses the general role of FDI policy in relation to and in combination with other domestic and external economic policies. It starts with an analysis of the extent to which FDI policy has been given a strategic role in the structural transformation towards a market economy. Next, the complementarity and mutually supporting role of other policy reforms are described in more detail. The chapter then explores Lithuanian FDI policy in the international context.

3.1 FDI policy as an integral part of structural transformation

Views on the strengths and weaknesses of Lithuanian FDI policy vary among local and outside commentators. This section analyses the way in which FDI policy is and has been integrated into other economic policies.

According to several interviewees from different government agencies, FDI policy has been given an important strategic role in structural transformation right from the beginning. “Lithuanians are not afraid of foreigners coming to buy us, overheating or anything! As long as money comes in, it does not matter from where it flows”.[26] It is generally thought that the enormous need for capital in Lithuania may be met in two ways, either by local investment or by opening up the economy, thus attracting more outside capital, and integration into the EU. In the early 1990s, the government’s FDI policy included a wide range of incentives. Later on it changed to national treatment, which is more transparent.

As opposed to local opinion, outsider views consider FDI policy to be one of the weak points of the Lithuanian government. As a result of this, Lithuania has not been able to attract as much FDI as the other two Baltic countries. Outsiders feel that the situation is due, firstly, to the government, which at the beginning did not want to give up state influence in companies, and secondly, the voucher privatisation programme, which resulted in insider ownership, no inflows of new capital and expertise into the companies and thus no restructuring.

In the government’s Medium-term Economic Strategy, prepared in the summer of 1999, FDI issues are discussed both within the context of international economic relations policy and industrial policy. Regarding international relations, the strategy announces an open policy for foreign investments. It is also designed to encourage both domestic and foreign investment by creating a level playing field for all investors. These aims are discussed further in Section 3.3. In the context of industrial policy, the attraction of foreign direct investment into the Lithuanian economy is seen as one of the principle prerequisites for improved industrial efficiency and competitiveness.[27]

In the concrete action plan of the strategy, FDI is mentioned only in the context of international economic relations under the heading of international financial relations, where the goals and objectives include the development of a favourable investment climate and plans to increase both

domestic and foreign investment. Table 3.1 presents the actions and implementation of these goals. The action plan for industrial policy in turn aims at increasing competitiveness of industrial products and restructuring industries, among other things, but without any explicit reference to foreign investment.

Table 3.1 Medium-Term Economic Strategy of Lithuania: International Financial Relations

Areas	Goals and objectives	Actions and implementation	Implementation
1	2		
Foreign investment	To develop a favourable investment climate	To establish non-discriminatory conditions for foreign and local investors	1999
		To improve laws governing the investment process, in particular in the area of investment protection	1999-2000
		To encourage non-traditional forms of investment promotion (concessions, R&D parks, business incubators, *etc.*)	1999-2005
		To promote the establishment of joint ventures	1999-2005
		To complete the implementation of the principles of free movement of capital and the EU requirements for investment policy	2005-2010
	To increase both domestic and foreign investment	To implement a Public Investment Programme	annually
		To implement a Direct Foreign Investment Promotion Programme	1999-2005
		To provide a legal basis for institutional investors (pension and investment funds)	1999-2000
		To sign new international agreements on mutual investment promotion and protection, avoidance of double taxation and fiscal infringements	1999-2005

Source: Ministry of Economy of the Republic of Lithuania: Medium Term Economic Strategy of Lithuania in the Context of its Accession to the European Union, 1999.

FDI as an instrument of regional integration

Both local and outside views emphasise that it may take time for a true Baltic common market to emerge. The fact that the three Baltic states are actually competitors for FDI is not conducive to integration. Free-trade agreements exist among the three, but there are other restrictions to economic integration.[28] However, the "new" sectors such as insurance and banking might facilitate international integration, since there are no historical barriers in these fields as exist in the traditional industries.

According to an interview with representatives of the field of financial services – a sector that has developed only after the Soviet era – the Lithuanian investment climate may be considered very positive towards foreign investors and the situation is considered quite similar in all three Baltic countries. Customers of the company interviewed are able to get similar products and services throughout the region, so that, to a certain extent, the markets are being integrated through foreign investment in this sector.

In some manufacturing industries as well, foreign direct investors are already a true integrating force in the Baltic markets. For example, the largest Nordic breweries have fully integrated the three Baltic states into their home markets.

Within the area of professional services, a representative of an international company in the field stated that they have not carried out many projects that cover all three Baltic countries, although they have worked for multinationals with branches in all three. At European level, the company intended to have an integrated Baltic marketing group, which was later reorganised into country units due to the fact that it did not really work in practice. Thus not all of the experiences of international companies reflect a trend of integration in the Baltic region.

In addition to foreign investors, another external integrating force is the EU. Lithuania was accepted into EU accession negotiations at the end of 1999[29] and these commenced in March 2000.

Active or passive policy towards FDI?

The Lithuanian government has been quite active in its investment promotion efforts and founded the Lithuanian Development Agency for this purpose. During the 1990s, it sought various ways to make it easier for especially large strategic investors to come into the country. Recently, there have been signs of a move towards a less incentive-focused policy.

The European Committee under the Government of the Republic of Lithuania is in charge, among other things, of co-ordinating the foreign direct investment promotion programme. It works as a mediator between the investors and authorities and deals particularly with the legislative and administrative barriers to FDI. The Committee is financed entirely by the Lithuanian government and is one of the founding institutions of the Lithuanian Development Agency.

At the beginning of 1999, a new Council of foreign investors was established by the Committee. It organises seminars on topical investment issues for the investors and government authorities. Concrete questions discussed so far include, for instance, customs and related problems such as border clearance procedures.

The Lithuanian Development Agency (LDA) continues its work as a one-stop support agency for foreign investors. According to the director of the Agency, government policy towards large-scale FDI

is already fairly favourable and incentives for investments larger than US$50 million are negotiable with the Lithuanian government. These incentives may include training grants, or a fast track around the administrative requirements relating to FDI, for example. The government has also actively promoted FDI by inviting groups of major investors to regular meetings with key government officials.

Although the role of the LDA may be seen first and foremost as promotional, it has open access to cabinet meetings and provides potential investors with information, facilitates contacts with ministers and municipalities and sometimes helps also in site selection. In addition, the LDA's activities include an annual investment climate survey among foreign investors (see section 1.3 above) and investor fora once or twice a year.

According to a major professional services firm, they have been able to put their representatives on the board of the Lithuanian Development Agency, the investment board, the auditing institute and other such organs, established for co-operation between the government, government agencies and the business sector. A senior marketing officer of the company interviewed stated, however, that they do not have a very active role in these institutions, partly due to the fact that these organs of co-operation are very recent. In practice, this may indicate that the framework for co-operation exists but is perhaps not yet utilised to its full potential.

As to the specific investment incentives on offer, taxation has had a crucial role in attracting foreign investment to Lithuania. Tax incentives have included different kinds of exemptions from the company profit tax and are partly linked to free economic zones. For example, to attract FDI a system of double depreciation has been accepted. The enterprise may choose between two ways of deducting profit from gross income. Firstly, the asset acquisition value can be totally deducted in from the gross income in the year in which it is made or, secondly, the asset value can be transferred to the expenses in part within the period of use of the assets. These kinds of incentives have been based on the idea that investors follow tax concessions, which is not likely to be what they appreciate the most in the long run.

Details on these company profit tax issues are provided in Chapter 4. In general, the preferential treatment of foreign entities should be of less importance in the future, as the current policies seem more focused on providing equal conditions for all investors, irrespective of their country of origin.

This positive development of the government's approach to FDI is partly due to the fact that up to now, Lithuanian FDI policy has depended on privatisation. As the FDI related to large-scale privatisation will inevitably come to an end, the Lithuanian Government is attempting to develop legislation, which would further improve the climate in order to attract other investment as well.

Towards equal treatment of investors

The new Investment Law of July 1999[30] established equal business conditions for foreign and domestic investors in Lithuania. Under the terms of this law, no distinctions will be made in the treatment of foreign and domestic investors. In practice, large investors tend to be preferred over smaller entities, which is reflected in the right of the government to engage in direct negotiations with the so-called strategic investors. It thus seems that more problems exist in the context of treating investors in projects of different sizes equally than in the treatment of domestic versus foreign investors.

The Lithuanian Free Market Institute, a widely respected independent research institute and a powerful lobby towards the government, has propagated the equal treatment of foreign investors as opposed to "the earlier policy of the government, which targeted only the 'big fish' and was based on bilateral negotiations between the potential investor and the government. It did not create an environment conducive to investment and led to many promises, which could not be honoured in practice and many disappointed investors left the country", as the Vice President of the Institute explained in an interview.

The Ministry of European Affairs has been reorganised into the European Committee mentioned above, working with a pro-investor agenda in general. There is no explicit policy of favouring large investors over small and medium-sized ones in the agenda of the government, except the above-mentioned possibility of negotiating directly with investors bringing more than US$50 million into the country.

The government attitude towards foreign SMEs is said to be changing and, accordingly, it has recently started to pay more attention to the problems of this type of enterprise. So far most domestic SMEs have been supported and this should benefit international SMEs as well. Foreign SMEs have mostly become involved in trading companies in Lithuania. The general problem for all SMEs lies, however, in acquiring funding. They are faced with everyday bureaucracy and the underlying rapidly changing regulatory environment and also have the disadvantage of not being able to afford professional services, such as tax and legal advice.

3.2 The complementarity and mutually supporting role of other policy reforms

Diversification and soundness of financial institutions[31]

The financial sector of Lithuania includes commercial banks and other credit institutions, leasing and insurance companies, the National Stock Exchange, the securities market and financial brokerage firms. The total bank assets amounted to 25 per cent of GDP in 1998. At the beginning of 1999, there were 10 commercial and two specialised banks – *Turto Bankas* (Asset Management Bank) and the *Lithuanian Development Bank*, which do not keep current deposits (*Turto Bankas* and the *Lithuanian Development Bank* together accounted for 2.7 per cent of the total bank assets in Lithuania).

At the end of March 2000, there were two foreign bank subsidiaries operating in Lithuania – the Estonian joint-stock company Hansabank, which received its licence from the Bank of Lithuania in May 1999 and the joint-stock company Industrijos bankas, which was acquired by the Latvian Parex Bank in March 2000. Two other foreign banks, the Polish Kredit Bank S.A. and the French Bank Sociéte Générale were also carrying out banking operations in Lithuania through their Vilnius branch offices. In addition there were 4 representative offices of foreign banks in Vilnius. Nord/LB opened a branch in Vilnius during 1999. At the beginning of 2000 Merita Bank purchased the former branch of Sociéte Générale and permission to establish a branch was also issued to German bank Vereins und Westbank.[32]

Under-capitalisation, poor regulation and a growing proportion of bad loans culminated in the banking crisis of late 1995. The Bank of Lithuania subsequently closed down several institutions for either fraud or insolvency and tightened its banking supervision. Turto Bankas was set up to take over and restructure bad loans and the large state banks were recapitalised through government bonds. By 1997, the number of operating banks had decreased to 11. The banks that survived the crisis were cautious to start lending activities at first. However, in 1997-1998, credit availability started growing more

rapidly, mainly in foreign currency and encouraged by lower interest rates abroad and the stability of the litas peg to the dollar.

Since 1998, Lithuania has witnessed bank consolidation. Assets are concentrated in four banks (two state-owned and two private banks) that manage about 85 per cent of the total bank assets and deposits. Two state-owned banks, the *Savings Bank* and the *Agricultural Bank*, held 50 per cent of the total bank deposits at the end of 1998. *Vilniaus Bankas* and *Bank Hermis* are the leading banking institutions among 8 private banks. These two banks doubled their share in the total amount of deposits from 15 per cent in 1996 to 33 per cent in 1998. The other banks are small and provide services in specialised areas. Foreign ownership exceeds 80 per cent of the share capital in the two leading private banks and both of them are major lenders to the corporate sector. They were about to merge in 1998, in anticipation of growing competition as foreign banks started moving into the Lithuanian market. The merger was, however, not completed until July 1999, when Vilniaus Bankas, after protracted negotiations between both banks, finally submitted an application to the Bank of Lithuania requesting permission to acquire a block of Bank Hermis shares. In September 1999 the Bank of Lithuania approved the merger by allowing Vilniaus Bankas to acquire and control more than two-thirds of Bank Hermis shares. The resulting banking institution holds about 41 per cent of total bank assets in Lithuania and 44 per cent of total loans.

For the past three years, the Lithuanian Government has attempted to sell three state-controlled banks. The State Commercial Bank did not attract a buyer and had to be liquidated. Its assets and liabilities were transferred to the Savings Bank. In 1998 an attempt was made to privatise the Agricultural Bank. This effort failed because the deadline for the final bids coincided with the week of the Russian Rouble crisis. The Government is once more in the process of selling the state's interest in the Agricultural bank and it is expected that this transaction will be successfully completed in September 2000, judging by the greater interest in Lithuania in general and in the banking sector in particular as evidenced by the influx of foreign-based banks. At the beginning of 1999, the Savings bank was included into the list of institutions for privatisation and this is now scheduled for mid-2001.

Generally favourable economic development in recent years and lower inflation have offered good conditions for improved performance of commercial banks. The quality of their loan portfolio has improved, the scope of services expanded, and the growth of personal deposits is an indication of the growing confidence in the banking system. The assets of the country's commercial banks amounted to LTL 10.5 billion at the end of 1998, after a growth of 26.6 per cent that year. The total deposits in Lithuanian banks were LTL 6.3 billion, hence 6.4 per cent annual growth, including LTL 3.0 billion of personal deposits, which was 34.4 per cent more than in 1997.

The 1998 World Bank country study on Lithuania cites one dominant objective among the recommended policy actions in the banking sector, namely to change the role of the state in the banking system from owner to regulator. The study called for immediate disinvestment and permanent severance of all channels of undue political interference within banking. Furthermore, the study found it essential that decisions on the placement of the state's funds, debt, targeted lending programmes, and restitution schemes across banks be made purely on a profit-maximising commercial basis, rather than serving as a tool for banking policy by the government. Under no circumstances should there be a situation where the state would act simultaneously both as a bank owner and as a deposit compensator of last resort.[33]

According to the World Bank, the Lithuanian authorities should also continue to strengthen the regulatory framework for bank operations. The Central Bank should have more power in bank resolutions and in gathering information on bank subsidiaries. Lenders, in their turn, should have

greater powers in perfecting and accessing their loan collateral. This should be made possible through, among other measures, allowing banks to own land.[34]

The Medium-term Economic Strategy of the government states that "the introduction of sound banking principles in line with EU requirements and Basle Committee recommendations will contribute to the development of a reliable and stable financial system which will be created by increasing bank efficiency and competitiveness. The main instruments employed for achieving this goal are the privatisation of state-owned banks (the Agricultural Bank and the Savings Bank) mentioned above and the creation of competitive conditions. This would lead to a wider scope of banking services and structure, better lending arrangements to enterprises and individuals, more effective financial activities of banks, and lower costs of investment activities". Thus, it seems the strategy is in line with the World Bank recommendations.

The Credit Institution Supervision Department, following the Basle Committee Core Principles on Banking Supervision and EU directives and recommendations, has continued to strengthen the regulatory framework. All basic prudential requirements (capital adequacy, maximum exposure to a single borrower, FX position and liquidity) are in line with Basle Committee recommendations. Recently prudential requirements have been further tightened, among others, by the introduction of more stringent liquidity calculation procedures and by requesting consolidated financial reports from the banks.

In addition to banks, investment funds emerged in the Lithuanian markets as a result of the voucher privatisation programme carried through in the earlier 1990s.[35] During the programme, they built up large holdings of assets and, by the end of 1995, they controlled almost one-third of all privatised assets. Most funds, however, failed to re-register by the 1997 deadline imposed by the Investment Company Law and have since gone out of business.

The non-banking financial sector is represented by insurance companies, brokerage firms, holding companies, credit unions and leasing firms. Four of 36 insurance companies belong to banks, and five are life assurance companies. Rapidly growing leasing companies, the largest of which are *Vilniaus Banko Lizingas* (Vilnius Bank Leasing) and *Hansa Lizingas* (Hansa Leasing) are mainly engaged in leasing of vehicles and are now expanding to leasing of manufacturing equipment.

The development of insurance markets has also received attention in the government's economic strategy. The aims pursued in this area are to encourage saving among society members and increase the efficiency of the insurance market. The basic tools in the short-term are the creation of conditions for long-term life assurance and private pension insurance, for the development of mandatory insurance of vehicles, the harmonisation of national legislation for this are in line with *acquis communautaire* considerations In the medium-term, the taxation of insurance institutions will be improved and conditions for the introduction of new insurance services fixed. At the same time the supervisory system will be consolidated, and in the forthcoming years a new insurance accounting system will be put in place. Also in the medium-term, a new insurance information system and co-operation with other financial sector supervisory institutions will be developed.

In May 1999, the government sold its 70 per cent stake in the state insurance company, Lietuvos Draudimas, the largest in the industry in the Baltic region, to the Danish Codan Insurance for LTL 100 million through an international tender. According to the EBRD Transition Report 1999, Lietuvos Draudimas has 48 per cent of the non-life insurance market in terms of written premiums and 70 per cent of the life insurance market.

Development and depth of local capital and equity markets

The Lithuanian National Stock Exchange (LNSE) was the first of the Baltic bourses to open in 1993. In 1998, the Lithuanian stock exchange's total market capitalisation of LTL13.35 billion (US$3.34 billion) was almost twice that of the Riga and Tallinn exchanges combined. However, the trading volumes were considerably lower compared to the market capitalisation than in the other Baltic countries, indicating the illiquidity of the market.

The Securities Commission and the National Stock Exchange are regulated by the Law on Public Trading and Securities, adopted in January 1996. Control over the Lithuanian securities market is exercised by the Securities Commission (SC) established in 1992. The Commission registers all securities issued in Lithuania. In 1999, 7 companies were listed on the NSEL Official List, the current list comprises 48 stocks and 1055 unlisted companies. Government Treasury Bills are also traded. Investments by non-residents are unrestricted.

In 1998, the exchange attracted little foreign interest despite structural reforms, including the move to continuous trading and a streamlining of listing procedures into a three-tiered system. Stock market prices slumped in the aftermath of the Asian crisis in late 1997, following the collapse of the Tallinn Stock Exchange. The Russian crisis in 1998 pushed prices down further. Lithuania is the most vulnerable Baltic country to deteriorating CIS trade, as some 45 per cent of its total exports were directed to these markets before the devaluation of the rouble in August 1998.

In 1999, the vast majority of the listed shares were still illiquid and rarely traded. The top 10 stocks by market capitalisation as of 30 June 1999 were:

1	*Lietuvos Energija*	*Energy*
2	*Vilniaus Bankas*	*Banking*
3	*Mazeikiu Nafta*	*Oil Refinery*
4	*Lietuvos Dujos*	*Natural Gas*
5	*Lietuvos Zemes Ukio Bankas*	*Banking*
6	*Švyturys*	*Brewery*
7	*Lifosa*	*Fertilisers*
8	*Klaipedos Nafta*	*Oil Terminal*
9	*Bankas Hermis*	*Banking*
10	*Kalnapilis*	*Brewery*

Companies on the official list are obliged to publish annual audited financial statements according to the International Accounting Standards (IAS). Although there are less than 10 of these companies, several of them have been able to raise capital through new share issues after the Russian crises. Examples include the refrigeration equipment manufacturer, Snaige, and Birzhu Milk. In contrast, a great number of other Lithuanian companies have faced difficulties in raising capital.

Due to the slowing economy, equity prices remained low for most of 1999. Activity is expected to pick up as the government goes ahead with plans to sell the remaining stakes in major state-controlled companies, especially Lietuvos Telekomas. Moreover, on 23 April 1999 the heads of the three Baltic bourses agreed to facilitate cross-border trading on the three markets, as a first step to a joint trading system. There have also been plans to create a joint Baltic blue-chip list to allow investors to track the three countries as a single market.

An important step was taken in the Lithuanian financial markets when the Law on Pension Funds was adopted in June 1999 and became effective as of 1 January 2000. It establishes the legal basis for private voluntary pension funds. However, the annual deficit of the Social Security Fund is increasing and the pay-as-you-go system requires an overhaul. While the government has resisted raising the retirement age to relieve pressure on the existing system, it has considered measures to strengthen its revenues.

The action plan of the World Bank country study for 1998 envisages two roles for the Lithuanian securities market: first, that it serve as a nexus between privatisation and the upcoming pension reform, and second, that it would become an independent, powerful stimulus for the efficient management of companies. The study states that the basic legal, regulatory and institutional frameworks for the market to play these roles are in place already. Simultaneous policy intervention is needed on three fronts. First, an improvement in information transmission should be carried out. Second, the obstacles to the emergence of active shareholders must be removed, and third, laws and institutions need to be adjusted to ensure correct handling of privatisation-related transactions. The issues of corporate governance will be discussed in the following sub-section, and the details of privatisation in Chapter 4.

The aims of the market development policy, outlined in the government's economic strategy, are the strengthening of the capital market, higher liquidity and more favourable conditions for institutional investors. The aims are set out for the medium-term and are meant to be reached by improving the accounting conditions for securities, establishing the compensation fund for investors and disseminating information about the capital market. The scale of privatisation through the stock exchange will grow during years 1999 and 2000 and, in the coming years, investment ceilings on banks and insurance companies will be lifted. A new trading system at the National Stock Exchange of Lithuania is to be introduced, tax incentives to invest into securities will be used, and the secondary legislation provided for in the Law on Pension Funds adopted. The year 2000 is expected to witness the appearance of the first investment and private pension funds. Their role will constantly grow and, in the medium-term perspective, they will be among the major actors on the capital market. Within several coming years the legal norms in this field will be aligned with the corresponding EU *acquis communautaire.*

The Strategy envisages the enhancement of the financial sector supervisory system. The basic measures to be taken to this effect are: in the near future, the introduction of a new accounting and reporting system; at a later date, the development of an information system, intergovernmental agreements on the exchange of confidential information, and legislation providing for the financing of supervisory institutions from the payments of market operators.

Corporate governance

The concessions granted to foreign investors and protection of their investments are largely catered for by taxation regulations. Minority shareholders are quite well protected by legislation in principle (with appropriate stipulations in the Company Law) but in practice they are not always taken into consideration. There are, however, also very few foreign minority shareholders, which reflects the small size of the markets from the point of view of foreign investors. Foreign investors usually buy a majority in a company. The remaining shares remain in the hands of the government, and thus the deals are clear-cut. Taking a smaller stake in a company would, in many cases, involve too high a risk for the investor.

The legal framework for companies in Lithuania is not yet up to western standards. The Company Law is particularly complicated. Accounting standards are not respected in practice and the information available to portfolio investors in particular is not adequate. Regulations exist, but the information is not really disseminated throughout the market. The Securities Commission is the sole true source of written information on companies. Furthermore, there is still very limited general understanding of corporate governance issues in the country.

In 1998, the Securities Commission strengthened the enforcement of rules that protect minority shareholders in the event of corporate take-overs. From July 1998, a single shareholder that acquires a majority stake in a company registered at the Stock Exchange has to submit a tender offer for all remaining shares at the weighted average price of its share purchases. The rules are not applicable in the case of privatisation to a strategic investor.

Currently there is an ongoing PHARE assistance project with the Securities Commission with the aim of improving the information available to investors. The project also covers aspects of minority shareholder protection. It is vital necessary to solve these issues before the capital market may become truly operative.

The prices quoted at the Lithuanian Stock Exchange are considered relatively low, partly due to the very limited turnover. According to a PHARE source, the price for Vilnius Bank, for example, is probably half of what it should be to reflect the bank's real value. Thus, the prices cannot act as a guideline for a serious purchase offer. Since the market is illiquid, companies do not avail of the capital market. The corporate governance system, however, is not truly bank-dominated either. The Lithuanian banks do not really have an interest in their clients' businesses. The state-owned companies have also not had transparent corporate governance, decision-making being dominated by the manager-owners, who in many cases withhold information to outside sources.

According to the World Bank country study of 1998, the power of shareholders, and, to a lesser extent, banks, could be better tapped as a source of efficiency-enhancement in Lithuania. Furthermore, relatively simple policy changes should be able to mobilise that power. First, it is seen as critical that international standards be introduced in accounting and auditing and that the regulation of those standards should be placed in the hands of the professions involved . As mentioned in the earlier sections, the IAS rules are in place already but their use is ambiguous in practice. Second, the Company Law should explicitly provide for a manager's "duty of loyalty", for external boards under non-executive control, and for a fuller range of management incentive contracts. Third, the regulatory environment for banks should encourage their participation in the boards of large corporate borrowers. Finally, it should be made possible to file complaints with the Seimas' Ombudsman against the managers of state-controlled enterprises.

The generally underdeveloped corporate governance system, combined with the inadequate implementation and enforcement of the already existing rules and regulations, poses a problem for the further improvement of the investment climate in Lithuania. This in turn affects both domestic and foreign investors. However, as long as the interaction between the government agencies and companies is a crucial practical problem as well, the smooth interaction between companies and different owners through an efficient system of corporate governance may be somewhat lower on the list of priority issues to be solved.

Taxation and accounting measures

In Lithuania, there is a trend away from extensive tax incentives to foreign investors towards the equal treatment of all investors. The remaining tax incentives are described in Chapter 4 below.

The European Committee has co-operated with the World Bank/IFC-financed Foreign Investment Advisory Service (FIAS) in a study on administrative barriers to foreign investment in Lithuania. An example of these barriers is that new tax regulations are being put into force too quickly, and thus companies receive the information too late in order to be able to adapt operations accordingly. Otherwise the tax legislation as such is not considered a barrier for foreign investors as is the general level of bureaucracy.

Harmonisation of accounting regulations in line with EU law is underway in Lithuania. IAS-rules were introduced last year and differences in accounting should therefore no longer present as great problems to companies as before.

The Lithuanians are, however, perceived as slow in giving out information on new regulations. Implementation of tax legislation varies from city to city. The law requires that an international accounting system is used but instructions as to what it means in practice are still lacking. The Ministry of Finance has recently set up an Accounting and Auditing Committee to solve these and related questions. For instance, the invoicing procedure using only forms printed by the state has caused many bureaucratic and administrative problems for companies.

The World Bank country study on Lithuania of 1998 considers the accumulated technical experience in Lithuania adequate for creating, in a relatively short period of time, a more efficient, transparent and equitable tax administration, which could facilitate private sector development and at the same time gather greater revenues for the fiscal budget. As the Bank expresses it, the key in this effort is to make the system much less arbitrary.

Competition policy[36]

Lithuanian competition law is quite new and there is no sound, established legal practice in the area as yet.

The first legal act governing competition was the 15 September 1992 Law on Competition. This initial law was supplemented by various regulatory provisions that together constituted Lithuanian competition law. The new Competition Law came into force in April 1999 and is geared towards harmonisation with European Union competition legislation.

According to the Law Update Bulletin by Law Firm Lideika, Petrauskas, Valiunas ir partneriai, the Law establishes an extra territoriality principle, according to which it will apply both to Lithuanian and to foreign economic entities, if their activities restrict competition in the Lithuanian market. The second important innovation is the broadening of the concept of “economic entity”. According to the Law, “economic entity” shall include enterprises, amalgamations of enterprises (associations, unions, consortia *etc.*), institutions and organisations and other legal and natural persons, which perform or may perform economic activities in the Republic of Lithuania. State and municipal institutions of the Republic of Lithuania are also considered as economic entities if they are engaged in economic activities.

It appears that Lithuanian Competition Law has accepted an "effects-based" doctrine. The determining factor in deciding whether restriction or distortion of competition has taken place is not the intention of the economic entity or the purpose behind its behaviour or agreements, it is the real effect on competition. *Restriction of competition* is defined in the law as "actions which prevent competition in a relevant market or may weaken, distort or otherwise have a negative effect on competition".

The Competition Council is a public body of the Republic of Lithuania which implements state competition policy and supervises compliance with the Law. It establishes the criteria and procedure for defining the relevant market and a dominant position, investigates relevant markets and determines the market share of undertakings, and their position in a relevant market. It is also within its powers to give obligatory instructions to enterprises, to investigate and consider infringements of the Law and to impose penalties on defaulters.

The Law on Competition defines dominant position as the position of an economic entity in a market that enables it to unilaterally and decisively influence that market. Unless proved otherwise, an undertaking with a market share of not less than 40 per cent shall be considered to have a dominant position in the relevant market. However, entities having less than 40 per cent of a particular market may, under certain circumstances, also be recognised as dominant. According to the old law, entities which held less than 40 per cent of particular market may not be recognised as dominant. In the new law it is stated that, unless proved otherwise, each of a group of three or fewer undertakings with the largest shares of the relevant market, jointly holding 70 per cent or more of the relevant market shall be considered to enjoy a dominant position.

Market concentration activities are defined in the Law on Competition as follows:

1. Merger: when one or more undertakings which terminate their activity as independent undertakings are joined to the undertaking which continues its operations or when a new undertaking is established from two ore more undertakings which terminate their activity as independent undertakings.

2. Acquisition of control: when one and the same natural person or persons already controlling one or more undertakings, or one or more undertakings, acting by contract, jointly set up a new undertaking or gain control over another undertaking by acquiring an enterprise or a part thereof, all or part of the assets of the undertaking, shares or other securities, voting rights, by contract or by any other means.

The law provides for the concept of market concentration. Although it seems to equate market concentration with the attainment of a position of dominance in the market, in practice, irrespective of whether dominance is achieved, all market concentration activities which meet the criteria as defined by the Competition Council must be reported. The intended concentration must be notified to the Competition Council and its permission will be required where the combined aggregate income of the undertakings concerned is more than LTL 30 million for the financial year preceding the concentration and the aggregate income of each of at least two undertakings concerned is more than LTL 5 million for the financial year preceding the concentration.

According to the law, all agreements which have as their object the restriction of competition or which may restrict competition are prohibited. Such prohibited agreements include, for instance:

- Agreements to directly or indirectly fix prices of certain goods or other conditions of sale or purchase;

- Agreements to share the product market on a territorial basis according to groups of buyers, suppliers or in any other way;
- Agreements to fix production or sale volumes for certain goods, as well as to restrict technical development or investment;
- Agreements to apply dissimilar (discriminating) conditions to equivalent transactions with individual undertakings, thereby placing them at a competitive disadvantage.

When concluded between competitors, these four types of agreements are always considered as restricting competition.

The old Law on Competition, unlike the corresponding provisions of the EC Competition Law, prohibited only horizontal agreements (*i.e.* agreements and co-ordinated activities between competing economic entities), while vertical agreements between suppliers and distributors, for example, were not considered restrictive or an impediment to competition, unless one of the parties to such an agreement was a dominant economic entity. According to Article 5 of the new Competition Law, both vertical and horizontal agreements are considered restrictive. Block or individual exemption may be granted to the prohibited agreements, provided the agreement in question promotes investment, technical or economic progress or improves the distribution of goods, thus allowing all consumers to gain additional benefit.

The Law on Competition deals also with unfair competition. The concept of unfair competition is not yet precisely defined, although the Law contains a list of acts that constitute unfair competition. The list of prohibited acts of unfair competition appears comprehensive. Thus, apparently, no act may be forbidden as an act of unfair competition, unless it falls within these stated prohibitions.

Undertakings whose interests have been violated due to restrictive practices, public and local authorities, as well as associations and unions representing the interests of undertakings and consumers may ask the Competition Council to commence an investigation of alleged abuse of dominant position, or anti-competitive agreements and co-ordinated activities, or acts of unfair competition, by submitting to the Competition Council a written application and all relevant documents and other information. The Competition Council may also start investigation on its own initiative. The new law regulates the examination process for the cases on actions restricting competition quite exhaustively.

3.3 Alignment with international and regional norms

In its Medium-term Economic Strategy of summer 1999, the Ministry of Economy describes the policy of international economic relations as an integral part of the general macroeconomic policy of the Republic of Lithuania.[37] Due to the size and openness of the economy, foreign trade and financial relations are recognised as playing a major role in the stability of the economic environment in the country, restructuring of its economy and the economic growth itself. The Strategy intends to provide for the continuing integration of the Lithuanian economy into the global economy by "creating conditions for open trade and conducting an open policy for foreign investments and also by utilising the relative advantages of the country".

According to the Ministry, the figures for Lithuanian foreign trade demonstrate the openness of the Lithuanian economy and the "considerable degree of its integration into the global economy". The turnover of Lithuania's foreign trade accounts for approximately 100 per cent of GDP. Furthermore,

Lithuania's import duties are among the lowest in Eastern and Central Europe. In December 1998, the arithmetic mean of Lithuanian conventional tariffs for industrial goods was 2.5 per cent, while the corresponding figure for agricultural products and foodstuffs was 14.2 per cent.

In its aspirations for EU and WTO membership, Lithuania is being urged to implement a foreign trade policy characterised by trade liberalisation, efforts to achieve competitiveness under the conditions of a free market economy and the expansion of its bilateral and multilateral relations with other countries. In its foreign trade Lithuania is guided by the EU economic and political guidelines in that it makes free-trade agreements (FTAs) only with those third countries which have signed such agreements with the EU, and strictly according to the WTO provisions. In making new FTAs, due consideration is taken of the provision for waiving compensation when Lithuania becomes a full member state of the EU.

Free-trade agreements have been signed with the EU, EFTA, Estonia, Latvia, Poland, the Czech Republic, Slovakia, Slovenia, Turkey and Hungary. Negotiations are under way with Romania and Bulgaria. One of the most immediate objectives of Lithuania is the accession to the CEFTA Treaty. Work has been started on adjusting the free-trade agreement with Ukraine according to the WTO provisions and the EU requirements.

The Baltic Transit Convention between Estonia, Latvia and Lithuania came into force in June 1999. Implementation is planned for early 2000. The Baltic system is based on the EU/EFTA Common Transit Agreement. Three free economic zones are expected to be set up in Lithuania in the course of 2000. The legislation governing the free economic zones is fully compatible with EU legislation.

The bilateral and multilateral negotiation process for Lithuania's accession to the World Trade Organisation is advancing well. Negotiations are expected to be completed in 2001. Lithuania has made commitments to ratify the mandatory WTO agreements without any transition periods, including the main agreements on the protection of intellectual property, obligations in the services area (GAT), investments related to trade, technical trade barriers, sanitary and phytosanitary means. Lithuania has also committed itself to join the greater part of the multilateral sectoral initiatives, including the harmonisation of agricultural and construction equipment, medical devices, pharmaceuticals, toys, the international agreement on technology, chemicals, textiles and others.

The Strategy provides for the encouragement of both domestic and foreign investments by creating a level playing ground for all investors. The Ministry of Economy states that, in the medium-term, programmes for the promotion of public investments and foreign direct investments will be implemented, a number of new international agreements on the mutual encouragement and protection of investments as well as agreements on the avoidance of double taxation of capital and fiscal infringements will be signed. Within ten years, the implementation of the EU principles applied to the free movement of capital and the non-discriminatory promotion of investments should be completed. Over the period 1999 and 2000 legal conditions should be in place for institutional investors – pension and investment funds. The Ministry's hope is that Lithuania's open and non-discriminatory foreign economic policy will contribute to the further restructuring of the economy and to the growth of its efficiency.

After the formulation of the Medium-Term Economic Strategy in October 1999, the European Commission published its second Regular Report on Progress towards Accession for Lithuania as well as for the other countries aspiring to join the EU. The report looks at whether intended reforms referred to in the 1998 Regular Reports have been carried out and examines new initiatives. The report also examines the extent to which Lithuania has addressed the short-term priorities and started to address the medium-term priorities set out in the Accession Partnership.[38] In the report, it is stated that

Lithuania has continued to implement the Europe Agreement correctly and contributed to the smooth functioning of the various joint institutions. In December 1999, Lithuania was accepted to start accession negotiations with the EU.

CHAPTER 4

THE REGULATORY FRAMEWORK FOR FEDERAL DIRECT INVESTMENT

This chapter examines the regulatory framework underlying FDI in Lithuania and other regulations, policies and practices, which have had a major influence on FDI decisions.[39]

Investment Law[40]

The goal of attracting foreign investment was set by the Republic of Lithuania shortly after it regained its independence. The first law on foreign investment was adopted on 29 December 1990. Until summer 1999, the main law regulating foreign investment in Lithuania was the Law on Foreign Capital Investment in the Republic of Lithuania, approved on 13 June 1995. A new Investment Law was passed by the Lithuanian parliament and came into force in July 1999.

The new Law stipulates the conditions for investment in the Republic of Lithuania, the rights of investors and protection measures for all forms of investment. It does not regulate investment in enterprises involved in financial activities. Investments are defined as "monetary assets and tangible, intangible and financial assets, evaluated in the established procedure, which are invested for the purpose of receiving profit (income) or a social result (education, culture, science, health and social security and other similar spheres) from the investment object or to ensure the execution of government functions."

The Law defines different forms of investment and determines the direct investment concept. It also fixes procedures for resolving investment disputes and dealing with cases of compensation. These concepts are in line with international agreements, such as the Energy Charter Agreement, Multi-Fibre Investment Agreement and Investment Incentive and Security agreements.

Investors may invest in Lithuania by the following ways:

- by establishing an economic entity, acquiring the capital or a share thereof in a registered economic entity;
- acquiring any type of securities;
- forming, acquiring or modernising the tangible and intangible long-term assets;

– lending pecuniary funds or other assets to economic entities, in which the investor has a portion of the capital, giving him the possibility of influencing the management and control of the economic entity;

– carrying out agreements on concessions and redeemable rental transactions (leasing).

The Law defines investors' rights and guarantees of these rights, as well as the procedures for securing investments in the case of reimbursable appropriation. The Law guarantees equal operating conditions to Lithuanian and foreign investors:

- Equal operating conditions are guaranteed to Lithuanian and foreign investors under this and other laws. The laws of the Republic of Lithuania protect the rights and other legitimate interests of investors.

- An investor shall be entitled to administer, use and dispose of the investment object in the Republic of Lithuania, in accordance with the laws of the Republic of Lithuania and other legal acts.

- An investor shall be entitled, on payment of taxes in the procedure established by the laws of the Republic of Lithuania, to convert the profit (income) belonging to him under the right of ownership into foreign currency and/or make transfers abroad without restrictions.

- A foreign investor can make his pecuniary contribution to the capital of the economic entity in both foreign and Lithuanian national currency.

In Article 6 of the Investment Law, it is stated that investment disputes shall be settled in accordance with the provisions of international treaties. Foreign investors shall be entitled to appeal directly to the Investment Dispute Settlement Centre. In the case of compensation, the amount of compensation for the investment object appropriated must conform to its market value at the time of appropriation or before its public announcement and is established according to procedure prescribed by the Republic of Lithuania Property Law and other legal acts.

Foreign investments are not allowed in the following areas:

- state security and defence (with exceptions);

- manufacture of narcotic and psychotropic materials for non-medicinal purposes, or of poisonous materials, as well as growing, processing and sale of cultures, containing narcotic, strong and poisonous materials;

- organisation of lotteries.

Investment law forms the basis of investment policy in Lithuania. The Law includes articles on state investment policy and the promotion of investment. One of its most significant features is that it grants the government rights to approve transactions directly with strategic investors, for whom special investment and business conditions may be set. The government shall be entitled to make investment agreements with investors for investments of not less than 200 million Litas (see Section 4.5 on investment incentives).

A major change in the new law is that it regulates all investment relations, including the relations between foreign subjects and the Lithuanian state, whereas the earlier law only regulated relations between local and foreign subjects. An amendment to the Law on Free Economic Zones is also in preparation.

The Investment Law is in harmony with the EU directives for free movement of capital. It is thus a step forward in the process of harmonising the Lithuanian law with international laws and regulations.

Foreign investment in Lithuania is also regulated and protected by various bilateral agreements on the promotion and protection of investments. Currently there are 22 valid agreements with most of the member states of the EU and many Central and East European countries. Such agreements have priority over the provisions of the laws of the Republic of Lithuania and usually provide for more favourable treatment for reciprocal investments.

Investment in Lithuania is widely supported by State institutions and various non-governmental organisations. The most significant non-governmental organisation promoting investment in Lithuania is the Lithuanian Development Agency. Other organisations involved in the promotion of foreign investment in Lithuania are the Lithuanian Free Market Institute, different services sections of foreign embassies and other government development agencies.

Enterprises with foreign capital are registered at the Ministry of Economy, which also consults on investment issues, and the Ministry of Foreign Affairs. From time to time, foreign investors are also invited to enter into direct consultations with the government of the Republic of Lithuania.

4.1 Horizontal measures

Licensing and registration requirements

The Law on Enterprises determines that the following activities will be prohibited without a licence issued in accordance with the procedure established by the government. These licence requirements apply both to foreign and to domestic business operators:

- Manufacturing of guns and their parts, ammunition, explosive chemicals, explosives, pyrotechnic products; repair services for guns, unless other laws provide otherwise.

- Pharmaceutical activities.

- Growing and selling plants which contain narcotic, psychotropic, deadly and poisonous substances, also manufacturing, importing, exporting, narcotic, psychotropic substances, precursors and wholesale and retail thereof.

- Manufacturing alcohol products with the volume of ethyl alcohol not exceeding 22°.

- Health care services, unless other laws establish otherwise,

- Teaching activities, unless a certificate of education recognised by the state is issued upon completion of courses involved.

- State land surveying activities, geodetic topographical works.

- Passenger transportation services within the Republic of Lithuania, also international passenger and cargo transportation services, unless other laws establish otherwise.

- Production and importation into the Republic of Lithuania and wholesale of tobacco and tobacco products.

- Purchases in the Republic of Lithuania of non-ferrous metals as well as their alloys: scrap and scrap metal for resale.

- Importation into the Republic of Lithuania of alcohol products, wholesale thereof, retail of alcoholic beverages.

- Organisation of cash and cash-and-prize lotteries.

- Purchases in the Republic of Lithuania of scrap and waste of ferrous metals for sale.

- Establishment and operation of a general telecommunications network, provision of telecommunications services.

- Manufacture of seals, stamps.

- Establishment and operation of shooting-ranges, shooting-galleries, hunting-shooting ranges.

- Manufacture, wholesale, transportation or storage of dangerous chemical, nuclear and radioactive materials specified in the list approved by the Ministry of Environmental Protection, also the collection, decontamination, storage and land-filling of hazardous waste.

- Importation, exportation, wholesale and retail of bulk oil products which are on the list compiled by the government of the Republic of Lithuania.

- Servicing of energy facilities (electricity generation, heat generation, natural and liquefied gas facilities).

- Importation and sale of pyrotechnic products (in accordance with the list drawn up by the Ministry of the Interior), firearms and ammunition for civilian use (with the exception of pistols, revolvers and ammunition for self-defence).

- Provision of shipping brokers' services.

- Insurance activities.

- Provision of tourism services.

- Printing of securities and document forms.

Ownership rights to land

The acquisition of land is still a problem in practice. An amendment of the Constitution allowed foreign investors to acquire non-agricultural land. Despite this, the division of responsibilities between the counties and municipalities is unclear and classifications are needed for non-agricultural land available for foreign investors. Furthermore, the process lacks transparency in defining which companies are eligible to buy land at auctions.

Currently there is work in progress on making the land purchase procedure more efficient. This work aims at dividing the responsibilities between counties and municipalities more clearly. So far the land registers have been kept in the counties, but decisions concerning them have been made jointly with the municipalities. According to the European Committee, a department at the Ministry of Agriculture has a new working group on the matter.

The main points of the current real estate law are as follows:

On 20 June 1996, Article 47 of the Constitution of the Republic of Lithuania was supplemented with Part 2, which provides that municipalities, other national entities, as well as foreign entities engaged in economic activity in Lithuania and complying with certain criteria determined by the law, may be allowed to acquire ownership of land plots for non-agricultural activities.

Together with the supplement to the Constitution of the Republic of Lithuania, the Constitutional Law On Subjects, Procedure, Terms and Conditions and Restrictions on the Acquisition for Ownership of Land Plots provided for in Article 47, Paragraph 2 of the Constitution was adopted. The effective date of the latter Law was co-ordinated with that of the European Agreement, for the establishment of Association between the European Communities and the member states thereof, on the one hand, and the Republic of Lithuania, on the other hand. The Constitutional Law came into force on 2 February 1998, the day after of the European Agreement.

According to the Constitutional Law, foreign entities registered and performing business activity in Lithuania, owned under effective control rights by foreign enterprises or persons, and foreign legal entities having established, for business purposes, affiliates or subdivisions without the status of a legal person in Lithuania, and Lithuanian entities (municipalities, Lithuanian enterprises having the rights of legal persons, *etc.*) are entitled to acquire the land plots necessary for the operation of premises and structures intended for their direct business activities, as well as land plots for the construction and operation of such premises and structures, provided the following conditions are met:

- The foreign enterprise is registered in a member state of the European Union (EU), or in a state which is a party to the European Agreement with the EU and the member states thereof, or in a state which, at the time of the adoption of the Constitutional Law, was a member of the Organisation for Economic Co-operation and Development (OECD) or a member of the North Atlantic Treaty Organisation (NATO).

- The foreign state of registration provides equal rights to Lithuanian entities, *i.e.* the rights are applied on a reciprocal basis.

- The foreign enterprise has its main place of business in the state of registration for at least 5 years.

- Permission of the government of the Republic of Lithuania is granted.

Entities complying with the above criteria may acquire land plots owned by private persons by way of purchase, exchange or other means according to the Laws, state- or municipal-owned land plots may be acquired (only where ownership is possible) by way of public sale and purchase or by way of purchase (without an auction or tender) if the land plot is leased from the state and buildings owned by lessee are located on it.

On 10 December 1998 the government adopted by resolution the procedure on the submission, examination and issuance of permits for the established national and foreign entities with respect to

applications for permission to acquire ownership of land plots for non-agricultural purposes. This resolution came into force on 17 December 1998, and it enables practical implementation of the provisions of the Constitutional Law. The main provisions of the resolution are the following:

- Permission to acquire ownership of land plots for non-agricultural purposes may be issued to the foreign entities, established by the Constitutional Law. Permission is issued by Area Governors, according to the location of land plots.

- The order regulates the form of national and foreign entities' applications for permission to acquire ownership of land plots for non-agricultural purposes, established by the Constitutional Law, specifies the documents and information to be submitted, the procedures of submission and examination of applications, and the issuance of permissions.

- The entities may file applications to acquire ownership of only those land plots for non-agricultural purposes, indicated in the Constitutional Law, which are, according to the detailed plans, approved under the procedure of the Law on Territory Planning of the Republic of Lithuania, stipulated for the construction of buildings and structures, necessary for appropriate business activities, or those necessary for the exploitation of the assigned buildings or structures for their primary business activities in Lithuania.

- The procedure provides details of the documents which the appropriate entities shall file together with an application (the latter to be completed according to the form attached to the resolution. Applications filed in breach of this procedure, will not be examined). Details are also provided of the information to be submitted together with an application as well as the established requirements, applied for the approval and legalisation of the submitted documents.

- The procedure stipulates periods of time, within which an area governor shall study submitted applications or, complete the necessary formalities, issue permission or inform the applicant of the reasons for the refusal of permission.

- The procedure also establishes that an area governor may apply to the appropriate state governing institutions of the Republic of Lithuania, seeking to get additional information regarding the financial reliability of the entities.

- The procedure defines the cases in which an area governor shall make a decision not to issue a permit, and in which an applicant may appeal against such decision to the government of the Republic of Lithuania or the ministry authorised by the former. If the government of the Republic of Lithuania or the ministry authorised by the former examine the said appeal, a decision, passed by the latter institutions shall be final.

- It has been established, that a permit to acquire ownership of a land plot for non-agricultural purposes is valid only for that national or foreign entity, for which the permit is issued. The terms of validity of the permit with respect to whether a land plot is intended to be acquired for exploitation of existing buildings or structures or for their future construction, as well as terms and the order of extension of the validity of the permit have also been prescribed.

There are no substantial restrictions for any Lithuanian or foreign entities to own, or in practice to purchase, buildings in Lithuania. The right of ownership of buildings is separated from the right of ownership of land. The ownership right to buildings itself does not create the ownership right to the land on which these buildings are located.

According to the Law on Land Lease, Lithuanian and foreign natural and legal persons are permitted to lease land in the country. The owners of private land and state-owned land are entitled to lease their land to natural or legal persons. The right of ownership of state-owned land is vested in state institutions, the area governor being the main owner, local municipalities, state authorities and state enterprises financed from the State budget.

The period of the private land lease is determined by the parties to the agreement. This period for state-owned land is determined by the area governor's administration and may not exceed 99 years. Both private and state-owned land may be sub-leased, but only upon obtaining permission from the lessor. In practice, the sub-lease period may not exceed the remaining period of the lease.

The state-owned land may be leased with or without holding an auction. Auctions are held in almost all cases, except when the state-owned land with structures and buildings is going to be leased to the owner of such structures and buildings. At the auction, a land plot is leased to the person who proposes the highest rental. The right to participate in an auction may not be restricted. The auctions for the lease of state-owned land are held by area governor's administration or by the mayor (the board) for a lease of land for a period up to 3 years. The institutions publish the list of land plots for lease in the privatisation bulletin every month.

Local representation of foreign companies

According to the "Law on the amendments and supplements to Articles 1, 2 12, 24 of Enterprise Law supplemented by Article no. 25" adopted on December 7, 1999 (No. VIII-1465), foreign enterprises can establish branches and representative offices in Lithuania. The number of branches and representative offices is not limited. The branch of a foreign enterprise is a subdivision of a foreign enterprise having its residence in Lithuania which can carry out commercial economic activity, make transactions and undertake liabilities only according to the authority delegated to it by its established enterprise. The branch is not a legal person.

Before this law came into force, one important obstacle for foreign companies willing to establish operations in Lithuania was that they were only allowed to open subsidiaries, not branches, in Lithuania. Among foreign companies, only commercial banks had the right to establish branches or "other analogous structural units that have right to earnings from commercial activity in Lithuania", pursuant to the Law on Commercial Banks.

Treatment of foreign personnel[41]

Foreign nationals and stateless persons who are not permanent residents of Lithuania may work temporarily in Lithuania under an employment contract or agreement, provided they have a *work permit* issued by the Lithuanian Labour Exchange under the Ministry of Social Protection and Labour. They also require a *special visa* issued by the diplomatic missions or consular offices of Lithuania abroad after permission is obtained from the Migration Department under the Ministry of Internal Affairs of the Republic of Lithuania. Employers may invite foreigners to Lithuania for temporary employment under an employment contract or according to a contract between a foreign company and a Lithuanian company only if the employer has a *license* to do so.

The law includes a list of exemptions for persons employed in certain situations. Exempted foreigners require *only a special visa*. Work permit and license requirements do not apply to the managing director, or the authorised representative of the managing director of a foreign company which has

established economic or trade relations with an appropriate company of the Republic of Lithuania; the managing director, or an authorised representative of the managing director of a company with capital of foreign origin. Also exempt are specialists, who come to start up or maintain equipment acquired abroad or train employees to work with it; consultants, who come to work for a period no longer than 3 months; or persons who are improving their educational or professional qualifications at the educational and training institutions in the Republic of Lithuania.

Administrative barriers and corruption

In spring 1999, the Foreign Investment Advisory Service (FIAS) of the World Bank Group conducted a mission in Lithuania to carry out a Study of Administrative Barriers to Investment. According to a July 1999 draft version of the resulting report, Lithuania has been making progress with its reforms, and improving its record in attracting investment. However, in many respects Lithuania is seen to be behind the other Baltic and Central European countries in its reform programmes. The issues referred to here were recognised to be of major importance.

First, business in Lithuania is still quite heavily regulated. It appears that there are more rules and regulations in force in the country than in the other Baltic states. Particularly over-regulated areas include access to land and labour. Most investors and lawyers who participated in the study complained about vague, confusing, and often contradictory laws and regulations. New legislation was frequent, with little advance notice to the business community and even less opportunities for input, although there were signs that this was starting to improve.

Second, many investors, large foreign ones in particular, described most of the administrative officials they dealt with in Lithuania as quite reasonable and flexible. This was especially true of the higher level officials. Some business people reported that they pay bribes regularly, some that they never did. It appeared that many service providers routinely paid small bribes to officials, and later on incorporated them in to their fees to their clients, who in turn might claim that they never pay bribes.

Third, a striking difference was found in attitude of the small and medium enterprise sector, which described the bulk of the Lithuanian bureaucracy as corrupt and discriminatory. Many interviewees, both in the public and the private sector, agreed that the government appeared to be biased in favour of big business.

Fourth, it appeared in the study that the complex rules and regulations were much more of a burden on SMEs, many of whom could not afford professional legal or accounting advice.

Finally, the government was found to have often taken an inappropriately harsh, yet ineffective approach towards revenue collection. Some of these campaigns have proven to be inefficient and fall short of expected results.

Corporate governance – legal protection of minority shareholders' rights

The protection of shareholders' rights is provided for in the Company Law. The following (minority) rights are specifically mentioned in the law:

The rights to receive information on the business activities of the company:

- Each shareholder shall have the right of access to the statutory report and the auditor's findings and the right to make copies thereof.

- During the stated period every shareholder shall have the right to familiarise himself with the company's plan of reorganisation, its valuation, business indices of the companies under reorganisation and the auditors' reports as well as to make copies thereof.

- At the shareholder's request, the company must present to him for inspection or copying the annual and intermediate financial statements, the reports of the Board on the activities of the company, the minutes of the meetings, and the share register; the company shall also present minutes of the supervisory board and board of management meetings to the shareholders who have given a written promise required by the company not to disclose confidential information, provided that the minutes contain no officially unpublished information on the company's stock movements.

- On giving a written promise not to disclose confidential information, the shareholder with shares of a total par value accounting for at least 1/20 of the company's authorised capital or the representatives of such shareholders shall have the right of access to all minutes of the supervisory board or the board of management, the transactions entered into by the company, also the guarantees offered, warranties, contracts of long-term pledge and exchange of tangible property. Information (except for the public information specified by the laws of the Republic of Lithuania) which is accorded the status of confidential information by the resolution of the company Board shall be considered as such.

The right to appeal:

- Shareholders shall have the right to appeal in court against the resolutions or actions of the general meeting, the supervisory board, the board of management and the head of administration, which violate the laws, the company's articles of association, the property and non-property rights of the shareholders.

The right to inspect the company's facilities and premises:

- Shareholders, with holdings of a total par value of not less than 1/10 of the authorised capital or the institution which holds the special shares shall have the right to appoint an expert (a group of experts) to inspect the company's facilities and accounting documentation in order to establish whether or not there are any indications of insolvency or fraudulent bankruptcy, or waste of the company's assets, entry into unprofitable transactions, infringement of the shareholders' rights, including, among all other things, unjustified payment of wages or granting of concessions or privileges (when this a causes reduction of the company' profit or brings about losses).

Rights, related to general meeting:

- The board must publish a notice about the convening of the general meeting in the periodicals specified in the articles of association or notify each shareholder by registered mail (with confirmation of delivery of such a letter) not later than 30 days prior to the day of the meeting.

- No later than 30 days prior to the day of the meeting, the board must send to the shareholder with not less than 1/20 of all votes the information specified in Paragraph 7 hereof by registered mail and/or by fax provided the shareholder has given his fax number and if he requests the information.

- Voting at the general meeting shall be open. On the issues on which at least one shareholder requests a secret vote to be taken, provided that he is supported by shareholders possessing at least 1/20 of the votes, secret voting shall be mandatory for all shareholders, except for the person representing the shares owned by the state or municipality.

- At the proposal of shareholders holding not less than 1/20 of all the votes submitted at least 15 days prior to the general meeting, additional items of business and draft resolutions must be put on the agenda, while the candidates for the members of company's managing bodies or inspectors (auditors) nominated by them (before or in the course of the meeting) must be included in the voting lists or ballots. The articles of association may also provide for a smaller number of votes to entitle the shareholders the above right.

- The right to take the initiative to convene the general meeting shall be vested in the shareholders with no less than 1/10 of the votes, unless the articles of association provide for a smaller amount of votes as well as the institution which holds the special shares.

The right to a proportional share of the raised authorised capital:

- The shareholder's priority right to gain part of new shares which are transferred to the shareholders in proportion equal to his owned authorised capital guarantees, so that his part of capital will be not decreased by an increase of the authorised capital.

In the 1998 World Bank country study on Lithuania, it is stated that the "size-specific" legal protection afforded minority shareholders in many developed countries is still partly lacking in Lithuania. For example, mandatory systems of cumulative voting, qualified majority, and supermajority requirements in major decisions; extensive disclosure requirements; and explicit obligations for managers to run companies in the interest of all shareholders, not just majority shareholders or insiders, are lacking in the country's legislation. According to the study, managers, especially owner-managers, are known to have "jawboned" small shareholders, particularly employees, into supporting them or selling their shares to management. Insider ownership in former state-owned companies will be discussed briefly in the next sub-section on privatisation.

4.2 Sectoral restrictions

The new Investment Law liberalises the former restrictions imposed on foreign investment to such an extent that, in practice, foreign investment will be allowed in all legal activities in Lithuania. Thus, the motivation for sectoral restrictions is generally similar to international standards and they are not aimed at discriminating against any economic entities by their country of origin. The relative economic importance of these sectors is rather marginal by nature.

In the new Investment Law, investment of capital of foreign origin is prohibited in the following spheres of economic activity:

- Investment related to security and defence of the state.

- Manufacture or sale of narcotic substances, and other non-medicinal, poisonous substances.

- Cultivation, processing and sale of cultures that contain narcotic and poisonous substances or potentially harmful substances.

There are also special restrictions on foreign investment in financial activities in Lithuanian legislation related to these activities: the Insurance Law and Law on Commercial Banks.

The 2 July 1996 document, "On Provision of Information to the Public", states that foreign citizens are not allowed to own mass media outlets. However, on 7 July 1999, the Amendment Law on Provision of Information to the Public was introduced (No. VIII-1308). The law amends Part 4 of the Article 16 and states that "conditions for investment in the mass media market are set by the new Investment Law". The new Investment law has no restrictions on investment in the mass media sector and foreign citizens are free to own mass media outlets in Lithuania.

4.3 Monopolies and concessions

In accordance with the Law on Enterprises, only state-owned enterprises, municipal enterprises and special purpose companies (public and private) shall have the right to engage in the following activities, provided that they have licences issued in the manner established by the Government of the Republic of Lithuania:

- Production of alcohol products in which the volume of ethyl alcohol exceeds 22°. This right shall be vested only in state-owned enterprises unless the Law on Alcohol Control establishes otherwise.

- Printing of currency, stamps and minting coins.

The concept of concession, objects of concessions and spheres of business activity for which concessions may be granted are defined in the Law on Concessions (10 September 1996). The law describes the procedure for granting concessions, the rights and duties of government institutions and those of enterprises, both Lithuanian and foreign, which operate on the basis of concession contracts.

In the Republic of Lithuania the following objects may be subject to concessions:

- Objects to which, according to the Constitution of the Republic of Lithuania, the State of Lithuania has exclusive rights, *e.g.* the continental shelf and the economic zone in the Baltic Sea.

- Objects which are in the exclusive ownership of the State of Lithuania, *i.e.* the land mass, internal waterways, roads, historic, archaeological and cultural objects of national significance.

- State-owned enterprises of the Republic of Lithuania which are not to be privatised within the term of the concession.

- Buildings, structures, installations, transport and other facilities which are not to be privatised within the term of the concession.

- Facilities and enterprises owned by municipalities which not to be privatised within the term of the concession.

State-owned land shall not be the object of concessions. Where the concession is related to the use of state-owned or private land, the competition for the concession contract may only be announced when the grantor of the concession is in the position to guarantee the drawing up of a land lease on the terms set in the state offer.

4.4 Privatisation[42]

Voucher and cash stages of Lithuanian privatisation

In the process of privatisation, two stages may be distinguished. The first one is the privatisation of distributive character that covered privatisation of state property for vouchers. The second one is commercial and ongoing as some major privatisations are still ahead.

The first stage of privatisation took place from the beginning of 1991 until mid-1995. Its characteristic feature was the fast privatisation of state property for vouchers. During this stage, privatisation was regulated by the Law on Initial Privatisation of State Property, adopted in February 1991. The process was also based on other relevant laws of the Republic of Lithuania and resolutions of the Lithuanian government that regulate certain aspects of privatisation.

During the first stage of privatisation only the citizens of Lithuania and special joint stock companies had the right to purchase industrial state property for vouchers, but both Lithuanian and foreign companies and citizens had the right to purchase property with convertible currency. In practice, this stage of privatisation resulted in insider-dominated and limited foreign ownership of Lithuanian enterprises.

The total number of enterprises participating in the privatisation process varied during the first phase. At the beginning of the process 3 500 enterprises were singled out for privatisation. During the first phase this number increased to 8 050. These companies represented approximately 70 per cent of all enterprise assets in terms of book value. By the end of the first phase, 5 714 enterprises or 88 per cent of the total assets offered for sale were privatised. 2 928 large and medium-sized enterprises were privatised through the public subscription of shares, 2 726 small companies were sold through auctions, 48 enterprises for hard currency and 12 companies were sold through tenders on the basis of the best business plan submitted.

In the first stage of privatisation, privatised state-owned capital amounted to LTL 3.9 billion or approximately US$975 million and accounted for about 30 per cent of the total value of the state assets. The majority of the state property (LTL 2 628 million or 78 per cent) was sold through public subscription of shares. State assets worth LTL 368 million (11 per cent) were privatised through tenders on the basis of the best business plan submitted and assets worth LTL 79 million (2.4 per cent) were privatised through auctions. The remaining state-owned property was valued at about LTL 9.9 billion or approximately an equivalent of US$2.5 billion. Thirty-one per cent of all state assets in industry, 60 per cent in trade, 6 per cent in transport and 4 per cent in utilities were transferred into private ownership during the first phase. It is estimated that around 45 per cent of the

assets were sold against the vouchers, which were originally distributed to all adult citizens, and 30 per cent were sold for cash. Cumulative state privatisation revenues amounted to about LTL 230 million (US$58 million) by the end of 1995.

The second stage of privatisation started in July 1995 with the passing of a new Law on Privatisation of State and Municipal Property. This law legalised commercial privatisation, set more diverse and flexible methods of privatisation and equal conditions for both foreign and Lithuanian investors when privatising state property. The amended Law on Privatisation of State and Municipal Property in the Republic of Lithuania, of 4 November 1997, came into force 1 December 1997. It legalised the State Property Fund as the main privatisation institution (in place of the Privatisation Agency) and the Municipal Property Funds. The State Property Fund operates as administrator of the privatisation assets and privatises the state property held by ownership right. The law specifies more exactly the functions of the privatisation institutions, the procedure for the privatisation operations and the methods used. This second stage is characterised by major infrastructure privatisations and thus a greater inflow of foreign capital into the economy.

In 1996 the government approved a new list of objects to be privatised. It comprised 454 objects with state capital of LTL 835 million. In 1996, 47 entities were privatised for LTL 3.2 million, state capital privatised amounted to LTL 48 million of all state capital foreseen for privatisation. During 1997, 272 entities were privatised for an amount of LTL 80.9 million.

The Government of Lithuania, by resolution of 11 February 1997, offered to privatise by way of international tender in 1997-1998 large and state-controlled enterprises of national importance in the transport, energy and telecommunications sectors. This included the following public limited companies:

- Lithuanian Telecom (“Lietuvos Telekomas”)
- Klaipėda Stevedore Company (“Klaipėdos Jūrų Krovinių Kompanija”)
- Lithuanian Shipping Company (“Lietuvos Jūrų Laivininkystė”)
- Lithuanian Airlines (“Lietuvos Avialinijos”)
- Lithuanian Aviacompany (“Aviakompanija Lietuva”, subsidiary airline of the above)
- Lithuanian Fuel Company(“Lietuvos Kuras”)
- Mažeikiai Oil Refinery (“Mažeikių Nafta”)
- Hotel Lietuva (“Vieðbutis Lietuva”)
- Ship Repair Yard (“Vakarų Laivų Remontas”), *etc.*

Later on, some enterprises, for example Hotel Lietuva (“Lietuvos Vieðbutis”), “Laivit•”, Kaunas Aviation Company (“Kaunos Aviacijos Gamykla”) were excluded from the list to be privatised according the usual procedure.

With the commercial privatisation procedures in place, the largest contract in Lithuania so far has been the transfer of 60 per cent of the shares of *Lietuvos Telekomas* (Lithuanian Telecom) to the strategic investor – Consortium *Amber Teleholdings* comprised of the Swedish company *Telia* and the Finnish

company *Sonera* – for US$510 million in cash and an investment commitment of US$221 million in the subsequent two years. In 1998, 344 entities were sold for LTL 2.33 billion. As of 31 December 1999, the second stage of privatisation had already witnessed the sale of 1364 privatisation objects for LTL 2.98 billion. As for 31 December 1999, 37.4 per cent or LTL 2 565.6 million of the total FDI stock of LTL 6 852 million originated from privatised enterprise purchases, and investment guarantees accounted for additional FDI volume of LTL 1 563.4 million. (according to data on concluded privatisation transactions).

Privatisation Law

The purpose of the law is to establish the privatisation procedure for the disposal of state-owned and municipal property for cash. Shares and other property owned by the state or municipalities may be transferred into the ownership of other persons only under this law and the Law on Public Trading in Securities, unless provided for by other legislation.

Each owner of an object to be privatised must present to the Property Fund and/or potential buyers documents and other information about the object in the manner prescribed by the government. Confidential information must be furnished to the potential buyers only on prior receipt of their written promise to treat the information accordingly. The requirements for the appropriate treatment of confidential information may be laid down in the privatisation transaction.

The value of the privatisation object shall be assessed by the Property Fund or the commission formed by the Fund from persons qualified in property valuation or from commercially operating property valuers selected by the Property Fund by way of tender.

The list of privatisation objects shall be approved by the government on the recommendation of the Property Fund. The list must include shares in all state- and municipality-owned enterprises, except for the shares in public and private companies where privatisation is restricted by law. On the recommendation of municipalities, the Property Fund shall also include in the privatisation list municipality-owned assets which have been identified for privatisation.

The information on the privatisation object specified in the law must be published in the Privatisation Information Bulletin at least 30 days prior to the commencement of acceptance of tenders or other privatisation documents for participation in the process. When shares are traded on the stock exchange, information on the privatisation object shall be published in the Privatisation Information Bulletin and in the stock exchange bulletin in accordance with the regulations laid down by the stock exchange. When it is feasible to sell the privatisation object to a foreign natural or legal person, the information on the privatisation object prescribed by the Property Fund must also be published in the foreign press.

Article 13 of the Law provides for the following six methods of privatisation: (i) public sale of shares; (ii) public auction; (iii) public tender; (iv) direct negotiations; (v) transfer of control of state or municipally controlled enterprises and (vi) lease with an option to purchase. Combinations of these methods may also be used:

- Public Sale of Shares – in a public sale, shares are offered without quantitative restrictions on either the number of purchasers or the amount of shares subscribed, and the sale price is determined by market-based supply-demand principles. Such shares are privatised by selling the state or municipally owned shares in public companies through

brokerage firms on the stock exchange in accordance with the rules approved by the exchange.

- Public Auction – the public auction method of privatisation is used in order to obtain the highest sale price for the privatised property, although other privatisation conditions established in the privatisation programmes of those properties must also be fulfilled. Only shareholdings of public and private companies or long-term material assets may be sold by public auction. The purchaser in either case is the bidder who has offered the highest price, with no limitation placed on the number of potential bidders.

- Public Tender – a public tender is the sale of one or several properties to a purchaser who, in response to a tender, is judged to have provided the best price and investment proposal in writing, including a discussion of the terms for the acquisition of long-term and short-term material assets and the increase of authorised capital in a public or private company, and conditions satisfying the minimum job requirements as stated in the tender. Negotiations to improve the offered conditions may be held with the potential purchaser who has presented the best proposal or with several potential purchasers whose proposals do not differ by more than 15 per cent. When privatising state or municipally controlled enterprises by way of public tender, the employees of such enterprises may be given the opportunity to purchase up to 5 per cent of state or municipally owned shares at a nominal price.

- Direct Negotiations – this method is used for the privatisation of properties with specific or unique features that may limit the number of potential purchasers. Potential purchasers in this case are known as *strategic investors*, and are chosen by applying special qualification criteria. The government must approve the list of potential strategic investors, together with the privatisation programme, for the specific asset in question. As in the case of privatisation by public tender, when privatising a state or municipally controlled enterprises through direct negotiation, the employees of such an enterprise may be given the opportunity to purchase up to 5 per cent of the state or municipally owned shares at a nominal price.

- Transfer of Control in State or Municipally Controlled Enterprises – this method is used for the privatisation of enterprises only if the shares of such an enterprise cannot be sold by other privatisation methods, or if more than 1/2 of the state or municipally owned shares in such an enterprise have already been privatised by applying by other methods. The method of privatising through the transfer of control in an enterprise involves the issue of convertible debentures, or new shares through additional capital contributions, that may result in a decrease in the state or municipality's shares below the 2/3, 1/2 or 1/3 levels necessary to vote on specific matters at the general meeting of shareholders. Transfer of control is executed by the refusal of the state or municipality to acquire newly issued securities; instead, the state or municipality transfers its right of first refusal to a privatising purchaser.

- Lease with the Option to Purchase – this is a public privatisation method under which a potential purchaser, upon agreeing to the transaction and taking over the property, acquires full rights of ownership and use. The lessee may exercise his ownership option by paying the full purchase price and fulfilling any other conditions established in the lease/purchase contract. Privatisation through a lease with an option to purchase is used for the privatisation of long-term material assets after a previous privatisation attempt has failed. The main criterion used in evaluating and accepting these proposals is the amount

of rent proposed, discounted on the day the tender is held. The maximum term of the lease, which cannot exceed 10 years, is established in the privatisation programme. The annual rental payment may not be less than the market value of the property divided by the lease term in years.

A combination of privatisation methods may be used for the privatisation of state-controlled enterprises that are deemed to be important entities in the country's overall infrastructure, or entities holding a dominant position in certain sectors of the economy. The following combinations of privatisation methods can be used:

- Public tender with transfer of control in a state- or municipally controlled enterprise, either at the time of the privatisation transaction or at a later date.

- Direct negotiations with transfer of control in a state- or municipally controlled enterprise, either at the time of the privatisation transaction or at a later date.

- Public tender and public sale of shares.

- Direct negotiations and public sale of shares.

The use of the public sale of shares in the third and fourth combinations above is envisaged for situations in which it is desirable to publicly sell a portion of the shares of the enterprise, or if a strategic investor has not acquired or cannot acquire all the shares on offer due to limitations on share acquisition. In these cases, the remaining number of shares may be sold by public sale on the stock exchange after the conclusion of the privatisation transaction with the strategic investor. In addition to these four combinations of methods, other combinations may be used as well.

At the start of mass privatisation, a decision was made not to privatise large industrial infrastructure assets. A special law even imposed a ban on their privatisation until 2000. Under new conditions, such prohibitions have disappeared from the privatisation agenda. The new law on privatisation provides possibilities and sets methods for privatisation of such large objects as Lithuanian Gas, KLASCO, Lithuanian Power Company as well as state commercial banks subject to the adoption of special resolutions. At this point it is noteworthy that the role of international corporations in the Lithuanian privatisation process has become increasingly important, as participation by local investors is not common when privatisation concerns high-value assets.

Shortcomings of privatisation procedures

Before the establishment of the State Property Fund and amendments to the Privatisation Law, investors faced a number of problems during the privatisation process. For example:

- The management of an enterprise being privatised did not always act openly when providing information.

- Most of the enterprises to be privatised had an excessive number of employees whose dismissal was strictly regulated by law.

- State institutions in charge of privatisation faced psychological problems when considering valid proposals to privatise a property for the price of "1 Litas", even if it was obvious that the enterprise could not survive under state or municipal control. Actually, only the joint stock fuel company *Lietuvos Kuras* was sold for 1 lita.

In the 1998 World Bank country study on Lithuania, it was stated that a complete re-engineering of individual and institutional incentives was needed in Lithuania's privatisation process. The need for the law to specify explicitly what is to be sold, by whom, and when was highlighted. If it is not

possible to revise the law in the short-term, the study suggested that the government should express these principles of its intended privatisation sales carefully and unambiguously and require the use of best privatisation practices, including those of market valuations, internationally established advisers, and transparent, modern sales techniques. Otherwise, according to the World Bank, privatisation would remain a protracted and episodic phenomenon, driven by *ad hoc* political expediency, rather than by a systematic effort to transfer the ownership of national resources to the private sector as soon as possible.

As discussed in Chapter 3, Lithuania has not availed of much foreign technical assistance for its privatisation programme and has, as a result, lost time and money and not achieved maximum efficiency in privatising industrial sectors. The initially established Privatisation Agency was unable to complete the task of privatisation and was replaced by the present State Property Fund.

The Privatisation Fund has also had to face certain criticisms. It handles all funds in connection with privatisation deals, and also those which the companies have received as loans. In early 1999, it was found that the balance on the Fund's account consisted only of borrowings, a fact, which had not been disclosed by the then Prime Minister. The actual balance from privatisation earnings was zero or negative, which was unfortunate for the government's plan to use such earnings to compensate those who lost their savings as a result of high inflation in the early years of economic reform.

As mandated by law, approximately two-thirds of the privatisation revenues must be spent on compensation for the households which lost their savings at the beginning of the decade and, as approved by the Government, on the creation of a reserve (stabilisation) fund. The remaining one-third of privatisation revenues may be allocated to finance economic programmes, such as public investment projects. With Lithuania under the effects of the Russian crisis, privatisation receipts were used as an additional source of liquidity for government expenditures. According to the European Commission Report of October 1999, such use of privatisation funds needs to be temporary, as it tends to aggravate the current account imbalance and might mask necessary structural reforms of public finances.

Status of privatisation

The voucher phase of Lithuanian privatisation came to an end in 1995 and cash privatisation has been dominant since 1996. In 1998, privatisation revenues accounted for 5.8 per cent of GDP, which was five times higher than the previous year.

During 1999, privatisation revenues accounted for about 1.3 per cent of GDP. In March 1999, a 90 per cent stake in the *Klaipeda Stevedore Company (KLASCO)* was sold to a Lithuanian-German consortium for LTL 200 million (US$50 million). In May, 70 per cent of the state insurance company *Lietuvos Draudimas* was sold to a Danish company for LTL 100 million (US$25 million) through an international tender. At the end of 1999 the privatisation transaction for an 80.89 per cent shareholding in the sea transport company *Klaip•dos transporto* laivynas was concluded with a Norwegian company for a total of LTL 83 million (US$20.75 million).

In May 2000, the privatisation list still contained almost 3000 items with public shares and real estate assets to be privatised. However, in the case of almost 700 items, the state share is less than 30 per cent while in the case of more than 200 companies, its share exceeds 50 per cent. As of the end of 1999, the most important sectors remaining to be privatised were the oil and gas, energy and financial services sectors.

Privatisation of the Agricultural Bank was originally planned for 1998, but was, however, delayed by the Russian crisis in autumn 1998. Since then, the government has decided to extend guarantees on some loans to the agricultural sector, which may increase the attractiveness of this bank. Advisers of the EU's Phare programme have made an evaluation of the bank's shares and the transformation of the shares of the Lithuanian Development Bank managed by the European Bank for Reconstruction and Development into shares of the Lithuanian Agriculture Bank has been finalised recently. The legal audit of the bank has already been carried out and the documents for privatisation have been drawn up. The privatisation plans for the Lithuanian Agricultural Bank were announced in March 2000 and the Tender Commission is currently reviewing the submissions.

The Lithuanian Savings Bank is being prepared for privatisation in two stages. The consortium managed by DFC is carrying out the necessary preparations for the privatisation transaction (legal and financial audit, evaluation of shares, drawing up of the Information Publication). After having been selected as the privatisation adviser, the investment bank will carry out a preliminary search for potential investors, prepare all the necessary background information and provide assistance in the evaluation of offers, negotiations and the drafting of the privatisation contract.

The remaining privatisation of the energy sector aims at unbundling the distribution, production and the networks of the oil and gas industries. The oil sector is composed of three parts: Butinge terminal, a refinery and state-owned pipelines.

The law regulating the reorganisation of the energy sector joint stock companies, *B•ting•s Nafta, Ma eiki• Nafta* and *Naftotieki* was adopted on 29 September 1998. It establishes the procedures for the reorganisation of these enterprises and stipulates that the state shareholding of *Ma eiki• Nafta*, the largest oil refinery complex in the Baltic region, shall be privatised as provided for in the Law on the Privatisation of State and Municipal Property after a new issue of the company shares has been acquired by a strategic investor. In June 1999, the parliament adopted amendments to the law governing the status of Mazeikiu Nafta so that a strategic investor could acquire a controlling stake of up to 66 per cent.

The sale of Mazeikiu Nafta was concluded in late October 1999 after almost two years of negotiations. United States-based Williams International bought a 33 per cent stake in the company for US$150 million. The agreement stipulates that the Lithuanian state must contribute US$344 million to the reconstruction of the refinery.

There has been a certain fear of Russian capital in Lithuania. This fear, which is mostly political, has been particularly strong where strategic sectors are concerned, such as energy, oil and gas. In those sectors, however, Russian investors are needed in order to ensure the availability of relatively cheap raw materials. When the industries have been restructured and production costs reduced, the situation might change. In 1999, a major Russian oil company, Lukoil, was also interested in acquiring a stake in Mazeikiu Nafta. A few times during the year, Russia cut crude oil supplies to the refinery in protest against the sale of the company to a United States investor.

In the gas sector, Lithuania is likely to follow Estonia and Latvia and sell part of the sector to the Russian Gazprom. Building a "power bridge" to Poland is an important for Lithuania in the energy sector.

In its medium-term economic strategy, the government sets out the short-term privatisation objectives. In accordance with these, the privatisation initially of large enterprises, followed subsequently by the privatisation of the remaining small and medium-sized enterprises, should be accomplished during 2000, while the privatisation of infrastructure enterprises and the reduction of state aid to

manufacturing enterprises are planned in the medium-term. Local investors are expected to acquire the largest part of small blocks of shares, while foreign investors are seen as major potential participants in the privatisation of large enterprises.

The four tables below present details on privatisation in Lithuania as of 30 November 1999.[43]

Table 4.1 Capital of privatised entities (in thousand Litas) by economic sector as of 1 May 2000

	1996	1997	1998	1999	2000
Total	4 802	54 665	846 657	495 718	200 055
Telecommunications	66	5	488 948	40 615	0
Industry	355	24 450	255 148	51 781	94 664
Transport	0	2 648	37 181	223 906	957
Construction	246	887	2 870	17 320	62 699
Trade	704	4 696	7 123	117 973	20 935
Public utilities	0	2 852	18 864	4 010	3 913
Services	862	469	683	482	25
Real Estate	2 569	18 402	31 189	18 171	8 682
Other	0	256	4 651	21 458	8 180

Table 4.2 Number of privatised entities by method as of 1 May 2000

	Direct negotiations	Leasing with an option to purchase	Public tender	Public subscription of shares	Public auction	Total
2000	-	9	13	10	279	308
1999	3	4	19	28	649	703
1998	1	2	14	6	321	344
1997	0	7	1	0	264	272
1996	0	1	0	0	46	47
	4	14	28	29	1182	1257

Table 4.3 Concluded transactions by privatisation method, thousand LTL as of 1 May 2000

	Leasing with an option to purchase	Public subscription of shares	Public auction	Public tender	Direct negotiation	Total
2000	1 078	3 870	28 221	58 230	-	91 399
1999	233	53 132	92 519	110 608	316 433	572 925
1998	107	1 733	72 130	214 875	2 040 000	2 328 845
1997	705	0	80 809	852	0	82 366
1996	29	0	3 204	0	0	3 233

Table 4.4 Number of privatised objects by economic sectors as of 1 May 2000

	1996	1997	1998	1999	2000
Total	47	272	344	703	308
Industry	5	31	39	67	34
Transport	1	6	8	10	5
Telecommunications	1	1	1	2	0
Construction	7	22	14	27	11
Trade	12	81	91	167	52
Public utilities	0	1	3	13	5
Services	3	7	11	17	4
Real Estate	18	116	158	367	187
Other	0	7	19	33	10

4.5 Investment Incentives

Investment promotion according to the Investment Law

The new Investment Law of July 1999 includes the following two articles on investment policy and promotion. In general, the law guarantees equal conditions to Lithuanian and foreign investors.

Article 12. State Investment Policy

1. The State shall provide favourable conditions for private investment and ensure efficient use of state funds earmarked for investment in order to promote economic and social development of the state.

2. The State, employing the methods specified in Article 13, shall support investment intended for state priorities, improvement of the ecological situation, upgrading of technology of prospective industries, development of small and medium -sized business and satisfaction of the basic social needs of the public.

3. Taking into account the parameters prescribed by the Government of the Republic of Lithuania or the competent authority, the state may allocate funds and give loans and loan guarantees for investment in the restructuring of sectors of the economy, reduction of economic and social differences between separate regions of the country, creation of new jobs and mitigation of natural disaster effects.

Article 13. Promotion of Investment

1. Tax privileges granted to investors shall be determined by appropriate tax laws.

2. A certain portion of interest on loans taken for the purpose of investment financing may be paid with the resources of target-oriented state (municipal) funds. The procedure and terms and conditions of payment of interest shall be determined by the regulations of the funds.

3. Lithuanian and foreign creditors who have granted loans for funding investment projects may be given state (municipality) guarantees in accordance with the procedure established by the laws of the Republic of Lithuania.

4. Loans intended for implementing investment projects may be insured with public funds in accordance with the procedure established by the Government of the Republic of Lithuania.

5. The Government or the competent authority shall have the right to conclude investment contracts with strategic investors, establishing special investment and business conditions, provided that the investment amounts to not less than LTL 200m and meets the criteria established by the Government of the Republic of Lithuania. The terms and conditions of taxation of business shall be established in such contracts according to the procedure laid down by the Law of the Republic of Lithuania on Tax Administration.

6. The municipality shall have the right to conclude investment contracts for investment in the infrastructure, production or service sectors of the municipality, provided that the contracts meet the criteria prescribed by the municipal council. Special terms and conditions of investment, business

or choice of land plot shall be established in such contracts according to the jurisdiction of the municipality.

Tax incentives

Tax concessions are still available to both foreign and local investors. The provisions on tax incentives are laid down in the Corporate Income Tax law. The CIT law covers some of the tax incentives, which were included in the old Capital Investment Law.

Prior to January 1997, foreign investors were given some special tax concessions but since then it has not generally been the case. However, the government has the right to make contracts directly with strategic investors and give them tax concessions. Moreover, in accordance with the Law on Administration of Taxes the government has committed itself not to increase the rate of direct taxation for strategic investors, which have concluded the contracts with the government. Free economic zones also can give tax concessions to foreign investors.

Another incentive was introduced in October 1998 to favour foreign investment made in the entity registered in Lithuania and amounting to LTL 200 million (US$50 million). If such investment is made in three years from the above mentioned date, the government will be obliged to enter into an investment agreement with the investor(s), whereby the investors will be assured that rates of direct taxation established and applicable at the time of investing will not be increased for that particular investor for a period of five years. At its own discretion, the government may prolong the term of application of the tax incentive for up to ten years for investors that are considered strategic.

Laws on taxation of profits of legal or physical persons provided for tax exemptions on all investments made in fixed tangible assets of enterprises until 1 April 1997. In these tax exemptions, there are no differences between the treatment of foreign and domestic investors in the law. From the above date, most special tax exemptions for foreign investors were abolished. The following are, however, still in force.[44]

Firstly, enterprises in free economic zones shall pay profit tax at an 80 per cent of the official rate for five years from the date of registration of the enterprise, while for the subsequent five-year period, the rate shall amount to 50 per cent of the regular profit tax rate. If a foreign investor acquires at least 30 per cent of the authorised capital of the enterprise and invests foreign capital of at least US$1 million, the enterprise shall be exempt from taxes on profits for a five-year period from its date of registration and for the subsequent 10 years the rate of tax levied on the enterprise's profits shall be reduced by 50 per cent.

Secondly, if an enterprise was set up (registered) or foreign capital was invested prior to 31 December 1993, the rate of profit tax applicable to the share of its profit (proportionate to the share of foreign capital in the enterprise's authorised capital) due to the foreign investment and not used for the payment of wages or re-invested, shall for a five-year period be reduced by 70 per cent. On expiry of this 5 year period the part of profit (income) due to the foreign investment shall be taxed for a further three years by corporation (income) tax reduced by 50 per cent.

Thirdly, if an enterprise was set up (registered) or foreign capital invested in the period from 1 January 1994 to 1 August 1995, the rate of profit tax applicable to the share of profit due to the foreign investment shall for a six-year period be reduced by 50 per cent.

Fourthly, an enterprise with a foreign capital participation of US$2 million shall be exempt from profit tax for a three-year period starting from the beginning of the accounting quarter in which the enterprise became profit-making. During the subsequent three years, the rate of profit tax applicable to the enterprise shall be reduced by 50 per cent. The tax concessions described here shall not apply to enterprises engaged in wholesale and retail trade in oil products if their income from trade in these products accounts for over 30 per cent of their sales revenue.

Lastly, companies with not more than 50 employees and a total gross annual turnover not exceeding LTL 1 million (US$250 000) are eligible for a reduced profit tax rate. As of 1 January 1999 the profit tax rate is 15 per cent. The incentive is not applied to legal entities that are engaged in activities related to sales of alcoholic beverages including beer or tobacco products.

It should be pointed out that despite the above-mentioned tax incentives, the ambiguity of taxation in general is perceived as one of the most important barriers to foreign investment in Lithuania, as described in the previous chapters.

Free Economic Zones

"Lithuania is continuing to enhance its appeal to foreign investors through the development of a network of Free Economic Zones (FEZ) set up at key transport and industrial centres. Šiauliai, Klaipeda and Kaunas, three of Lithuania's largest cities, were chosen for their blend of modern infrastructure, well-developed industrial bases and experienced labour force." – Lithuanian Development Agency.

In June 1995, Lithuania's Parliament adopted the Law on the Fundamentals of Free Economic Zones. Lithuanian and foreign companies, corporations and associations are eligible to participate in the free economic zones. FEZ incentives include:

- For investments over US$1 million:
  - a corporate tax holiday for the first 5 years and
  - 50 per cent tax reduction for the following 10 years (an actual rate of 14.5 per cent)
- For investments under US$1 million:
  - corporate tax reduction of 80 per cent for the first 5 years (an actual rate of 5.8 per cent) and
  - 50 per cent tax reduction for the following 5 years (an actual rate of 14.5 per cent)
- No customs duties
- No VAT and excise taxes
- No road taxes
- No real estate taxes
- No foreign exchange restrictions

- Streamlined and simplified customs and administrative procedures
- The same legal guarantees apply to companies located inside a FEZ as to those outside
- Special write-offs for investments and other expenses on long-term assets and new technologies.

Areas of capital investment and activities prohibited within free economic zones include:

- Industrial or commercial activities connected with ensuring state security and defence, as well as with the production, storage or sale of arms, ammunition or explosives, or having a harmful effect on the environment.
- Production, processing, storage and neutralisation of hazardous and radioactive materials.
- Production, sale and storage of narcotics, virulent and poisonous substances.
- Processing, sale and storage of crops containing narcotic, virulent and poisonous substances.
- Manufacture of vodka, liqueurs and other liquors.
- Manufacture of tobacco products.
- Printing of securities, paper money and postage stamps, minting coins.
- Operation of gambling establishments.
- Organisation of lotteries.
- Publishing activities, except for personal needs, preparation and broadcasting of radio and TV programmes, with the exception of technical servicing of printing facilities, radio and television.
- Treatment of patients who are ill with serious and dangerous infectious diseases, including venereal and contagious skin diseases, aggressive forms of mental diseases.
- Treatment of animals dangerous diseases.
- Settlement of labour migration issues.
- Investment of foreign capital in the exploitation of natural resources shall be prohibited without a concession.

The Law on the Fundamentals of Free Economic Zones, 1995 (No. I-976) has several amendments. In addition, in October 1999, government Resolution No. 1094 was adopted, declaring the free economic zones in Kaunas, Klaipeda and Siauliai to be economic projects of national importance.

According to the second Regular Report from the EU Commission on Progress towards Accession, none of the free zones were operational and the legislation was only partially compatible with EU legislation as of October 1999.

Investment guarantees and protection

In the 1999 Investment Law, Articles 6 and 7 set out the guarantees of the rights of investors and the provisions for securing investments in the case of reimbursable appropriation in the following way:

Article 6. Guarantees of Investors' Rights

1. State and local authorities and officers shall have no right to interfere with the management, use and disposal of by the investors of the object of investment according to the procedure prescribed by the laws of the Republic of Lithuania. Damage inflicted on the investor by unlawful acts of state or local authorities and their officers shall be compensated according to the procedure established by the laws of the Republic of Lithuania.

2. Disputes relating to infringement of the rights and lawful interests of the investor/investors shall be settled according to the procedure established by the laws of the Republic of Lithuania. Disputes between the foreign investor(s) and the Republic of Lithuania relating to infringement of their rights and lawful interests (investment disputes) shall be handled, on agreement between the parties, by the courts of the Republic of Lithuania, international arbitration bodies or other institutions.

3. Investment disputes shall also be settled with due regard to international treaty provisions. In the case of investment disputes, the foreign investor(s) shall have the right to apply directly to the International Centre for Settlement of Investment Disputes.

Article 7. Protection of Investment in the Event of Expropriation

1. Expropriation of the object of investment shall be allowed only in the cases specified and according to the procedure set forth in the laws of the Republic of Lithuania and only for public needs, In such cases, the investor(s) will receive just compensation in the manner prescribed by the Government.

2. The amount of compensation for the object of investment taken shall be determined in accordance with the procedure established by the Law of the Republic of Lithuania on the Principles of Property and Business Assessment and other legal acts and must correspond to the market value of the said object prior to the expropriation or prior to public declaration thereof, whichever happens earlier (hereinafter – the day of assessment). Compensation must be paid in the national currency of Lithuania within 3 months of the day of expropriation of the object of investment. Included in the sum of compensation shall be the sum of interest amounting to the arithmetical weighted average of the annual interest rate of the last calendar quarter auctions of Government securities with maturities of up to one year, within the period from the moment of expropriation of the object of investment to the day of payment of the compensation (hereinafter – period of delay).

3. On the request of a foreign investor, compensation shall be paid in any currency for which the London Inter Bank Offered Rate (LIBOR) is quoted. The sum of compensation shall be converted according to the official exchange rate of the litas against the foreign currency announced by the Bank of Lithuania on the day of assessment. The sum of compensation shall include the sum of interest amounting to the London Inter Bank Offered Rate (LIBOR) quoted for the appropriate

currency on the day of receipt of compensation, calculated for a period of duration closest to the period of delay. Compensation may be transferred abroad without any restrictions.

CHAPTER 5

POLICY CHALLENGES FOR THE FUTURE

FDI post privatisation – sustaining inflows of foreign capital

With major privatisation sales and investment guarantees dominating the FDI inflow to Lithuania, it is a commonly recognised fact that one of the major challenges for investment policy will be to continue to attract and sustain FDI inflows to the country, especially after the currently ongoing phase of large-scale infrastructure privatisation has been completed in the near future.

This challenge is already on the agenda of several government and other public agencies and, in order to prevent a significant drop in post-privatisation FDI inflows, the Development Agency sees attracting new greenfield and brownfield investments and encouraging reinvestment as its major task.

So far the government policies have helped to attract only a modest amount of greenfield investment into the Lithuanian economy. Progress in abolishing barriers to entry has been slow, partly due to the fact that the Lithuanians have perhaps not availed of as much outside expertise in this area as they could have. Large-scale privatisation started in Lithuania after some other countries had already experienced learned from both the positive and negative aspects of the process. It may be argued that some bad examples in other countries led to Lithuania to rely less on outside advisors and more on local expertise than has been the case in Estonia, for example.

As time has passed, both public and private advisory organisations have accumulated expertise and experience in the field of privatisation sales in transition economies. Thus, they might be of more use to Lithuania at the present stage of continuous large-scale privatisation than they were a few years ago. It seems likely that this development has been recognised by the government, which has had the issue of seeking external advice on privatisation matters on its agenda during the second half of 1999. The government has approved partial changes to the procedure applied in the privatisation of major energy, telecommunications and other companies. New variants of privatisation of large companies through a tender process have been added and terms of settlement with advisers and other specialists have been changed. Although the State Property Fund has announced that only some procedural provisions have been changed, the fact that the issue is topical at the moment speaks for itself.

Growing international competition for foreign direct investment

Another major challenge for Lithuanian policy-makers will be responding effectively to increasing international competition for FDI and identifying areas in which the country has a competitive edge.

The first requirement for any country willing to succeed against this background of fierce competition is to have the necessary regulations, administrative processes and general institutional framework in place and fully operative. This alone, however, is not enough. After establishing an appropriate framework for the FDI process to run smoothly from an investing company's perspective, the country should still have certain distinguishing characteristics to attract investors – "a unique selling proposition", as the director of the Lithuanian Development Agency formulated the issue.

From Chapter 1, we recall the "Ten Reasons to Invest in Lithuania" of the Lithuanian Development Agency. In reality, many, if not all, of these ten reasons to invest could be ascribed to other Central and Eastern European countries and it is therefore hard for Lithuania to differentiate itself from these other countries eager to attract FDI. Furthermore, the competition is not only between the countries in this particular region. In fact, all of the Central and Eastern European countries that are promoted as attractive locations for subcontracting work for Western European countries also face competition from countries such as Ireland, Portugal, Turkey and Northern Africa, not to mention the Far East.

On the other hand, Lithuania might have a certain competitive edge as a stepping-stone for the Russian and other CIS markets, given the Russians' favourable attitude to the Lithuanians and the country's superior infrastructure to some of the neighbouring countries. However, the current FDI policy seems to be more geared at increasing the role of the EU in the economy rather than utilising this potential advantage towards the markets in the East.

In addition to the economic fundamentals, active provision of investment incentives, such as free economic zones, has been counted on in the effort to attract FDI to Lithuania. There have been aspirations of putting in place an Irish-type investment promotion and incentive programme in Lithuania. However, as already mentioned, the free economic zones in Lithuania are not yet fully operative. There are also certain indications of an international trend away from special treatment of foreign investment in Europe and reliance on incentives in general may be increasingly limited as Lithuania moves towards EU accession.

Since arguments such as "gateway to the CIS markets" and "low-cost skilled labour" are true for almost every country in the region, it may be more effective to look sector-specific attributes. Sectors with potential for investors in Lithuania include:

- General and electrical engineering.
- Some very narrow speciality areas such as multicoloured lasers – research-related sectors in general.
- Services sector, especially banking and insurance, where the development only started after the economic reform was introduced.
- Textiles, furniture and software, may have the same level of attractiveness in all three Baltic countries, but at least in Lithuania they present interesting opportunities for FDI.
- The energy and oil trade are expected to attract FDI through privatisation and are also among the most interesting sectors in Lithuania.

If the focus of FDI policy should move more closely in line with sector-specific developments, it is all the more significant to note that FDI is not mentioned explicitly in the industrial policy measures of the medium- term economic strategy of the government.

Further attention must also be paid to streamlining the regulatory framework affecting the business and investment climate. The complex nature of Lithuanian company law, everyday bureaucracy, rapid and frequent underlying legislative changes with a complex duty and tax structure are seen as barriers to investment, particularly for foreign SMEs whose importance for the Lithuanian economy is only now being acknowledged by the government.

Information on accounting practices in place needs to be better disseminated to raise standards. Better protection of shareholders' rights and the development and implementation of internationally accepted corporate governance standards in general should be among the priority issues of the Lithuanian government in its work on improving the investment climate.

Integration into the EU should make Lithuania more attractive, ensuring harmonised legislation and regulations. Outside the EU enlargement issue, however, international co-operation has not played any significant role in alleviating the problem of growing international competition for FDI. There is very little co-operation between the three Baltic countries in the field of FDI promotion. The free-trade agreements (FTA) between the countries are the most concrete achievements of co-operation, but there are still serious differences in regulations and practices among the countries. As was concluded in a recent EU-Phare study, companies in the Baltic countries do not feel any benefits from the FTA. Instead, they sense that certain aspects of post-Soviet individualism and cultural differences form an obstacle to further integration.

Lithuania: on the road to EU

In Lithuania, membership of the European Union is seen as one of the most important conditions for the implementation of the objectives of economic and social policy. The medium-term (up to 2010) economic strategy of the country is geared towards achieving stable economic growth by implementing the Copenhagen criteria, which are:

- an efficiently functioning market economy;
- ability to cope with the pressures of competition and market forces;
- ability to meet EU membership obligations;
- administrative capacity to enforce and supervise statutory and regulatory requirements in a country.

The strategy is based on the analysis of the country's economic development, as well as on the co-ordination of Lithuania's economic reforms with the requirements for EU membership. It has also been shaped by the wish of the country to meet the Maastricht convergence criteria and the criterion of the "four freedoms" concerning the movement of persons, goods, services and capital. It aims to integrate through various general and sector-specific economic reform programmes, focussing on areas such as the adoption of the *acquis communautaire,* national energy, environment and transport and strategies, pre-accession agricultural strategy, investment and export policy and promotion and SME development.

This ongoing reform is the logical continuation of the dialogue with European economic partner's put in place after the re-establishment of Lithuania's independence. The main milestones in this area have been the Agreement of Trade and Co-operation (1992), the Free-Trade Agreement and the Europe

Agreement (the Agreement of Association) (1995), and the acceptance of Lithuania into EU membership negotiations in December 1999.

Concluding remarks

It may thus be concluded that the Lithuanian Government has demonstrated a true interest in developing a broad and integrated view on different aspects of the country's economic development and that developing a welcoming and favourable economic environment for foreign direct investment has been a key and successful element of this strategy.

This endeavour is not by all means over. The present study strongly recommends that Lithuania pursue its efforts in the foreign direct investment field in the following three main areas.

First, Lithuania should complete the privatisation of its financial and energy sectors by continuing to provide foreign investors the opportunity to bring in the needed capital and expertise.

Second, considerable efforts on the part of the Lithuanian authorities are required to implement best practices in regard to the domestic regulatory and administrative framework.

Third, FDI policy should not only continue to place emphasis on attracting and facilitating FDI but new efforts should be deployed on the integration of the local companies into the supplier network of the foreign-owned enterprises.

NOTES

1. Further information on this Baltic Regional Programme are available on the Internet, at: http://www.oecd.org/sge/ccnm/about/Baltic.htm

2. The conclusions of the Conference are reproduced as an Annex to this publication.

3. The activities of the Baltic Regional Programme are described in the OECD publication Annual Report: September 1998-September 1999.

4. The main contributors of the study are Director Inkeri Hirvensalo, Center for Markets in Transition at Helsinki School of Economics and Tuuli Juurikkala, Department of Economics at Helsinki School of Economics.

   The reader should also bear in mind that FDI statistics by Statistics Lithuania can be considered consistent with other sources only from 1997 on. With older data, the current process of data compilation was not in place yet and thus figures from different sources vary.

5. Throughout the paper, figures are based on sources available on 15 December 1999. The reader should also bear in mind that FDI statistics by Statistics Lithuania can be considered consistent with other sources only from 1997 on. With older data, the current process of data compilation was not in place yet and thus figures from different sources vary.

6. See section 1.4 for more details on the process of compiling FDI statistics.

7. 4 LTL = 1 US$ from April 1994 onwards.

8. The financial structure of FDI is discussed in chapter two, which concentrates on the economic impact of FDI.

9. 4 LTL = 1 US$ from April 1994 on.

10. Source: Lithuanian Development Agency at www.lda.lt.

11. A comment made by Mr. Kristoffersen, PHARE resident advisor at the Bank of Lithuania and the Ministry of Finance.

12. Division by economic activities according to the categorisation by Statistics Lithuania.

13. 4 LTL = 1 US$.

14. Source: OECD Economic Surveys 1999-2000 – The Baltic States, A Regional Economic Assessment (2/2000).

15. Classification according to International Civil Organisation standards based on the quality of the airport landing surface.

16. Source of the figures: Bank of Finland Institute for Economies in Transition, BOFIT: Baltic Economies – The Quarter in Review 4/99.

17. The Medium Term Economic Strategy was prepared by the government in summer 1999. In November, Lithuanian president Valdas Adamkus confirmed Lithuania's tenth government since independence. The previous government, which formulated the strategy, disbanded in October in a dispute over privatisation of Mazheikiu Nafta, the state oil company. While most members of the former cabinet continued, this government has a new conservative prime minister Andrius Kubilius, a new conservative finance minister Vytautas Dudenas, and new non-party economy minister Valentinas Milaknis. The new government's programme does not differ substantially from that of the previous government. It seeks political and economic stability. Privatisation of state assets will continue and tight fiscal policy will be emphasised. Memberships in NATO and the EU are the top foreign policy objectives. (Source: BOFIT: Russian and Baltic Economies, the Week in Review).

18. Source of the cited survey results: Lithuanian Development Agency 1999 Foreign Investors Survey.

19. Source: Interview with Deputy Director J. Markelevicius and Head of Construction and Innovation Statistics Unit D. Arëskienë of Statistics Lithuania.

20. The information on the role of the Central Bank is based on an interview with Chief Economist R. Tamosiunas of the Bank of Lithuania.

21. There is some ambiguity over how the inflow of capital from the 1998 Lietuvos Telekomas privatisation was treated in the FDI statistics. According to some of the interviewees, the sum paid for the company is not shown in its entirety in the FDI figures. Lithuanian Development Agency reports larger FDI figures for 1998 and 1999 than the official statistics. According to the agency, the accumulated stock of FDI reached US$1 975 million in 1998 and US$2 217 million after the first half of 1999.

22. Source: Investment in Tangible Fixed Assets and Construction I Quarter 1999, Statistics Lithuania B411.

23. Balance of payments statistics, Bank of Lithuania 1999/Q3.

24. Analysis of Lithuanian Capital market by USAID and MAS-Consult, mimeograph, pp. 90-91.

25. Source: Free Trade Regime, Foreign Direct Investment and Technological Spillovers in Lithuania, Economic Research Centre, November, 1998.

26. Source: Official of Ministry of Foreign Affairs, Lithuania.

27. The government was changed in November. The new government's programme, however, does not differ substantially from that of the previous one. See section 1.2 above for more details on the government change.

28. Section 3.3 discusses Lithuania’s alignment to international and regional norms, including the existing international agreements, in more detail.

29. Presidency conclusions, Helsinki European Council 10 and 11, December 1999, SN 300/99.

30. See Chapter 4 and the new Investment Law of 1999.

31. Sources of this and the following subsection include: World Bank country study on Lithuania, 1998: Lithuania – An Opportunity for Economic Success; Economist Intelligence Unit Country Profile 1998-1999 and Country Report 2 Q 1999; Bank of Finland Institute for Economies in

Transition – Review of Economies in Transition 1/1999 and several issues of Baltic Economies – The Quarter in Review; MeritaNordbanken Group: Lithuania, January 1999; Medium Term Economic Strategy of the Lithuanian Government, 1999; Lithuanian Development Agency on the internet www.lda.lt; EBRD Transition Report 1999: Ten years of transition.

32. Balance of payments statistics, Bank of Lithuania 1999/Q3.

33. Source: World Bank: Lithuania: An Opportunity for Economic Success, Vol. 1 & 2. A World Bank country study, August 1998.

34. In addition to the 1998 country study and the 1999 FIAS study on administrative barriers to market entry, the World Bank/IFC has undertaken banking-related operations in Lithuania. The Bank's financing in Lithuania has been channelled through the banking sector and directed at the development of both the banking sector and the SME-sector. IFC activated its operations in Lithuania only in 1998. Equity investments have been made so far in a textile factory and a TV-tube factory. In addition, a US$20 million credit was granted to Vilnius Bank for the development of the SME-sector.

35. See Chapter 4 for more detailed information on the Lithuanian privatisation process.

36. Source: Seimas of the Republic of Lithuania. The analysis of the contents of the Law owes partly to the presentation of the old Competition Law on the internet pages of the Lithuanian Development Agency, and to the internet Law Update Bulletin, March 1999, both prepared and updated by Law Firm Lideika, Petrauskas, Valiunas ir partneriai.

37. This section is based mostly on the strategy paper, prepared in summer 1999. The government was changed in November 1999, which, however, did not affect the government programme considerably. See section 2.1 above for more details.

38. "The purpose of the Accession Partnership is to set out in a single framework:

   - the priority areas for further work identified in the Commission's Opinions,
   - the financial means available to help candidate countries implement these priorities,
   - the conditions which will apply to this assistance.

   Each candidate country was invited to adopt a National Programme for the Adoption of the Acquis. This sets out how it would deal with the Accession Partnership, the timetable for implementing its priorities and human and financial resources implications. Both the Accession Partnerships and the National Programme for the Adoption of the Acquis will be revised regularly to take account of progress made and to allow for new priorities to be set." – The second Regular Report from the European Commission on Progress towards Accession, Lithuania. October 1999. See chapter 5 below for the Commission's assessment of Lithuania.

39. The information on laws and regulations throughout Chapter 4 is derived from unofficial translations as available and/or was received from the following sources:

   - The Institute of Economy and Privatisation, which is a state institution taking part in the preparation of legal acts;
   - The European Committee under the government of the Republic of Lithuania; and
   - Mr. Seimas of the Republic of Lithuania

   The analysis of the contents of the laws owes partly to their presentation on the internet pages of the Lithuanian Development Agency, and to the internet "Law Update Bulletin", both prepared and

updated by Law Firm Lideika, Petrauskas, Valiunas ir partneriai. Information as available 15 December 1999.

Sources are quoted directly in many cases.

40. The analysis of the Investment Law in chapter 4 is based on an unofficial translation provided by Osvaldas Smitas, Chief Officer of Foreign Investment Division at the European Committee under the government of Lithuania in December 1999.

41. Source: Lithuanian Development Agency.

42. This section is based on information from the Institute of Economics and Privatisation; the Lithuanian Development Agency and the State Property Fund on the internet; OECD: The Baltic States – a Regional Economic Assessment – 1999-2000, draft by the OECD secretariat; the second Regular Report from the European Commission on Progress towards Accession, Lithuania, October 1999; and BOFIT: Baltic Economies, The Quarter in Review 4/99.

43. Source: State Property Fund.

44. Source: Institute of Economics and Privatisation.

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Law on the Privatisation of State-Owned and Municipal Property, 4 November 1997, No. VIII-480

Law on Pension Funds, 3 June 1999 No. VIII – 1212

Investment Law, 7 July 1999 No. VIII-1312

ANNEX 1

LAW ON INVESTMENT
7 JULY 1999 NO. VIII-1312
VILNIUS

CHAPTER ONE
GENERAL PROVISIONS

Article 1. Purpose of the Law

1. The Law sets forth the terms and conditions of investment in the Republic of Lithuania, the rights of the investors and investment protection measures for all types of investments.

2. The specific features of investment into commercial banks, other credit institutions, insurance companies and other undertakings engaged in financial activities shall be established by the laws of the Republic of Lithuania which regulate the activities of the above undertakings and institutions.

Article 2. Definitions

As used in this Law,

1. "Investment" means funds and tangible, intangible and financial assets assessed in the manner prescribed by laws and other legal acts, invested in order to obtain from the object of investment profit (income), social result (in education, culture, science, health and social security as well as other similar spheres) or to ensure the implementation of state functions.

2. "Reinvestment" means investment of the profit (income) in the economic entity in which the profit (income) was obtained.

3. "Investment" means the act of investing performed by the investor in the manner prescribed by this Law whereby he acquires the right of ownership or the creditor's right of claim over the object of investment, or the right to manage and use the object.

4. "Investors" means legal and natural persons of the Republic of Lithuania and foreign states, also undertakings without the rights of legal person, who invest, according to the procedure set forth in the laws of the Republic of Lithuania, own or borrowed assets or assets held and used on trust.

5. "Strategic investor" means investor with whom the Government of the Republic of Lithuania or the competent authority concludes an investment contract in the manner laid down in this Law.

6. "Object of investment" means own capital of the economic entity, all types of securities, fixed tangible assets and fixed intangible assets.

7. “Economic entities” means undertakings, agencies and organisations of all types and forms of ownership established in accordance with the procedure laid down in the laws of the Republic of Lithuania.

8. “State priorities” means the basic needs of economic development, social and defence needs of the state, established by the Seimas or the Government of the Republic of Lithuania.

9. “State Investment Programme” means the document defining the investment strategy of the state, which provides for funds required in order to implement the state-supported investment projects, also the sources of financing and the time limits for the implementation of the above investment projects.

10. “Investment project” means a document corroborating the feasibility of the project from the financial (economic), technical and social point of view, assessing the return on the investment (commercial investment) and other indicators of efficiency, indicating funds required for project implementation as well as sources and time limits of financing.

11. “Municipality investor” means an investor with whom the municipality concludes an investment contract in accordance with the procedure established by this Law.

Article 3. Types of Investment

1. Types of investment according to the investor’s influence on the economic entity:

   1) direct investment – investment aimed at establishing an economic entity and acquiring the capital of a registered economic entity or a share in the capital, also reinvestment, loans to economic entities the capital whereof is owned by the investor or in which he has a share in the capital, subordinated loans where the objective of an investment is to establish or maintain long-term direct links between the investor and the economic entity in which the investment is made, and the share in the capital acquired through investment accords the investor a possibility either to control the economic entity or to exert a considerable influence upon it;

   2) indirect (portfolio) investment – where a share in the capital acquired through investment does not accord the investor any possibility to exert any considerable influence on the economic entity.

2. Types of investment according to the investor’s registered office (domicile):

   1) domestic investment – investment in the Republic of Lithuania made by the State of Lithuania, natural and legal persons of the Republic of Lithuania, also the domestic undertakings without the rights of the legal person;

   2) foreign investment – investment in the Republic of Lithuania by foreign states, international organisations, foreign natural and legal persons.

3. Types of investment according to the status of the investor:

   1) state investment – investment made by using the national budget resources, state (municipal) fund resources, loans obtained in the name of the State of Lithuania (municipalities), resources of state-owned (municipal) enterprises and other state-owned (municipal) assets as well as loan guarantees extended by the state (municipalities), in order to meet the needs of the state ;

2) private investment – investment by the holders of the right of private property of the Republic of Lithuania and foreign states;

3) investment by foreign states and international organisations.

4. Types of investment according to the object of investment:

1) capital investment – investment in the production, acquisition or increase of value of fixed tangible and intangible assets;

2) financial investment – all investment other than that specified in subparagraph 1 hereof.

Article 4. Methods of Investment

Investors may invest in the Republic of Lithuania according to the procedure established by law by employing the following methods:

1) by setting up an economic entity, acquiring the capital of an economic entity registered in the Republic of Lithuania or a share therein;

2) by acquiring securities of all types;

3) by creating, acquiring fixed assets or increasing the value thereof;

4) by lending funds or other assets to economic entities, in which the investor owns a share in the capital, enabling them to control the economic entity or to exert a considerable influence thereon;

5) by executing concession contracts and contracts of lease with option to purchase.

CHAPTER TWO
RIGHTS OF INVESTORS AND PROTECTION OF INVESTMENT

Article 5. Rights of Investors

1. Domestic and foreign investors shall be guaranteed under this and other laws equal conditions for operation. The rights and lawful interests of investors shall be protected under the laws of the Republic of Lithuania.

2. The investor shall have the right to manage, use and dispose of the object of investment in the Republic of Lithuania, in compliance with the laws and other legal acts of the Republic of Lithuania.

3. The investor shall have the right, upon paying the taxes in the manner prescribed by the laws of the Republic of Lithuania, to convert into foreign currency and/or transfer abroad without any restrictions the profits (income) held by him by ownership right.

4. Foreign investor may make a monetary contribution into the economic entity's capital under formation both in foreign currency and in the national currency of Lithuania.

Article 6. Guarantees of Investors' Rights

1. State and local authorities and officers shall have no right to interfere with the management and use as well as disposal of by the investors of the object of investment according to the procedure prescribed by the laws of the Republic of Lithuania. Damage inflicted upon the investor by unlawful acts of state or local authorities and their officers shall be compensated according to the procedure established by the laws of the Republic of Lithuania.

2. Disputes relating to infringement of the rights and lawful interests of the investor/investors shall be settled according to the procedure established by the laws of the Republic of Lithuania. Disputes between the foreign investor/investors and the Republic of Lithuania relating to infringement of their rights and lawful interests (investment disputes) shall be considered, upon agreement between the parties, by the courts of the Republic of Lithuania, international arbitration bodies or other institutions.

3. Investment disputes shall also be settled with due regard being taken of the international treaty provisions. In the case of investment disputes the foreign investor/investors shall have the right to apply directly to the International Centre for Settlement of Investment Disputes.

Article 7. Protection of Investment in the Event of Expropriation

1. Expropriation of the object of investment shall be allowed only in the cases specified and according to the procedure set forth in the laws of the Republic of Lithuania and only for public needs, paying the investor/investors just compensation in the manner prescribed by the Government.

2. The amount of compensation for the object of investment taken shall be determined in accordance with the procedure established by the Law of the Republic of Lithuania on the Principles of Property and Business Assessment and other legal acts and must correspond to the market value of the said object prior to the expropriation or prior to public declaration thereof, whichever happens earlier (hereinafter – the day of assessment). Compensation must be paid in the national currency of Lithuania within 3 months of the day of expropriation of the object of investment. Included in the sum of compensation shall be the sum of interest amounting to the arithmetical weighted average of the annual interest rate of the last calendar quarter auctions of Government securities with maturities of up to one

year, within the period from the moment of expropriation of the object of investment to the day of payment of the compensation (hereinafter – period of delay).

3. Upon the request of a foreign investor, compensation shall be paid in any currency for which London Inter Bank Offered Rate (LIBOR) is quoted. The sum of compensation shall be converted according to the official exchange rate of the litas against the foreign currency announced by the Bank of Lithuania on the day of assessment. The sum of compensation shall include the sum of interest amounting to the London Inter Bank Offered Rate (LIBOR) quoted for the appropriate currency on the day of receipt of compensation, calculated for the period the duration whereof is the closest to the period of delay. Compensation may be transferred abroad without any restrictions.

CHAPTER THREE
SPECIFIC FEATURES OF INVESTMENT

Article 8. Areas of Investment

1. Investment in the Republic of Lithuania shall be permitted in all lawful commercial-economic activities, subject to the restrictions established by this Law and other legal acts of the Republic of Lithuania.

2. Foreign investment shall be prohibited in the following commercial-economic activities:

1) guaranteeing state security and defence (except for investment by the foreign entities meeting the criteria of European and Transatlantic integration which Lithuania has opted for, provided this is approved of by the State Defence Council);

2) production and sale of narcotic and psychotropic substances, non-medicinal highly effective or poisonous substances as well as cultivation, processing and sale of cultures containing narcotic, highly effective and poisonous substances;

3) organisation of lotteries.

3. When investing in the economic entity under formation, the activities whereof are subject to licensing under the Law of the Republic of Lithuania on Enterprises and other laws regulating the specific sphere of activities, the economic entity must acquire a licence for its activities in accordance with the procedure prescribed by laws and other legal acts.

Article 9. Investment in Free Economic Zones

The specific features of investment in free economic zones shall be regulated by the Law of the Republic of Lithuania on the Fundamentals of Free Economic Zones as well as laws on the setting up of individual free economic zones.

Article 10. Investment by Acquiring Immovable Property

1. Investors shall have the right to acquire title to all types of immovable property in the Republic of Lithuania.

2. The procedure and terms and conditions of investment by acquiring title to land by legal persons of the Republic of Lithuania and foreign legal and natural persons shall be established by the Constitutional Law on the Subjects, Procedure, Terms and Conditions and Restrictions of the Acquisition

into Ownership of Land Plots Provided for in Article 47, Paragraph 2 of the Constitution of the Republic of Lithuania.

3. The investors may take a lease on the state-owned land plots according to the procedure set forth in the Law of the Republic of Lithuania on the Lease of Land.

4. Foreign states shall have the right to acquire title to land according to the procedure and under the terms and conditions established by the Law of the Republic of Lithuania on the Acquisition and Lease of Land Plots by Foreign State Diplomatic Missions and Consular Institutions.

Article 11. Investment in the Exploitation of Natural Resources

Investment into objects related to the exploitation of natural resources owned by the state by exclusive ownership right shall be permitted under the Law of the Republic of Lithuania on the Underground and other laws.

CHAPTER FOUR
STATE INVESTMENT POLICY

Article 12. State Investment Policy

1. The state shall provide favourable conditions for private investment and ensure efficient use of state funds earmarked for investment in order to promote economic and social development of the state.

2. The state, employing the methods specified in Article 13, shall support investment intended for state priorities, improvement of the ecological situation, upgrading of technology of prospective industries, development of small and medium-sized business and satisfaction of the basic social needs of the public.

3. Taking into account the parameters prescribed by the Government of the Republic of Lithuania or the competent authority, the state may allocate funds and give loans and loan guarantees for investment into the restructuring of sectors of the economy, reduction of economic and social differences between separate regions of the country, creation of new jobs and mitigation of natural disaster effects.

Article 13. Promotion of Investment

1. Tax privileges granted to investors shall be determined by appropriate tax laws.

2. A certain portion of interest on loans taken for the purpose of investment financing may be paid with the resources of target-oriented state (municipal) funds. The procedure and terms and conditions of payment of interest shall be determined by the regulations of the funds.

3. Lithuanian and foreign creditors who have granted loans for funding the carrying out of investment projects may be given state (municipality) guarantees in accordance with the procedure established by the laws of the Republic of Lithuania.

4. Loans intended for the carrying out of investment projects may be insured with public funds in accordance with the procedure established by the Government of the Republic of Lithuania.

5. The Government or the competent authority shall have the right to conclude investment contracts with strategic investors, establishing special investment and business conditions, provided that the investment amounts to not less than LTL 200m and meets the criteria established by the Government of

the Republic of Lithuania. The terms and conditions of taxation of business shall be established in such contracts according to the procedure laid down by the Law of the Republic of Lithuania on Tax Administration.

6. The municipality shall have the right to conclude investment contracts for investment into the infrastructure, production or service sectors of the municipality, provided that the contracts meet the criteria prescribed by the municipal council. Special terms and conditions of investment, business or choice of land plot shall be established in such contracts according to the competence of the municipality.

Article 14. Regulation of State Investment

1. The state investment policy shall be shaped in the Programme of the Government of the Republic of Lithuania, state-supported programmes, State Investment and State Borrowing programmes, with due regard being given to the forecasts of the development of the economy and economic-social development of the Republic of Lithuania.

2. The State Investment Programme drawn up for an at least 3-year period shall be approved by the Government of the Republic of Lithuania. The State Investment Programme shall be submitted to the Seimas of the Republic of Lithuania together with the draft law on the approval of financial indicators of the state budget and municipal budgets of the appropriate year.

3. The Government of the Republic of Lithuania shall establish the procedure for the planning, revision, use, accounting and control of state funds earmarked for state investment.

Article 15. International Agreements

1. Foreign investment in the Republic of Lithuania and overseas investment by the investors of the Republic of Lithuania shall also be regulated by bilateral and multilateral agreements of the Republic of Lithuania on investment promotion and protection as well as other international agreements.

2. If the international agreement ratified by the Seimas of the Republic of Lithuania establishes other terms and conditions of foreign investment in the Republic of Lithuania than those prescribed by this Law, the provisions of the international agreement shall apply.

CHAPTER FIVE
FINAL PROVISIONS

Article 16. Recognition of the Law Regulating Foreign Capital Investment as Invalid

The Law of the Republic of Lithuania on Foreign Capital Investment in the Republic of Lithuania shall be recognised as invalid.

I hereby proclaim this Law enacted by the Seimas of the Republic of Lithuania

PRESIDENT OF THE REPUBLIC VALDAS ADAMKUS

ANNEX 2

FOREIGN DIRECT INVESTMENT STATISTICS

45. Received from the Institute of Economics / Economy and Privatisation under the government of the Republic of Lithuania. Available on the internet through the Lithuanian Parliament, Seimas. This list is not pre-emptive: it does not contain all of the laws mentioned in the paper.

Table 1. Direct investment from abroad in OECD countries: inflows

Million US dollars

	Cumulative flows										
	1971-1980	**1981-1990**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998 p**
Australia	11295	39822	6513	4042	5036	3007	3951	12729	5106	8724	6494
Austria	1455	3274	647	359	940	982	1314	1904	4429	2656	5917
Belgium-Luxembourg	9215	27986	7966	9292	11326	10751	8313	10812	14061	12451	20887
Canada	5534	33409	7562	2870	4717	4748	8204	9255	9405	11465	16500
Czech Republic	..	..	..	..	1004	654	869	2562	1429	1301	2540
Denmark	1561	3467	1212	1453	1015	1681	4890	4176	776	2801	6452
Finland	376	2838	787	-247	406	864	1578	1063	1109	2116	12141
France	16908	54588	15609	15157	17855	16439	15580	23681	21960	23178	28033
Germany	13816	19691	2962	4729	-2089	368	7134	12019	5637	9605	19888
Greece	..	6145	1005	1135	1144	2583	3081	4272	5888	3586	3709
Hungary	..	512	311	1462	1479	2339	1146	4453	1983	2085	1935
Iceland	..	74	22	18	-11	..	..	14	82	149	112
Ireland	1659	1371	258	1168	1244	850	420	621	1888	1676	2236
Italy	5698	24888	6344	2481	3210	3746	2236	4817	3535	3698	1212
Japan	1424	3324	1806	1286	2755	210	888	41	228	3224	3193
Korea	..	4025	789	1180	728	588	809	1176	2325	2844	5143
Mexico	..	24421	2633	4762	4393	4389	10973	9526	9185	12478	10238
Netherlands	10822	37857	12165	6552	7824	8561	7333	12150	14754	9198	22491
New Zealand	2598	3940	1681	1695	1089	2212	2690	2697	3697	1832	1930
Norway	3074	5634	1807	655	-426	2244	2713	2229	3257	3630	3600
Poland	..	88	88	359	678	1715	1875	3659	4498	4908	6365
Portugal	535	6920	2608	2451	1914	1550	1265	695	1315	2520	1773
Spain	7060	46158	13839	12445	13352	8073	9425	6217	6468	5540	8680
Sweden	897	8619	1971	6351	-41	3843	6346	14448	5076	10905	18900
Switzerland	..	14068	5485	2644	411	-83	3368	2224	3078	5028	4781
Turkey	228	2434	778	910	911	746	636	935	913	852	953
United Kingdom	40503	130469	32889	16027	16214	15468	10497	22738	26084	37051	63545
United States	56276	365084	48422	22799	19222	50663	45095	58772	84455	105488	188960
TOTAL OECD	**190934**	**871105**	**178158**	**124035**	**116299**	**149190**	**162628**	**229885**	**242621**	**290989**	**468608**

p. Provisional.

Break in series: Australia 1995, France 1988, Greece 1992, Ireland 1990.
Source: *International Direct Investment Statistics Yearbook*, 1999, OECD.

Table 2. Direct investment abroad from OECD countries: outflows

Million US dollars

	Cumulative flows 1971-1980	1981-1990	1990	1991	1992	1993	1994	1995	1996	1997	1998 p
Australia	2510	22266	265	3001	951	1779	5291	3844	5921	5913	671
Austria	578	4132	1663	1288	1871	1467	1201	1131	1935	1948	3013
Belgium-Luxembourg	3213	20984	6130	6493	10389	4693	1205	11712	8065	7742	23111
Canada	11335	42337	5222	5813	3586	5868	9293	11462	12877	22044	26577
Czech Republic	..	..	..	..	21	101	120	37	153	25	55
Denmark	1063	6292	1509	1844	2225	1373	4041	3069	2518	4210	3868
Finland	605	11577	2708	-124	-753	1409	4297	1498	3596	5292	18643
France	13940	101365	36220	25115	30416	19732	24381	15760	30419	35591	40578
Germany	27830	94239	24233	22947	18596	17197	18858	39052	50830	40284	86641
Greece	..	..	..	..	..	..	..	..	..	..	..
Hungary	..	..	..	..	..	11	49	43	-3	431	481
Iceland	..	26	10	27	3	11	23	24	62	51	99
Ireland	..	..	..	..	..	..	..	..	..	..	..
Italy	3597	28707	7612	7326	5948	7221	5109	5732	6465	10619	15591
Japan	18052	192410	50774	31688	17301	13916	18117	22629	23424	25991	24159
Korea	..	2406	1052	1489	1162	1340	2461	3552	4670	4449	4756
Mexico	..	..	..	..	..	..	..	..	..	..	..
Netherlands	27829	65771	15288	13577	14366	12343	17745	20002	31646	19955	35942
New Zealand	375	4556	2358	1472	391	-1386	2015	1751	-1260	-1602	343
Norway	1079	8995	1478	1840	-80	791	2098	3140	5901	5016	2546
Poland	..	..	..	..	13	18	29	42	53	45	316
Portugal	21	374	165	474	687	141	283	689	749	1918	2923
Spain	1274	8793	3442	4424	2171	2648	3900	3608	5222	10142	15427
Sweden	4597	48074	14743	7053	409	1357	6698	11214	4664	12641	21231
Switzerland	..	33553	6709	6212	6050	8765	10798	12214	16152	18023	14225
Turkey	..	97	88	127	133	175	78	163	110	251	367
United Kingdom	55112	185581	18636	15972	19156	25573	28251	44329	34125	63734	114957
Unites States	134354	175985	30982	32696	42647	78164	73252	92074	84426	99517	121644
TOTAL OECD	**307364**	**1058520**	**231287**	**190754**	**177659**	**204707**	**239593**	**308771**	**332720**	**394229**	**578163**

p. Provisional.

Break in series: Australia 1995, France 1988.

Source: *International Direct Investment Statistics Yearbook*, 1999, OECD.

Table 3. Direct investment from abroad in OECD countries: inflows

As a percentage of GDP

	1990	1991	1992	1993	1994	1995	1996	1997	1998 p
Australia	2.20	1.36	1.72	1.05	1.21	3.60	1.29	2.22	1.85
Austria	0.41	0.22	0.50	0.54	0.67	0.82	1.94	1.29	2.78
Belgium-Luxembourg	3.86	4.38	4.77	4.74	3.37	3.72	4.93	4.82	7.82
Canada	1.32	0.49	0.83	0.86	1.49	1.61	1.59	1.89	2.84
Czech Republic	..	..	3.36	1.90	2.18	5.04	2.53	2.50	4.62
Denmark	0.91	1.08	0.69	1.21	3.22	2.31	0.42	1.65	3.69
Finland	0.58	-0.20	0.38	1.02	1.61	0.84	0.89	1.77	9.73
France	1.31	1.26	1.35	1.32	1.17	1.54	1.43	1.66	1.96
Germany	0.18	0.28	-0.11	0.02	0.35	0.50	0.24	0.46	0.93
Greece	1.21	1.27	1.16	2.80	3.12	3.68	4.77	2.99	3.08
Hungary	0.87	4.37	3.97	6.06	2.76	10.06	4.43	4.60	4.08
Iceland	0.35	0.27	-0.16	..	..	0.20	1.12	2.01	1.37
Ireland	0.57	2.53	2.38	1.73	0.77	0.95	2.62	2.17	2.69
Italy	0.58	0.22	0.26	0.38	0.22	0.44	0.29	0.32	0.10
Japan	0.06	0.04	0.07	0.00	0.02	0.00	0.00	0.08	0.08
Korea	0.31	0.40	0.24	0.18	0.21	0.26	0.48	0.64	1.73
Mexico	1.00	1.51	1.21	1.09	2.61	3.33	2.79	3.10	2.46
Netherlands	4.29	2.26	2.43	2.73	2.17	3.05	3.72	2.53	5.96
New Zealand	3.90	4.07	2.72	5.06	5.24	4.49	5.65	2.82	3.63
Norway	1.57	0.56	-0.34	1.93	2.21	1.52	2.06	2.37	2.46
Poland	0.15	0.47	0.80	1.99	2.02	3.07	3.34	3.62	4.24
Portugal	3.77	3.13	2.03	1.85	1.44	0.66	1.21	2.49	1.67
Spain	2.81	2.35	2.31	1.69	1.95	1.11	1.11	1.04	1.57
Sweden	0.86	2.65	-0.02	2.07	3.20	6.25	2.02	4.79	8.33
Switzerland	2.40	1.14	0.17	-0.04	1.29	0.72	1.04	1.97	1.81
Turkey	0.52	0.60	0.57	0.41	0.49	0.55	0.50	0.45	0.48
United Kingdom	3.37	1.58	1.55	1.64	1.03	2.05	2.26	2.89	4.68
United States	0.87	0.40	0.32	0.80	0.67	0.84	1.14	1.35	2.30

p. Provisional.

Source: *International Direct Investment Statistics Yearbook*, 1999, OECD.

Chart 1. Direct investment from abroad in OECD countries: inflows

As a percentage of GDP: 1998

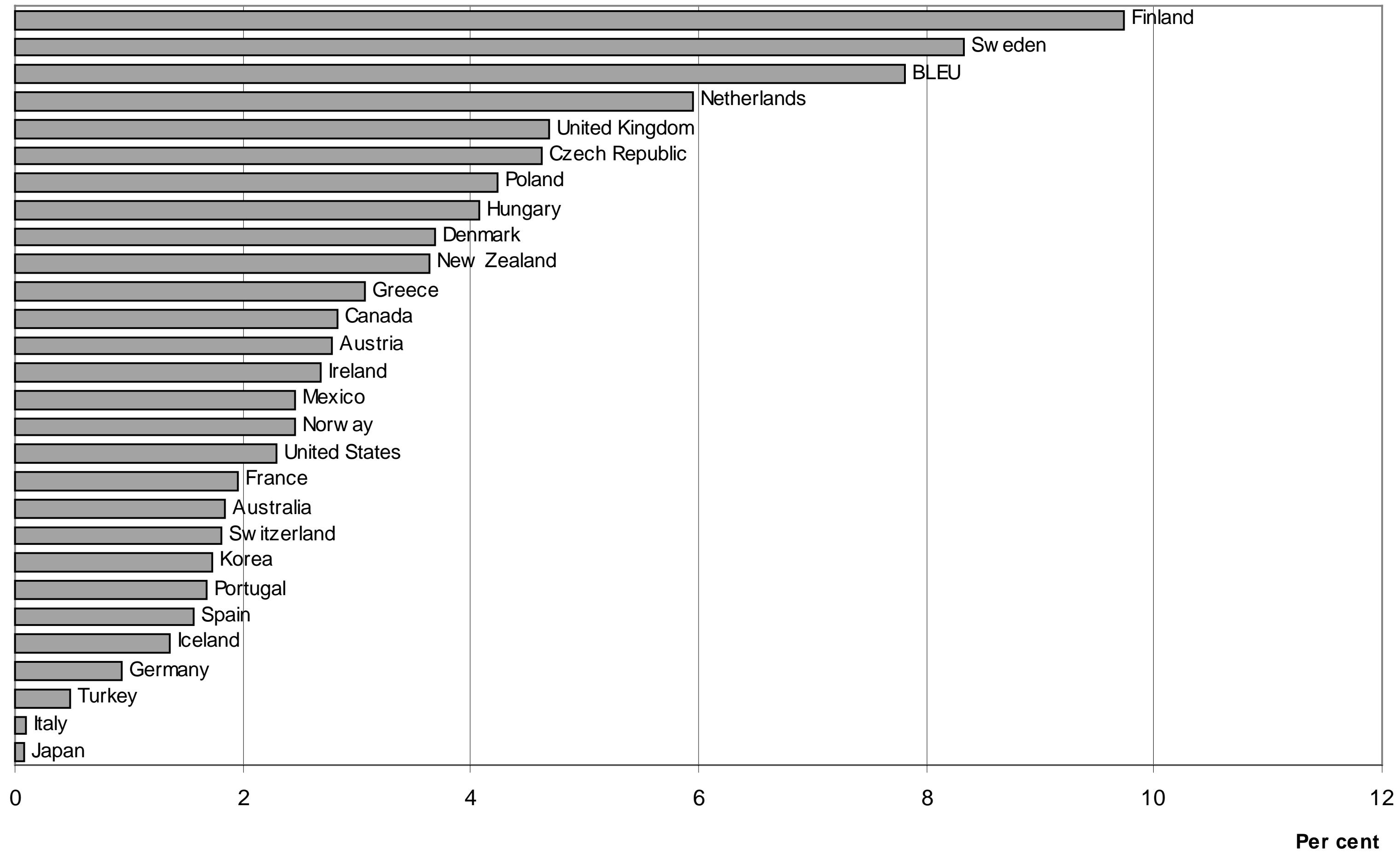

Table 4. Direct investment abroad from OECD countries: outflows

As a percentage of GDP

	1990	1991	1992	1993	1994	1995	1996	1997	1998 p
Australia	0.09	1.01	0.33	0.62	1.62	1.09	1.50	1.50	0.19
Austria	1.04	0.77	1.00	0.80	0.61	0.49	0.85	0.94	1.42
Belgium-Luxembourg	2.97	3.06	4.38	2.07	0.49	4.03	2.83	3.00	8.65
Canada	0.91	0.99	0.63	1.06	1.69	2.00	2.17	3.63	4.57
Czech Republic	..	..	0.07	0.29	0.30	0.07	0.27	0.05	0.10
Denmark	1.13	1.38	1.51	0.99	2.66	1.70	1.37	2.48	2.21
Finland	2.01	-0.10	-0.71	1.67	4.39	1.19	2.88	4.42	14.94
France	3.03	2.09	2.30	1.58	1.83	1.03	1.98	2.55	2.83
Germany	1.48	1.33	0.94	0.90	0.92	1.63	2.17	1.93	4.06
Greece	..	..	..	..	..	..	..	..	..
Hungary	..	..	..	0.03	0.12	0.10	-0.01	0.95	1.01
Iceland	0.16	0.40	0.04	0.18	0.37	0.34	0.85	0.69	1.21
Ireland	..	..	..	..	..	..	..	..	..
Italy	0.70	0.64	0.49	0.73	0.50	0.53	0.53	0.93	1.33
Japan	1.71	0.93	0.47	0.33	0.39	0.44	0.51	0.62	0.64
Korea	0.41	0.51	0.38	0.40	0.65	0.78	0.96	1.01	1.60
Mexico	..	..	..	..	..	..	..	..	..
Netherlands	5.39	4.68	4.46	3.94	5.26	5.02	7.97	5.49	9.52
New Zealand	5.47	3.53	0.98	-3.17	3.93	2.92	-1.93	-2.47	0.65
Norway	1.28	1.56	-0.06	0.68	1.71	2.14	3.73	3.27	1.74
Poland	..	..	0.02	0.02	0.03	0.04	0.04	0.03	0.21
Portugal	0.24	0.61	0.73	0.17	0.32	0.66	0.69	1.89	2.76
Spain	0.70	0.84	0.38	0.55	0.81	0.64	0.90	1.91	2.79
Sweden	6.42	2.95	0.17	0.73	3.38	4.85	1.85	5.55	9.36
Switzerland	2.94	2.67	2.48	3.70	4.13	3.97	5.47	7.06	5.39
Turkey	0.06	0.08	0.08	0.10	0.06	0.10	0.06	0.13	0.18
United Kingdom	1.91	1.58	1.83	2.71	2.77	4.00	2.96	4.97	8.47
United States	0.56	0.57	0.71	1.23	1.09	1.31	1.14	1.27	1.48

p. Provisional.

Source: *International Direct Investment Statistics Yearbook*, 1999, OECD.

Chart 2. Direct investment abroad from OECD countries: outflows

As a percentage of GDP: 1998

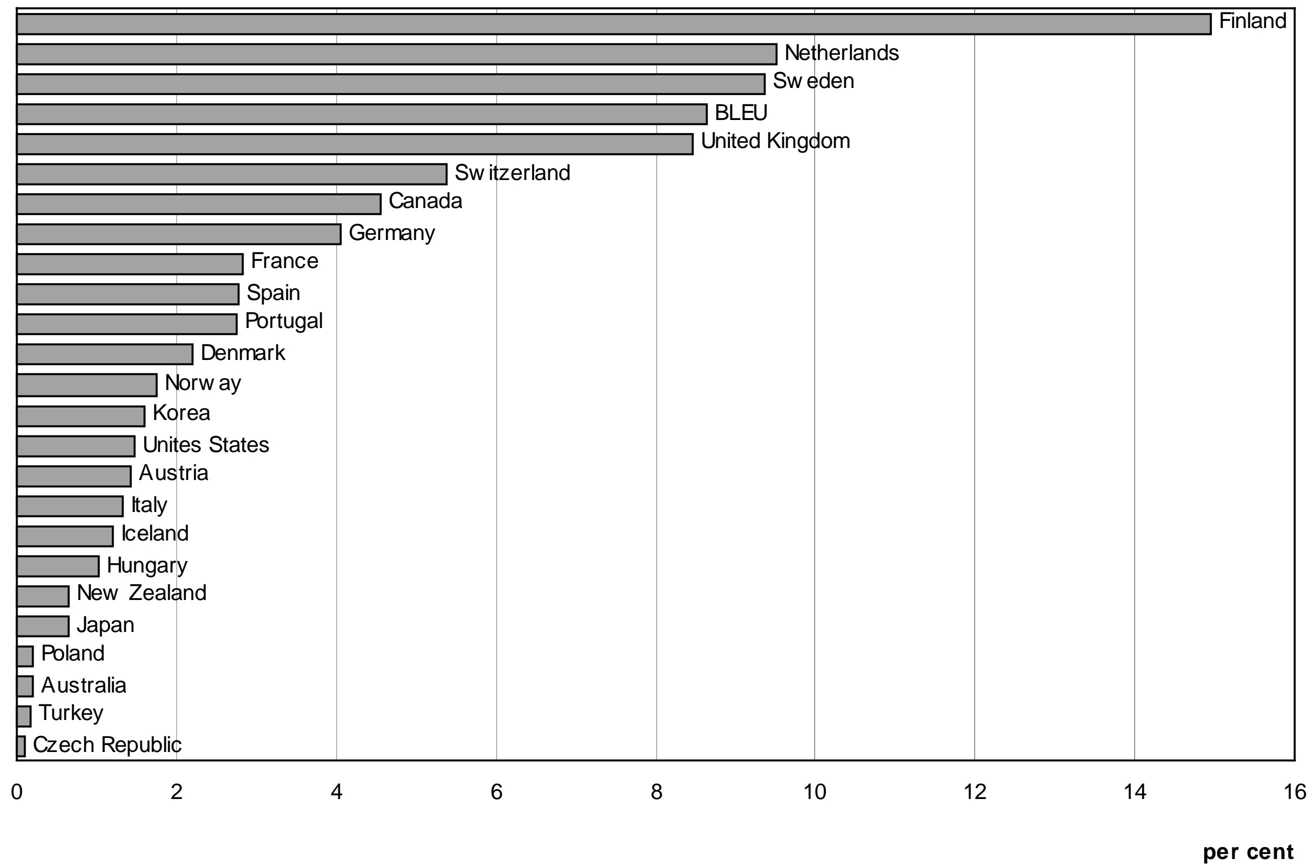

Table 5. Direct investment from abroad in OECD countries: inward and outward position

At year-end in million US dollars

	Inward									*Outward*								
	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998 p**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998 p**
Australia	75801	78018	78592	76808	86974	87497	107615	112315	96881	31153	29436	34712	35412	39857	44210	51237	57212	55599
Austria	9976	10368	11209	11373	13092	17532	18258	17510	24943	4498	6030	6862	8111	9282	11702	12781	13310	17111
Belgium-Luxembourg	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Canada	112844	117025	108503	106868	110204	123316	131071	137648	141822	84808	94382	87870	92468	104302	120279	132416	143937	156655
Czech Republic	..	595	1606	2053	3077	5797	7061	6763	..	..	..	..	..	..	..	..	..	..
Denmark	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Finland	5132	4220	3689	4217	6714	8464	8797	9530	16455	11227	10845	8565	9178	12534	14993	17666	20297	28037
France	86508	97799	100209	103197	123887	143673	143937	141136	..	110119	129903	140679	141430	163075	184388	192973	189681	..
Germany	119618	131818	129970	129781	160128	192898	188502	185980	..	148456	167185	170867	178648	213654	258142	271241	280779	..
Greece	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Hungary	569	2107	3424	5576	7087	11919	14690	15882	18255	..	..	..	226	291	489	493	900	1286
Iceland	147	165	124	117	128	129	197	332	457	75	101	97	112	146	179	241	249	361
Ireland	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Italy	57996	59686	48474	52512	58846	63453	72482	81082	..	59039	65912	65816	76422	81383	97038	107441	124977	..
Japan	9850	12297	15511	16884	19211	33532	32675	..	26647	201441	231791	248058	259795	275574	238452	282257	..	267584
Korea	..	..	..	..	..	..	..	..	..	2339	3376	4511	5588	7623	10500	13796	16546	20433
Mexico	7613	10026	11453	13072	6234	5382	5975	6860	..	..	..	..	..	..	..	..	..	..
Netherlands	73824	78144	81191	82792	103359	121970	131146	127434	..	109094	119713	124746	124820	149023	177279	203248	209594	..
New Zealand	..	..	..	15552	19849	26009	33584	37644	35735	..	..	..	4400	5167	7624	8925	6746	5784
Norway	17712	14620	15206	14463	16305	19512	20519	20703	..	10278	11196	13144	13482	16909	22519	25442	..	..
Poland	109	425	1370	2307	3789	7843	11463	14587	22479	..	..	101	198	461	539	735	678	1165
Portugal	..	..	..	..	..	18170	18945	18555	21616	..	..	..	..	..	4408	4725	5933	9842
Spain	65917	79572	79203	71071	86161	99769	98431	100684	118794	15654	20532	20911	22403	28331	34489	36616	47606	68461
Sweden	12461	18085	13773	13007	22247	30489	34202	41767	..	49491	53531	47707	44559	59237	71941	70877	75283	..
Switzerland	34245	35749	32990	38714	48667	57063	53919	52968	..	66086	75884	74413	91571	112586	142479	141591	161913	..
Turkey	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..
United Kingdom	218213	224680	185925	196811	218211	203825	228642	259595	326731	230824	234055	223774	253213	286394	314340	330432	371119	498506
United States	394911	419108	423130	467412	480667	535553	598021	693207	811756	430521	467844	502063	564283	612893	699015	795195	865531	980565
TOTAL OECD	**1303447**	**1394507**	**1345551**	**1424587**	**1594838**	**1813795**	**1960132**	**2082183**	**1662572**	**1565103**	**1721716**	**1774896**	**1926319**	**2178722**	**2455006**	**2700328**	**2592292**	**2111390**

Note: Data are converted using the end-of-year exchange rates.

p: Provisional.

Break in series: Australia 1994, Germany 1992, Japan 1995, Poland 1993.

Source*: International Direct Investment Statistics Yearbook*, 1999, OECD.