

FICE EXECUTIVE SURVEY 2023



FOREIGN INVESTORS'
COUNCIL IN ESTONIA

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Introduction

The Foreign Investors' Council in Estonia conducted a comprehensive survey among its members at the beginning of 2023 to assess their sentiments and predictions regarding the current state of the Estonian economy. The survey also sought to gather insights on Estonia's growth prospects, challenges to growth, business environment and the labour market. Against the backdrop of a challenging year marked by economic shocks and destabilisation across the region, this report presents the findings of the survey.

The past year witnessed a series of economic disruptions that have had far reaching consequences. The negative impacts of the Covid-19 pandemic on global supply chains were compounded by the Russian invasion of Ukraine in February 2022. These events have significantly increased inflationary pressures, particularly in the energy and food sectors. Given Estonia's status as a small, highly open economy, it has been particularly susceptible to rising world commodity prices. The decline in trade with Russia, one of its primary sources for imports, especially energy, as well as a key market for Estonian exports, has further exacerbated these challenges.

As a result of these developments, Estonia experienced the highest inflation rate among EU countries in 2022, reaching 22%. Rising food and energy prices emerged as the primary drivers of

inflation. In response to mounting inflationary pressures across the euro-zone, the European Central Bank has raised interest rates to levels not seen since before the global financial crisis of 2008. This has placed considerable strain on heavily indebted businesses and households, leading to weakened consumption and heightened concerns of insolvency.

Nevertheless, despite these destabilising trends, the majority of businesses surveyed by the Foreign Investors' Council in Estonia maintain an optimistic outlook for the future direction of the Estonian economy. In fact, the majority of respondents anticipate moderate to significant GDP growth over the next 12 months. This optimism is further reflected in the fact that the majority of those surveyed expect their company's revenues to expand moderately or significantly within the same timeframe.

However, several challenges persist and have been highlighted as significant impediments to the growth of businesses surveyed. These include increasing labour costs, shortages of skilled workers, rising inflation, and the impact of interest rates hikes. These factors necessitate careful attention from the Estonian government and strategic planning to ensure sustained growth and economic resilience in the face of adversity.

Respondents' Profile

Figure 1. Nationalities of our 72 Respondents

Series 1

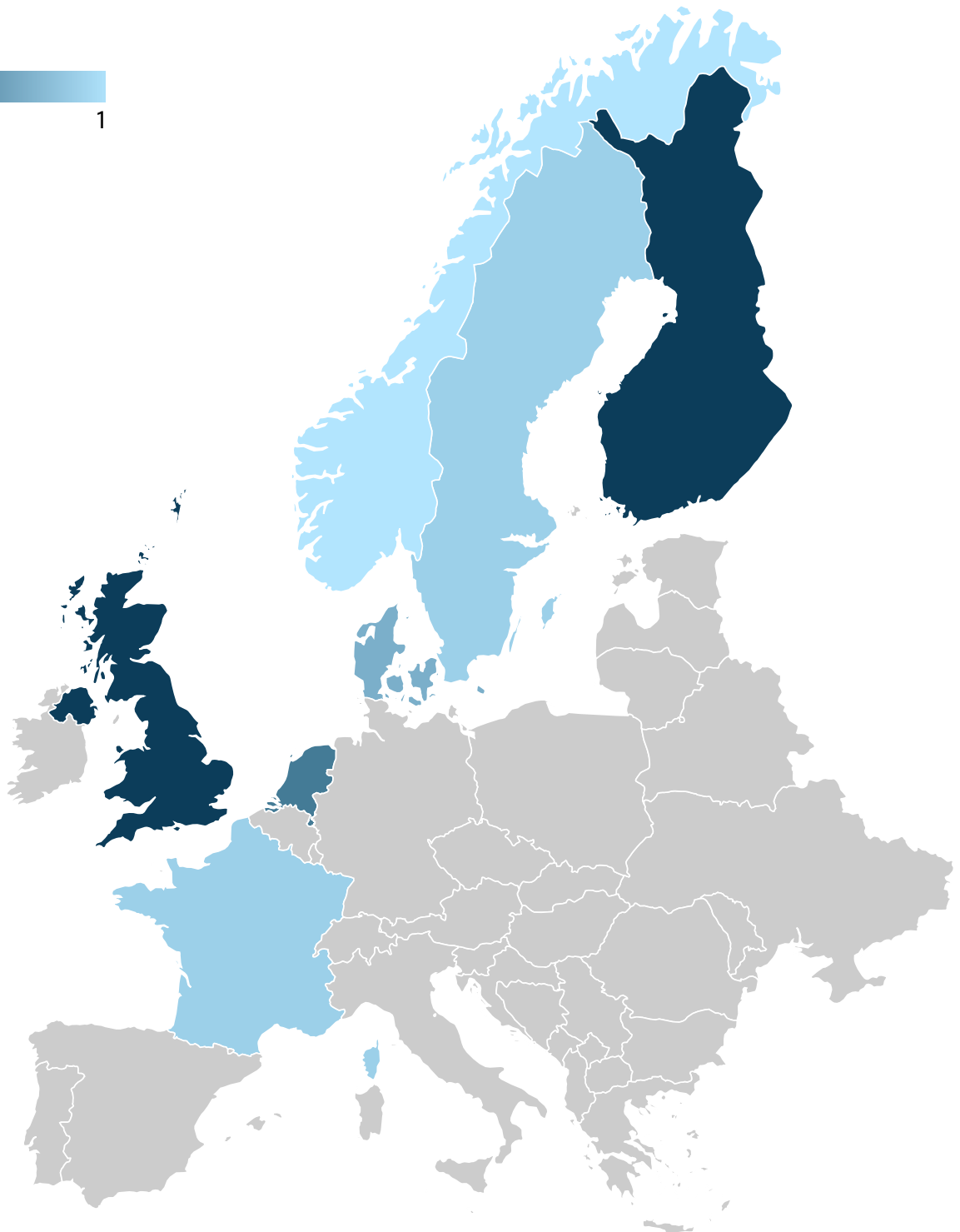


Figure 2.
Years of Investment in Estonia.

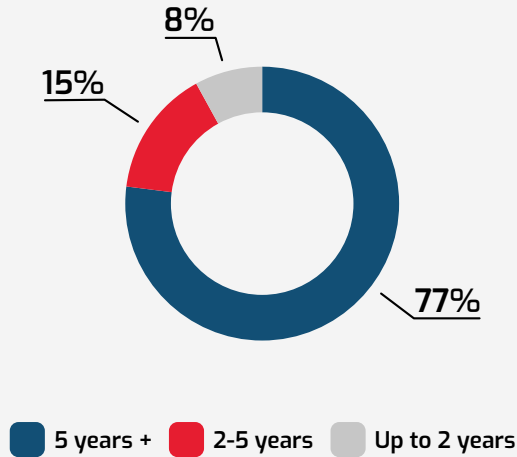
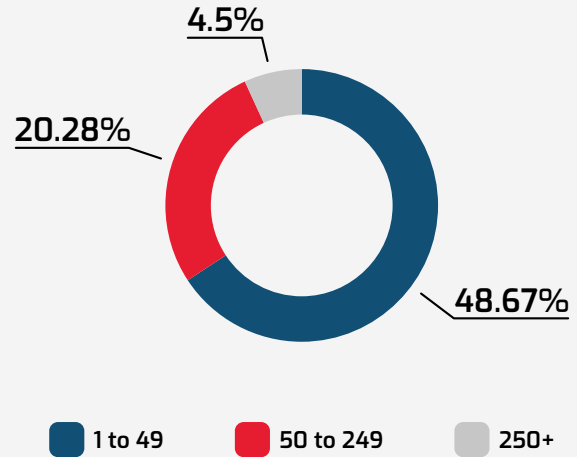


Figure 3.
Number of Full-time Employees in Estonia.



In Brief

75%

expect the economy to expand over the next 12 months.

75%

expect their revenue to increase in the next 12 months.

46%

plan to increase their number of employees.

85%

expect Digital to lead growth in the next 1 to 3 years.

71%

of respondents are concerned or very concerned about rising energy prices for the survival of their business.

56%

of respondents consider rising labour costs as a major challenge for their business.

57%

consider a competitive corporate tax system as the most positive aspect of investing in Estonia.

Growth Prospects

This chapter explores the prevailing sentiments among our members regarding Estonia's economic growth and the prospects of their businesses. Despite significant challenges faced over the past year, including Covid-19 supply shocks, the invasion of Ukraine, and rising inflation, Estonia's resilience shines through. The overall sentiment among those surveyed remains positive, highlighting a promising growth trajectory and its influence on investment decisions and business expansion. However, it is important to address significant challenges, including skilled labour shortages, increasing labour costs, and inflation.

Economic Growth Prospects:

A substantial majority of respondents express optimism about Estonia's growth prospects, indicating their confidence in the economy's resilience. An overwhelming 75% of those surveyed anticipate GDP expansion over the next 12 months, underscoring positive expectations for Estonia's economic performance. This positive sentiment reflects the country's ability to weather the challenges and forge ahead.

Positive Business Outlook:

Aligned with their positive outlook for the overall economy, our respondents also display a favourable outlook for their own

businesses. An impressive 75% of surveyed members forecast moderate to significant revenue growth within the next 12 months, showcasing their strong belief in their business' prospects. This optimistic outlook underscores the potential for continued business growth and development within Estonia.

Implications for Investment:

The prevailing optimism among respondents holds significant implications for Estonia's investment landscape. Positive sentiments regarding the country's growth trajectory serve as a driving force for investment decisions and future business expansion. The expressed optimism creates a favourable environment for both domestic and international investors, reaffirming Estonia's status as an attractive investment destination.

Figure 4. Growth Forecast for the next 12 months.

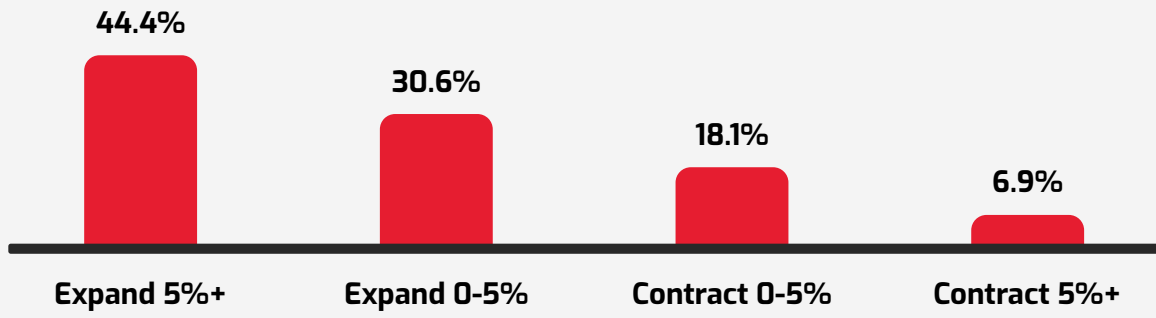
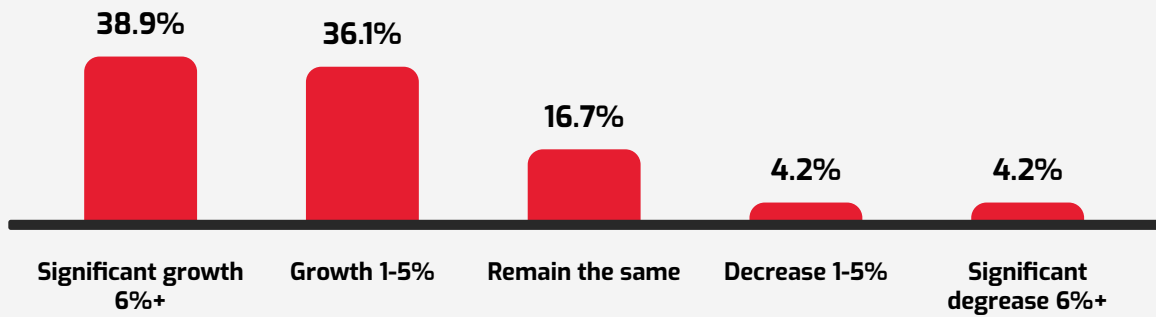


Figure 5. Revenue Growth forecast for the next 12 months.



Challenges to Growth

This chapter focuses on the significant challenges that pose obstacles to business and economic growth in Estonia, as identified by our members. The key challenges include increasing labour costs, a shortage of skilled labour, and rising inflation. These challenges require attention and strategic measures to sustain and enhance economic growth in the short term.

Labour Market Dynamics:

The Estonian labour market remains tight, with a low unemployment rate of 5.3% as of the first quarter of 2023. As a result, labour shortages are driving up wages, as highlighted by the European Commission. While nominal wage growth is expected to be robust through 2023, it is important to note that average wages have fallen by 13% in real terms over the past year, according to Eesti Pank. This situation is likely to exert upward pressure on wages as employees seek compensation for their real term losses.

Impact on Businesses:

With nominal labour costs continuing to rise, businesses face mounting pressure from inflation. In response, businesses may be compelled to reduce their workforce or limit wage growth, potentially leading to an increase in the unemployment rate. This delicate balance

between labour costs and business viability presents a significant challenge to sustainable economic growth.

Skilled Labour Shortages:

Access to skilled labour emerges as a crucial challenge for businesses, as reported by OSKA. Insufficient numbers of graduates in specialised roles such as systems analysts, engineers in various fields, welders and software developers are observed within Estonia. Concurrently, there is a growing demand for ICT specialists, technicians, and engineers (OSKA). Addressing these skill shortages in the medium to short term necessitates a focused approach by the Estonian government to attract highly skilled workers from abroad and a longer term strategy of reorienting the education system towards filling these skills gaps.

Mitigating Skill Gaps:

Mitigating the shortage of skilled labour is vital to sustain and enhance economic growth in Estonia. Attracting talented professionals from abroad becomes a priority to bridge the identified skill gaps highlighted by OSKA. By emphasising the attraction and retention of skilled workers, Estonia can ensure the availability of a competent workforce capable of meeting the evolving demands of various industries.

Figure 6. Top 3 challenges to business growth.

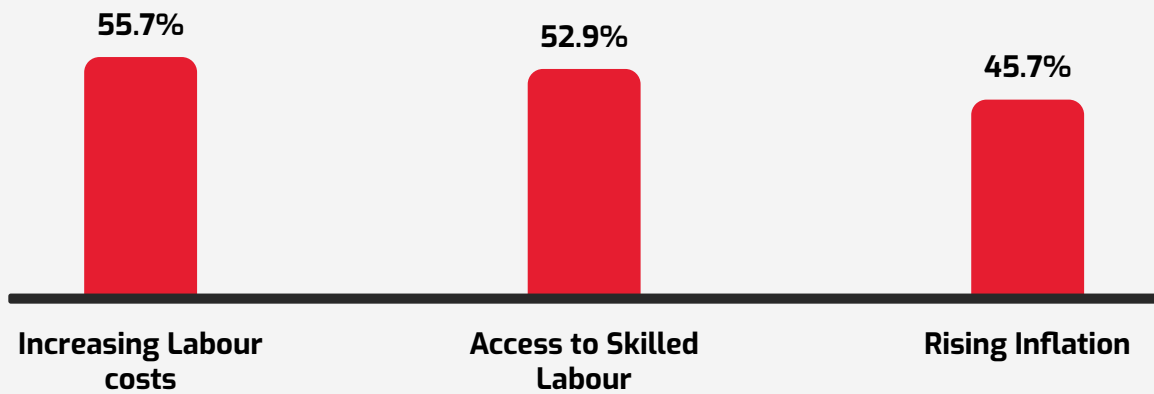
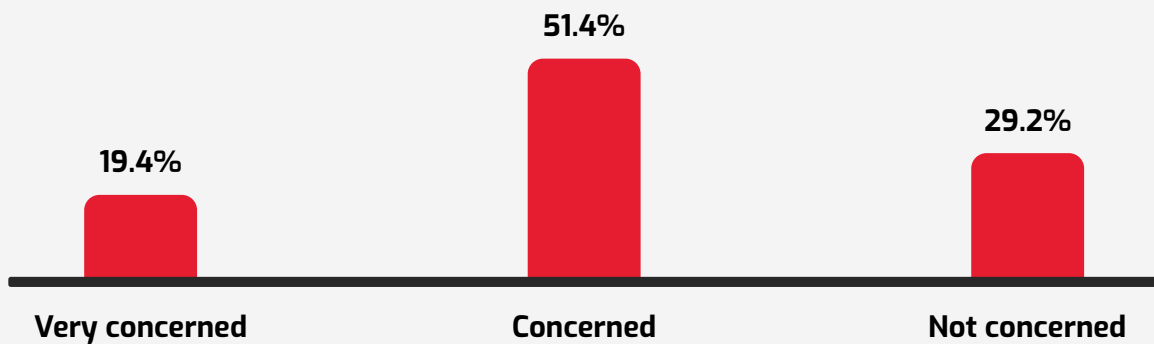


Figure 7. Impact of rising energy prices on business survival.



Business Environment

This chapter provides an overview of the business environment in Estonia, highlighting the positive aspects that attract investment and addressing the concerns raised by our respondents. It emphasises the importance of government responsiveness and identifies key areas for improvement to enhance Estonia's competitiveness.

Positive Aspects:

Respondents identified several positive factors that contribute to Estonia's favourable business environment. The competitive corporate tax system was regarded as the most significant positive aspect by nearly 57% of the surveyed members. Additionally, over 36% highlighted Estonia's flat income tax as a favourable characteristic. Other noteworthy factors included Estonia's membership in the European Union's single market, the quality of human capital, and political and societal stability. These factors collectively contribute to Estonia's attractiveness as an investment destination.

Government Responsiveness:

An encouraging finding is that 83% of respondents acknowledged the responsiveness of the Estonian government to their business concerns, either categorising it as somewhat responsive or responsive.

This responsiveness is crucial, as governments perceived to be receptive to business concerns tend to attract and retain foreign investment. However, there is room for further improvement in this area to enhance the business environment and promote sustained economic growth.

Concerns and Challenges:

Despite the positive aspects, several concerns were highlighted regarding the Estonian business environment. Rising energy costs emerged as a significant concern, with 71% of respondents expressing worry or significant concern about the survival of their businesses. Although energy prices have eased in recent months, they continue to pose a threat to Estonia's competitiveness. Given the country's export-oriented economy, rising energy costs could undermine the competitiveness of Estonian-based exporters.

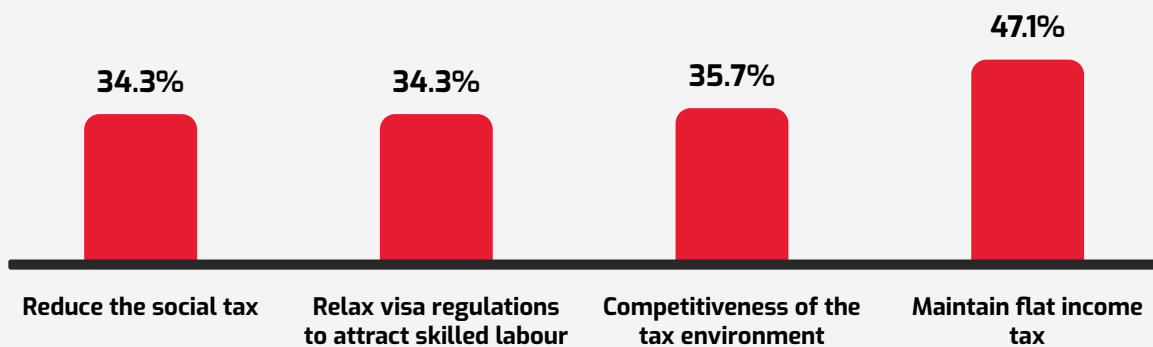
Labour Cost Challenges:

Rising nominal labour costs were identified as a pressing concern, particularly for export-focused firms. Increased labour costs exert upward pressure on production costs, eroding profit margins and diminishing competitiveness in international markets. As Estonia has limited influence in setting prices for its leading exports globally, maintaining profit margins becomes challenging. However, the inflationary trends observed in other countries in the region may provide some scope for Estonian exporters to increase prices and support their profit margins.

Policy Recommendations:

Respondents emphasised the importance of implementing policies aimed at controlling labour costs, such as reducing the social tax, which exceeds the European average of approximately 20%. They also urged the government to review visa regulations to expand the pool of highly skilled labour available in Estonia. Additionally, maintaining the flat income tax system was considered a key priority by 47% of respondents to preserve Estonia's attractiveness. Approximately 36% of the surveyed members emphasised the need for a competitive tax system as a central focus for improving the overall business environment.

Figure 8. Policy Proposals of respondents



Labour Market

This chapter looks into the dynamics and challenges of the labour market in Estonia. It examines the sentiments of our respondents regarding salary expectations, employment plans, the quality of human capital, and the issues that hinder labour market efficiency. Furthermore, it explores potential improvements to enhance the labour market environment.

Salary Expectations and Employment Plans:

The majority of respondents expressed plans to increase employee salaries over the next 12 months. Of those surveyed, 72% anticipate moderate or significant salary increases, while less than 3% plan to decrease salaries. Additionally, 46% of respondents plan to expand their workforce or significantly increase the number of employees in the next 12 months. These positive indicators signify business growth and potential job creation within Estonia.

Challenges in Accessing Skilled Labour:

Despite positive trends, accessing skilled labour remains a significant challenge for businesses. Approximately 53% of respondents identified it as one of the leading obstacles to their business growth in the next 12 months. This issue has consistently been highlighted in the FICE surveys since 2018.

While close to 70% of respondents reported similar difficulty in accessing skilled labour, over 18% noted an increased challenge over the past year.

Rising Labour Costs:

Labour shortages have led to increased labour costs, with 56% of respondents viewing this as the biggest challenge to their companies' growth in the next 12 months. As labour costs rise in response to inflationary pressures, businesses face the need to balance profitability and competitiveness. The potential influx of refugees from Ukraine into the labour force could alleviate labour shortages over time, but successful integration and possessing in-demand skills will be crucial factors.

Potential Improvements:

To address the challenges in the labour market, respondents highlighted several potential improvements. First, 47% believed that reducing the tax burden on labour would help mitigate the growth in labour costs for businesses. Additionally, 43% of respondents suggested relaxing immigration rules to attract skilled labour from abroad, as discussed in the previous chapter. Strengthening cooperation between businesses and educational institutions was proposed by 37.5% of those surveyed to better align qualifications with the growth sectors of the Estonian economy. Furthermore, 25% of respondents emphasised the importance of retraining and up-skilling programs to alleviate skills shortages and address unemployment resulting from technological changes.

Figure 9. Percentage of respondents that have difficulty accessing skilled labour

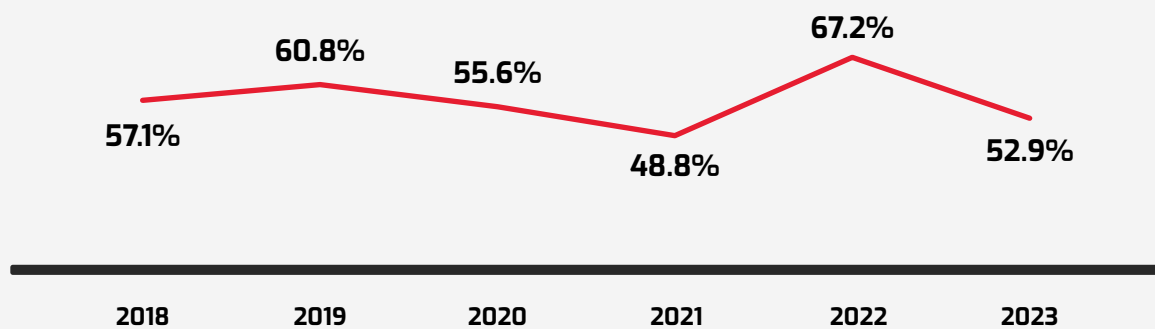
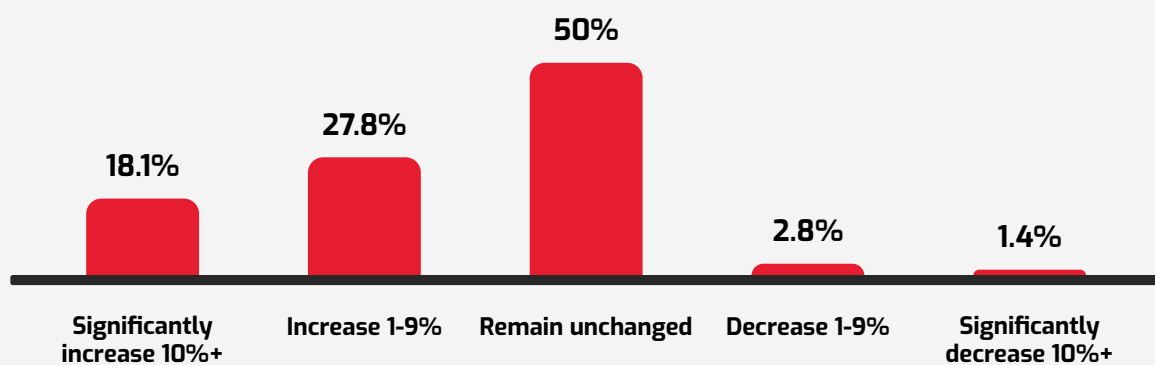


Figure 10. Forecasted change in the number of employees over the next 12 months



Direct investment screening law

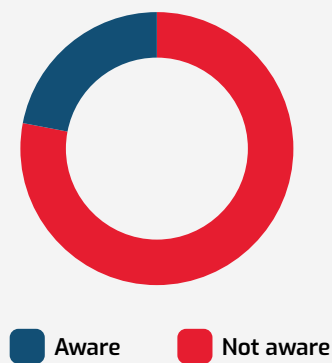
The Estonian Parliament adopted the Foreign Investment Reliability Assessment Act on 25 January 2023. The Act is set to enter into force on 1 September 2023. The primary objective of the Act is to screen both direct and indirect investments made by non-EU investors in strategically important and sensitive areas in Estonia.

Of those surveyed, a little over 79% are not aware of Estonia's draft Foreign Direct Investment Screening Law. As a result, 76% of respondents could not state how this would impact their investments in Estonia.

In order to address this lack of knowledge, FICE has arranged for this issue to be addressed at an event in late summer.

For further information about this legislation, please use the following link: [Estonia will start screening foreign investments from September 2023 \(sorainen.com\)](https://sorainen.com/en/insights/estonia-will-start-screening-foreign-investments-from-september-2023).

Figure 11. Awareness of Estonia's draft Foreign Direct Investment Screening Law



Key Findings

01

Access to highly skilled labour remains a challenge.

02

Rising labour costs are a threat to competitiveness.

03

Rising energy prices are a major concern for our members.

04

Digital sector will drive growth over the next 1 to 3 years.

05

Optimism regarding Estonia's future growth is high.

06

Competitive corporate tax system makes Estonia an attractive place to invest.

07

Flat income tax is an important aspect of Estonia's attractiveness.

Suggestions for the Government

Relax visa regulations to attract skilled labour.

This will help to increase the pool of highly skilled labour in the medium to short term.

Reduce the social tax.

Reducing the social tax closer to the European average would dampen the rise in labour costs for employers.

Strengthen cooperation between businesses and educational institutions.

This will help to increase the pool of highly skilled labour in the medium to short term.

Prioritise the Competitiveness of the tax system.

Tax competitiveness is an important aspect of Estonia's attractiveness, so maintaining it should be a priority.

Increase retraining and up skilling towards high-growth sectors.

This would improve the availability of skilled labour in the long-run, while alleviating unemployment related to technological change.

Thank you.



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