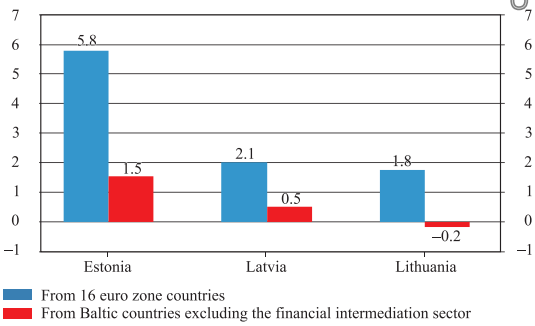
3. In Focus

Situation in the Baltic States in terms of attracting foreign direct investment

Chart 1
FDI growth in the Baltic States from 31 December 2010 to 31 December 2012
(% of GDP)

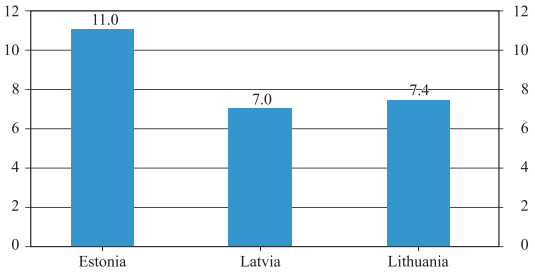


Sources: national central banks, Eurostat.

After the introduction of the euro, Estonia has been the Baltic State with the highest growth of foreign direct investment (FDI) from the 16 euro area countries as well as from the Baltic States, both in nominal terms and as percentage of GDP (Chart 1).

FDI inflows to Estonia from the euro area were supported by a rise in its credibility in the eyes of investors. In 2011, Estonia's first year as a euro country, 50 major investment projects received funding inflows in Estonia, 20% higher than in 2010. Moreover, more than half of the above projects were associated with industrial investment, mostly from Finland, Spain and Germany. For example, the company *Atienza & Climent Group* (representative of the *Hello Kitty* brand) from Spain invested 10 million euro in a plant in Estonia, claiming that the euro was a major factor underlying the company's investment choice. The rise in Estonia's credibility contributed to receiving FDI inflows from other Baltic States as well, e.g. *Latvijas Finieris* invested 20 million euro in a plant in Estonia.

Chart 2
Average income as a % of FDI to Baltic countries in 2004–2012



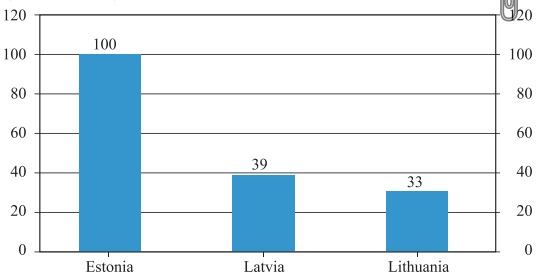
Source: Eurostat.

The very substantial fall in FDI observed in Latvia and Lithuania during the same period mostly reflected the restructuring of *Swedbank*.[1] Nevertheless, even omitting the restructuring of Swedbank (and FDI flows in the financial sector) from the calculation, the growth of the Baltic States' FDI to Estonia would be higher than that to Latvia, with the respective FDI in Lithuania even posting a decrease.

Apart from Estonia's higher credibility since the euro introduction, there are some other reasons supporting the FDI inflows in this Baltic country. First, from 2004 to 2011 the largest average income from FDI in the Baltic States was recorded in Estonia (Chart 2). Second, a favourable corporate income tax system is in place in Estonia. Third, Estonia continues to pursue responsible fiscal policy also after joining the euro area.

Obviously, responsible fiscal policy can also be pursued outside the euro area, and the introduction of the euro stimulates investment only subject to the condition that an economy implements responsible economic policy; nevertheless, it is expected that Latvia would encourage FDI inflows by introducing the euro in 2014. This is particularly important as Latvia currently lags behind Estonia in terms of FDI attraction. Already before the crisis reinvested earnings as a share of income from FDI were considerably higher in Estonia in comparison to Lithuania and Latvia; this means that the funds once invested in the Estonian economy remain there also in the future, continuing to promote its economic growth. Moreover, already in 2004–2012 the average FDI per capita in Estonia exceeded that in other Baltic States approximately three times (Chart 3). With such situation persisting, it is even more important for Latvia to introduce the euro and thus attract more FDI.

Chart 3
Average FDI per capita in the Baltic States in 2004–2012 (Estonia=100)



Source: Eurostat.

[1] The Estonian Swedbank, formerly the parent company of its daughter companies in Latvia and Lithuania, sold the shares of its daughter companies in a formal transaction to Swedbank in Sweden, thus reducing the FDI in Latvia and Lithuania considerably according to the principles underlying the balance of payments (the amount of the actual investment remained unchanged).