Poland and Lithuania – selected aspects of economic development and cooperation[1]

Wojciech Paczyński

Transition record in Poland and Lithuania – an overview

Both Poland and Lithuania certainly belong to the group of the most successful transition countries. After the sharp output contraction in the beginning of transition, economic growth resumed as early as 1992 in the case of Poland and in 1995 in Lithuania. Interestingly, the countries adopted different stabilization strategies. In both countries exchange rate was used as a nominal anchor. However, while Poland resolved to different modes of the crawling peg regime, Lithuania adopted a currency board in 1994. Consequently, disinflation process was much faster in Lithuania. Several important structural reforms have been implemented in both countries that formed a solid basis for a development of market based economies. Undoubtedly, the reform agenda still remains vast, in particular in fiscal sphere and labour markets (both countries suffer high unemployment). Significant progress has also been achieved in the accession dialogue with the EU. While Poland started the formal entry negotiations as early as March 1998, and Lithuania only in February 2000, the latter proceeded much faster and by June 2001 surpassed Poland in the progress measured by the number of closed chapters of negotiations. Certainly, the size of Poland's economy to a large extent determines the more difficult and slower progress of negotiations.

In 1995-1998 both countries maintained a steady and high by international standards rates of growth. The Russian crisis of 1998 represented a major external shock to their economies. However, Lithuania, being significantly more exposed to Russia (via trade in goods and services, investment, and financial links), suffered more than Poland. In fact Lithuania experienced a prolonged period of recession during 1998-1999. As this happened in the environment of the political crisis (three successive governments over the period of six months) and weakening fiscal and external positions, the country found itself at the brink of major financial turbulence. The confidence in the currency board was eroded and some voices suggested the need for devaluation. Thanks to responsible policies undertaken by the authorities Lithuania managed to restore investors confidence, allowing for renewed access to domestic and international capital markets at low spreads. GDP growth resumed in the first quarter of 2000.

In Poland, financial markets proved to a large extent invincible to the impact of the Russian crisis. However, it badly hit registered and shuttle trade with CIS countries. Economic growth slowed somewhat but remained healthy at 4.8 percent in 1998 and 4.1 percent in 1999. From the current perspective it is visible that the crisis had some positive effects on both countries as it forced the re-orientation of export markets and the necessary restructuring processes in the enterprises. The production sectors apparently managed to enhance their competitiveness that enabled the impressive export performance observed in 2000 and 2001. In fact exports remained the major engine of growth in that period.

[1] References: IMF (2000). Republic of Lithuania. Staff Report for the Article IV Consultation and First Review under the Stand-By Arrangement, www.imf.org; RP Embassy (2001). Ambasada Rzeczypospolitej Polskiej. Wydział Ekonomiczno Handlowy. Wilno, *Sprawozdanie Ekonomiczne za rok 2000* (The Embassy of the Republic of Poland. Economics and Trade Department, *Economics Report 2000*), mimeo, Vilnius 2001

The year 2000 and the first months of 2001 were marked by a slow but steady rebound of economic activities in Lithuania and a slowdown in Poland. Manufacturing and trade activities pushed the overall growth in Lithuania. In both countries domestic demand remained weak. The situation in Poland was affected by high real interest rates and worsening situation in the labor market. The prospects for 2001 remain perhaps more optimistic for Lithuania, where the growth momentum is expected to accelerate. In Poland a more vibrant growth will likely not materialize earlier than end-2001 or the beginning of 2002. The long run outlook remains very positive for both countries and in particular the membership in the EU should provide a further stimulus for catching up with more developed economies of Western Europe.

Recent trends in foreign trade

Lithuania, being much smaller than Poland remains significantly more open to trade. The exports plus imports over GDP ratio averaged some 88 percent in 2000. For Poland a respective figure was around 50 percent[2]. As already mentioned, both countries experienced a healthy growth of exports, which in 2000 exceeded 15 percent in Poland and 26 percent in Lithuania (in USD terms). Worth noting is that this was achieved in the environment of the zloty and the litas strong real appreciation against the euro. As indicated by IMF (2000), Lithuania's strong export performance suggests the significantly faster productivity growth than in trading partner countries or the Balassa-Samuelson effect. Moreover, Lithuania's external competitiveness has been supported by factors such as terms of trade gains, declining prices of intermediate products, keeping wage bill in check, product quality upgrade, better marketing as well as improved business environment in general and increased flexibility in the labor market thanks to structural reforms undertaken by the government.

European Union remains by far the most important trade partner for Poland and Lithuania. In 2000, it accounted for 70 percent of Polish exports and 48 percent of Lithuanian exports. The respective figures for imports were 61 percent and 43 percent. Former Soviet Union (FSU) countries (including Baltic States) accounted for 9.3 percent of Polish exports and 11.7 percent of imports. The CIS countries (i.e. FSU countries excluding Baltic States) accounted for 16.3 percent of Lithuanian exports and 31.7 percent of imports. This last figure resulted from increased imports from Russia, which its share in total Lithuanian imports to 27.4 percent. This was a direct consequence of the large increase in the prices of oil and oil product that dominate Lithuanian imports from Russia.

According to Lithuanian statistics Poland was the third biggest import market (4.9 percent share) and the fifth biggest export market (5.5 percent share) for Lithuania in 2000. Russia and Germany recorded larger exports and imports with Lithuania, and on the exports side Latvia and the UK also outpaced Poland. Worth noting is high growth of Lithuanian exports to Poland last year. Polish customs statistics placed Lithuania as the 15th export market (1.8 percent share) and 26th import market (0.6 percent share). It should be stressed that there are very substantial differences in recording the bilateral trade flows in countries' statistics. The table below gives the comparable data for 1999 and 2000. The differences largely result from different methods of classifying the origin country in trade flows (final destination vs. direct destination.

Table 1. Comparison of trade statistics

[2] Unless stated otherwise, customs statistics data are used for both Poland and Lithuania.

		1999	2000
Polish exports to Lithuania	Polish statistics	433.6	561.7
	Lithuanian statistics	273.7	269.1
Polish imports from Lithuania	Polish statistics	201.8	278
	Lithuanian statistics	136.4	208.1

Source: Polish Ministry of Economy and Lithuanian Department of Statistics.

There is a visible asymmetry in the commodity structure of the bilateral trade. Polish exports to Lithuania cover broad range of commodity groups, with the highest shares recorded in chemical industry (21 percent in 2000), machinery, mechanical appliances and electrical equipment (14.8 percent), plastic and plastic products (11.8 percent), pulp and paper (11.3 percent), and food and agricultural products (10.9 percent). On the other hand, mineral products (mostly fuels) dominated Lithuanian exports to Poland in 2000 with a share of 62.8 percent (RP Embassy, 2001).

Other aspects of cooperation[3]

The geography determines that Poland remains an important transit country for Lithuanian trade flows. Bilateral agreements regulate road transport. The future developments in this sphere will be influenced by the progress in projects aiming at the modernization of existing road infrastructure (especially in Poland). The recent intensification of contacts devoted to this group of problems of cooperation allows for a more optimistic outlook. The rail transportation is also likely to expand. Last year saw the opening of direct rail link from Warsaw to Vilnius (not passing through Belarus).

Another sphere having large potential for beneficial cooperation in the future is the energy sector. For some time now there have been discussion concerning the linking of countries' electricity grids. Also, Poland will participate in the costs of the decommissioning of the Ignalina nuclear power plant (even after decommissioning Lithuania will likely remain self-sufficient in terms of electricity production). There are also some prospects for cooperation of Polish and Lithuanian oil companies.

Poland does not belong to the group of the biggest home country for foreign direct investment in Lithuania. However, Poland's share in inward FDI stock has been on the rise reaching 2.2 percent in 2000[4]. It placed Poland as the 11th biggest foreign investors in Lithuania. This result is quite remarkable given the generally low level of outward FDI originating from Poland. It confirms a good climate for foreign investment in Lithuania and increasing interest among Polish companies in establishing a firmer presence in that market.

Instead of conclusions – agenda for the future

[3] This part draws from RP Embassy (2001).
[4] According to Lithuanian Department of Statistics data.

The experience of the last decade should be viewed as an indication of the high potential for intensification of the economic cooperation between Poland and Lithuania. One could note several factors that are likely to have the biggest impact on shaping the relations. First, both countries will likely become members of the European Union in the near future (most probably in 2004-2005). The impact of that event can hardly be overestimated and will be transmitted through several channels. It will diminish existing formal barriers for transfer of people, goods and capital. Also, it will have a major impact on the institutional reforms in both countries. While it is hard to prove this in a formal manner, the institutional factors likely remain important obstacles to the development of economic cooperation. It should be stressed that positive outcomes of changes in this sphere can be sizeable much earlier than the formal membership.

Second, solid growth of both economies underpinned by responsible macroeconomic policies will naturally lead to the expansion of trade and investment activities in both directions. The intensity of this process will be determined by several factors, many of which lie in the responsibility of decision making circles at different levels (e.g. development of transport infrastructure, access to information, etc.).

Third, geographical proximity combined with important elements of common history, etc. provide a valuable basis for the intensification of the movements of individuals, the growth of tourism, etc. These contacts, being very important for many other reasons, would also positively influence business relations. The more we learn about ourselves, the better will be the future of our cooperation.

Poland and Lithuania – selected macroeconomic indicators

		1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	*2001*	*2002*
GDP growth	Poland	-7,0	2,0	4,3	5,2	6,8	5,9	6,8	4,8	4,1	4,1	*4?*	*4,5*
	Lithuania	-5,7	-21,3	-16,2	-9,8	3,3	4,7	7,3	5,1	-4,2	2,7	*3,2?*	*3,8*
GDP per capita, USD	Poland	1995	2196	2229	2553	3288	3719	3721	4090	4008	4153	*4577*	*4979*
	Lithuania	6299	513	719	1128	1603	2100	2550	2867	2868	3012	*3199*	*3428*
CPI inflation	Poland	70,3	43	35,3	32,2	27,88	19,9	14,9	11,8	7,3	10,1	*7*	*5*
	Lithuania	224,7	1021,0	410,4	72,1	39,5	24,7	8,8	5,1	0,8	1,0	*1,3*	*2,6*

Notes: The 2001 and 2002 data are forecasts.
Presented inflation data are period averages.
GDP per capita is in current prices using market exchange rates.
? and *?* indicate directions of likely forecast revisions (derived from various sources).
IMF WEO data as presented in this table incorporate IMF staff estimates and may differ from official data provided by countries' statistical agencies.

Sources: GDP and inflation data are taken from IMF, WEO database (May 2001)