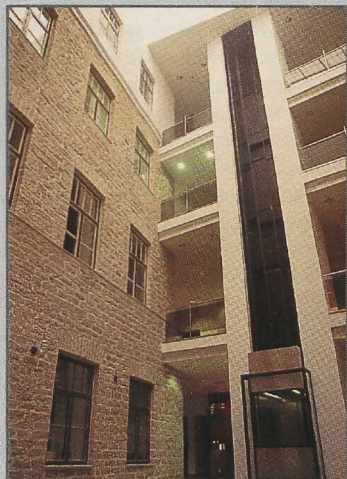


ESTONIA

Forging a Path to Prosperity



EESTI
RAHVUSRAAMATUKOGU
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A Return to Independence

Estonia leads the Baltics in its economic transformation

Estonia is the new powerhouse of the Baltics, outstripping the other developing economies of the former Soviet republics. That transformation is built on a tradition of business and trade closer to that found in the Nordic countries to its north than to its former comrades in the U.S.S.R.

Estonia re-established its independence in a bloodless revolution on Aug. 20, 1991, after half a century as part of the Soviet Union. Since then, it has emerged as a leader among the Baltic states—becoming the first former Soviet republic to issue its own currency, doubling exports, more than doubling foreign-exchange reserves and decreasing its dependence on trade with Russia.

The changes represent a return to the country's traditional Nordic trading roots and a determination among Estonians to establish a strong and independent nation, says Prime Minister Mart Laar. "Before the Soviet occupation, Estonia was a center for shipping and com-

merce," he says. "The commercial instincts are returning rapidly. Trade with the West is more important than aid. Aid can create dependency, but trade sustains long-term growth."

The evidence of Estonia's rapid transition to a free-market economy is visible even to the most casual observer. Shipping traffic is booming off the Estonian coast. Some 11 million tons of cargo were shipped in and out of Estonia in 1992; Peeter Palu, the general director of the Port of Tallinn, expects the burgeoning transit trade to boost that figure as much as 40 percent this year. Factories that a few years ago were producing equipment for the Soviet military machine are being transformed into facilities for manufacturing everything from kitchen cookers to skateboards.

Above all, the new vigor of Estonia is captured in Estonia's capital city, Tallinn, founded in the 11th century. Fine old merchants' houses are being converted into offices and stores, while business executives jostle in the traffic in BMWs, Volvos and an occasional Jaguar.

A Hub for Trade and Transit

Evidence of Estonia's boom is also visible in the mounting investment from Western countries, who have recognized the country's value as a hub for trade and transit. Explains Estonian President Lennart Meri: "Over the next decade, we expect more companies to realize the advantages of an inexpensive and

well-educated labor force, a liberal market economy and an excellent geographic position."

A number of large multinationals have already staked their claims in Estonia, including the Coca-Cola Company, Swiss-Swedish engineering giant ABB Group and Swedish appliance manufacturer Electrolux. According to the Estonian Privatization Agency, the production cost of doing business is about

10 percent of Scandinavian levels.

Estonian exiles, who fled the country during World War II, are demonstrating their faith in the new Estonia as well. Many are returning to their homeland to reclaim property under the government's restitution program, injecting commercial know-how and capital in return. Jaan Manitski, an exile who carved out a business career in Sweden and Belgium, has returned to Estonia and is now vice-chairman of the board of the Estonian Privatization Agency. "We are giving the country back to its people," he says, "as well as bringing in new investors."

The family of Peter Jakobson, a London-based cognac company executive, has taken back the large villa built by his ship-owning father in the resort town and spa town of Pärnu. "My daughter is converting it into a hotel and business center," says Jakobson. "I thought the

Estonia: Forging a Path to Prosperity was written by freelance journalist Brian Moynahan in Estonia. Editor: Lisa Benenson. Art direction: Freeman Design, New York.

Cover photos (and credits), clockwise from top left: Town Hall (Estonian Foreign Ministry); Business Center (Estonian Foreign Ministry); Cement Factory (Bob Stern/Gamma-Liaison); Coastal Gates (Estonian Foreign Ministry); Viru Hotel (Estonian Foreign Ministry); Modern building (Novosti/Gamma-Liaison). © 1993 by NEWSWEEK INC. All rights reserved.



MICHAEL FREEMAN

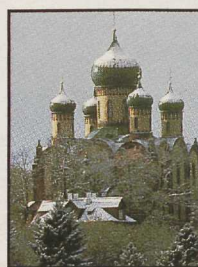
MILESTONES IN ESTONIAN HISTORY

The Estonians are a Finno-Ugric people who came from the area bounded by the Urals and the Volga and Oka rivers. They migrated westward to the Baltic shores some 5,000 years ago. Fields they tilled near Tallinn are thought to be the oldest farmlands in Northern Europe.

By the middle of the first millennium B.C., Estonians were navigating small ships over the Baltic. In the ninth century A.D. Viking ships (below) invaded Estonia and the country became a vital link in the seaborne trade between East and West. A natural harbor was found on the horseshoe-shaped bay where Tallinn now stands. In the 12th century, the Arabian geographer al-Idrisi had placed the city on his maps.



ESTONIAN FOREIGN MINISTRY



BOB STERN/GAMMA-LIAISON

Danish, Swedish and German crusaders had succeeded in conquering and Christianizing Estonia by 1227. Numerous churches and monasteries were built. Tallinn's St. Nicholas Church, originally constructed in the 13th century, contains a Bernt Notke masterpiece. The Baltic German nobility, descendants of the crusaders, were a ruling caste until the early 20th century. (Left: convent)

Estonia: Forging a Path to Prosperity

family had said goodbye to Estonia forever. I am delighted to be proved wrong."

Improving Business Facilities

Those new to Estonia, as well as the returning exiles, will find that facilities for international business are improving. "The business infrastructure is good," says ABB Estonia's president, Bo Henriksson. "The phone system is excellent. Air and sea connections are good."

Demand for office space is being met by the Tallinn Business Center, which opened this July. John Battle, CEO for Tricorp Development, Ltd., the real-estate concern behind the facility, is a U.S.-trained Sovietologist who was studying political economy at Moscow State University when he first visited Estonia in 1988. "I knew within 48 hours that I could do business here," he says. "It is the natural bridge into Russia."

Battle has invested close to \$4 million in the center, which includes retail space, its own communications network and an Irish pub. Tenants include Rank Xerox, the European Bank for Reconstruction and Development (EBRD), and the Japanese Embassy.

Business executives will find they aren't the only travelers to Estonia's shores. The seas alone are bringing more than 2 million people a year to Estonia, whose entire population is just over 1.5 million. Scandinavian visitors come to Tallinn to sightsee and to shop. Foodstuffs, drink and clothing cost a fourth of Helsinki or Stockholm prices; the savings can pay for a round-trip ferry ticket several times over.



Architectural transformation: Modern building on a 15th-century foundation

For Port of Tallinn General Director Palu, looking over the bustling docks from his operations room, the incoming traffic underscores the startling and exhilarating change from the old regime. "Only a short time ago, few visitors came here," he says. "There was almost nothing for them to buy, and the Soviet system hardly made them feel welcome. Now we are rebuilding the passenger terminal to cope with arrivals."

Symbol of Independence

For other Estonians, the symbol of their country's renaissance is the kroon, Estonia's new national currency. Estonia was the first of the old Soviet republics to replace the Russian ruble, which was being savaged by inflation nearing 100 percent a month. The kroon is convertible and backed by hard currency reserves.

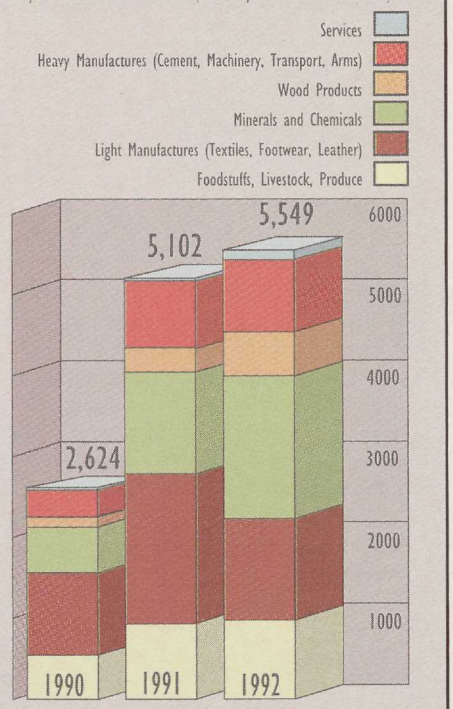
Estonia's quick establishment of a hard currency was a bold move, but one that President Meri considers vital. "Independence involved discipline," he says. "It was easy to blame everything on the ruble. We had to cut the umbilical cord. The country needed the responsibility of maintaining its own money."

Results have exceeded expectations. Exports are outrunning imports, with a balance-of-payments surplus of some \$25 million last year. Tight monetary policy has brought inflation down to a projected annual rate of some 25 percent for 1993, with a single-digit figure expected next year. In addition, the state budget was in surplus for 1992, and the Estonians more than met IMF targets, says Ardo Hansson, government economic adviser.

The transition to the kroon has also had a substantial impact on trading patterns. In pre-kroon days, 90 percent of trade was with the former Soviet republics. Estonia remains an important window into Russia; the ports are poised at the northwest extremity of the Russian rail system, and Estonians understand Russians and their language. But commercial flows have reversed since independence. Western countries now account for about two thirds of trade—a situation that is helping speed Estonia's recovery, while its trading partners in the East are strug-

BOOM IN ESTONIAN TRADE

Exports in Millions of Rubles (1992 equivalent in Million EEK)



SOURCE: ESTONIA STATISTICAL OFFICE

gling to make similar transitions. As those countries grow stronger, Estonia figures to be in an excellent position to serve as a transshipment and manufacturing point for businesses interested in selling to the former Soviet republics.

The political consensus achieved in the parliamentary elections last fall has helped speed Estonia's economic transformation as well. Although the rapid shift to a free-market economy has caused some dislocation and unemployment for the country's citizens, Estonians have made it clear that they agree with their government that the problems of transition need "to be faced and not deferred," says President Meri.

"Overall, I have no hesitation in saying that progress has been very good," says Lars Jurling, World Bank representative to Estonia. "The foundations are good—the stabilization policy that's in place is the key to growth. The challenge is to turn it into economic growth."

That view is shared by U.S. Ambassador Robert C. Frasure, who considers the move to hard currency and low inflation the key to the country's success. "I'm convinced Estonia is going to make it," he says.

MILESTONES IN ESTONIAN HISTORY

In the 13th century, Tallinn joined the Hanseatic League, the union of European commercial towns that stretched from London to Novgorod. Pärnu, Viljandi and Tartu were also members. Estonia was an essential bridge in the trade between East and West. St. Olaf's Church in Tallinn (right), used as a navigation mark from the sea, is one of the world's tallest medieval structures.



ESTONIAN FOREIGN MINISTRY

After the Reformation, a written Estonian language began to develop. The oldest preserved excerpt of a book written in Estonian, a catechism, dates from 1535. Tartu University was established in 1632, on orders from Sweden's King Gustav II Adolf. Literacy spread. The Bible was translated into Estonian in 1739.



NOVOSTI/GAMMA-LIAISON

A period of war began in the 16th century, bringing parts of Estonia under the control of Russia, Denmark, Poland and Sweden. For most of the 17th century, Sweden ruled Estonia. In the 18th century Russian Tsar Peter the Great joined Estonia to his empire.

Moving toward Privatization

Selling off state businesses is at the core of Estonia's economy

International investors have noted a series of full-page ads appearing in leading business dailies around the world of late—and what's being advertised is clearly worth their attention. Estonia is privatizing scores of lucrative, state-owned properties, and the country wants to be certain that the entire world knows.

"The companies are open to bid by international tender," says Jaan Manitski, vice-chairman of the board of the Estonian Privatization Agency. "We didn't want any prospective buyer not to know it."

Privatization is at the core of government policy for Estonia. The overall task of privatization is fourfold, embracing agricultural land, residential property and small and large businesses. "Privatization anchors the Estonian economy and society into the West," says Manitski. "More than any army, it is the most important part of our defense system."

An East German Model

Estonia's tendering procedures are based on the East German model, selling state-owned firms through public tender to one or several buyers, including foreign bidders. Consultants from the Treuhand, the German privatization agency, are based in Tallinn to help pass along the best of the German experience. Other legal experts and economists have been drafted from Europe and the United States to help evaluate the process, with assistance from the EC's PHARE program, which aids privatization in Eastern Europe, and the European Bank for Reconstruction and Development.

Estonia has taken the lead in privatization among former Soviet republics.... "Confidence is building rapidly."



Jaan Manitski
Vice-Chairman, Estonian Privatization Agency

ESTONIAN FOREIGN MINISTRY: MERILA & LAURITS

"We want businessmen to feel on familiar ground," says Manitski.

Up for Sale

The first public tender of state properties was held in November 1992, with the offer of 38 enterprises; bids were ultimately accepted on 25 of those companies. When the second group of 52 companies was advertised in May 1993, interest was even stronger. "We had 1,400 inquiries from countries including the United States, Japan and Australia, as well as Europe," says Manitski, "and 180 firm bids at tender closing."

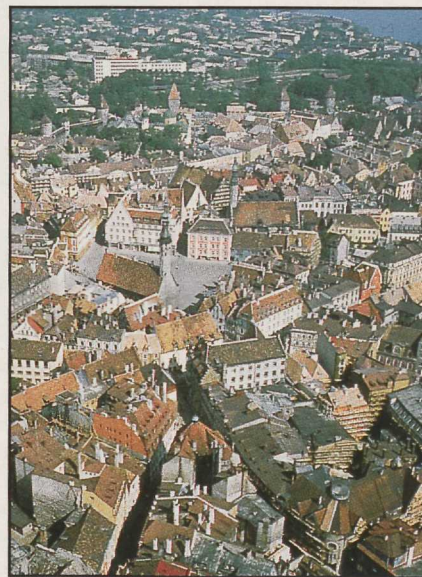
The sectors included in this second round of privatization run from food and beverages, paper products and chemicals to textiles and machine tools. Some companies are old-style behemoths, sprawling and overmanned operations, which will require restructuring but may offer unbeatable potential for the right buyer. Others, including Leibur, a Tallinn bakery that employs 740 people and makes 42,000 tons of bread and bakery products a year, are already profitable and have strong cash flows. Also of note is the offer of the firm Tallinna Klaverivabrik, a 120-employee maker of

pianos and other musical instruments. Successful bidders on all firms are to be selected later this year.

A sample of other companies up for privatization gives an idea of the range of

opportunities available to investors:

- Viljandi Metsakombinaat, a logger and furniture maker in central Estonia with 386 employees.
- Klementi, a big Tallinn textile manufac-



NOVOSTI/GAMMA-LIAISON

Thriving capital of Tallinn: Private enterprise is flourishing

turer, producing pillowcases, children's wear and 540,000 pieces of women's wear a year with a staff of 804.

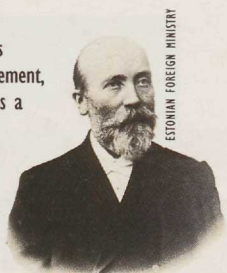
- Kommunaar, whose 1,100 workers produce 2 million pairs of shoes and boots a year.
- Tööstusaparaat, a producer of calorimeters, water meters and position indicators.

Speeding Privatization

Manitski notes that Estonia has taken the lead in privatization among former Soviet republics, although some 60 percent of the country's economy remains state controlled. That figure includes the 800 major companies whose fate will be determined

MILESTONES IN ESTONIAN HISTORY

Repressive government from Russia and economic control by German landowners and burghers spurred a nationalist movement, which began in the late 19th century as a cultural movement centering on the gathering of folklore, songs and poetry. This effort, directed by Pastor Jakob Hurt (right), produced one of the finest folklore collections in the world.



ESTONIAN FOREIGN MINISTRY

The first true political parties emerged at the turn of the century, demanding autonomy for Estonia. Following the Russian Revolution of 1917 (right), Estonian nationalists declared independence from Russia on Feb. 24, 1918. Invasions by German forces and, later, the Red Army followed. At the Peace of Tartu on Feb. 2, 1920, Soviet Russia agreed to renounce its territorial claims "for all time." Tallinn became the capital of the Republic of Estonia.



ESTONIAN FOREIGN MINISTRY

Estonia: Forging a Path to Prosperity



YULGANNIA VODKA

Estonian entrepreneurship: vodka production at Liviko distillery

by the privatization agency.

Also a priority is the return of some 40,000 private farms to their owners. "So far we have returned about 10,000 farms," says Manitski. "We believe the market will ensure farms are a suitable size through land sales and leasing." The process of returning both farms and city properties has been helped along by the survival of Estonia's 1938 census and other documents.

Less complex is the privatization of the 3,000 or so small state-owned businesses, and the transfer of that sector is proceeding quickly. Half have already been sold, often to employees. The results are visible: fresh paint and careful window displays in shops, smartly turned-out waiters and adventurous menus in restaurants. Add the mass of new companies to the privatized firms, and almost 90 percent of small enterprise is now private.

In an effort to further speed privatization and strengthen the economy, the government has moved to help domestic investors purchase privatized companies. One program allows investors to make a 20 percent down payment with the balance spread over 10 years.

Encouraging Foreigners

Foreign investors can take advantage of the same payment plan offered to domestic investors by forming an Estonian company without losing any of the incentives aimed at outside money.

Another popular route to privatization is the management buy-out, where Estonian managers seek foreign partners to invest in

MILESTONES IN ESTONIAN HISTORY

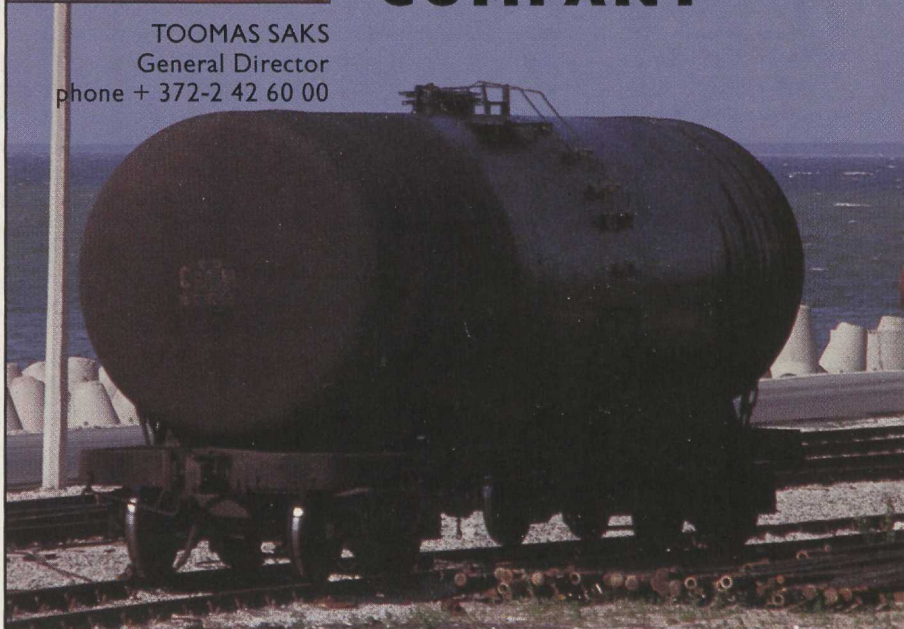
Independent Estonia made large strides between wars. In 1925 minorities were granted complete cultural autonomy. The currency reform of 1927 enabled rapid economic



development in the 1930s. Education and culture flourished; one of the best-known cultural figures was the graphic artist Eduard Wiiralt. (Left: cultural center)



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Estonia: Forging a Path to Prosperity

their companies. Manitski says the Estonian government is well aware of the importance of foreign funds in such ventures: "To move forward, managers often find they need to set up a joint venture

and bring in outside capital."

Manitski adds that those interested in investing in Estonian businesses will find the country's government a most cooperative institution. "There is no problem with feed-

back and relations with government," he says. "If we run into a snag in the program, we can amend it very rapidly. Frustrations exist, of course, but confidence is building rapidly." ■

Privatization in Action

Baltika exhibits a knack for prosperity

Look closely at that off-the-rack suit you brought back from England, those trousers from Germany or that jacket from Finland. It may well be that your clothing was made in Estonia.

The Baltika clothing company was the first large state-owned enterprise to be privatized in Estonia, and the company has quickly demonstrated that formerly state-owned businesses in this country can not only survive but prosper. Originally established in 1928, the firm was taken over by the state in 1940. In 1991 its men's clothing division was converted to a joint stock company when part of the company's shares were sold to Baltika's managers and work force.

Today the business is flourishing; hard-currency turnover has quadrupled since the sale. Together with management, some 800 Baltika employees now expect to buy out the state's remaining 15 percent stake in the company.

"Our motto is European quality at Estonian prices," says Meelis Milder, Baltika's chairman of the board. "It is a formidable combination. Our employees make around \$100 a month. That is well above the Estonian average, but it still means our costs are a tenth of what they would be in Sweden." Those lower costs have also insulated Baltika from the European recession. "A lot of retailers are having

to buy less expensive products," Milder explains. "It's a good opportunity for us to get established."

Baltika was once wholly dependent on the Soviet market. With hyperinflation in Russia and a tight fiscal situation at home, the company has lost much of its original market but has managed to compensate by carving out exports to the West. "A lot of Estonian companies have had to do the same over the past 18 months simply to survive," says Milder. "We have learned a lot."

Milder is in constant touch with buyers on his mobile phone. He encourages them to visit the plant. "In the old system, a suit sold itself simply by existing," he says.

"Nobody needed to bother with customers. Now we need to treat them as part of the family. We have to know how they are feeling. In textiles the competition starts in Portugal and ends somewhere in the Urals."

The labels sewn into the racks of men's trousers, suits and jackets in the cutting rooms show that Baltika is adapting to the challenge. The company is making clothes for Western European chain stores, including NEXT, BHS and

C&A. Trucks make regular runs to other customers in Sweden, Germany and Finland.

Production is running at 1,000 jackets and 2,500 trousers a day, well above last year. Milder's ambitions run beyond sup-



Baltika fashions: Making a statement in European chain stores

plying own-label goods to multiple stores however. "Subcontracting keeps you alive, but not flourishing," he says. "We are expanding our own designs and retail outlets. We hope that these will eventually contribute the bulk of sales."

Baltika has opened five men's stores, named "Baltman," in Estonia and is expanding into neighboring Latvia and Lithuania. The shops, which sell shirts and raincoats as well as Baltika-made suits and jackets, are popular with tourists and are helping to boost Baltika revenues to an expected \$8 million this year.

Domestic demand currently accounts for only 30 percent of turnover, but Milder says that in some ways the drop-off has been a blessing. Competing in the international marketplace has been an excellent learning experience for the fledgling company. "Exports are tough," he says. "The best school that exists."

"Our motto is European quality at Estonian prices."



Meelis Milder
Chairman of the Board, Baltika

BRIAN NOTMANN

MILESTONES IN ESTONIAN HISTORY

World War II ended Estonia's independence. Under the Molotov-Ribbentrop pact, Estonia fell within the Soviet sphere of influence. The country was occupied by the Soviet Army in June 1940. Thousands of Estonians were killed or deported to Siberia. The Germans invaded in 1941. The Soviet Army returned in 1944, and Estonia became part of the Soviet Union. Most Western countries refused to recognize this annexation. A large influx of Russians began. Pro-independence guerrilla forces continued to fight against the Soviets into the 1950s. (Right: the War Memorial)



MARINO/THE IMAGE BANK

In the "Singing Revolution" of the 1980s, Estonians showed their desire for independence in peaceful mass meetings. In 1989, 2 million people from the three Baltic countries linked hands in a human chain stretching from Tallinn to Vilnius in Lithuania. In March 1990 the unofficial Congress of Estonia demanded independence.

Reclaiming Its Place

Prime Minister Mart Laar reflects on Estonia's progress

Two years ago Estonia reclaimed its place among the sovereign nations of the world when it reinstated its independence, breaking with the Soviet Union. On Oct. 8, 1992, Mart Laar—a 33-year-old historian and leader of the free-market-oriented alliance *Isamaa* (Pro Patria)—was sworn in as the country's prime minister, heading the center-right coalition government. In this recent interview, Laar discusses the progress of Estonia's shift to a free-market economy.

Q.What are your goals for Estonia as you move out of the communist system?

A.To create a liberal, open, European society and an open market economy. We are full of hope that we will achieve this. The key is the new constitution, adopted last year with help from the Council of Europe, and the successful parliamentary elections. A stable democratic base is essential in a period of radical economic reform.

Q.How has the transformation been progressing?

A.The dangerous time, the initial period of high inflation and falling production, is over. It is an inevitable stage for any country coming out of the communist system, but it is important to move on, and we have. Monetary reform has been carried through successfully. Our currency, the kroon, is fully convertible. Inflation has been brought under control and is falling rapidly. Our trade has shifted from almost total dependence on the former Soviet Union to the greater part of business being done with the West. Production has started to rise again. We have held elections and we enjoy political stability. We have fulfilled all our obligations to the IMF.

Not much more than a year ago, we had breadlines. Meat and milk were rationed. The difference now is enormous. The shops are bustling. The market economy works. Competition does bring down prices. Monetary policy does bear down on inflation. We have seen it with our own eyes.

Q.Where do you envision Estonia fitting in the world economic picture?

A.I believe we will be somewhere close to Finnish living standards by the end of the century. We all know that there is only one way to get there, and that is through work and accepting competition. We want to integrate fully with the Nordic community and to move closer with it to the rest of Europe. We have applied for associate membership in the EC, and we hope for full membership in due time.

Q.How do you intend to proceed in order to accomplish those goals?

A.We are creating new structure to underpin development. We hope to complete work on commercial and banking laws this year. We are speeding the pace of property and agricultural reform, as well as moving ahead on changes in the education and the justice systems.

We are also fully committed to privatization. The more that private ownership, private property and private activity come into power, the better. In less than a year, Estonia has already changed so much that it is no longer possible for the old system to be put back together again. We have promised our people hard work, and that we will create the possibility for hard work and success. Individuals have to respond to that, and they are doing so.

"We want to integrate fully with the Nordic community and to move closer with it to the rest of Europe."



Prime Minister Mart Laar

ESTONIAN FOREIGN MINISTER: HERIJA & LAURITS

Q.What does Estonia have to offer potential investors?

A.We have a good program of tax and other incentives. Profits can be repatriated in full, and foreign nationals are free to acquire 100 percent of companies. They have the same opportunities as everyone to own land and property.

Estonia can offer businesses a work force with European educational standards that is willing to work for very low pay rates. Foreign investors will

find Estonia offers the best and cheapest harbors in the region and a good geographical position as a transit, banking and communications center. Estonia is a country with an open outlook—more than half of Estonians speak two or more foreign languages. Finally, we have strong links to the Scandinavian and the huge Russian markets.

Q.Would you say there is a new business ethos developing in Estonia?

A.I don't think it ever completely disappeared. Under the Soviet system, we still managed to watch Finnish TV, listen to Radio Free Europe and keep in touch with Estonian exiles. People remembered that independent Estonia had been a commercial nation. The instinct is still there. We all understand one thing about the changes: Estonia is a very good place to do business, and everyone is given that opportunity. ■

MILESTONES IN ESTONIAN HISTORY



Independence was proclaimed on Aug. 20, 1991. Within weeks, Estonia was recognized as a free and independent country by Russia, the EC and the United States. On June 20, 1992, the kroon (left) replaced the ruble.

ESTONIAN FOREIGN MINISTER



In September 1992 Estonians elected their first president and parliament in more than 50 years. In May 1993, the Council of Europe voted Estonia a full member. (Left: the Parliament building)

ESTONIAN FOREIGN MINISTER

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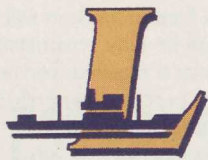
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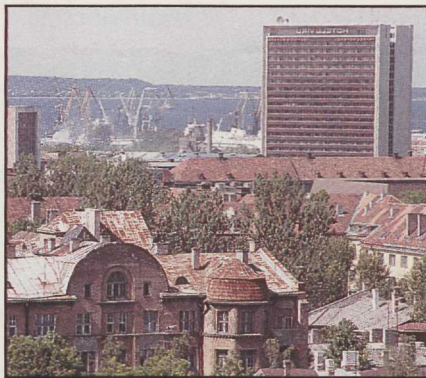
Choosing Estonia

Opportunities and a stable economy attract investors

When considering investment in most of the former Soviet Union, foreigners are well advised to proceed with caution, given the fluid economic situation in those countries. But the road to Estonia stands apart. The country's economy is marked by a solid, Westernized financial base, and the public and private sectors are well prepared to offer international businesses lucrative joint-venture opportunities and other investment opportunities.

"Two years ago we were almost entirely dependent on the Soviet Union. Today more than 70 percent of trade is with the West," says Toomas Sildmae, Estonia's minister of economy. "We have had to adapt rapidly."

The key to the country's quick conversion has been monetary reform, which began in June 1992, when Estonia became the first former Soviet republic to issue its own fully convertible currency, backed by gold and hard-currency reserves and freely exchangeable for any Western moneys. The benefits of currency reforms have taken hold quickly. Estonia's foreign-exchange reserves have more than doubled—from \$123 million in August 1992, to \$297 million. The establishment of a convertible currency has been accompanied by a strict



Tallinn skyline: Estonian industry is stirring global interest

control over the amount of new money that can be issued. Any new money must be backed by an influx of foreign-exchange reserves.

The tight controls initially created a sharp drop in industrial production as domestic companies were forced to live within their means rather than turning to the government to make up any deficits as they had under the Soviet system. But the policy also squeezed out inflation, now averaging 2.5 percent a month, and industrial output has been stable for four months. "The worst seems to be over," says Siim Kallas, governor of the independent central bank, the Bank of Estonia. "The balance-of-payments surplus proves that Estonia is viable."

Attracting Investment

Indeed, multinational investors have clearly taken notice of Estonia's efforts to build a strong foundation for its developing economy. The country has already attracted some \$250 million in foreign capital, money drawn to Estonia for its winning combination of geographic desirability as a trade route between Eastern and Western Europe, low wage rates, skilled labor and generous investment-incentives. Among those investors is soft-drink giant Coca-Cola. The company set up a bottling plant with local partner Tallinna Karastusjoogid in May 1992. Another multinational with interest in Estonia is Norway's Statoil, which established the subsidiary Eesti Statoil and is expanding its network of petrol and service stations in Estonia. Electrolux, a household name in white goods, returned to Estonia in 1992 after pulling out before the Soviet occupation 52 years ago.

For many of those companies choosing to locate in Estonia, cost is a leading factor in the decision. "Production cost here is half that of our Norwegian operation, even when we are assembling 100 percent from imported



Multinational investors: Building a strong economic foundation

components," says Priit Raud, Electrolux's general manager in Estonia.

The country's "peace dividend"—reaped by converting Estonian industry from military to peacetime production—is also proving to be a drawing card for international investors. "Arms plants had the pick of machinery and a skilled work force," says Raud, who is considering installing his production line in a factory that used to make engine starters and transformers for the Soviet military.

Business Incentives

The Estonian government is doing its part to sweeten the pot for investors by offering a number of business incentives, including favorable tax exemptions. Foreign investors will find that their profits can be fully repatriated, in any Western currency if required. Foreigners are permitted 100 percent ownership of Estonian companies, and joint ventures are actively encouraged as well.

Where foreign investment accounts for at least 30 percent of a company's fixed capital and has a value of not less than \$50,000, the company is completely tax exempt for two years after it earns its first net profit. Income tax is kept at 50 percent for a further two years.

For those who make the decision to locate in Estonia, the country's entrepreneurs have been quick to develop businesses aimed at aiding foreign investors. For example, Mainor Ltd., once a state planning bureau for light industry, has become one of the country's leading investment consultants. The partially

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Estonia: Forging a Path to Prosperity

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Recruitment services, as well as business and management consulting and training, are also provided by business consulting firms like Eke Ariko and its subsidiaries. They also advise on market conditions and personnel assessment.

Foreign investors will find that research on the Estonian marketplace is easy to obtain, thanks to Estonian firms such as EMOR Ltd., an opinion- and market-research center founded by Mainor veteran Karin Niinas. As a full member of London-headquartered Gallup International, EMOR has expanded into media, audience and market research.

Investment Opportunities

For foreigners just beginning to look for investment options in Estonia, excellent opportunities exist in a variety of fields, including timber and building materials, hotel construction, textiles and food processing.

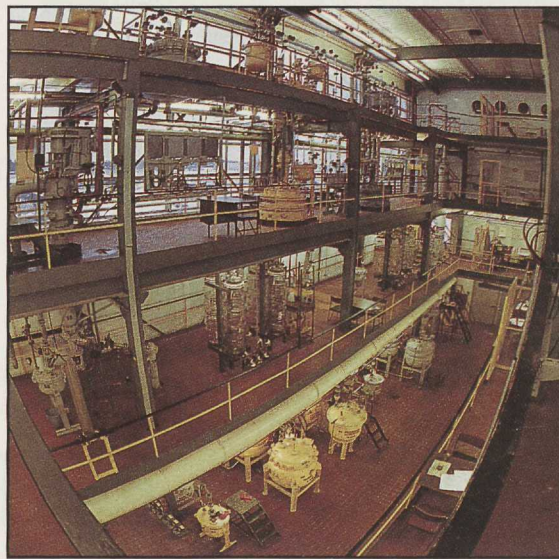
Swiss-Swedish engineering giant ABB Group already has a joint venture with local company Harju Elekter to manufacture low-voltage electrical switch gear and is looking to expand into other areas. "We see good growth in construction, textiles, food processing and the ports and transit trade," says Bo Henriksson, president of ABB Estonia. Food processing is an investment target for several multinationals. PepsiCo Foods International has bought a potato-chip plant near Tartu; Estgold, an Estonian company backed by U.S. investors, is manufacturing potato chips in the south.

Another industry with considerable potential is boat building. Naviko Ltd., a yacht and sport-boat maker, is looking for foreign partners to exploit its low-cost production. The private company has leased production facilities at the large and well-equipped Experimental Yacht Yard, rebuilt in conjunction with the sailing events of the 1980 Moscow Olympics, which were held in Tallinn.

Even small investors are finding opportunities in Estonia. California-based Miramar Trading International has formed a partnership with Estonia's Liviko distillery to bring the top-of-the-line vodka, Volganaya, to the United States. Under the Soviet Union, Liviko, a state stock company, was one of the top producers of vodka for Stolichnaya. So far, Volganaya is available in 28 states in the United States.

The Banking Sector

Those investors seeking financing will find that Estonia's banking sector is rebounding, after a shake-up late last year, which the



Shampoo factory: Estonia offers modern facilities and low production costs

ESTONIAN FOREIGN MINISTRY: MERILIA & LAURITS

country's bankers say has left them stronger and wiser. Three of Estonia's largest banks were closed after they developed liquidity problems—the first time such enterprises had been allowed to fold in the former Soviet republics. "The survivors are in good shape and have become very cautious," says Bank of Estonia's Kallas. During the second quarter of 1993, the banks' total share capital rose 17 percent.

Among the renewed banks is the Estonian Investment Bank, in which the Bank of Estonia and the European Bank for Reconstruction and Development (EBRD) are shareholders. The bank, which specializes in medium-term loans, expects to extend financing on some 15 projects by the end of the year, for amounts between \$100,000 and \$1 million.

New banks are also making a mark in Estonia. NOWE Bank, which was registered last year, now has two branches in addition to its head office and employs 52 people.

Due to the uncertain position of many of the Russian banks, Dmitri Ilyushin, NOWE's chairman of the management, and others see Estonia's finance industry as well situated to serve international business in the region. "This leaves Estonia in a strong position to benefit from the growing number of transactions between businesses in the former Soviet republics and the West," says Ilyushin.

It is impressive indeed that Estonia's ambitious reforms—from the banking sector to monetary policy—have placed it so quickly at the forefront of the former Soviet states when it comes to investment opportunity. And with the Estonian business sector firmly poised on the edge of the East—but now wide open to Western investors—the economic achievements in the two years since independence seem but a happy prelude of things to come.

Hong Kong on the Baltic

The country has a new role as a key trade route

For centuries the sea has brought change to Estonia. Today it is doing so again, bringing new people, new trade and new industries as the country rejoins the free market and develops as a well-placed hub for trade and transit.

"I like to think that this will be the Hong Kong of the former Soviet Union," says Dmitri Ilyushin, chairman of the management of Tallinn-based NOWE Bank. "It is a bridge between East and West. Estonians know Russia, the language, the mentality, the way of doing business." Estonians know the West as well. Despite more than 50 years under the yoke of the U.S.S.R., the country's close proximity to Finland created an admiring understanding of Western culture that a generation of Estonians saw daily on Finnish television in the years before independence. "Although we had no commercial culture, it has flooded back quickly," says Toomas Sildmae, Estonia's minister of economy.

Booming Transit

Already there is physical evidence of an abundance of transit business with the huge nation to the east. Coal from the Donets Basin awaits shipment to Western power stations on the docks of Tallinn. Russian-built cars and four-wheel-drives cram the decks of freighters heading for Latin America. Moscow-bound containers sway on railroad flatcars.

In fact, a full 95 percent of freight passing through Estonian terminals is in transit to or from Russia and the other new republics, estimates Peeter Palu, Port of Tallinn general director. "We did 11 million tons last year," he says. "We expect that to be more than 14 million this year." The traffic is important to Estonia, bringing in some \$50 million a year.

Palu hopes eventually to concentrate passenger shipping and cruise liners in the Tallinn city port, transferring cargo handling to the deep-water port at Muuga, 13 kilometers away. Muuga can take 150,000-tonners with depths of up to 18 meters. It has direct railroad links to Russia and is key to Russian wheat imports. The grain transshipment facility will handle 5 million

Plans are in place to increase cargo capacity at Muuga to 25 million tons a year.



Peeter Palu
General Director, Port of Tallinn

tons this year; Palu says plans are in place to increase cargo handling at Muuga over the next five to seven years to more than 25 million tons a year.

Shipping Expertise

With 81 ships, the largest shipping line operating out of the Port of Tallinn is the state-owned Estonian Shipping Co., ESCO. ESCO ships haul timber and paper from Finland to the Red Sea port of Jidda, and general cargoes between the Baltic and from Europe to

West Africa, along with regular container and Ro-Ro services to the Scandinavian countries, Belgium and Holland. Five new ships are being built for West African and North Sea services.

As new markets open, the freight forwarding business thrives. Baltic Transport Ltd. operates a trucking service through the Baltic countries and on to the former Soviet republic of Belarus. The company also handles a growing volume of air cargo through Tallinn for SAS, Lufthansa and Finnair, some of which is then trucked on to Latvia and Lithuania. The company is 65 percent owned by the Finnish freight forwarder Huolintakeskus.

A Link to the East

Estonia's geographic advantage is proving of interest to investors who are making use of

Estonian factories to manufacture goods for transport to Russia and the rest of Europe. Est-Stein, an Estonian-Finnish construction-materials maker, has built a healthy export trade selling roof tiles to the East. And Eesti Ehitus, one of the largest construction outfits in Estonia, exported 2,500 truckloads of precast concrete units last year for a town being built on a new site 330 kilometers south of Moscow.

Both business and political leaders in Estonia note that the country's large Russian population gives them a particular expertise in dealing with the giant to their east. Russians make up some 30 percent of Estonia's 1.5 million residents. They arrived during the Soviet occupation to work in heavy industrial plants and remain concentrated in Tallinn and the industrialized northeast.

Independence was achieved without bloodshed between the two communities. And although some disagreement has arisen over the language requirement of Estonia's citizenship law, Prime Minister Mart Laar says that most post-independence tensions have eased. In addition, he emphasizes the importance of Estonia's Russian population. "The younger Russians are among the greatest supporters of the government," says Laar. "We want more and more active relations with Russian business, and the Russian community here helps to supply a link."



The Port of Tallinn: A new role as "Hong Kong of the former Soviet Union"

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The Best of East and West

Estonia offers an intriguing mix of ancient and modern

During the famed "white nights" of Estonia's high summer, Tallinn's Gothic spires and towers stand in black outline against the sky. The sea washes red in the distance, and the pastel shades of the elaborately gabled houses of merchants shine softly in the twilight. Snatches of live music waft from vaulted cellars, and footsteps echo on cobbled streets. It is a magical scene.

It is also a scene that was well guarded in Soviet days. A single ferry to Helsinki was the only link to the West. But that isolation is history now, with the flow of visitors reaching 2 to 3 million a year.

Many foreign visitors do not need so



Modern accommodations: The Viru Hotel

much as a visa to savor the country's medieval cities, its unspoiled archipelagoes and lush forests.

Further, Estonia's position on the edge of the former Soviet Union and within the scope of television signals from Finland has made the country an intriguing mix of East and West. Before Estonia had regained its independence, those living in more cloistered areas of the Soviet Union viewed a trip to Estonia as a trip to the West.

Now those traveling into Estonia from the West will find striking and familiar Germanic architecture and Lutheran churches—and a



Through the fog: Sparkling spires

hint of the East in Tallinn's Russian Orthodox cathedral.

Getting There

Getting there is increasingly easy. Superferries with luxury restaurants and discos make the overnight run to Stockholm, while hydrofoils skim to Helsinki in 90 minutes and cost \$40 each way. SAS, Finnair and Lufthansa fly into Tallinn's

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Estonia: Forging a Path to Prosperity

international airport, renovated when the city hosted the sailing events in the Moscow Olympics and targeted for a \$19 million improvement project aimed at boosting service to Western Europe. The country's national carrier, Estonian Air, plans to expand its routes as well.

Estonia's success as a tourist destination is partly price driven. A gourmet meal—salmon, steak and strawberries—served in a fine 17th century building in the capital costs less than \$10. For the same price, a pleasant room with shower can be had in Pärnu, a coastal resort town originally founded by the Knights of the Sword in the 13th century. Finns stock up on excellent local vodka at \$1.50 a bottle, and meat at a fifth of Helsinki prices.

Visitors account for as much as a fifth of retail sales in central Tallinn. "They think nothing of popping over to Tallinn for the day to pick up some bargains," says Rein Ojasaar, deputy general director of Inreko, which operates a fleet of hydrofoils and ferries across the Baltic to Finnish shores and back. The demand for low-cost Estonian goods has also led Inreko to expand its operations into the shopping arena: The company now operates six stores, selling food, drink, clothes and electronic goods.

A Rich History

For other travelers, Estonia's rich history is the attraction. The Teutonic Knights and merchants of the Hanseatic League—the ancient union of European commercial towns that once stretched from London to Novgorod—have left their mark in the medieval walls, rambling lanes and bastions of old Tallinn.



The Olympic Yachting Center at Pirita: For Estonians and Western visitors seeking a nautical experience

Atop the spire of the Gothic Town Hall, Old Thomas, the warrior weather vane, has shifted with the winds since 1530; Town Hall Square in Tallinn's Lower Town was in use as a market as early as a thousand years ago.

For those interested in exploring Estonia's more remote regions, there are more than 800 seldom-seen islands off Estonia's coast. The largest of them is Saaremaa, whose castle and Gothic churches were built by German knights. For those traveling the Tallinn-Riga highway in May or September, the bird preserve at Matsalu—astride the great European migration routes—is not to be missed.

Visitors anywhere in Estonia will also find that the development of a quality hotel network in the country is also well underway. "I am very

optimistic," says Toomas Niinemae, a former police captain who has set up his own travel agency, Estravel. "Existing hotels are being upgraded, and new developments are in the planning stage." The Hotel Viru in Tallinn, with more than 400 rooms priced from \$60 to \$120 per night, is attracting considerable interest from both locals and foreigners.

Whether a traveler is seeking the great outdoors or a glimpse of the ancient past, Estonia has something to offer. The combination of superb medieval architecture, quiet seaside and forest getaways, and low prices is a rare one, according to Arvi Karotam, president of Estonia's Hermann Travel Ltd. "Add to that the warmth of welcome here, and it is easy to see why Estonia is becoming a great destination." ■



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