FDI and Spillovers in the Baltic Countries[1]

JARI HYVÄRINEN
Senior Adviser, Economist, PhD
Tekes, the National Technology Agency of Finland, Helsinki

The reform programs carried out in the Baltic countries generally led to the conclusion that the role of foreign investors seemed to be a remarkable cornerstone in the industrial restructuring process and economic growth, and their role was accentuated especially in large-scale privatization (Hyvärinen 2004). In the beginning of the 2000s, Estonian industry already had three success stories: food processing, textiles and electronics. Conceivably, the human-capital intensive electronics industry contains the clearest opportunities for industrial integration with foreign companies. As in Estonia, Latvia's success in competition and reorientation towards the international markets rests mostly on electronics but also on industries such as machinery and wood industries. The metal industry is estimated to be one of the important future industries in Lithuania.

Most of the industrial FDI to the Baltic countries belonged to the operations of the multinational companies. They have utilized the internalization advantage to expand their activities in the CEE markets, because it is more advantageous to produce near consumers using high-skilled, low-wage Baltic employees. Moreover, the Baltic firms needed these core investors abroad who could be helpful in installing new methods of corporate governance and managerial incentives as well as enclosing Baltic firms in market-based information, know-how and innovation networks (Hyvärinen – Borsos 1994; Hyvärinen 1996; Hyvärinen 2004).

FDI FLOWS TO THE BALTIC COUNTRIES: ESTONIAN INDUSTRY AND SERVICES SEEM TO BE THE MAIN TARGETS

The Baltic countries started to reap the fruits of the transition period when the FDI inflows began to grow steadily, even if at a slower rate than in the other CEE countries (EBRD 2000).

However, in Estonia both the FDI inflows per capita and the ratio of FDI to GDP are among the CEE's highest. Based on the UNCTAD (2003) and Baltic Central Bank statistics, Estonia's inward FDI stock has tripled in 1998-2003, reaching USD 6.5 billion in 2003. The FDI inflows have been channeled mostly from Finland and Sweden to the finance, trade, transport and telecommunications sectors but also to labor-intensive manufacturing sectors such as the textiles, wood and food industries.

The FDI inflows to Latvia had an increasing trend from 1990 to 2000 but there was a dramatic slump in 2001, and by the end of 2003 an inward FDI stock of USD 3.3 billion had accumulated. The FDI, mainly from the United States, Germany, Sweden, Finland and Denmark, has been directed to trade, finance and business activities but also to the energy sector, especially to gas.

In Lithuania, the FDI inflows grew appreciably during the 1990s and reached a stock valued as USD 4.8 billion in 2003. The FDI stock is mainly directed toward trade, telecommunications and financial intermediation, and when

considering the industrial sectors, the main targets are the fuel and chemical industry. The main FDI partners come from Denmark, Sweden and Estonia.

HUMAN CAPITAL AND SKILL SPILLOVERS LEAD TO SUCCESSFUL INNOVATIONS AND ATTRACT FDI

High-skilled human capital is the strength of the Baltic innovation system and the FDI policy guidelines. By furthering the progress of skilled human capital, the Baltic firms need close links with high-technology EU firms and advanced EU technology programs.

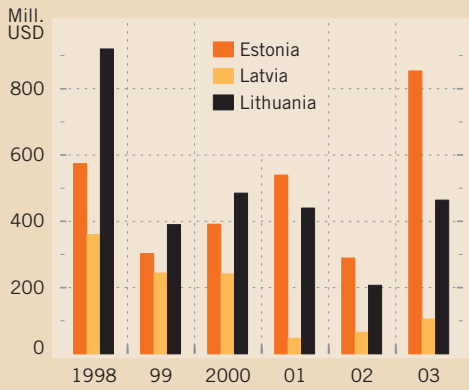
As is well known, the Baltic infrastructure already includes advanced computer and communication technology, which is needed for keeping up the learning economy paradigm. However, it still requires, first, new organizational forms for the higher utilization of innovation resources in EU-Baltic industrial integration, and second, strong support of educational institutions in order to have an impact on innovation capabilities. That is the government policy that supports the advanced learning process by keeping up the educational institutions, incentives for education and creative destruction in education.

R&D FINANCING AND SPILLOVERS IMPORTANT WHEN CONSIDERING TECHNOLOGICAL CHANGE IN THE BALTICS

In relation to EU-Baltic technological cooperation, benefits from spillover effects are one of the clear externalities. Cooperation is thus highly advisable for Baltic firms because it might offer the fastest way to close their gap with EU technology. As found above, international dissemination of new ideas and technologies takes place by international industrial integration and through the operations of multinational corporations, and the spillover effect is positively related to efficiency gains both in intra-industry and inter-industry spillovers.

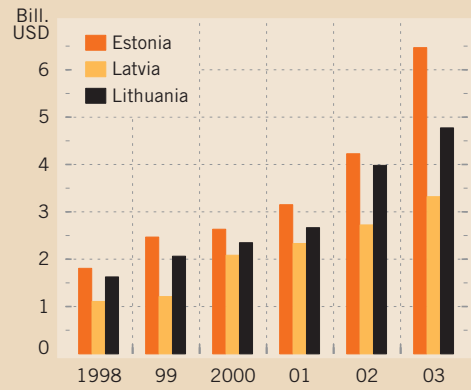
Finally, the Baltic countries are dependent on EU funding of R&D both at the public and firm level. While large firms can channel their cash flow and new equity to the R&D projects, smaller firms are more likely to finance their R&D spending with debt. Therefore, in these circumstances, the banking sector should find resources to finance the R&D investments of the small firms. This is because small firms are more active in creating new innovations, and without public funding the finance should be

FDI Inflows



Sources: UNCTAD (2003), The Central Banks of the Baltic Countries. ETLA S04.3/f177

Inward FDI Stock



Sources: UNCTAD (2003), The Central Banks of the Baltic Countries. ETLA S04.3/f176

channeled through the EU technology programs or as a by-product of industrial integration via the EU final producers.

FOOTNOTE

[1] This paper is based on the research of my PhD project at the Graduate Institute of International Studies, Geneva, 2000-2004.

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