

BACKGROUND INFORMATION

LEVEL OF CONCENTRATION IN THE MANUFACTURING PRODUCTION IN ESTONIA

Over more than ten years, the European Union economic policy (single market programme, common monetary policy) has significantly curbed intra-EU trading costs. According to most of the trade theories, a cut in transaction costs means specialisation, which allows the state to make use of the relative advantage but involves also several risks. In case of sector-specific shocks the vulnerability of economy will grow.

The recent Competition Report, 2003¹, published by the European Commission evaluates the level of concentration in manufacturing both in the European Union and in Central and Eastern European Countries (CEEC). The concentration is calculated using a defined number of industries (eg, 1; 3; 5, etc) and establishing the share of their production to the whole manufacturing. There has been no uniform trend of concentration increase or decrease in the EU Member States since 1990. The highest industrial

concentration occurs in Ireland where three largest industries were responsible for 76% of industrial production in 2001. Finland ranks second after Ireland, with 55%.

In the CEE countries concentration in manufacturing production reaches 50–60% by industries, exceeding most of the EU Member States, in which the indicator is 40–50%. In the 1990s, the indicator displayed major growth in most of the CEE countries. The concentration indicator shrank only in Estonia.

In Estonia, in 1992, food industry (37%), textile industry (14%) and chemical industry (9%) accounted for most of the manufacturing production. More recently, the share of wood processing and manufacturing of wooden products (14% in 2001), metal industry and manufacturing of metal products (8%) and furniture production has been constantly

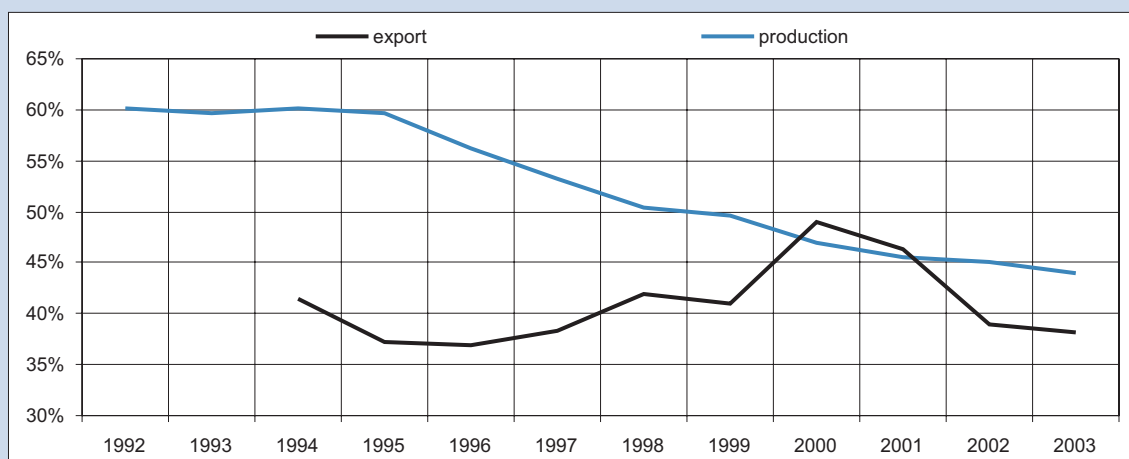


Figure 1a. The change of manufacturing production concentration in 1992–2003 (by three major sectors)

Source: Statistical Office of Estonia; <http://www.stat.ee>

¹ http://europa.eu.int/comm/economy_finance/publications/priceandcostcompetitiveness_en.htm

increasing whereas the total level of concentration has gradually fallen (see Figure 1a).

In manufacturing exports, the level of concentration has been lower and more constant but three leading branches have persistently changed. Also in 1994, food industry (22%), garment production (11%) and chemical industry (9%) were leading exporters. By today, the share of wooden products' export has reached 15% and the share of food and beverages

export has shrank to 8%. Since 2000, export of radio, television and communication equipment has leaped forward and equalled the share of wooden products exports. The opening an Elcoteq Group plant in Tallinn has been a contributing factor.

The above indicates that Estonia's manufacturing lacks dominant branches; and, therefore, implications of sector-specific shocks would be weaker than in other CEE countries and EU Member States.

WHY HAS THE CONTINUOUS DEPRECIATION OF THE DOLLAR NOT IMPROVED ESTONIA'S TRADE BALANCE?

Since the first half of 2002, the US dollar has displayed a downward trend; and, therefore, its implications on Estonia's trade have been persistently on the agenda. According to theoretical and empirical literature, the first phase of the impact lies in the price change of imported goods and services arising from the appreciation of the national currency, upon converting prices into national currency. This impact is automatic and exercised immediately¹.

The depreciation of the dollar against the euro should lower the price in Estonian kroons of the goods purchased for dollars. Indirectly, certain similarity in the dynamics of the exchange rate of the dollar and the price index dynamics of imported goods confirms the link (see Figure 2a)².

A price decline in the goods purchased for dollars should, in its turn, reduce foreign trade deficit. Nevertheless, trade deficit has been increasing during the last two years and the share of goods imported

for dollars has not shrank, either (depreciation of these goods should have cut their share as well). While in 2002, the share of goods purchased in dollars in normal exports shrank to 20% from 21%, year-on-year, the spring of 2003 brought a new rise. Why?

The underlying reason lies in the growing import of means of transport purchased for dollars, which reflects a booming rental business with rail tanks, which were bought for dollars (see Figure 3a). The rail tank business is not attractive because of the favourable exchange rate of the dollar. Rail tanks would have been imported even if the exchange rate of the dollar had not dropped. In this case Estonia's trade deficit to GDP would be approximately 0.5 percentage points larger.

All in all, we should reiterate that, although depreciation of the dollar has a favourable impact on the trade balance of Estonia, it cannot be distinguished due to other more powerful processes.

¹ See, for example, Monetary Developments & Policy Survey, September 2002. Eesti Pank, Tallinn.

² The price index of goods is calculated from GDP's supply-side data.

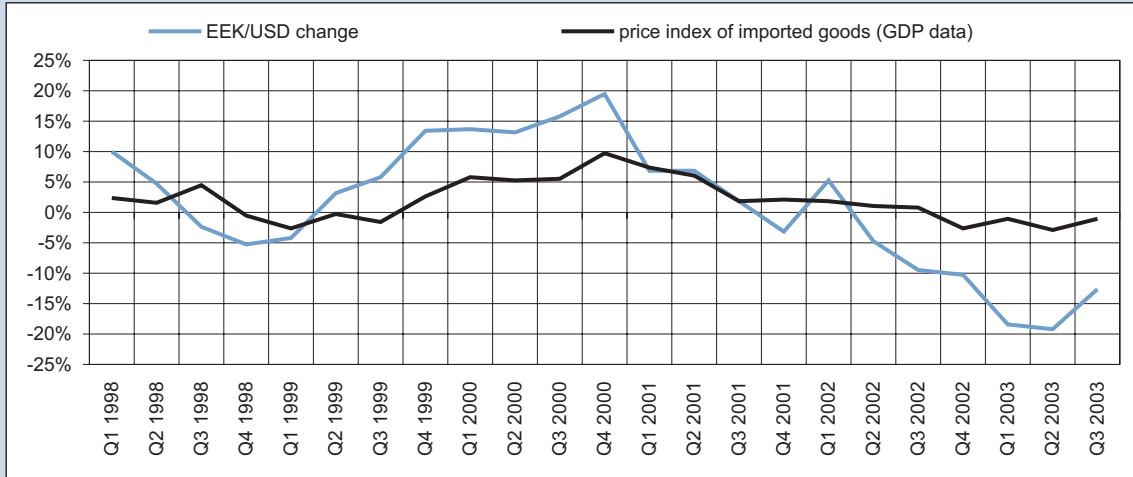


Figure 2a. The dynamics of dollar exchange rate and the price index of imported goods in 1998-2003

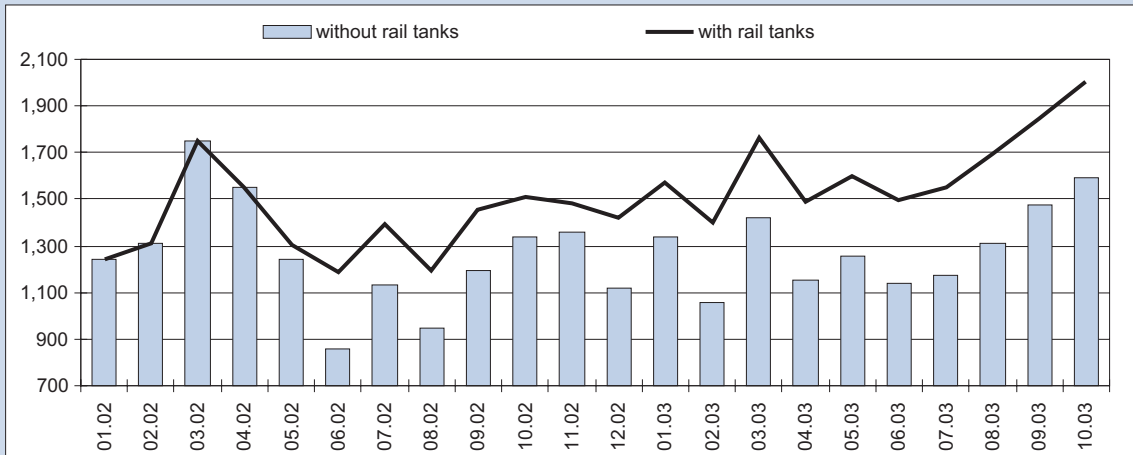


Figure 3a. Goods imported for dollars with and without rail tanks in January-October 2003