'SMART AUSTERITY' AND THE NEW BALTIC GROWTH MODEL

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MINISTER OF ECONOMICS OF LATVIA
MARCH 2013
Where is Latvia?

- **Capital City**: Riga
- **Territory**: 64.6 ths.sq.km
- **Population**: 2.07 million
- **Language**: Latvian
### Cities by Population

<table>
<thead>
<tr>
<th>City</th>
<th>Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stockholm</td>
<td>864,324</td>
</tr>
<tr>
<td><strong>Riga</strong></td>
<td><strong>657,424</strong></td>
</tr>
<tr>
<td>Oslo</td>
<td>599,230</td>
</tr>
<tr>
<td>Copenhagen</td>
<td>593,013</td>
</tr>
<tr>
<td>Helsinki</td>
<td>583,350</td>
</tr>
<tr>
<td>Vilnius</td>
<td>554,400</td>
</tr>
<tr>
<td>Tallinn</td>
<td>409,342</td>
</tr>
</tbody>
</table>
17 Airlines Operate 83 Direct Flights to/from Riga International Airport
LATVIA: GATEWAY BETWEEN EUROPE AND CIS
Latvia – Well-Connected Transit Hub

Main gas pipeline
Oil pipeline
Underground Gas Storage
Railway
Airports

Cities with SEZ
Main Cities

Stockholm 280 km
Rotterdam 1700 km

Tallinn 312 km
Pskov 285 km

St. Petersburg 390 km
Moscow 938 km
Vitebsk 498 km

Baltic Sea
Riga Gulf

LITHUANIA
BELARUS
RUSSIA
ESTONIA
Strong International Presence
“LATVIA’S BASIC ECONOMIC FIGURES ARE ALL BETTER THAN REQUIRED”

“LATVIAN GOVERNMENT DEBT STANDS AT AROUND 41% OF GROSS DOMESTIC PRODUCT, AND INFLATION IN 2012 AVERAGED 2%, MAKING IT LOOK LIKE A MODEL MEMBER OF THE EURO CURRENCY BLOC”

“LATVIA IS GROWING STRONGLY”

“LATVIAN LEADERS HAVE SHOWN THAT THEY WILL DO WHATEVER IT TAKES TO GET THEIR ECONOMY IN ORDER” (March 2013)
Latvia’s GDP Dynamics

SOURCE: EUROSTAT

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>8.7%</td>
</tr>
<tr>
<td>2005</td>
<td>10.6%</td>
</tr>
<tr>
<td>2006</td>
<td>11.2%</td>
</tr>
<tr>
<td>2007</td>
<td>9.6%</td>
</tr>
<tr>
<td>2008</td>
<td>-3.3%</td>
</tr>
<tr>
<td>2009</td>
<td>-0.3%</td>
</tr>
<tr>
<td>2011</td>
<td>5.1%</td>
</tr>
<tr>
<td>2012</td>
<td>5.3%</td>
</tr>
<tr>
<td>2013</td>
<td>3.8%</td>
</tr>
</tbody>
</table>
Fiscal strategy to prevent excessive budget deficit
% of GDP

-0.4% -4.2% -9.7% -8.1% -3.4% -1.5% -1.4% -0.8%

Maastricht criteria

Fiscal Strategy

2007 2008 2009 2010 2011 2012 2013 2014

SOURCE: CENTRAL STATISTICAL BUREAU OF LATVIA
FORECASTS: MINISTRY OF FINANCE
Between 2009 and 2010, the number of state agencies was reduced from 148 to 97.

The number of government employees has been cut by 24% since 2008, and government wages have been slashed by 30%.

Red tape has been strongly reduced for businesses and public administration.
Latvia’s current GDP growth defies trends in Europe

SOURCE: EUROSTAT
Export and import volumes
Millions LVL

SOURCE: BANK OF LATVIA
Improved competitiveness defines export growth

<table>
<thead>
<tr>
<th>Year</th>
<th>External Demand</th>
<th>Competitiveness</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>-21.0%</td>
<td>-21.0%</td>
</tr>
<tr>
<td>2010</td>
<td>+29.4%</td>
<td>+29.4%</td>
</tr>
<tr>
<td>2011</td>
<td>+28.9%</td>
<td>+28.9%</td>
</tr>
<tr>
<td>2012 Jan-Nov</td>
<td>+12.6%</td>
<td>+12.6%</td>
</tr>
</tbody>
</table>

Source: Ministry of Economics
Investors’ confidence has returned - CDS spreads have decreased, ratings improved

5Y CDS spreads and announcements from credit rating agencies

- **February 2010**: S&P changed outlook to stable
- **March 2010**: Moody’s changed outlook to stable
- **September 2010**: Fitch changed outlook to stable
- **December 2010**: S&P upgraded rating to BB+ (stable)
- **March 2011**: S&P changed outlook to positive; Fitch upgraded rating to BBB-; changed outlook to positive
- **May 2012**: S&P upgraded rating to BBB- (stable)
- **November 2012**: S&P and Fitch upgraded rating to BBB; S&P changed outlook to positive

Lithuania | Latvia | Portugal | Ireland
### Latvia’s Rankings – Rising

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013 March</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Moody’s</strong>&lt;br&gt;(long term liabilities)</td>
<td>Baa3</td>
<td>Baa3</td>
<td>Baa3</td>
<td>Baa3</td>
<td>Baa3</td>
</tr>
<tr>
<td>Moody’s future estimation</td>
<td>Negative</td>
<td>Stable</td>
<td>Positive</td>
<td>Positive</td>
<td>Positive</td>
</tr>
<tr>
<td><strong>Standart&amp;Poor’s</strong>&lt;br&gt;(long term liabilities)</td>
<td>BB</td>
<td>BB+</td>
<td>BB+</td>
<td>BBB</td>
<td>BBB</td>
</tr>
<tr>
<td>Standart&amp;Poor’s future estimation</td>
<td>Negative</td>
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<td>Positive</td>
<td>Positive</td>
<td>Positive</td>
</tr>
<tr>
<td><strong>Fitch</strong>&lt;br&gt;(long term liabilities)</td>
<td>BB+</td>
<td>BB+</td>
<td>BBB-</td>
<td>BBB</td>
<td>BBB</td>
</tr>
<tr>
<td>Fitch future estimation</td>
<td>Negative</td>
<td>Stable</td>
<td>Stable</td>
<td>Stable</td>
<td>Positive</td>
</tr>
</tbody>
</table>
Latvia’s Rankings – High and Rising

- **DOING BUSINESS 2013**
  Source: World Bank
  RANK 25

- **PAYING TAXES 2012**
  Source: PricewaterhouseCoopers / The World Bank
  RANK 11

- **STATE OF THE INTERNET 2012**
  for global average connection speed 2012 Q2
  Source: Akamai
  RANK 4

- **GLOBAL SERVICES LOCATION 2011**
  Source: A.T. Kearney
  RANK 13

- **OVERALL FREEZONES OF THE FUTURE 2010/11**
  Source: FDI Magazine
  RANK 5

- **THE ENVIRONMENTAL PERFORMANCE INDEX 2009**
  Source: The Columbia University and Yale University
  RANK 2
European Commission Business and Consumer Survey

**Investors**
- Policy of the public authorities, Factors influencing investments, 2004 = 0
- Financial position to change over the next year, 2004 = 0

**Consumers**
- Financial position to change over the next year, 2004 = 0

Latvia has the Confidence of Investors and Consumers
BUT... Productivity In Manufacturing Is Low

'000 EUR PER ONE WORKER ANNUALLY

SOURCE: EUROSTAT, MINISTRY OF ECONOMICS OF LATVIA
LATVIA – WHAT’S NEXT?
NATIONAL DEVELOPMENT PLAN 2020

IS THE PIVOTAL MEDIUM TERM PLANNING DOCUMENT IN LATVIA.
NDP2020 TAKES INTO ACCOUNT:

THE SUSTAINABLE DEVELOPMENT STRATEGY OF LATVIA UNTIL 2030

THE NATIONAL REFORM PROGRAMME FOR THE IMPLEMENTATION OF THE “EU2020” STRATEGY

THE CONVERGENCE PROGRAMME
EUROPEAN COUNCIL RECOMMENDATIONS
NATIONAL INDUSTRIAL POLICY = ECONOMIC PART OF NDP
National Development Plan

National Industrial Policy

- Tax Policy
- Policy for Education and Science
- Entrepreneurship Policy
- Innovation Policy
- Employment Policy
- Policy for Export Promotion and Attraction of FDI
- Other Policies
National Industrial Policy Goals

40%
Productivity growth in manufacturing 2020 compared to 2011

20%
GDP share of manufacturing in 2020

1.5%
Expenditure on R&D of GDP in 2020

73%
Employment rate in 2020

40%
Increase of export volumes 2020 compared to 2011
MINIMIZE RENT-SEEKING BY ABOLISHING PRIORITY INDUSTRIES

AVOID PICKING WINNERS

IDENTIFY MARKET AND GOVERNMENT FAILURES

MINIMIZE RISK TO REPLACE PRIVATE INVESTMENT

COLLABORATE WITH STAKEHOLDERS

(DIALOGUE 2.0)
Main Advantages of Latvian Companies

MADE in EU

Knowledge of labour force

Price

Delivery on time

Quality

Specialization (niche production)

Production by order in flexible volumes
Main Challenges Identified by Latvian Entrepreneurs

- Access to Capital Markets
- Shortage of Labour Force
- Lack of Growth Strategies
- R&D
- Regulation in Export Countries
- Industrial Infrastructure
- Energy Costs
**Policy Implementation Priorities**

**Support Existing Product Producers**
- Clusters, Export promotion,
- Upgrade of management skills, Energy efficiency

**Correct Market Failures**
- Business environment,
- Shadow economy, Industrial premises, Employment issues

**Support Future Product Producers**
- Venture capital, Competence centres and innovation vouchers, Technology transfer
National Industrial Policy - Partnership

Ministry of Economics

NGOs

Ministry of Education and Science

National Industrial Policy

Other ministries

Ministry of Environmental Protection and Regional Development
Policy Action Priorities

- Access to labour force and skills development
- Access to finance
- Development of business infrastructure
- Capacity building of innovation performance
- Export promotion
- Reduction of costs of energy resources
HIGHER
VALUE-ADDED AND PRODUCTIVITY

DRIVING
ROLE OF MANUFACTURING

MODERN
PRODUCTS AND SERVICES

SOPHISTICATED
EXPORT STRUCTURE

NEW AND BETTER-PAID
JOBS
Future challenges

2014
Joining Eurozone

Sustainable Economic Growth

National Industrial Policy
- Business environment
- Enhanced competitiveness

Structural Reforms
- Social sector
- Education
- Public administration

Investment environment
Favorable funding costs
AND ONE MORE THING...
2009 Q4 = 100

SOURCE: EUROSTAT
Budget deficit, % of GDP, European Countries

Maastricht Criterion

SOURCE: EUROSTAT
Nordic states [Sweden, Denmark, Finland, Norway and Iceland], which now increasingly include the Baltic states of Estonia, Latvia and Lithuania, offer an example. They constitute an attractive vision for the future of Europe that contrasts the dominant 'declinist' paradigm. It is critical therefore that the Nordics see their relative well-being not just an economic asset but also as a strategic asset with real-world implications.

The Success of the Nordics: It's the Mindset, Stupid!
THEHUFFINGTONPOST.COM
FEBRUARY 11, 2013