Investment as Productivity Driver in the Baltic States:

How to Reach the Higher Hanging Fruit?
What Is Your Strategy?
Investment has been a growth driver in the Baltic region

- Since 2000, economic growth in the Baltic States has averaged >4% per year
- This economic performance is comparable to some of the Asian tigers (China, S. Korea)
- Investment, mostly – FDI, has played a key role in economic development of the initially capital-starved Baltic States
- Baltic States now have reached 70-80% of the average income and 60-70% of productivity level of the EU
- There is a risk of falling into «middle-income trap»

Source: CSB, Bank of Latvia
Strong FDI in all major sectors of the economy across the Baltics, Estonia leads

Source: Bank of Latvia, Bank of Lithuania, Bank of Estonia
Sweden plays an outsized role in the Baltics, especially in financial activities.
Global trade has driven investment in the Baltics, but now impact is slowing

Source: Bank of Latvia, IMF, UNdata
Changing investment landscape:
#1 – Diversification of the economy

Export of goods and services in Latvia, MEUR

Source: CSB, Bank of Latvia
Changing investment landscape: #2 – Scarcity of labour

- Collapse of the inefficient Soviet economy left large unemployment and underutilized labour force
- Unemployment in the region now at the lowest level in more than 30 years; also lowest in the EU
- Foreign investors report increasing difficulties to finding labour; quality and quantity of labour No 1 barrier to investment
- Cheap and abundant labour is now the past

Source: Eurostat
Changing investment landscape: #3 – Increased domestic capital base

- Baltic region is no longer as capital poor (but not rich either)
- Household deposits have exceeded domestic loan portfolio. Currency and deposits make up 60-70% of household financial assets
- Stock market capitalization remains very low and there are few alternatives to bank lending
- Need for new instruments to move domestic savings into investments including pension assets

Source: Bank of Latvia
Changing investment landscape: #4 - Preference for hoarding cash

- Since 2000, Baltic companies have held back investment into fixed assets
- Higher capitalization has not translated into higher investment rate
- Firms have preferred to hold onto their cash, rather than convert it into further productive assets
- Governments should incentivize capital markets and IPOs, including for state- and municipal-owned enterprises
Changing investment landscape #5 – Demographic decline

- Low birth rates in the 1990’s are now catching up with the economy
- Number of people retiring has begun to exceed number of people entering labour market
- Foreign Investors’ Council in Latvia has identified demography and access to labour as key policy priorities
- Depending on the migration trends/policy, this is the new normal for the next 20-40 years

Source: Eurostat
Fast wage growth is increasingly happening at the expense of private investment.

Source: CSB, Eurostat, Citadele calculations.
Baltic growth model is changing and will not happen without smart investment

- So far - 20% of work and 80% of results
- Wage growth cannot exceed productivity forever
- Time to change growth model from resource utilization to smart growth
- Investments to support new priorities - R&D, energy efficiency and increasing the share of high value added sectors
- New channels for domestic savings and FDI

Source: Eurostat
Level of FDI impacts productivity

- FDI growth correlates with level of productivity growth
- Less quality foreign investment lessens the transfer of management know-how, technology and innovation
- Without a productivity-boosting FDI strategy, Baltic states risk losing international competitiveness

Source: Eurostat, OECD 2019
Level of R&D investment determines productivity and, ultimately, wealth.
- Lithuania: #11
- Estonia: #18
- Latvia: #19
The Global Competitiveness Report 2019

- Estonia: #31
- Lithuania: #39
- Latvia: #41
Investment Guidelines of Cohesion Policy Funding, 2021-2017

- SMART EUROPE
- GREEN EUROPE
- CONNECTED EUROPE
- SOCIAL EUROPE
- EUROPE CLOSER TO CITIZENS
High Priority Investment Needs for Latvia, 2021-2017

- Innovation
- Human Capital
- Regional Development
Thank you!