

Competitiveness:

How does Lithuania compare to other countries?

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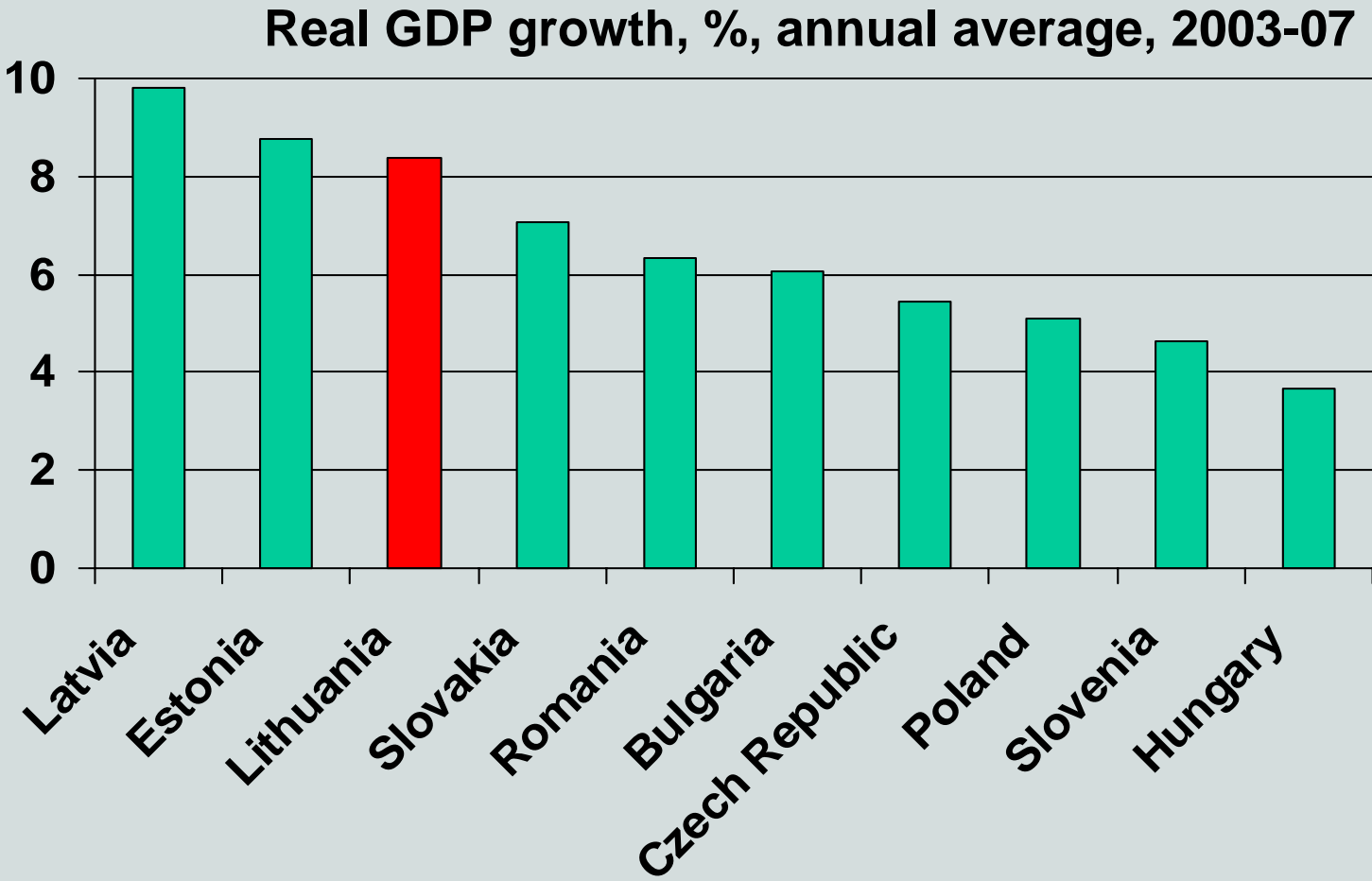
Outline

1. Background
2. Price competitiveness
3. Non-price competitiveness: the business environment
4. Challenges for the longer term
5. Conclusions

1. Background

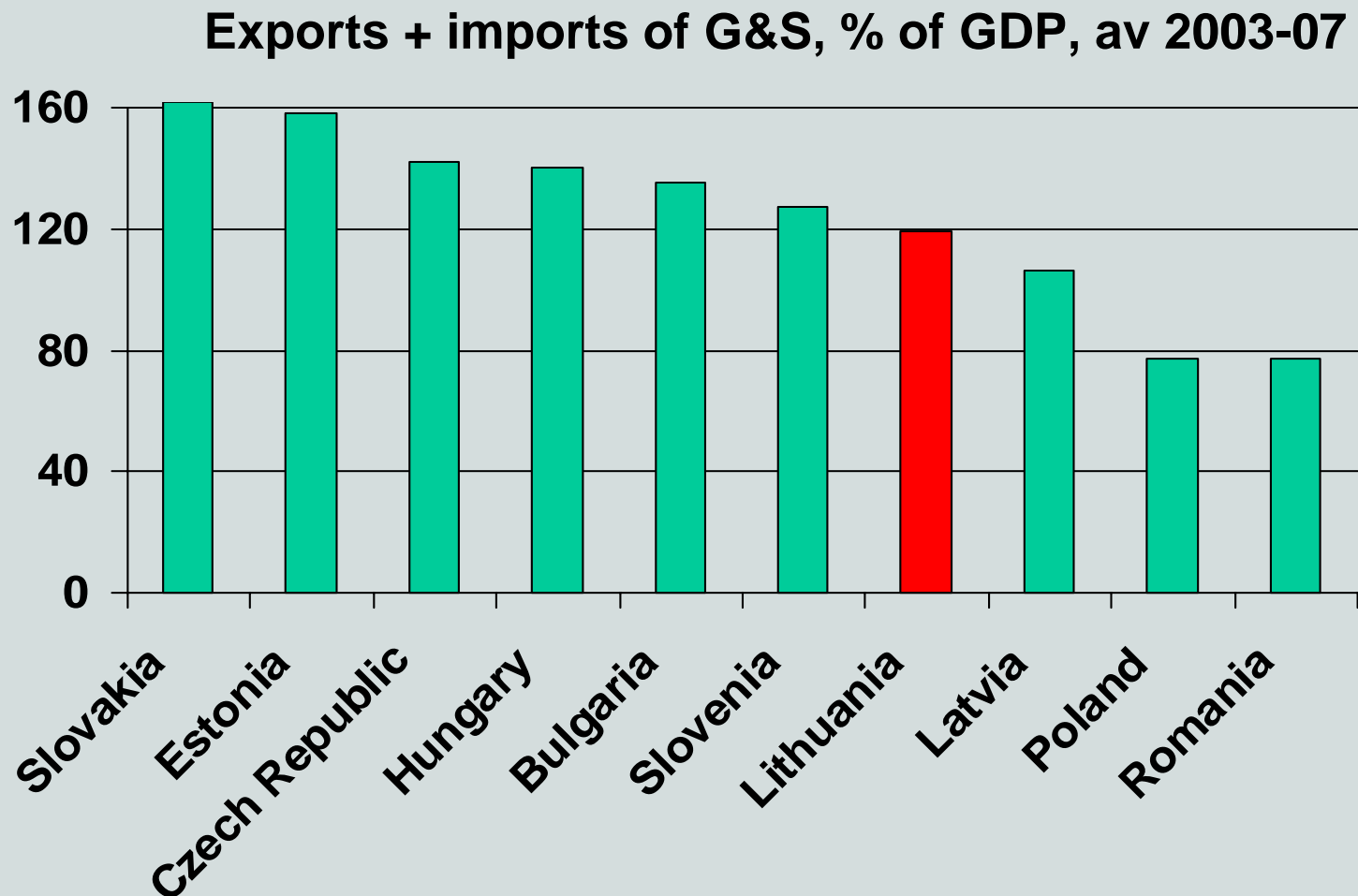
1. Rapid growth in the “EU10”
2. Open economies:
 - Exports + imports of goods & services mostly $>100\%$ of GDP
 - Rapid export/import growth
3. Large current-account deficits
4. Deficits can be sustainable given robust FDI
5. Lithuania looks more vulnerable in this respect?

Rapid growth



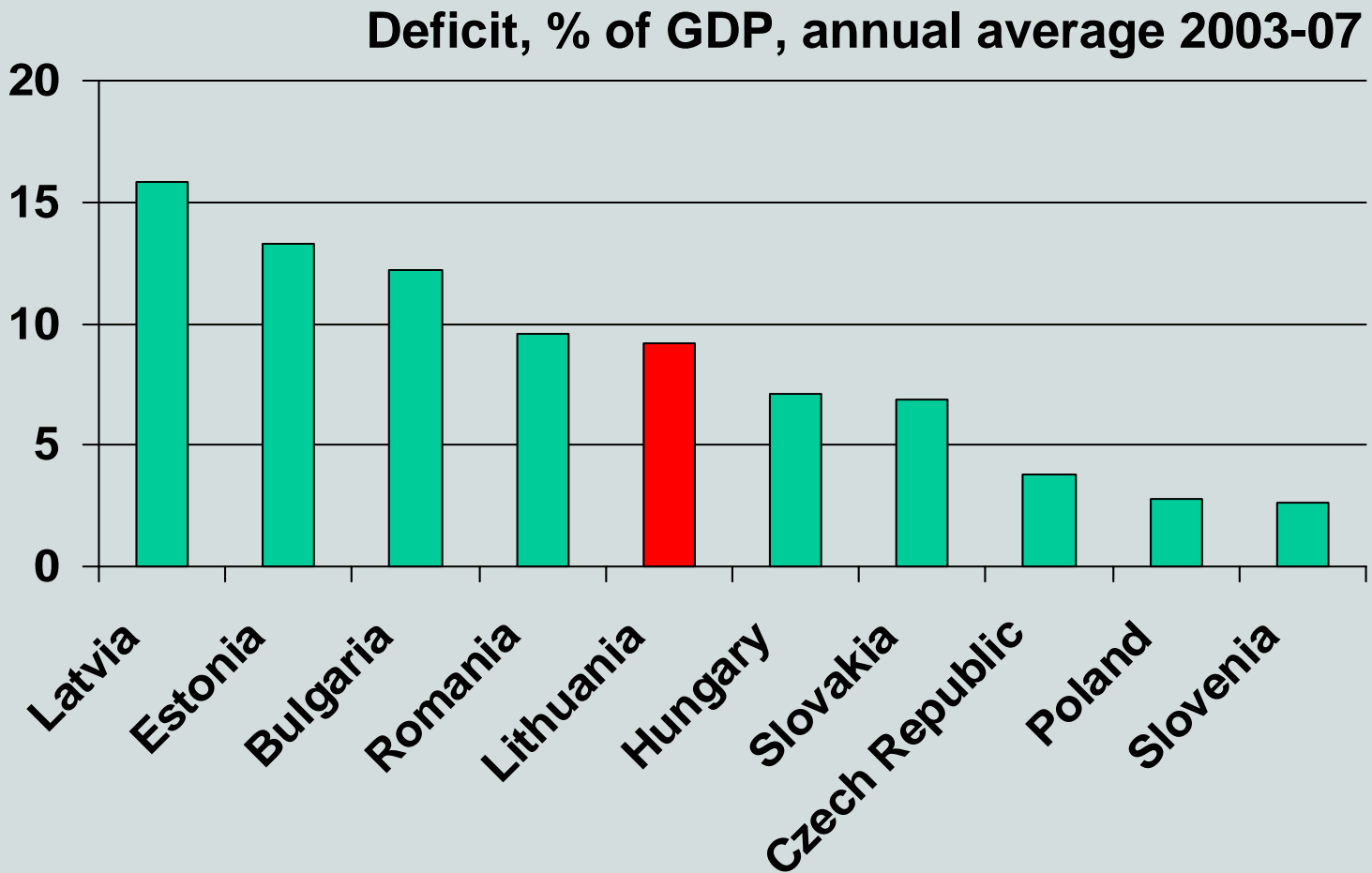
Source: Economist Intelligence Unit.

Open economies...



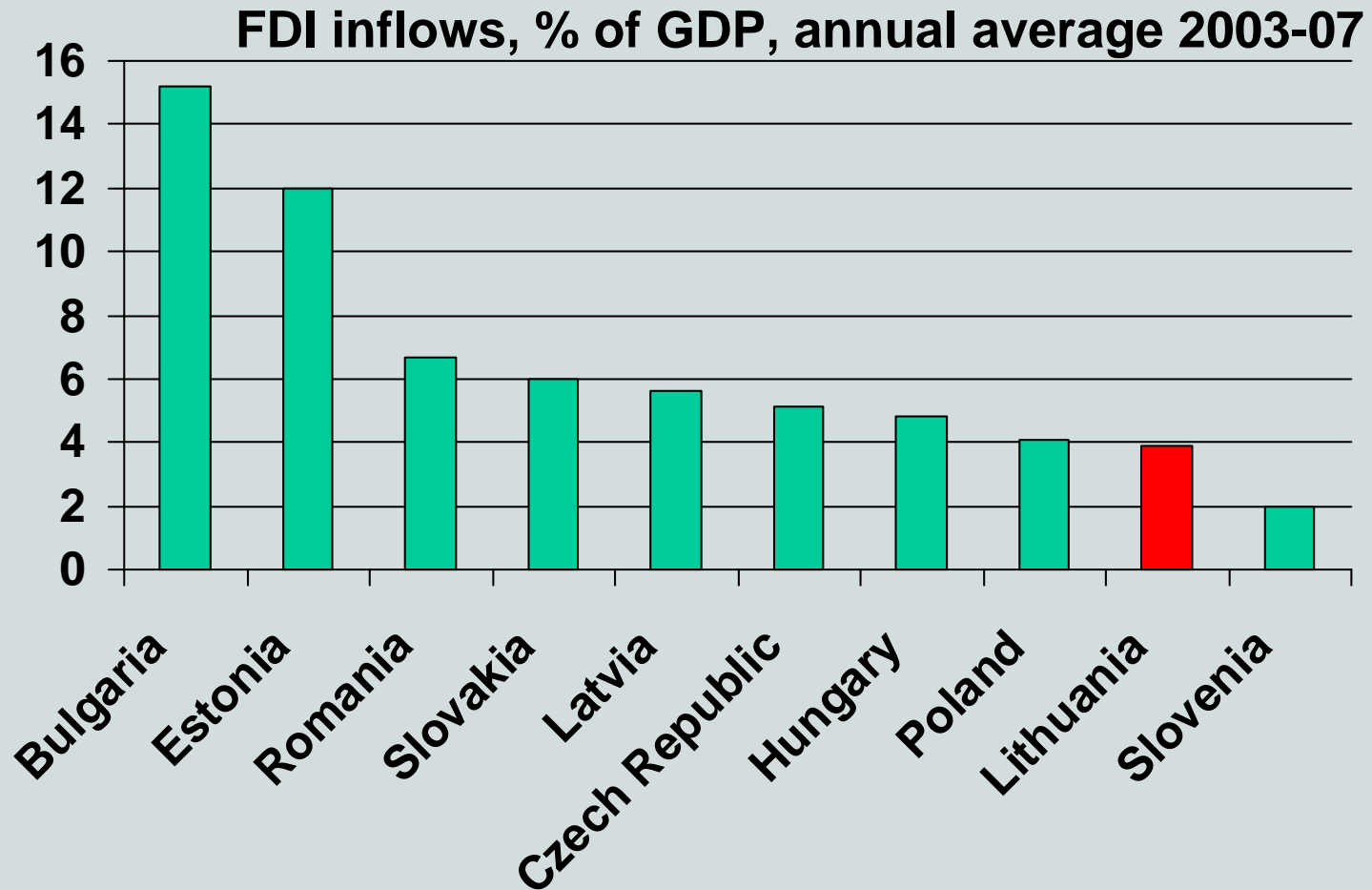
Source: Economist Intelligence Unit.

Some high current-account deficits...



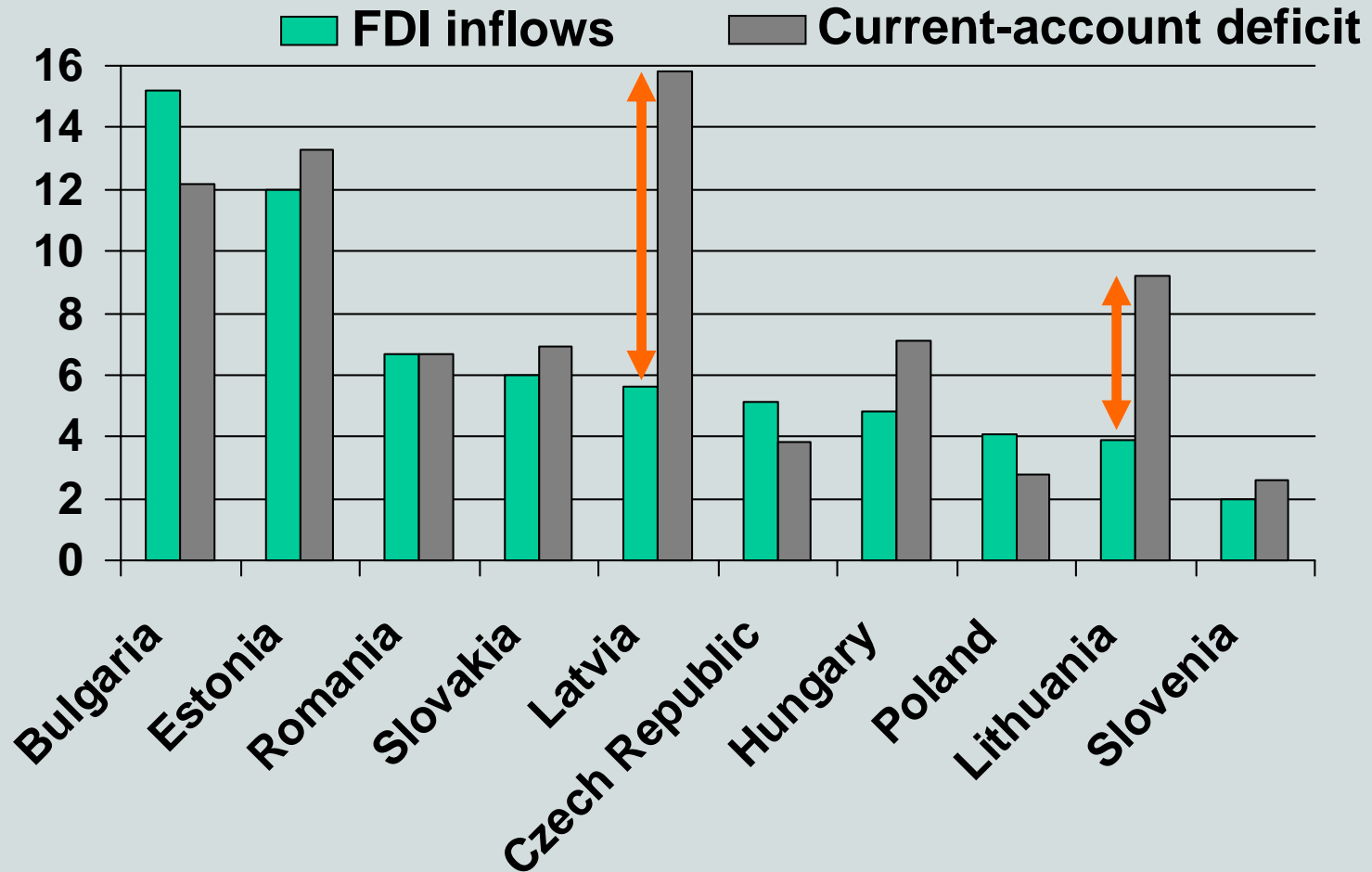
Source: Economist Intelligence Unit.

...financing helped by solid FDI



Source: Economist Intelligence Unit.

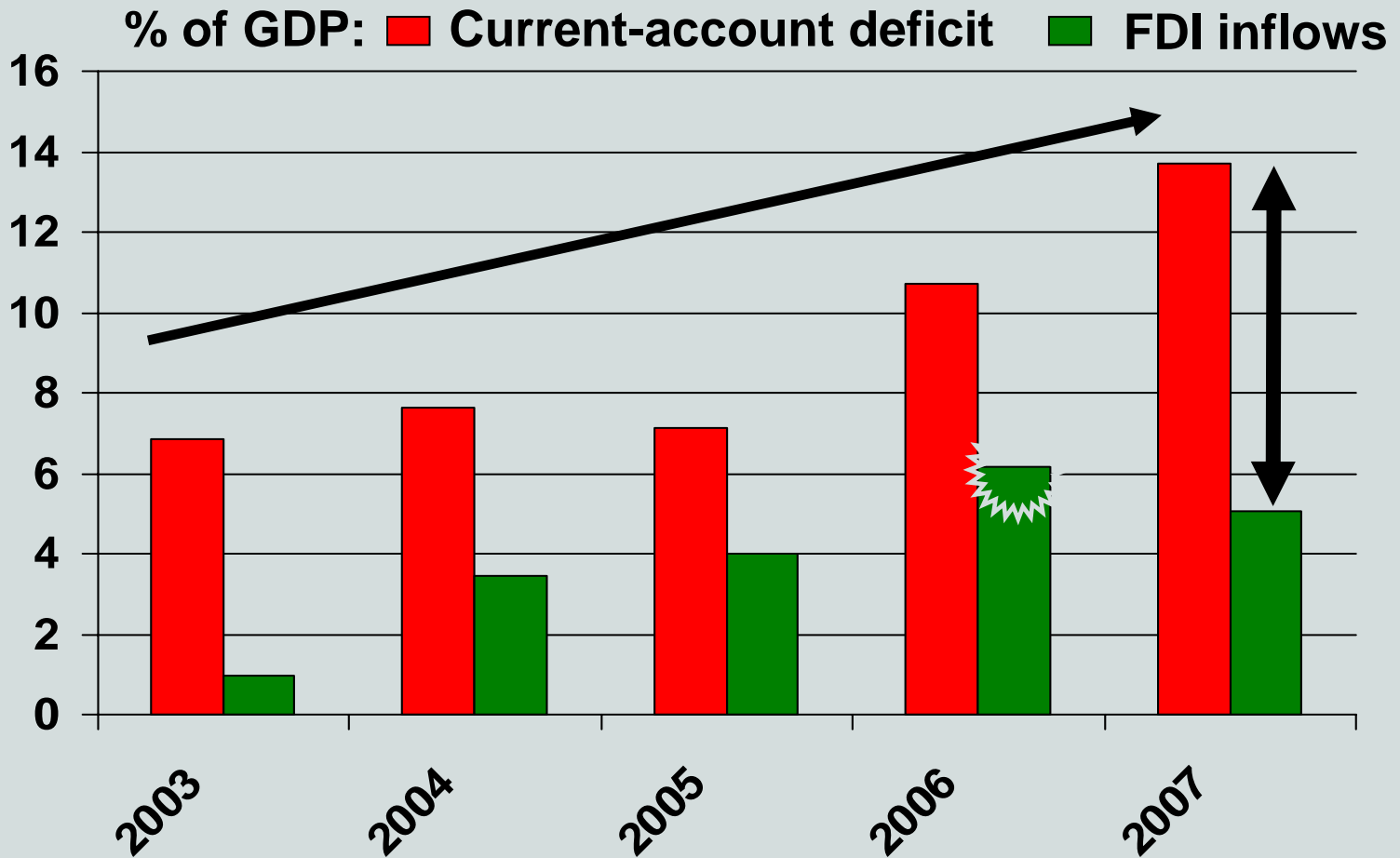
But not so solid for some...



Note: % of GDP; annual average, 2003-07

Source: Economist Intelligence Unit.

Widening gaps for Lithuania?



Source: Economist Intelligence Unit.

How to address this in longer term?

1. Grow exports

- How price competitive?
- How non-price competitive?

2. Grow FDI

- How attractive is Lithuania's business environment for FDI?

2. Price competitiveness

How price competitive is Lithuania?

- Labour costs still low
 - but wages growing rapidly
 - and “low-labour-cost” model not sustainable
- Growth in productivity respectable
 - but productivity still low
- Real effective exchange rate has been favourable
 - but now appreciating faster

Downside: rapid wage growth

	Real wages, % change, year on year	
	2006	2007
Latvia	15.4	19.6
Romania	11.6	16.9
Lithuania	15.2	15.5
Estonia	11.6	11.6
Bulgaria	3.5	8.8
Poland	3.9	6.5
Czech Rep	3.6	4.3
Slovakia	3.9	4.3
Slovenia	2.2	2.2
Hungary	3.8	0.0

Source: Economist Intelligence Unit.

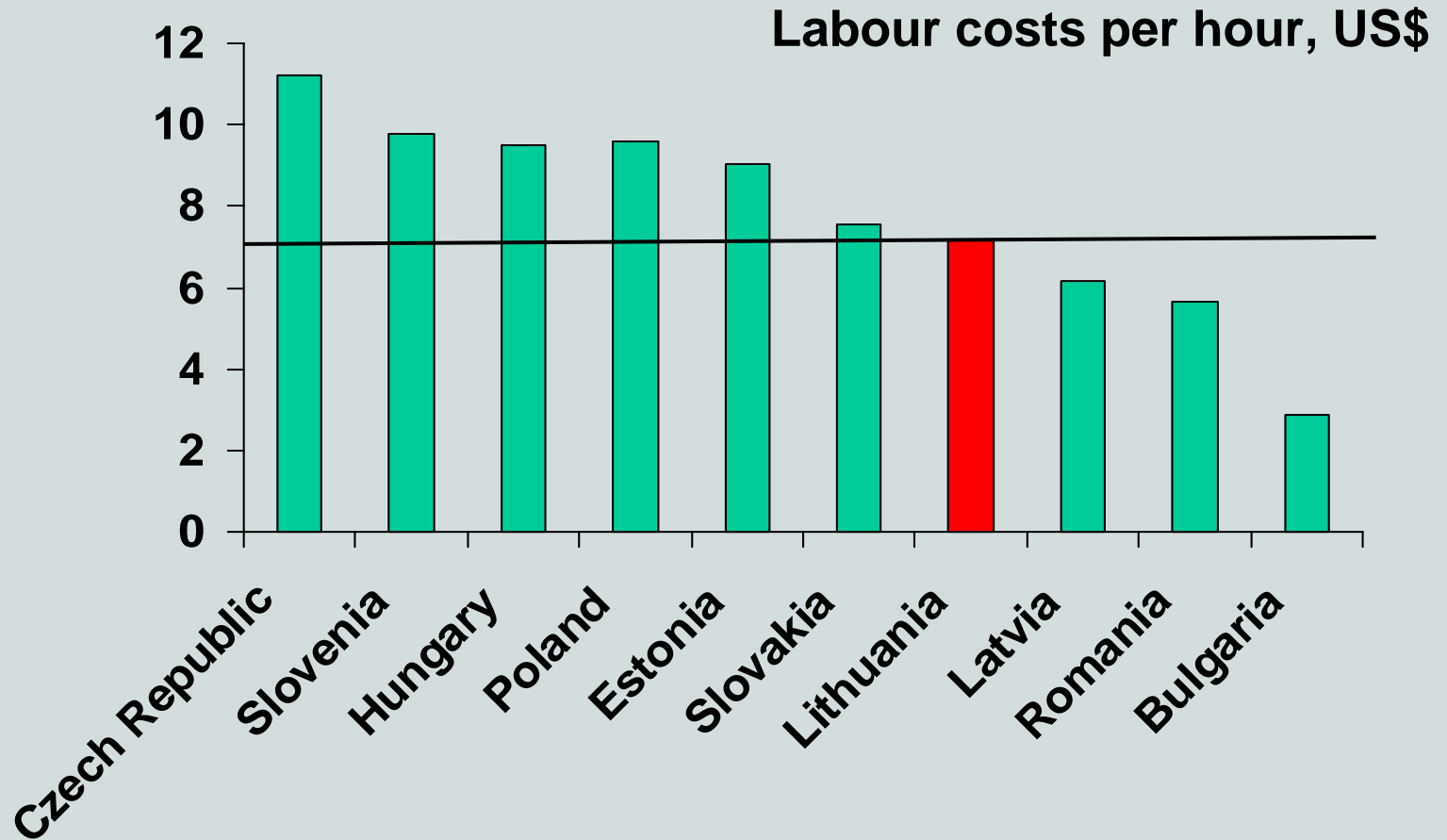
Upside: productivity also rising

Labour productivity benchmarked against EU27 average: % change from 2003 to 2007

Romania	30.1
Estonia	24.0
Latvia	21.2
Slovakia	21.0
Lithuania	16.2
Slovenia	10.0
Czech Republic	9.9
Poland	7.0
Bulgaria	6.3
Hungary	4.0

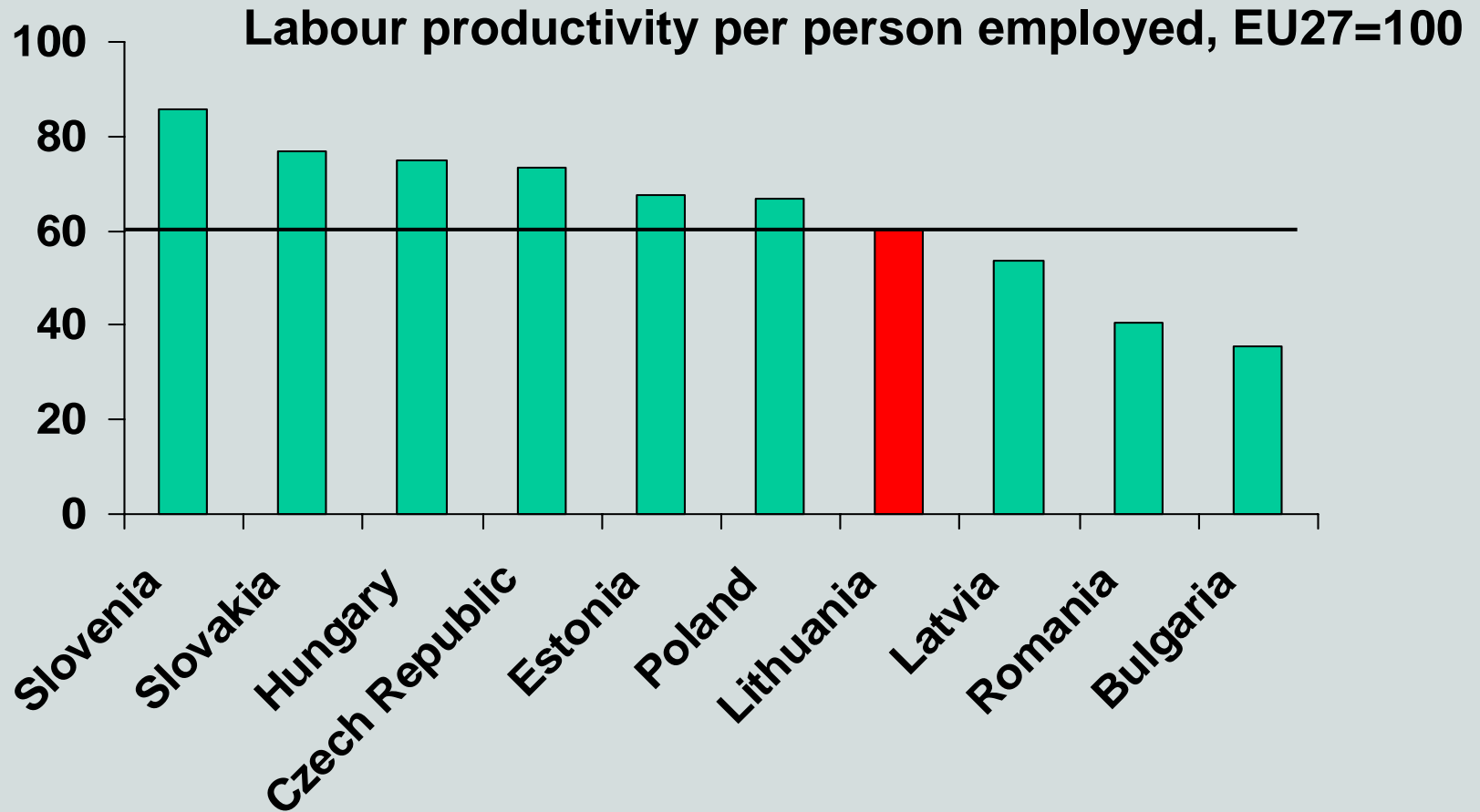
Source: Eurostat.

Labour costs still low...



Source: Economist Intelligence Unit.

... but so is productivity



Source: Eurostat.

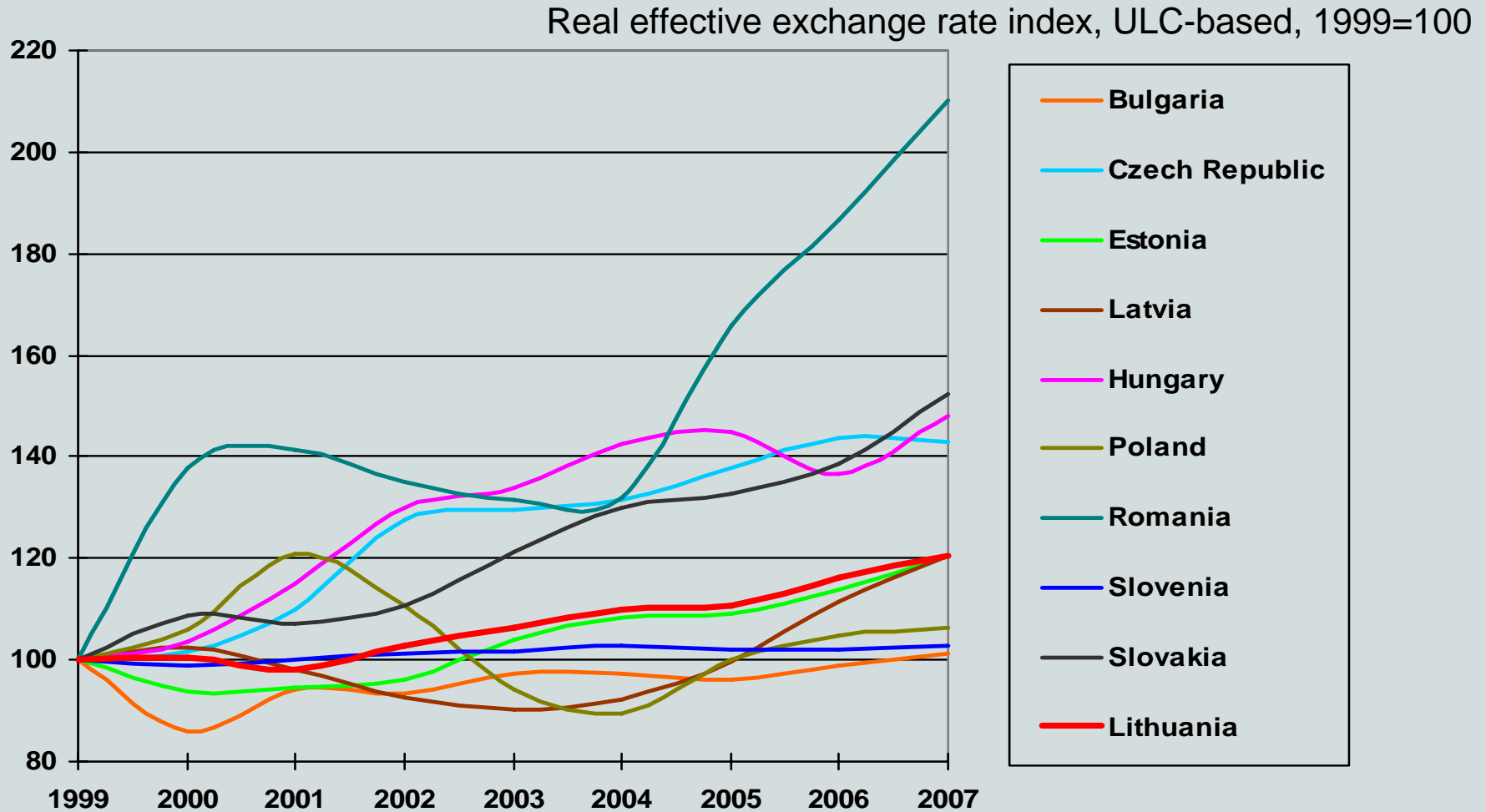
Still price-competitive?

Movements in real effective exchange rates suggest Lithuania still price-competitive — just

BUT

- Accelerating rate of appreciation in 2005-07

REER: competing — but pressures growing



Source: Eurostat.

Price competitiveness: recap

Some swings, some roundabouts:

- Low (but rising) labour costs
- Rising (but low) productivity
- REER movements: competitiveness may be at risk from rising cost base

3. Non-price competitiveness

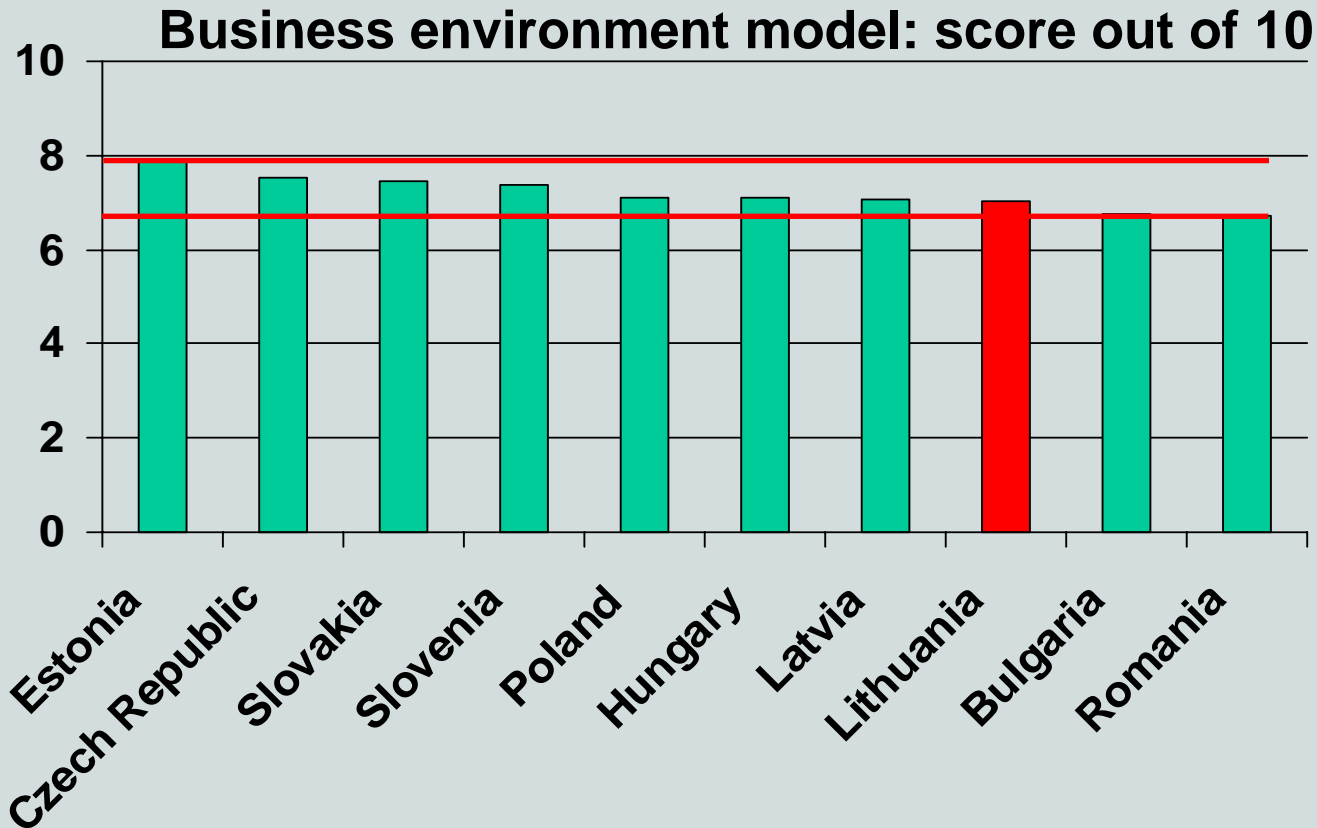
- An elusive concept
- Some studies attempt to measure non-price competitiveness, but in different ways:
 - **EIU Business Environment Rankings**
 - quality of business environment and attractiveness to FDI
 - **World Bank *Doing Business***
 - regulatory effects on business activity
 - **World Economic Forum “Global Competitiveness Index”**
 - factors affecting productivity growth
 - **Plus others.....**

Lithuania often compares badly

- EIU Business Environment Rankings for 2008-12:
 - behind Estonia and Latvia
- World Bank *Doing Business 2008*:
 - behind Estonia and Latvia
- World Economic Forum GCI 2008:
 - behind Estonia, but above Latvia
- **But** Baltic states tend to rank highly as a whole

EIU ranking: Lithuania not first...

But “not first” among equals



Source: Economist Intelligence Unit.

Lithuania performs well regionally in:

- Policy towards private enterprise & competition: ranks 3rd
 - easing of regulatory burden
- Financing: ranks 4th
 - well-developed banking sector

And not so well in:

- Labour market: ranks 11th
 - labour shortages an increasing constraint
- Market opportunities: ranks 9th
 - small internal market
- Taxes: ranks 7th
 - high social security contributions
 - paying taxes more burdensome than in other Baltic states?

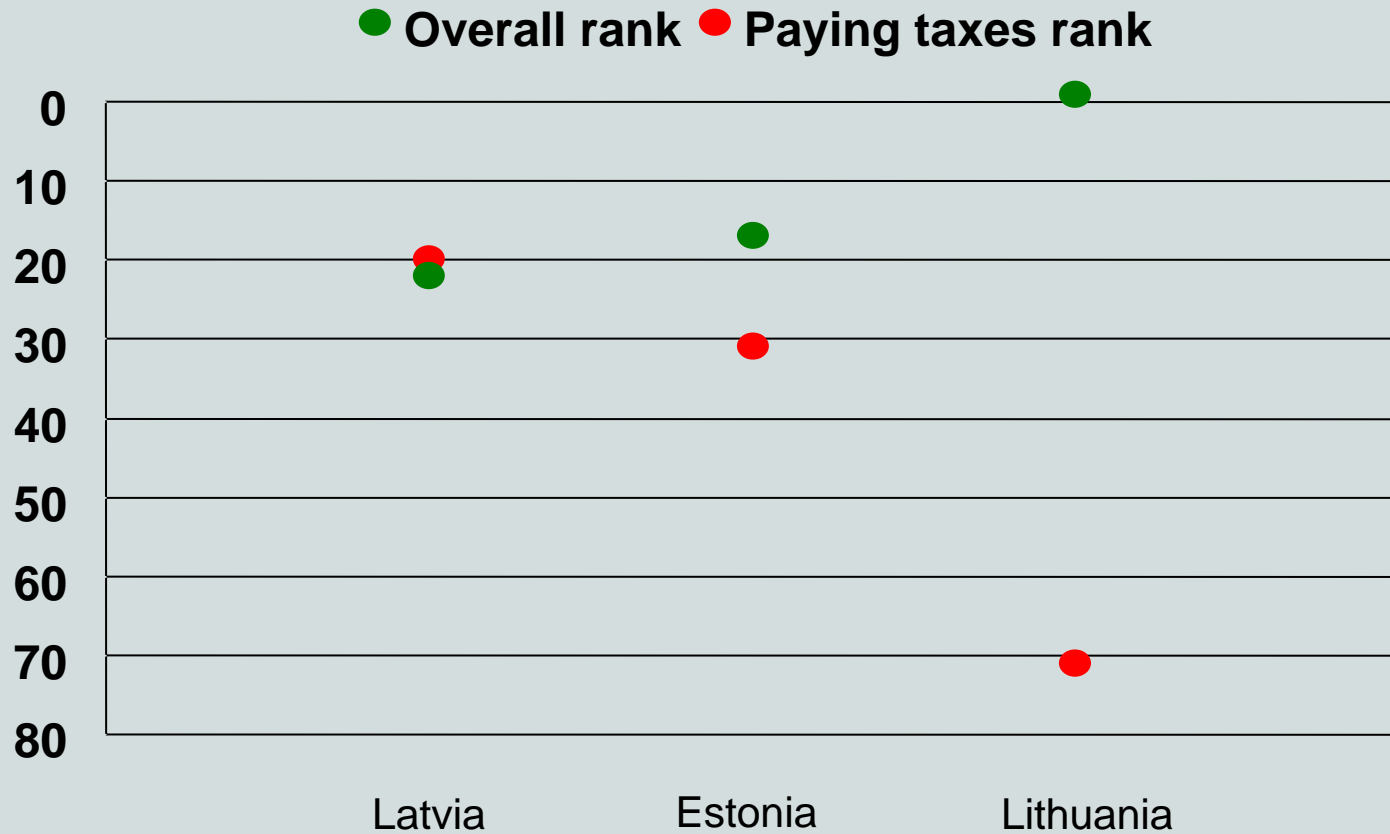
World Bank ranks Lithuania highly

Overall “ease of doing business” rank is 26th
(out of 178 economies)

Dragged down by:

- “employing workers” category (as are Estonia and Latvia)
- “paying taxes” category (which the other two are not)

Tax system drags the ranking down



Source: World Bank, *Doing Business in 2008*.

Non-price competitiveness: recap

On some measures Lithuania lags behind its regional peers

- Competition, financing: **good**
- Labour market, taxes: **less good**

BUT: overall gaps between the EU10 are small

4. Challenges for the longer term

How can exports compete?

Move to higher value-added ... needs investment:

1. In capital stock

- *Lithuania broadly comparable with peers*

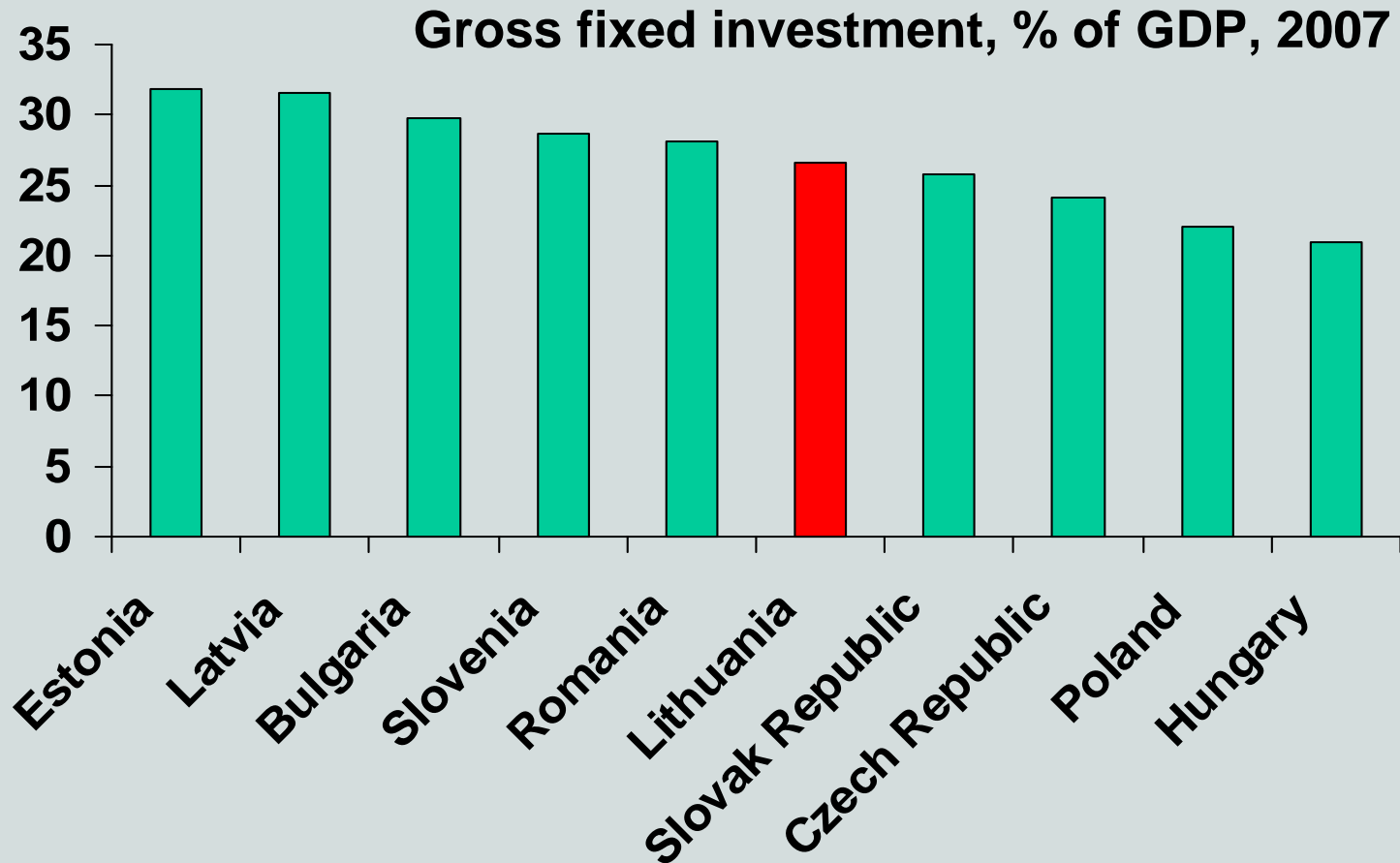
2. In labour force: education & training

- *“could do better”*

3. In R&D

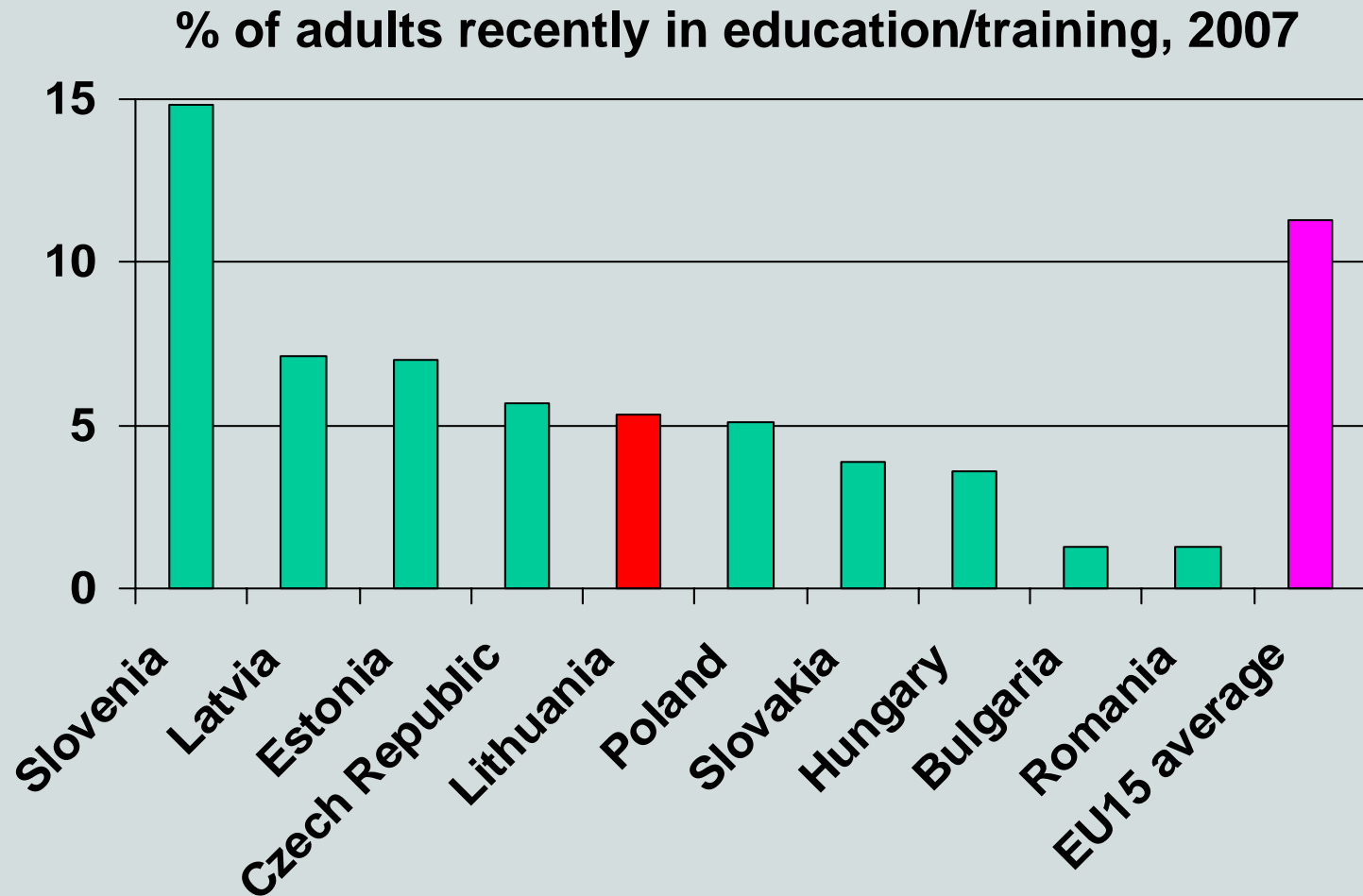
- *a mixed picture*

Investment spending broadly comparable



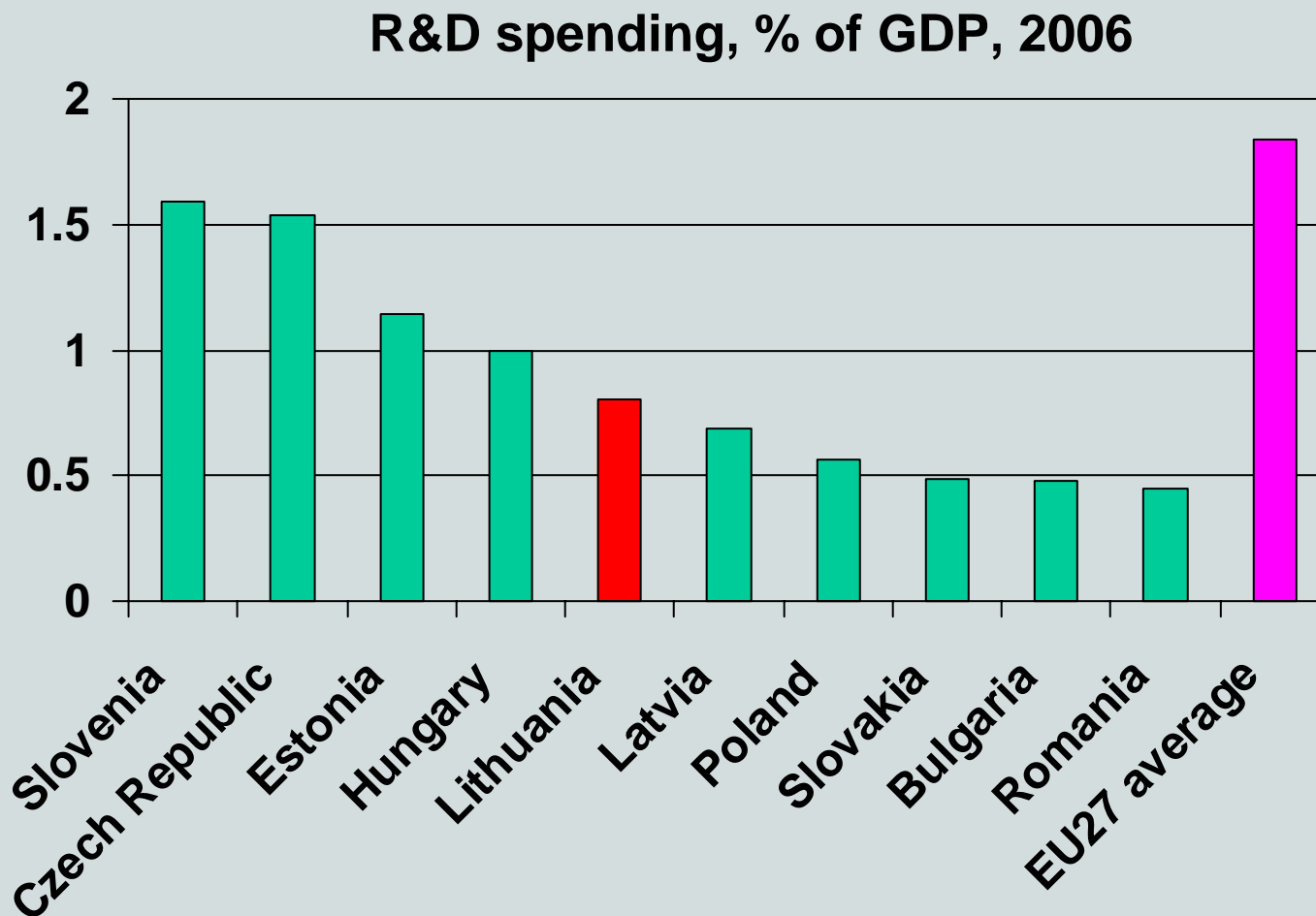
Source: Economist Intelligence Unit.

Education & training: “must try harder”?



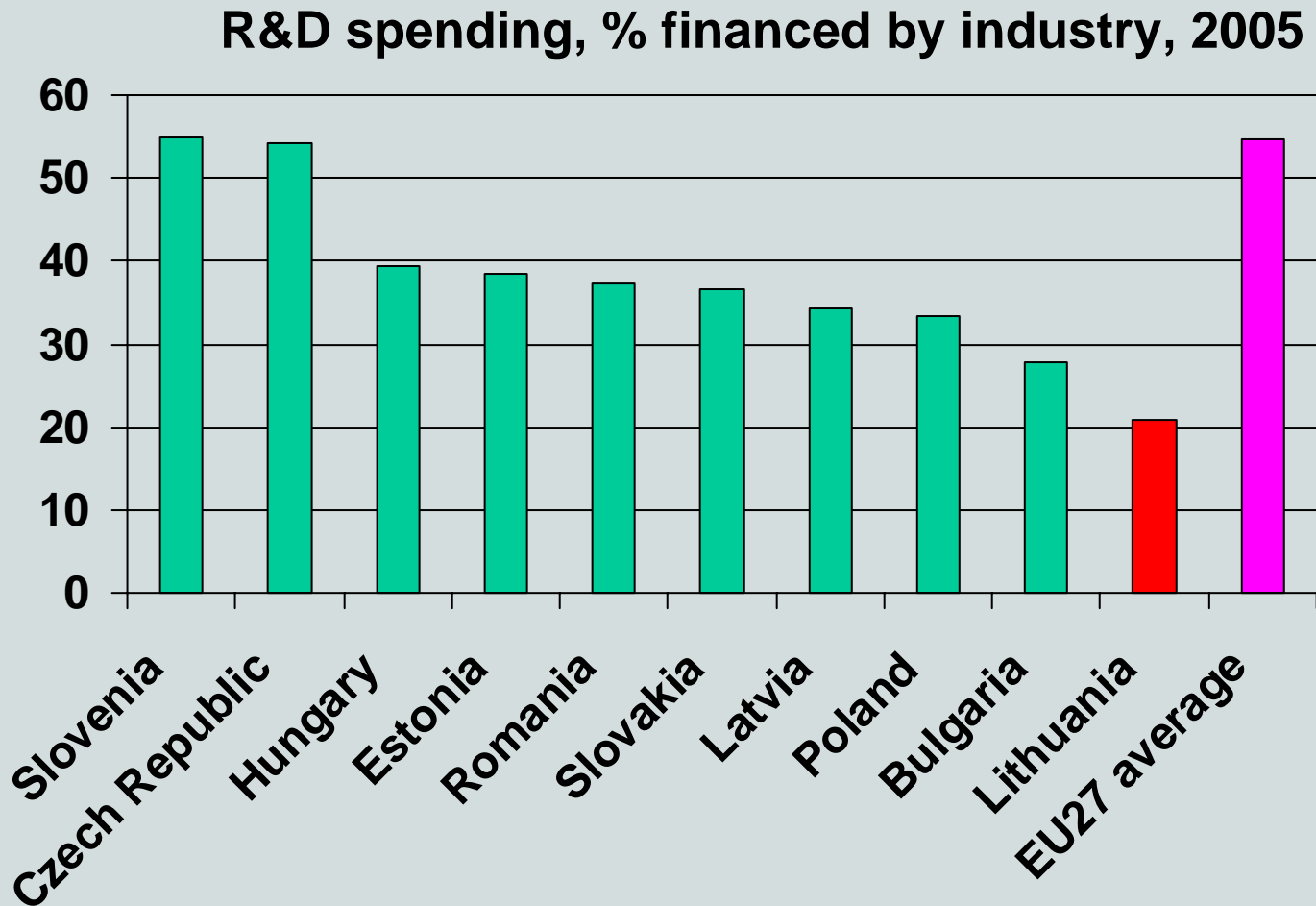
Source: Eurostat.

R&D: Lithuania falls mid-range



Source: Eurostat.

But lags behind in industrial R&D spending



Source: Eurostat.

Longer-term challenges: recap

- Fixed capital investment holds up well compared with regional peers
- Educational endowment needs improvement to address skills shortages
- R&D spending needs increasing to move export base up the value chain

5. Conclusions

1. On some measures of price competitiveness, Lithuania compares well with regional peers
 - but low cost advantage being eroded — and not viable long-term
2. On non-price competitiveness, a mixed picture
 - but most advantages/disadvantages are not highly significant
3. Longer-term, need to move up the value chain to remain competitive
 - low-value sectors now at risk of being priced out
 - higher-value sectors face skills shortages and low R&D spending