

VIEWPOINTS OF FOREIGN INVESTORS
ON THE DEVELOPMENT OF THE INVESTMENT
CLIMATE IN LATVIA: ELECTION EDITION

FICIL SENTIMENT INDEX 2021



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ABOUT THE AUTHOR

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His academic research findings have appeared in journals such as Strategic Entrepreneurship Journal, Journal of Business Ethics, International Small Business Journal, Journal of Comparative Economics as well as books published by Springer, Routledge, Edward Elgar, IGI Global, Blackwell, and Peter Lang. Arnis is extensively involved in applied research, including studies contracted by the OECD, Eurofound, and various banks, industry associations and NGOs. He is co-author of the Shadow Economy Index for the Baltic Countries. Arnis also hosts the talk show “Money talks” on the TVNET.lv portal, featuring discussions and interviews with prominent Latvian economists, politicians, entrepreneurs, and representatives of non-governmental organizations.

FOREWORD

There has been a string of various challenges coming our way over the last few years starting with a global pandemic that changed the way we carry out mundane tasks to how we plan business ventures. Currently we are mostly preoccupied with the ongoing war in the region. Russia's senseless aggression and invasion of Ukraine has severely impacted the whole region, it is vital that companies currently lend a hand in whatever way possible to help all those affected.



We will not be able to escape the fact that we have an upcoming election only in a few months, many different topics come into the forefront when discussing what and how needs to be changed in the country. FICIL has always been a critical friend to the Government and public sector, putting forward recommendations on how to improve the business environment so we can increase the amount of investment in Latvia.

More focus should be put on investment security and predictability of the investment climate. Foreign investors are still the ones who contribute greatly to the state budget, and with all the upcoming challenges that Latvia will have to deal with – we need to look more at how we will make up the necessary resources to carry out various reforms and plans that are currently in place.

EU Green Deal goals are at the top of the list, with a specific focus on energy independence, energy security. Combatting shadow economy should also be one of the main topics being tackled with comprehensive action that brings real change. Society as well as investors need to see tangible change that can increase trust in public sector representatives, including politicians.

We see public sector transformation as a precondition for further positive changes and economy development. Competent, fairly-compensated professionals that can tackle cross sectoral issues at a high quality and responsibility level – this should be the basis for our public sector transformation. It is time we reevaluate if the system that was created decades ago can serve Latvia, as we head into the next years with unprecedented challenges for everyone, society, public and private sector.

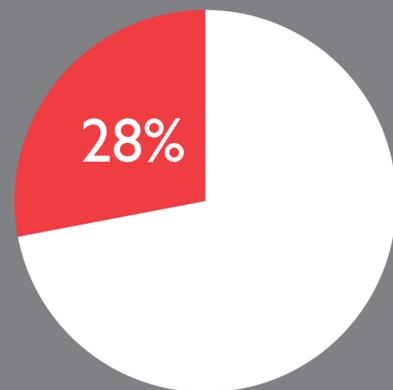
FICIL Sentiment Index serves as a temperature measurement each year to let our cooperation partners know what are the most pressing issues at the forefront and solutions the business community can identify for various issues. This time we asked the investors to evaluate the Governments work since the last election that took place in 2018. It is understandable that many larger reforms and transformations that need to take place, can not be carried out in one or two years, but it is vital that we see movement in the right direction. It is also important that the representatives in Saeima and the Government can manage solving long standing problems alongside of any crisis that may come along. FICIL would like to see Latvia as the most attractive and secure place for investment in the Baltic Sea region, and we believe cooperation based on expertise and problem-solving, would achieve economic development for Latvia.

Zlata Elksniņa - Zaščirinska
FICIL Chairperson of the Board

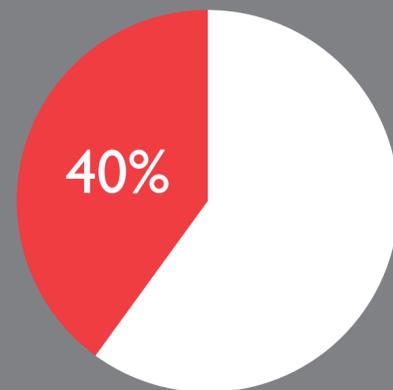
THE NUMBER OF COMPANIES ABOVE 145K EUR TURNOVER AND 50% FOREIGN CAPITAL (MAJORITY)

3008

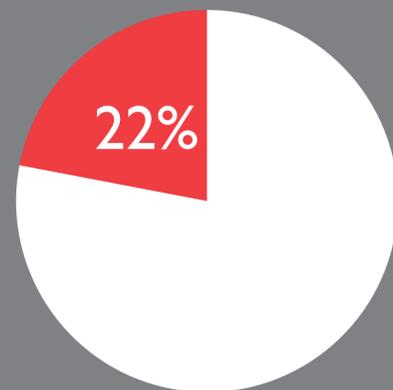
OR 1/7 OF TOTAL NUMBER OF COMPANIES IN LATVIA



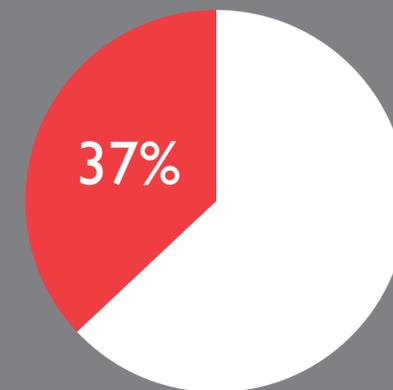
OF TOTAL SOCIAL TAX



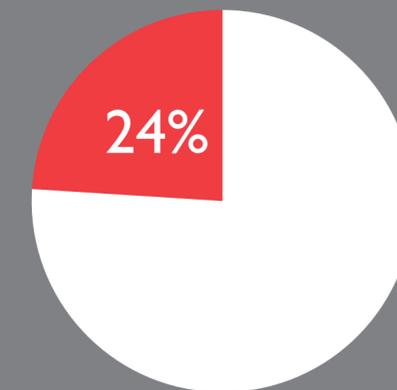
OF TOTAL TAXES PAID



OF TOTAL WORKFORCE



OF TOTAL TURNOVER



OF TOTAL PROFIT

INTRODUCTION

The FICIL Sentiment Index was first launched in 2015 by the Foreign Investors' Council in Latvia (FICIL), in cooperation with the Stockholm School of Economics in Riga (SSE Riga).

This is the seventh FICIL Sentiment Index report, following the six reports written in 2015, 2016, 2017, 2018, 2019 and 2020. The key aim of this report is to provide an in-depth exploration of the main challenges and concerns for the foreign investors in Latvia, in particular considering the upcoming election of Saeima taking place October 2022. Investors evaluate the work done by policy makers in the previous years, as well as outline upcoming challenges and potential solutions.

As in previous studies, this report draws on a survey: mini case studies of foreign investors in Latvia. From November 2021 to January 2022, we interviewed 53 senior executives representing companies that are key investors in Latvia. We also asked 3 additional questions to the participating investors in May 2022 concerning the impact of Russia's invasion of Ukraine on business environment in Latvia.

Altogether, these companies (including their subsidiaries) contribute to 25% of Latvia's total tax revenue and employ 15% of the total workforce of companies with a turnover above 145 000 EUR and 50% foreign capital (data from Lursoft, 2020).

FOCUS OF 2021 STUDY:



Do investors see progress with regards to policy initiatives to meet the main challenges as identified in previous studies?



How do investors evaluate government's efforts and current policy initiatives aimed at improving the investment climate in Latvia looking at a 4 year perspective?



EU Green Deal implementation process: investors evaluation and priorities?

AREAS HIGHLIGHTED IN 2021 STUDY:



Best and worst decisions of policy makers over the last 4 years



Focus areas of the upcoming Saeima and Government

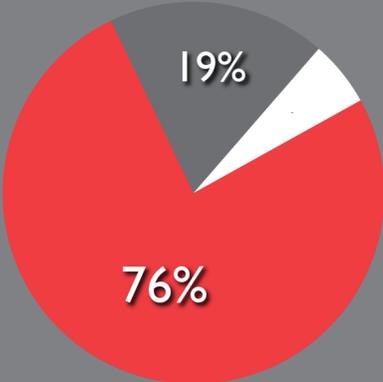


Priorities of policy makers and public sector regarding impact of geopolitical situation

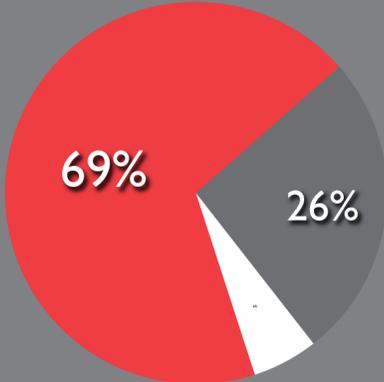


KEY RESULTS

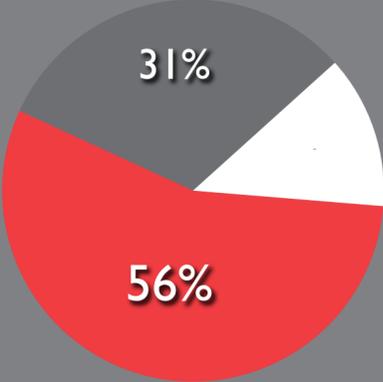
FOREIGN INVESTORS' ASSESSMENT OF THE PROGRESS OVER THE PAST 4 YEARS WITH REGARD TO THE KEY AREAS OF CONCERN AS IDENTIFIED IN THE PREVIOUS STUDIES: FINDINGS FROM ELECTION EDITION



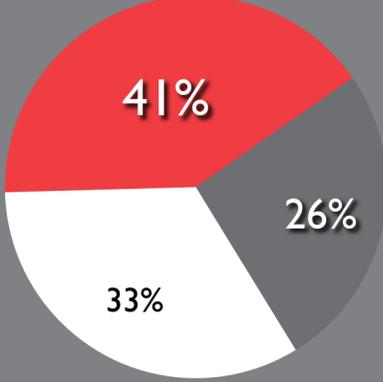
DEMOGRAPHY



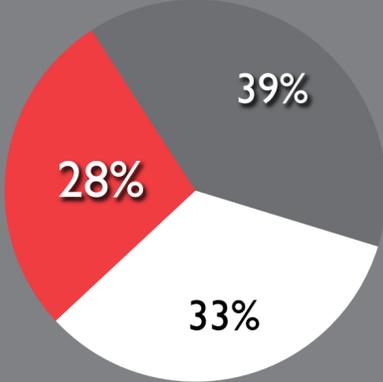
ACCESS TO LABOR



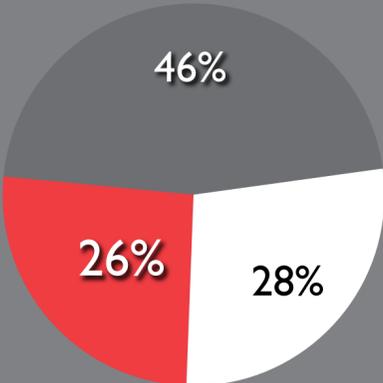
UNCERTAINTY



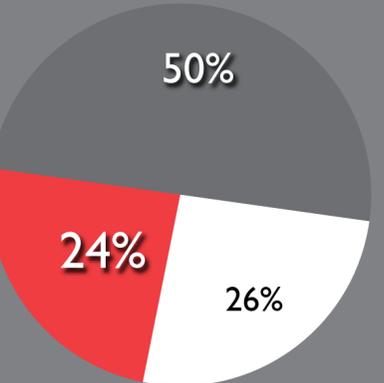
LEVEL OF HIGHER EDUCATION AND SCIENCE



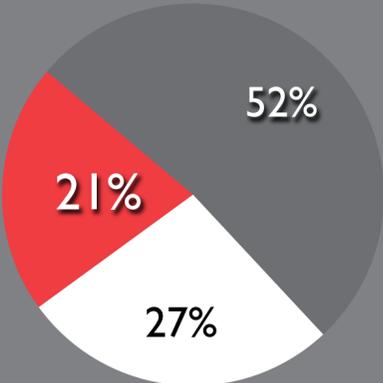
SUPPORT FROM THE GOVERNMENT AND COMMUNICATION WITH THE POLICY MAKERS



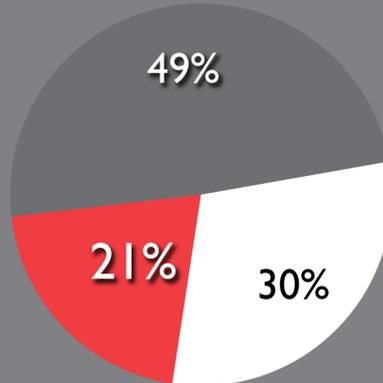
UNETHICAL / ILLEGAL BEHAVIOUR BY ENTREPRENEURS, UNFAIR COMPETITION



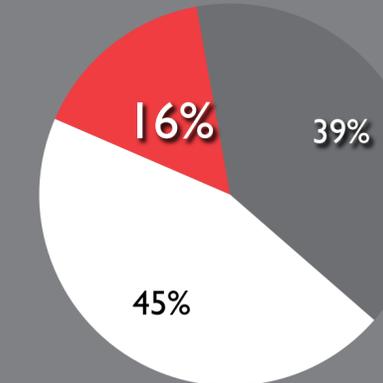
QUALITY OF THE TAX SYSTEM



THE HEALTHCARE SYSTEM IN LATVIA



QUALITY OF BUSINESS LEGISLATION



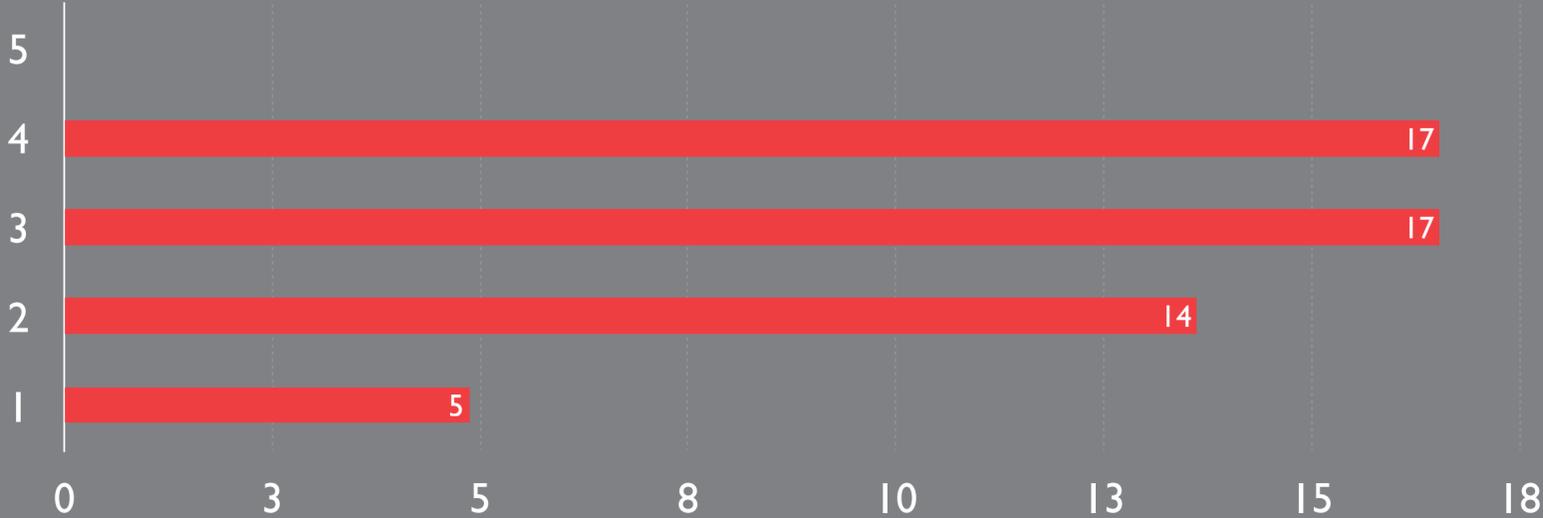
THE COURT SYSTEM IN LATVIA

GOOD PROGRESS
 NO PROGRESS
 SOME PROGRESS

HAS THE INVESTMENT ATTRACTIVENESS OF LATVIA IMPROVED OVER THE PAST 4 YEARS?



2018 - 2022



SCALE 1-5, WHERE '1' - INVESTMENT ATTRACTIVENESS HAS NOT IMPROVED AT ALL, '3' - THERE HAVE BEEN SOME POSITIVE IMPROVEMENTS, '5' - INVESTMENT ATTRACTIVENESS HAS IMPROVED SIGNIFICANTLY.



Mainly because nothing is being done to solve workforce availability issues. There is this marvellous will from the Government's side to just ignore this issue and not solve anything in a meaningful way.

ICT COMPANY



For us, questions of the overall state reputation are important. Over the last 4 years, the question of financial reputation was very topical, however, it was resolved. The international reputation has not deteriorated, instead it has improved.

RETAIL TRADE AND SERVICE COMPANY



We need to focus on the shadow economy, we have a very good workforce which is highly motivated and productive, but a lot of people in Latvia sin when it comes to paying taxes.

REAL ESTATE COMPANY



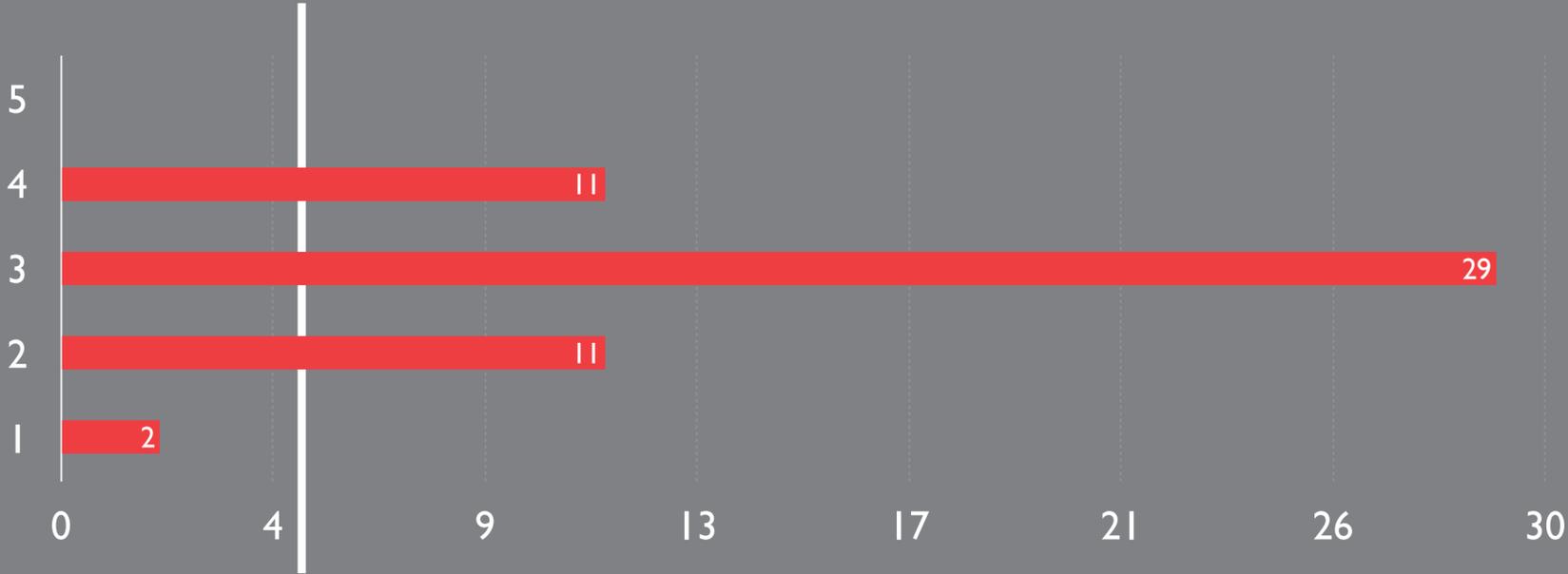
Riga city and governance have made huge progress, though there is still work to do to clean up previous wrongdoings. Court system, banking system improvements. Access to labour issue is No 1. LV needs to make up its mind how to position itself: "What we offer"... "This is the place for..."

FINANCE AND BANKING COMPANY

FOREIGN INVESTORS' ASSESSMENT OF POLICY MAKERS' EFFORTS TO IMPROVE THE INVESTMENT CLIMATE OVER THE PAST 4 YEARS



2018 - 2022



SCALE 1-5, WHERE '1'- FAIL, '3'- AVERAGE' AND '5'- EXCELLENT



There is new leadership in LIAA, in the Prosecutors Office, Bank of Latvia – new energy with experts taking leadership roles – this is very good and highly appreciated.

REAL ESTATE COMPANY



It has improved compared to the past, but mostly there is the illusion that actions are being taken or credit is taken for actions carried out by others. It's not getting worse, but not improving a lot either.

MANUFACTURING COMPANY



Any decision taken today will play out in the next 15 years. So I don't understand how these important decisions can be put off for so long and just get reviewed without any real progress.

ICT COMPANY



Business growth is closely linked to the available labour force. Absolutely nothing has happened in the last few years to comprehensively solve this problem. Ignoring the problem won't make it go away, it might make investors go away, but then you lose good tax payers.

ICT COMPANY

BEST DECISIONS BY POLICY MAKERS OVER THE PAST 4 YEARS



PROGRESS IN THE TAX SYSTEM



HIGHER EDUCATION REFORM



FINANCIAL SECTOR OVERHAUL



ADMINISTRATIVE TERRITOTRIAL REFORM

“A decision that you do not have to pay taxes on profits that are reinvested and not taken out of business. Now more of the profit is reinvested which is good for business growth, we can invest now more in automated services.”

Service company

“Higher education reform – centralisation and reducing the number of higher education institutions.”

Real estate company

“The financial sector overhaul was a great thing (positive decision in the long-term). There are many investors who really appreciate the steps taken in AML issues in Latvia, this is a must have to even start discussing increasing investment in Latvia.”

Service company

“Regional reform – this is not a popular decision by the Government, but from a structure point of view this was necessary. It also signals that the Government is not afraid to accept and implement unpopular decisions. Also, it shows that the Government is thinking about these sorts of things and changes in general. The effect of this reform is still not clear, but the idea of it is good for more effective governance.”

ICT company

WORST DECISIONS BY POLICY MAKERS OVER THE PAST 4 YEARS



LACK OF PROGRESS IN
LABOUR FORCE POLICY



LACK OF EFFECTIVENESS
OF POLICY MAKERS



UNCERTAINTY
SURROUNDING POLICY
MAKER DECISIONS



NO TANGIBLE PROGRESS
WITH EU GREEN DEAL

“A lot of things have been delayed in relation to green transition. The Green Deal is very topical and impactful for our industry and all the regulations that are related to it. Resource availability for the future. A lot of investors are discouraged to come because of this uncertainty with regulations.”

Manufacturing company

“The complete lack of a desire to solve the workforce issues in Latvia. We are increasing salaries very unnaturally because we have to buy employees from other companies. Emigration is also high – what’s being done about any of this?”

ICT company

“Communication with experts on various topics was lacking, how we explain certain decisions is not ok. Very little data-based decision-making.”

Wholesale and retail company

“Lack of decisions in a crisis. Delaying positive policies that we have heard about in the media or elsewhere. Low decision-making, understandable that it is difficult with 5 or more parties, but still, that has to work. Some companies have received a lack of support, subsidies.”

Manufacturing company

CURRENT EFFORTS OF THE POLICY MAKERS TO IMPLEMENT THE EU GREEN DEAL STRATEGY IN LATVIA

2.2

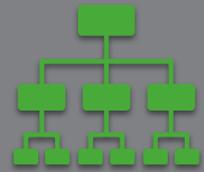


SCALE 1-5, WHERE '1'- FAIL, '3'- AVERAGE' AND '5'- EXCELLENT

PRIORITIES INVESTORS VIEW AS IMPORTANT TO IMPLEMENT EU GREEN DEAL



Clear strategy and mid-term, long-term plans with KPI's, data based decisions



One responsible party, distinct governance over green transition in Latvia



Practical involvement of experts, not just formally to tick boxes



More development of renewable energy resources, less red tape (not just in regulatory framework, but during practical implementation)



Educating society, public and private sector on importance of green transition

PRIORITIES INVESTORS VIEW AS IMPORTANT TO IMPLEMENT EU GREEN DEAL



We need legislation changes to allow large green economy development projects to go forward without setbacks at later stages of the project.

Real estate company



Make it a cross-sectoral priority, a broad plan covering everyone, regulations have to be changed, the energy model and energy business will change and current regulations would not fit with the new system, there needs to be much more flexibility of the energy market.

Retail trade and service company



Just be more pragmatic, listen to up-to-date data and science!

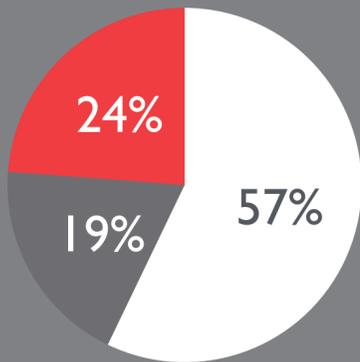
Wholesale and retail company



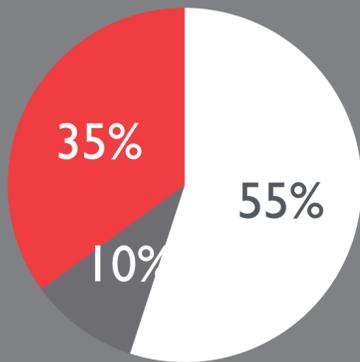
Educating everyone, from the public to the public sector officials, to the politicians who will be in charge.

Professional assurance and advisory services company

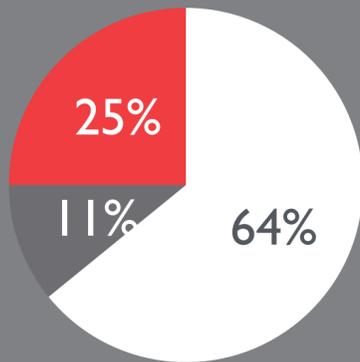
FURTHER INVESTMENT PLANS



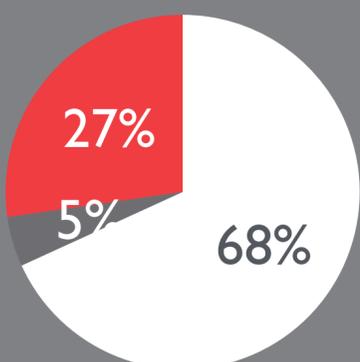
2017 (N=42)



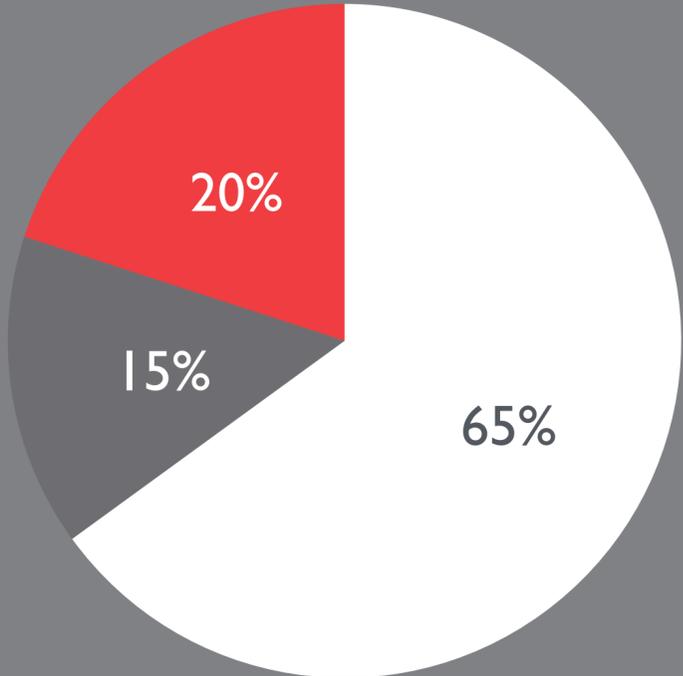
2018 (N=40)



2019 (N=47)



2020 (N=44)



2021 (N=53)

■ YES, WE PLAN TO INCREASE INVESTMENT ■ NO, WE DO NOT PLAN TO INCREASE INVESTMENT ■ NOT DECIDED, DEPENDS ON CIRCUMSTANCES OR NO NEED



YES, WE PLAN TO INCREASE INVESTMENT



We are planning to increase investments. Our plans are much bigger than we will probably realise. One obstacle for us is often the municipalities. For us investment in equipment for reducing CO2 and modernisation in general will continue. The investment will certainly be more than 10 million per year. We will also invest in IT innovations and digitalisation tools.

RETAIL TRADE AND SERVICE COMPANY



Around 100 million in the next few years.

MANUFACTURING COMPANY



We have a long-term strategy which includes investing further into Latvia. We have two concrete investments in Riga that we will implement in the next 2-3 years, where we will invest about 50 million euros. Then, hopefully, another 50 after that.

REAL ESTATE COMPANY



We do plan to increase investment but cannot mention specific amounts. Today, our office in Riga has around 150 people, the target is to grow to 500 people. Investment is hampered by the accessibility of labour.

ICT COMPANY



NO, WE DO NOT PLAN TO INCREASE INVESTMENT



Not investing more in Latvia, if anything we are looking to decrease exposure in Latvia, too many uncertainties.

MANUFACTURING COMPANY



No, due to current volatile market conditions.

FINANCE AND BANKING COMPANY



We have no plans to invest further. We will continue investing at a normal level in transportation, warehousing etc., but no more. This market is not very interesting, very low profitability.

MANUFACTURING COMPANY



No. Downsizing of market, no potential customers in future. If there is no clear vision on how to reduce and control labour market costs, we can't implement digital solutions. This is the first time we have decided to decrease our investment.

RETAIL TRADE AND SERVICE COMPANY



NOT DECIDED, DEPENDS ON CIRCUMSTANCES OR NO NEED



It depends on the circumstances, these investments are tied to energy transition, the regulatory part of the energy system is preventing the building of solar farms and wind plants, the old-style system is still kept in place.

RETAIL TRADE AND SERVICE COMPANY



Only if we have more workforce in Latvia.

ICT COMPANY



We are trying to grow in Latvia as fast as possible, but progress is hindered because of a lack of a skilled workforce, we have potential clients and work, but we lack employees.

ICT COMPANY

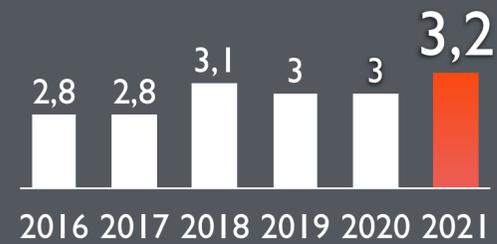
FOREIGN INVESTORS' ASSESSMENT OF THE POTENTIAL DRIVERS OF ECONOMIC COMPETITIVENESS OF LATVIA



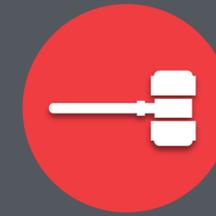
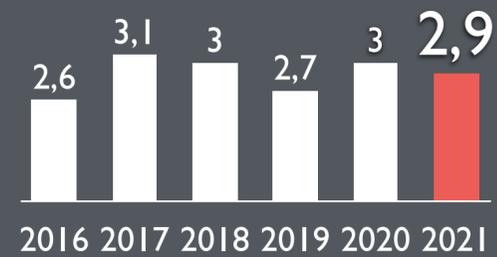
DEMOGRAPHY



TAX SYSTEM



QUALITY OF EDUCATION AND SCIENCE



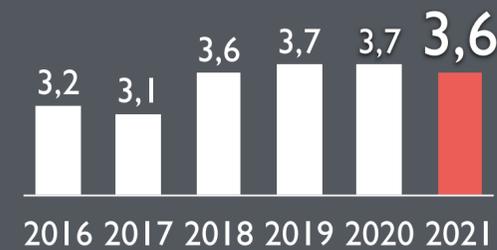
LEGAL SYSTEM



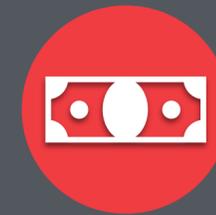
AVAILABILITY OF LABOUR



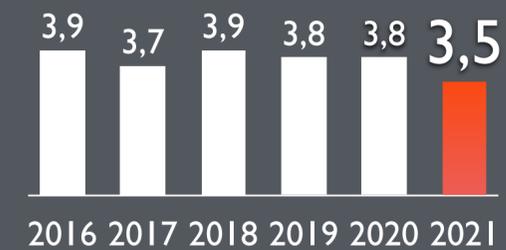
ATTITUDES TOWARDS FOREIGN INVESTORS



QUALITY OF HEALTHCARE SYSTEM

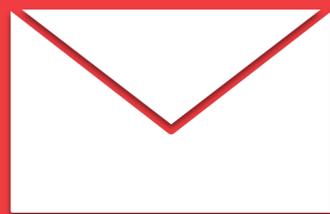


STANDARD OF LIVING IN LATVIA



SCALE 1-5, WHERE '1' - REPRESENTS LOW COMPETITIVENESS AND, '5' - REPRESENTS HIGH COMPETITIVENESS

BEST ONE-LINERS
FROM INVESTORS'
LETTERS TO THE
**PRIME
MINISTER**



“On an individual level, Mr. Kariņš, I wish you would knock around your ministers a bit more, in a constructive manner, of course. You have to be more active in your personal communication, people trust you, you make sense. I understand the cards you have been dealt – it is tough, but I would like to see you be more active. You are great at keeping the peace and holding the balance, but sometimes, to get things done – you need to rock the boat. To be more precise, you need to stand for more, we hear your own opinion very rarely. It’s better to have an opinion that part of the society doesn’t appreciate, rather than leaving everyone confused because we don’t understand what you are thinking.”

Wholesale and retail company

“The fundamental question is consistency of decisions. The Prime Minister is trying to apply this. Of course, we have four coalition parties and the Prime Minister has a certain role as a moderator. However, I would like to see more consistency “

ICT company

“Be brave enough to make the tough decisions that are in Latvia’s interests and don’t only focus on political decisions. Politicians think about the next election, but statesmen think about the country first”

Service company

“Please talk more to rational social partners. A lot of businesses have the experience and are willing to share, but you can’t expect us to do everything for you, the public sector has to participate in the creation and implementation of good ideas.”

ICT company

BEST ONE-LINERS
FROM INVESTORS'
LETTERS TO THE
**PRIME
MINISTER**



“We need to have more transparency and explanations on why certain decisions are made, what are the next steps, why a decision was made, based on what data and what information. More clarity and more transparency.”

Manufacturing company

“Stick to your decisions, be consequential, so people can trust that you know what you are doing. Law-abiding citizens find it difficult to hear more uncertainty than certainty from elected officials. The communication culture needs to take a few steps forward, explain decisions based on comprehensible data and information you have used.”

Real estate company

“We see that the public sector has very formal policies in place as mechanisms to cooperate with experts and businesses. This needs to change if we want to achieve real progress, it is only normal that public sector officials can't be experts in every single question – then please just ask and listen. You can't fake the Green Deal, you can't fake availability of labour – solve these problems. Last minute changes to legislation and last-minute consultations with those who will be affected by legislation is very bad practice, it reduces trust”

Retail trade and service company

“Clear and data-based decisions in policy planning and decision-making, not based on the principle of the “lesser evil” (something a consensus can be reached on) but rather on the best development opportunities for Latvia in the long run to become a prosperous country which uses its human capital in the best way possible”

Professional assurance and advisory services company

“Clear plans, clear and consistent execution of the plans. This would improve trust in the Government. You cannot create trust quickly - this is done over a period of time.”

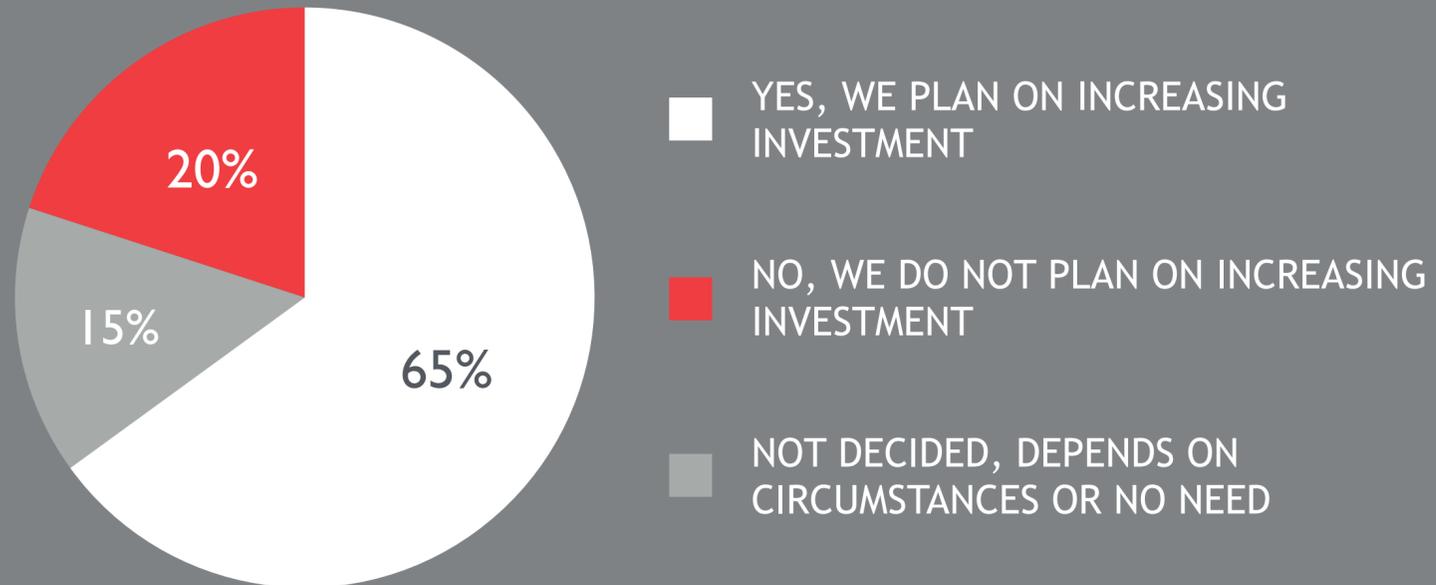
Manufacturing company

ADDITIONAL QUESTIONS ASKED IN MAY 2022 REGARDING THE GEOPOLITICAL SITUATION

Since FICIL Sentiment Index: Election edition interviews with investors were carried out at the end of 2021, we asked additional questions in May 2022 in light of Russia's invasion of Ukraine and what impact the geopolitical situation would have on the investment climate.

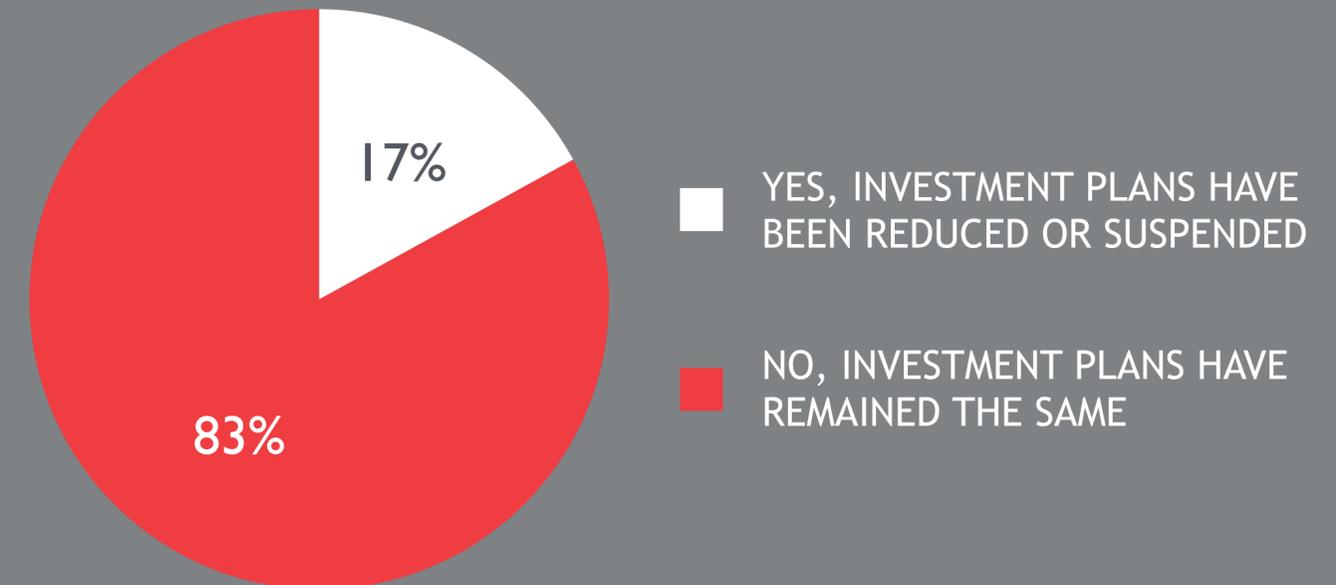
1. Have your investment plans changed since Russias' invasion of Ukraine?
2. What are the main concerns currently for your companies management or mother companies management regarding investment climate in Latvia?
3. What should be the top priorities for the next Government and Saeima?

DOES YOUR COMPANY PLAN ON INCREASING INVESTMENT IN LATVIA?



ANSWERS RECEIVED AT THE END OF 2021

HAVE YOUR COMPANY'S PLANS TO INVEST IN LATVIA CHANGED BECAUSE OF RUSSIA'S INVASION OF UKRAINE?



ANSWERS RECEIVED MAY 2022



We suspended our investment plans for a few weeks, but we have already resumed implementing all our plans. Due to rising prices and inflation, suppliers/sellers are reluctant to make long-term binding offers. This means that investments will be delayed.

MANUFACTURING COMPANY



Some investments have been suspended due to our customers' anxiety, but I would say we have recovered and are back on track.

ICT COMPANY



We have not changed our plans. We are long-term investors and see ourselves in Latvia in the future as well. We do not believe that there is a huge risk of a Russian military attack on Latvia at the moment.

SERVICE COMPANY



Long-term investment plans have not changed significantly, while short- and medium-term investments need to be assessed and analysed on a case-by-case basis. As for long-term investments, we are looking into renting production facilities instead of building them.

MANUFACTURING COMPANY

WHAT CONCERNS YOU MOST REGARDING THE INVESTMENT CLIMATE OF LATVIA ?



The main issues include energy prices (high electricity and fuel prices), rising inflation and labour shortages. After the war began, we at our company conducted a fairly comprehensive risk analysis of the possible consequences. It is clear that the risk of war has increased and could also affect the investment environment in Latvia in the long run.



RETAIL TRADE AND SERVICE COMPANY

The biggest question and, at the same time, a challenge is the total uncertainty in the market – e.g. there are significant changes in construction as well as energy costs (fuel & gas). Against this background, of course, implementing investment projects is a bigger challenge, because the cost of such projects may change in a week, and there is uncertainty regarding delivery times, etc. In addition, we are certainly concerned about the rising inflation.



SERVICE COMPANY

Rising energy prices, especially electricity prices, pose the biggest problem. Compared to other neighbouring countries in the North, such as Finland and Sweden, electricity prices in Latvia are much higher and this has a negative impact on our competitiveness and exports. We had to change various commodity supply chains, which has significantly increased costs. Because of the war, we anticipate higher inflation and unpredictability, which will slow economic growth. Demand is still high, but we expect it to decline in the second half of the year, which will affect short-term investments. Shadow economy is no longer a government priority and there is a feeling that it is an accepted part of the economy, it is stable or growing, which has a negative effect on the investment climate.



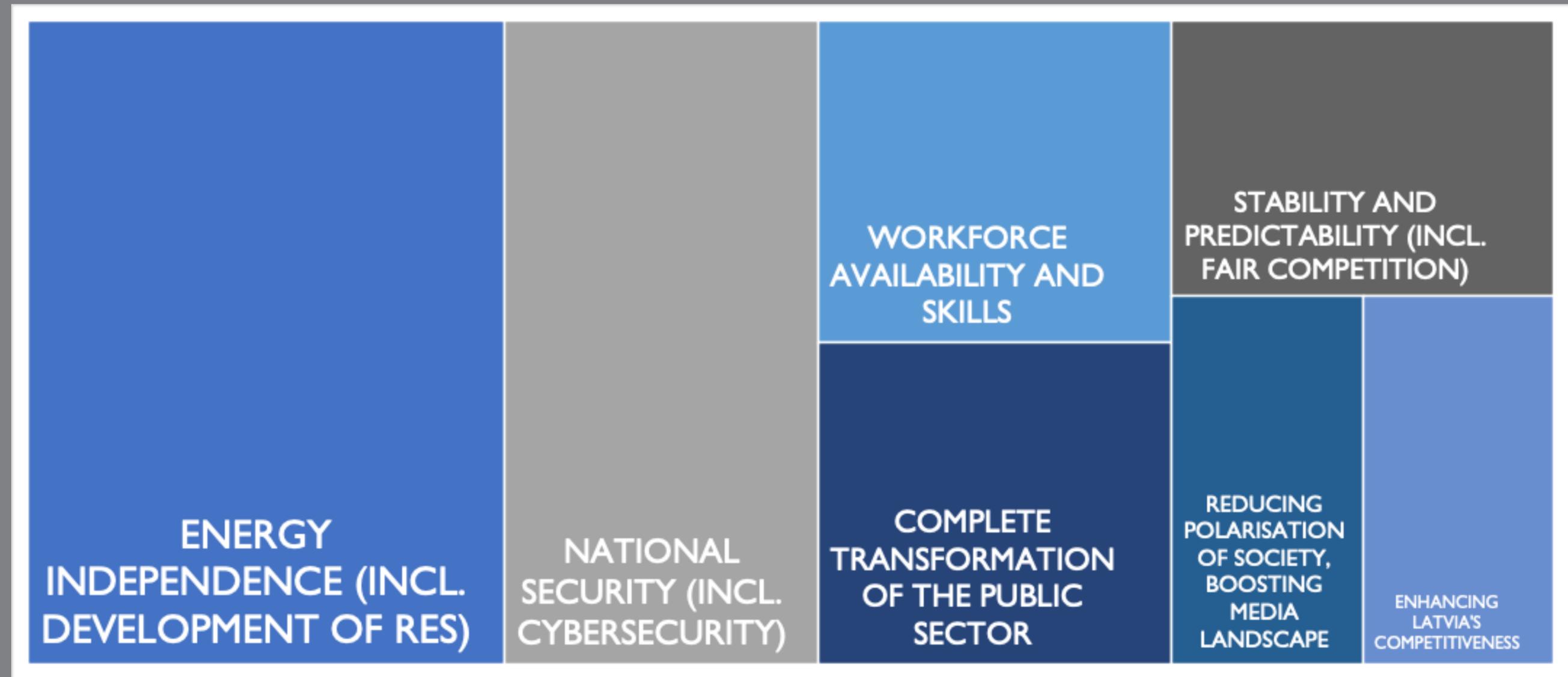
MANUFACTURING COMPANY

Inflation, rising costs, we cannot predict how cost and wage inflation could affect businesses. Most of us have long-term projects. Uncertainty is a big problem – it is difficult to plan ahead, which was a weak point for Latvia before all the crises.



PROFESSIONAL ASSURANCE AND ADVISORY SERVICES COMPANY

WHAT PRIORITIES SHOULD BE SET BY THE NEXT GOVERNMENT AND SAEIMA?



Energy independence: the state needs to think and actively invest in infrastructure / opportunities that would make it possible to completely abandon Russia's gas resources. Reducing the polarization of Latvia's society: this situation has further widened the gap between Latvians and Russian-speaking citizens of Latvia. This must be given special attention and work must be done to improve the situation.



WHOLESALE AND RETAIL COMPANY

(1) Energy independence, avoiding interruptions. (2) Human resources. (3) Efficiency of the public administration and effective cross-sectoral/inter-dimensional coordination.



FINANCE AND BANKING COMPANY

The government needs to work on the migration policy, improve the procedures to facilitate and motivate skilled labour to seek employment in the Latvian labour market.



ICT COMPANY

In our opinion, there are (at least) three things. 1) Replacing Russian energy resources with alternative supplies that our society can afford (with subsidies, if necessary) and that, ideally, would also be greener. 2) Strengthening NATO presence in Latvia, incl., for example, a larger contingent, air defence, bolstering the Navy, etc. 3) Addressing the mounting integration issues by moving towards more cohesive, open, inclusive society, where a citizen of any ethnic origin would proudly call him or herself a Latvian in the sense of belonging to the country.



REAL ESTATE COMPANY

COMPANIES THAT TOOK PART IN THE STUDY



Foreign Investors' Council in Latvia (FICIL) is a non-governmental organisation that brings together the largest foreign companies in Latvia, the foreign chambers of commerce and the Stockholm School of Economics in Riga.

FICIL actively searches for and proposes solutions to improve and develop the business and investment environment in the country in cooperation with the Government of Latvia.

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