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The Baltics Attractiveness Survey

Estonia

August 2024



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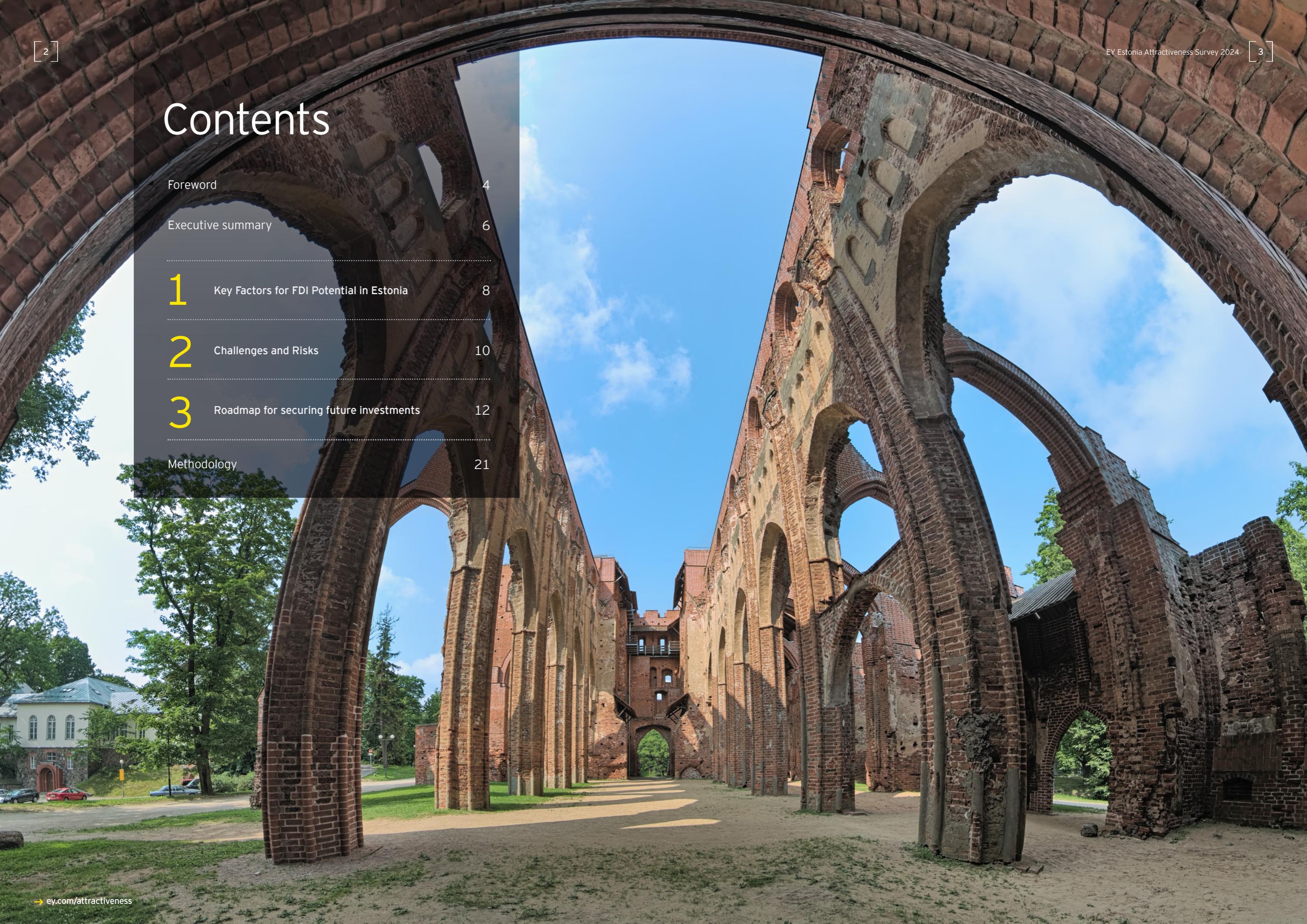
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Foreword



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“

Change is the only constant in life.

This sentiment, famously attributed to Heraclitus, a pre-Socratic Greek philosopher, resonates deeply when evaluating the findings of the latest Estonian Foreign Direct Investment (FDI) Sentiment Report.

For Estonia to maintain and enhance its attractiveness as a destination for FDI, it is imperative for businesses and the government to collaborate and adapt swiftly and effectively. The urgency of this cooperation cannot be overstated.

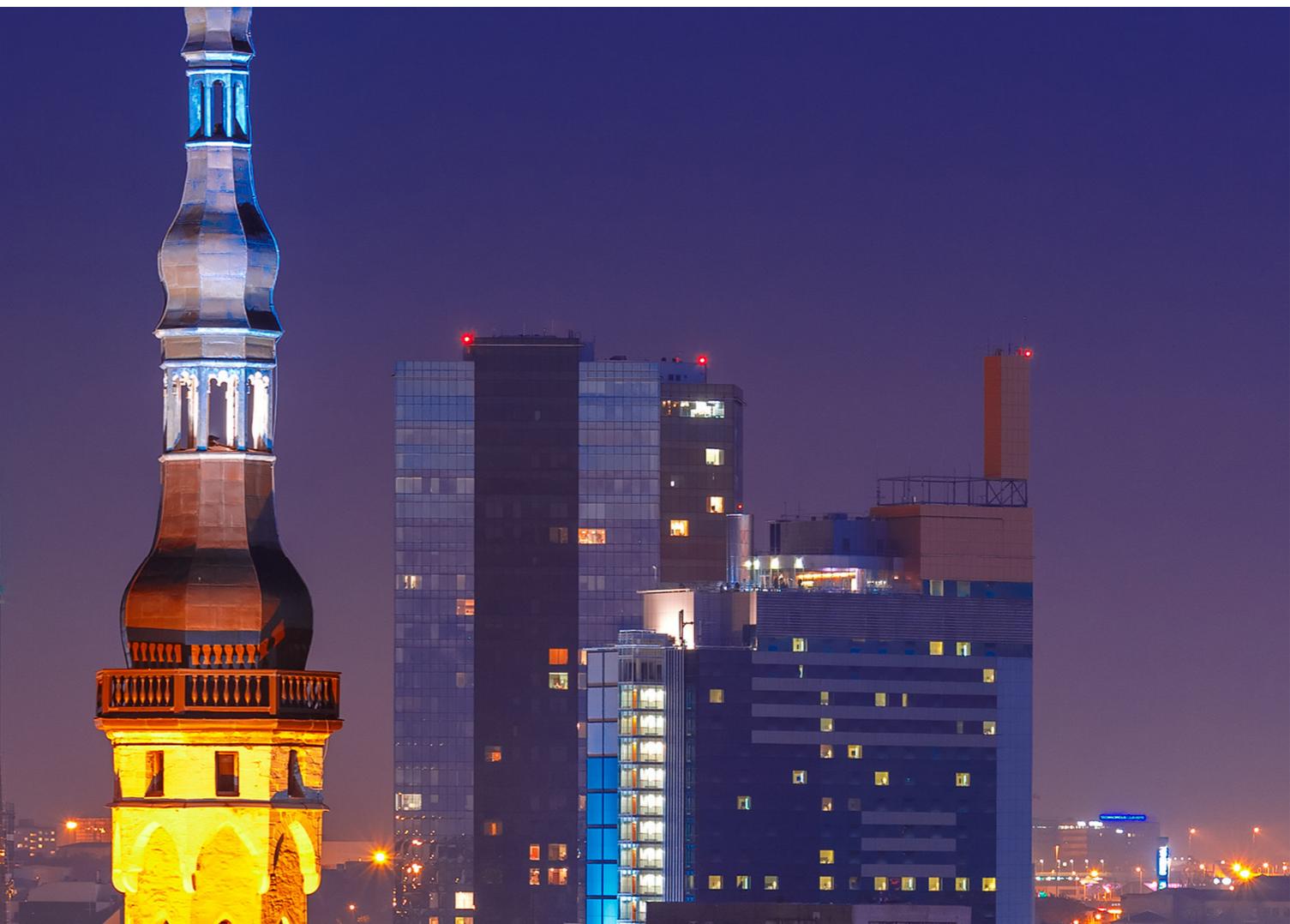
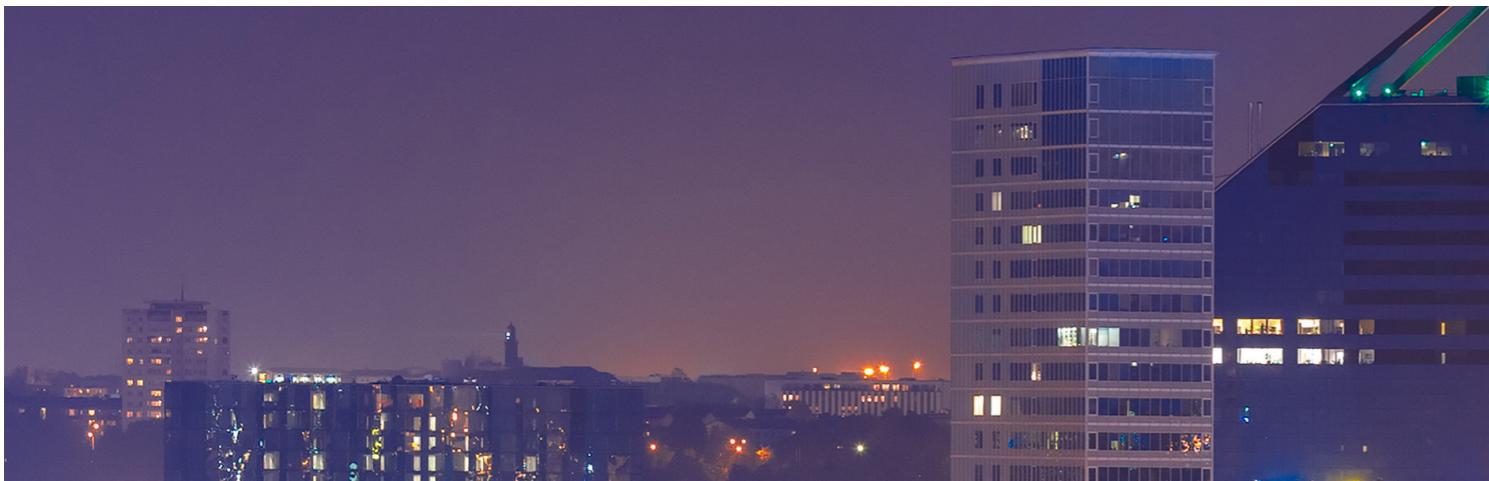
A Nation in Transition

Estonia, a dynamic and innovative country, is known for its advanced digital infrastructure, highly skilled workforce, and strong startup ecosystem. According to the the latest EY Baltic Attractiveness Survey, Estonia ranks 6th in the EU for jobs created by new investment projects per million population, highlighting its competitive edge within the region.

However, the landscape is shifting. While Estonia has seen notable investments in high technology and green projects, the overall number of new FDI projects and jobs created has declined slightly. In 2023, new investment projects in Estonia fell slightly from 9 to 8, reflecting broader trends observed across Europe, where FDI inflows dropped by 4%, and job creation declined by 7%.

The Estonian economy, like much of Europe, faces challenges such as high inflation, geopolitical tensions, and political instability. These factors contribute to a cautious investment climate. Yet, there is optimism. Many investors believe Estonia's investment climate will improve in the coming years, driven by its focus on technological and green investments.

This report underscores the need for Estonia to redouble its efforts to remain an attractive and competitive destination for FDI. By leveraging its strengths in digitalization and sustainability and addressing economic and geopolitical risks in addition to keeping bureaucracy to minimum Estonia can continue to thrive and attract global investments.



Executive summary

In 2023, Estonia experienced a minor decline in new FDI projects and jobs created. Despite this, Estonia is far behind Latvia and Lithuania in the number of FDI projects in 2023. The country remains competitive within the Baltics in job creation per capita. Key trends indicate a diversification of the industrial base and

significant investments in high technology and green projects. Challenges such as high inflation, geopolitical risks, and political instability persist. However, the outlook remains optimistic, with expectations of improved investment attractiveness driven by economic recovery and favorable investment climates.

01
Total number of projects in the Baltics

28
in Lithuania **22**
in Latvia **8**
in Estonia

02
FDI projects by size of population in the EU

Estonia #6
Jobs created (per 1M of population)
Latvia #8
FDI projects (per 1M of population)
Lithuania #10
FDI projects (per 1M of population)

03
Estonia has stagnated in terms of an attractive investment destination over long term

53%
2022 **61%**
2023 **60%**
2024

50% think Estonia's attractiveness will increase during the next **three years**.

04
To maintain Estonia's appeal to foreign investors, policymakers must consider the **current factors** that influence investment decisions ...

Addresses sustainability issues 40%
Benefits from tax conditions 38%
Access skills 38%

05
... and mitigate more fundamental challenges. In the next three years, investors perceive the **main risks** for the Baltic countries' attractiveness to be:

Latvia 48% Political instability in BAL
Lithuania 40% Geopolitical tension/conflicts
Estonia 38% High inflation

05
% of companies that have plans to **establish or expand operations** in the Baltics over the next year

Estonia 60%
Latvia 66%
Lithuania 68%

“ Despite the challenges posed by high inflation and geopolitical tensions, Estonia remains a competitive destination for foreign direct investment. Our focus on supporting struggling industries, empowering SMEs, and fostering high-tech innovation positions us well for future growth. With 50% of investors optimistic about the next three years, Estonia is poised to leverage its strengths in digitalization and sustainability to attract significant investments.

Olesia Abramova
EY Estonia
Assurance Partner

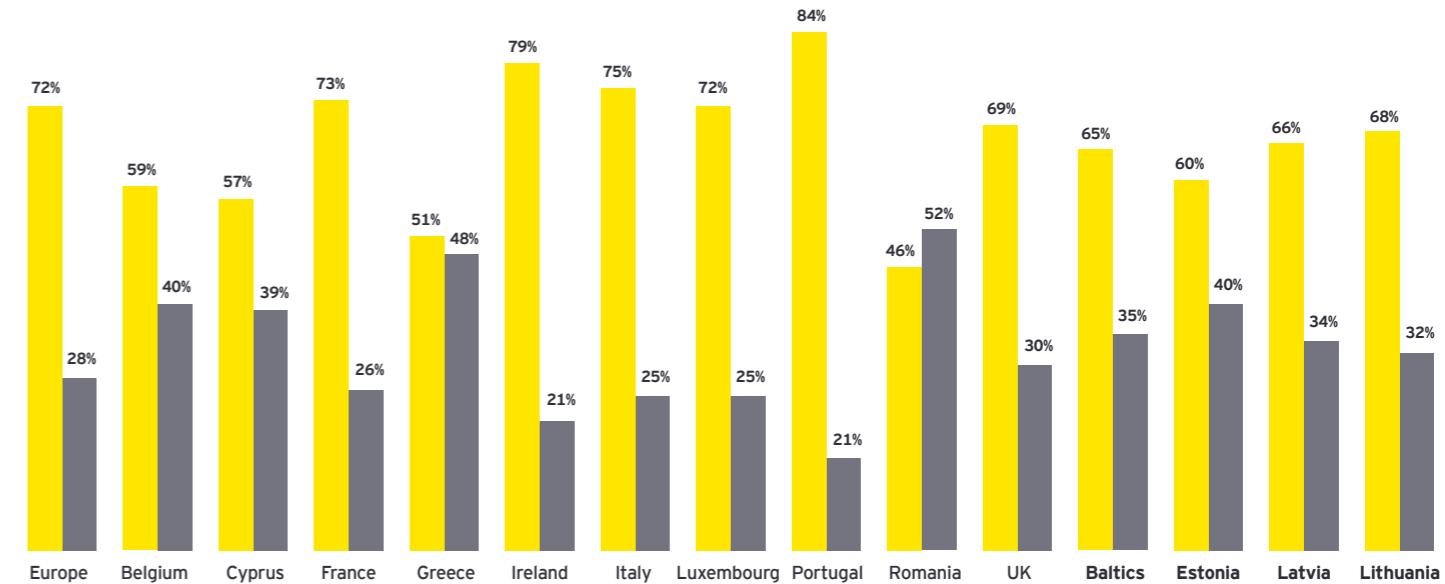
Investment could rebound, but a recovery is not guaranteed

Estonia has seen fluctuations in its attractiveness as an investment destination over the past few years. According to the EY Baltic Attractiveness Survey, the percentage of executives who considered Estonia an attractive investment destination was 53% in 2022, 61% in 2023, and slightly dipped to 60% in 2024. However, 50% of investors believe that Estonia's attractiveness will improve

over the next three years, reflecting cautious optimism.

Compared to its Baltic neighbors, Estonia's performance is middling. Latvia's attractiveness saw a significant spike and subsequent drop, reflecting volatility. Lithuania's steady rise suggests better management of economic conditions and investor relations.

Does your company have plans to establish or expand operations in 2023?



In comparison, Europe as a whole has seen a more pronounced positive trend. In 2022, 53% of surveyed executives planned to establish or expand projects in Europe. This figure increased to 67% in 2023 and further to 72% in 2024. Additionally, 75% of executives expect

Europe's attractiveness to improve in the next three years. This optimism is attributed to pent-up demand for project execution following years of low investment, coupled with expectations of stabilizing economic conditions.



Key Factors for FDI Potential in Estonia

Key Factors

Pent-up demand

1

Economic stabilization

2

Technological and green investments

3

Government initiatives

4



TOP Risks ranking

While the outlook is positive, several challenges must be addressed to fully realize Estonia's FDI potential:

38% High inflation

High inflation poses a significant risk to Estonia's attractiveness for foreign direct investment. Inflation peaked in early 2023, reaching rates as high as 25% in some months, driven primarily by rising energy prices and supply chain disruptions. Although inflation has eased somewhat, it remains above the euro area average, posing ongoing challenges for competitiveness and investment attractiveness.

32% Geopolitical tension and/or conflicts

Geopolitical tensions are a major concern for investors in Estonia, particularly due to the country's proximity to Russia and the ongoing conflict in Ukraine. These tensions create an uncertain environment, potentially deterring new investments. The conflict has disrupted trade and increased the volatility of commodity prices, further complicating economic conditions. The recent accession of Finland and Sweden to NATO is a positive development that could enhance regional security and stability, providing a more favorable environment for investments.

28% Increased regulatory burden

The expanding regulatory framework is another significant risk factor. New regulatory initiatives, such as carbon disclosure, supply chain due diligence, data protection, and the safe use of AI, although essential for long-term sustainability and consumer protection, are perceived as potential barriers to business growth and agility. Investors express concerns that these regulations could stifle innovation and increase compliance costs, making Europe—and by extension, Estonia—less attractive compared to other regions with more flexible regulatory environments.

Other highly ranked challenges and risks

→ **28%** Slow growth in the Baltics

28% Public debt (and impact on taxes)

28% Political instability

Estonia's potential for an increase in FDI is significant, driven by a recovering economic landscape, strategic focus on high-tech and green investments, and proactive government policies. By addressing the existing

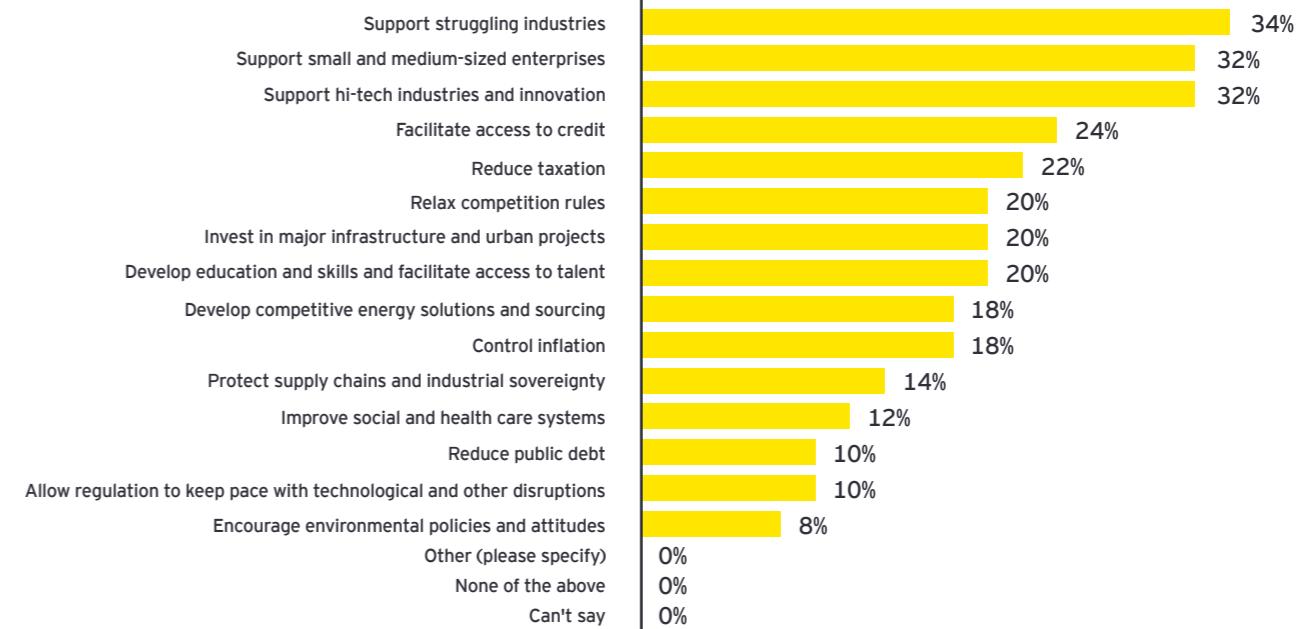
challenges and leveraging its strengths, Estonia can attract more foreign investments and enhance its position as a competitive destination in the global market.



Roadmap for securing future investments

Estonia

Where should Estonia concentrate its efforts in order to maintain its competitive position in the global economy?



Support struggling industries

Addressing the needs of struggling industries can help stabilize the economy and create a foundation for growth. Investors recognize the importance of revitalizing these sectors to ensure a balanced economic recovery. Fostering partnerships between the government and private sector to facilitate investment in modernization and technological upgrades.

Support small and medium-sized enterprises

SMEs are the backbone of the economy, driving innovation and employment. Ensuring their growth and sustainability is essential for a robust economic environment. Reducing Bureaucracy, creating access to capital and Digital Transformation are some of the tools that can help achieve this.

Support hi-tech industries and innovation

High-tech industries and innovation are pivotal for long-term economic growth and competitiveness. Estonia's strengths in digital infrastructure and technological skills provide a solid foundation for attracting investments in these areas.

To maintain and enhance its competitive position in the global economy, Estonia must focus on several key areas identified by investors as crucial for attracting and securing FDI. These areas include supporting

struggling industries, bolstering small and medium-sized enterprises (SMEs), and promoting high-tech industries and innovation.

Strengths to leverage

14%

Skills and availability of workforce

Estonia boasts a highly skilled workforce, particularly in digital and technological fields. This talent pool is crucial for attracting high-tech and innovative investments.

10%

Cost of energy and availability of capital

Competitive energy costs and a robust financial market are attractive to investors. Ensuring stability in these areas will continue to draw investment.

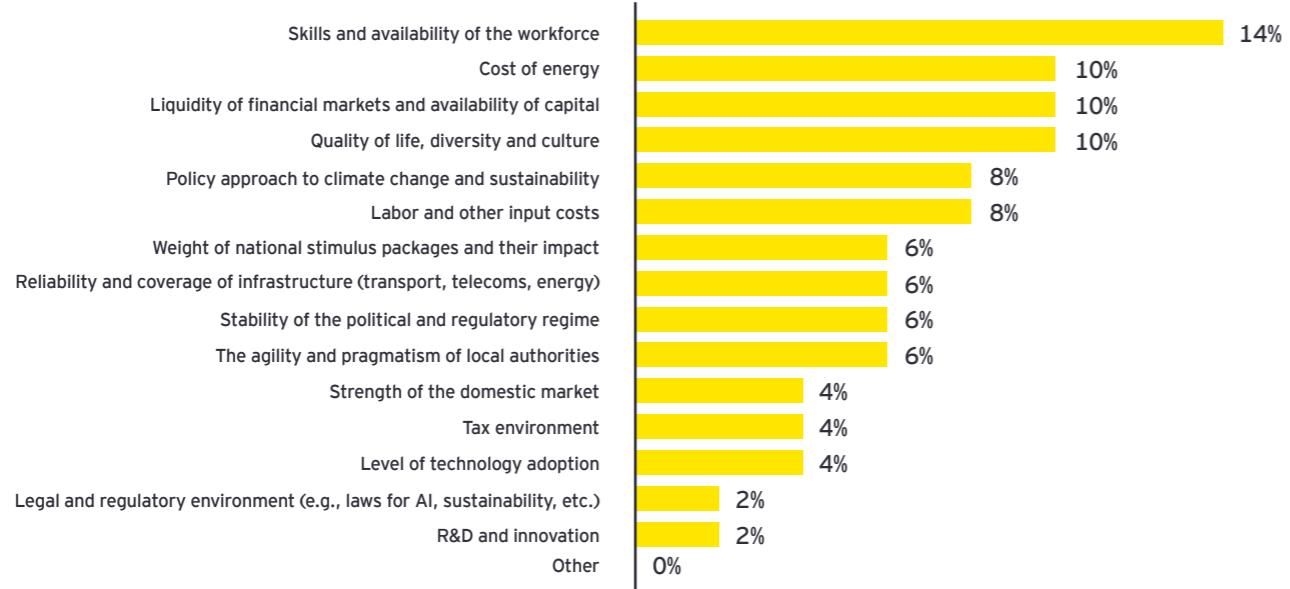
10%

Quality of life, diversity, and culture

Estonia's high quality of life, cultural diversity, and vibrant cultural scene contribute to its attractiveness as a place to live and work, enhancing its appeal to foreign investors.

Estonia

Which factors are the most important when choosing a country to invest in?



By focusing on supporting struggling industries, bolstering SMEs, and promoting high-tech innovation, Estonia can enhance its attractiveness as an investment destination. Leveraging its strengths in workforce skills, energy costs, and quality of life will further bolster

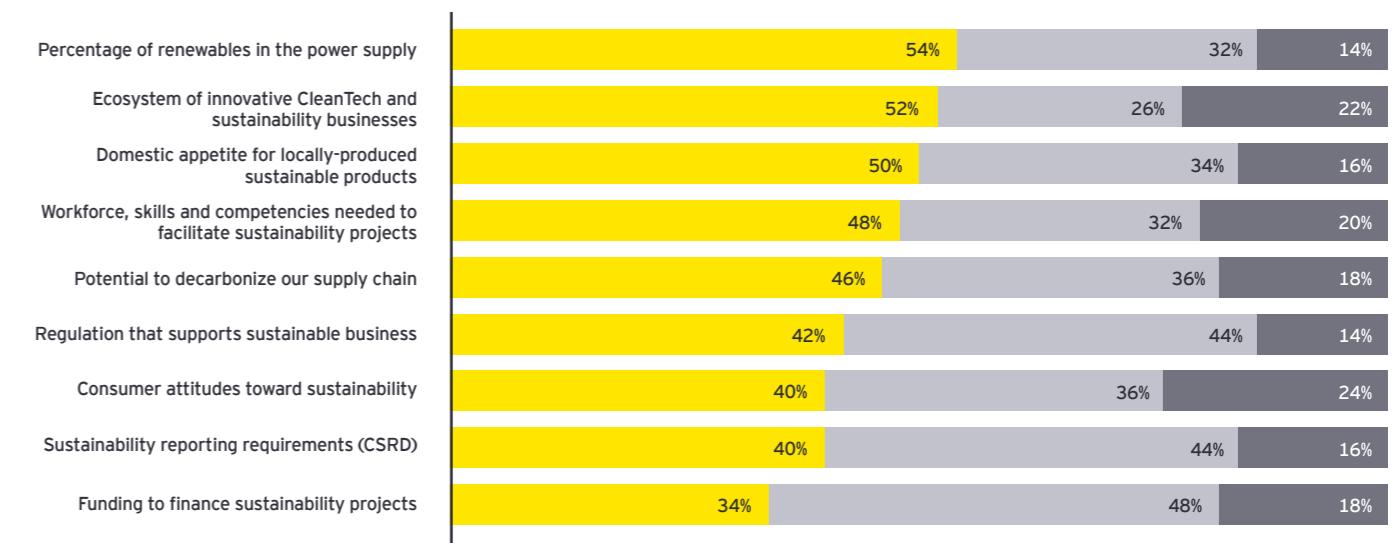
its competitive position. Strategic initiatives aimed at improving infrastructure, simplifying regulations, and promoting sustainability will create a conducive environment for sustained economic growth and investment.

Harnessing green potential

Sustainability is increasingly becoming a critical factor for investors when deciding where to allocate their resources. When it comes to sustainability, Estonia does not yet stand out significantly compared to other countries. According to the latest research, 54% of

investors believe that Estonia is better than other countries in terms of the percentage of renewables in its power supply, and 52% say the same about the ecosystem of innovative CleanTech and sustainability businesses.

Compared with other regions, how does Estonia perform with regard to the following sustainability-related factors?



Estonia has the potential to significantly enhance its FDI attractiveness by focusing on sustainability. By increasing the share of renewables in its energy mix, fostering a robust CleanTech ecosystem, and developing the necessary workforce skills, Estonia can position

itself as a leading destination for sustainability-focused investments. Strategic actions such as increasing funding for sustainability projects and balancing environmental regulations with business needs will further strengthen its competitiveness.

Is Estonia losing its edge as a pioneer in digital and technology innovation?

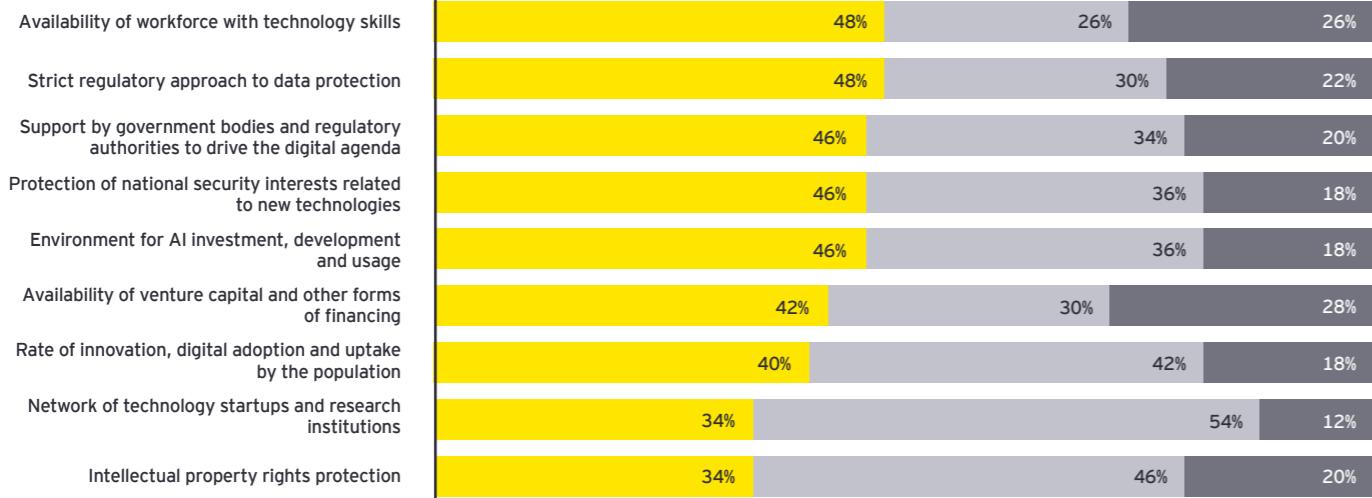
Estonia has long been recognized as a pioneer in digital innovation and technology, often referred to as "e-Estonia" due to its advanced digital infrastructure and government services. However, recent surveys and research indicate that the country may be losing its edge in this competitive field.

Unfortunately, investors see Estonia performing the worst in the technology area compared to other

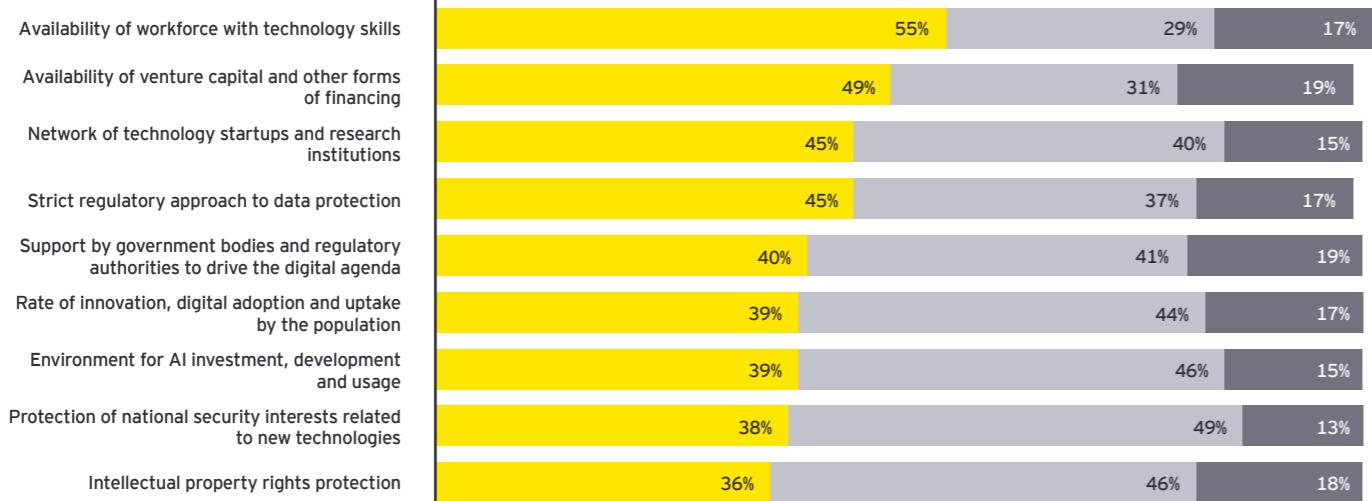
Baltic countries. The closest positive perception is the availability of workforce with technology skills, with 48% of investors acknowledging Estonia's strengths in this area. Strict regulatory approaches to data protection also receive some recognition, but overall, Estonia is not seen as outperforming other regions in significant technological factors.

Estonia**Compared with other regions, how does Estonia perform with regard to the following technology-related factors?**

■ Better ■ The same ■ Worse

**Baltics****Compared with other regions, how does Baltics perform with regard to the following technology-related factors?**

■ Better ■ The same ■ Worse



Estonia's reputation as a digitally advanced country is at a crossroads. While it still possesses significant strengths in its skilled workforce and digital infrastructure, there is an urgent need to address the challenges and enhance its technological environment. By focusing on

workforce development, boosting the startup ecosystem, accelerating innovation, and adapting regulatory frameworks, Estonia can regain its position as a pioneer in digital innovation and technology.

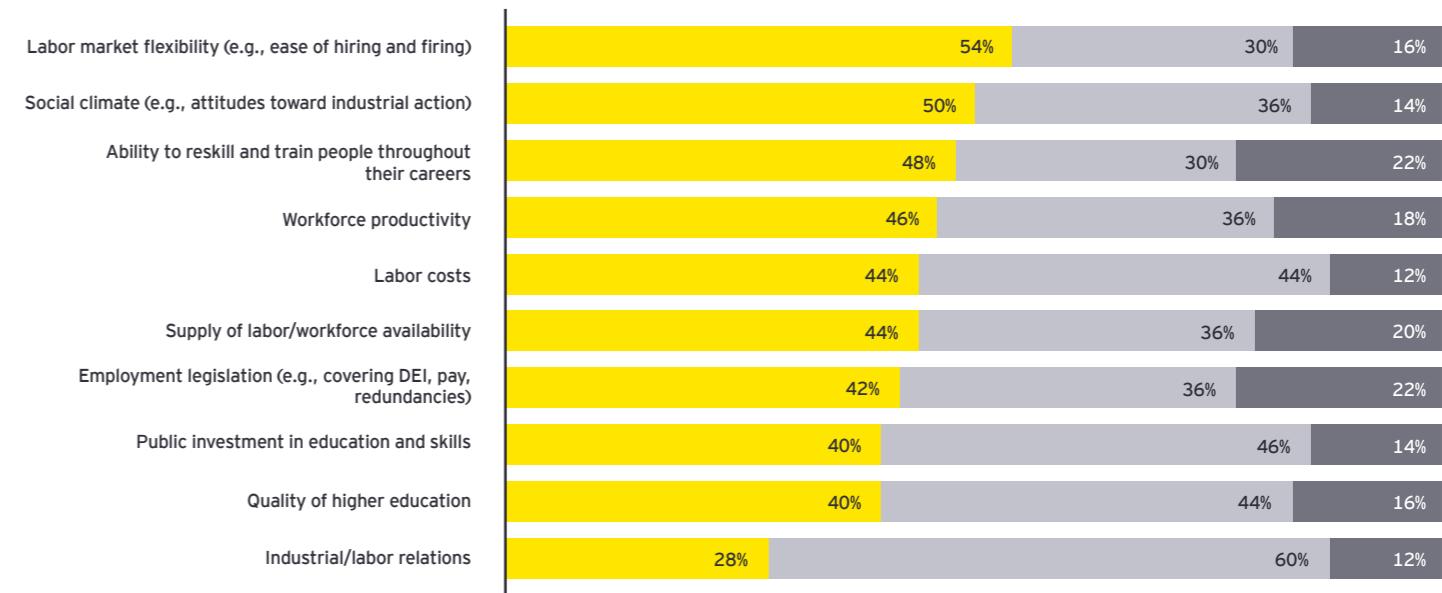
Labor Flexibility and Social Climate Boost FDI

Estonia is recognized for its labor market flexibility and favorable social climate, which are significant factors influencing its attractiveness for foreign direct investment. According to the latest survey, 54% of

respondents perceive Estonia's labor market flexibility as a key advantage, while 50% highlight the positive social climate, including attitudes toward industrial action.

Compared with other regions, how does Estonia perform with regard to the following talent-related factors?

■ Better ■ The same ■ Worse



Estonia's labor market flexibility and favorable social climate are significant advantages that enhance its attractiveness for foreign direct investment. By focusing on improving workforce availability, higher education quality, and industrial relations, Estonia can further

strengthen its position as a competitive destination for global businesses. Strategic investments in education, skills development, and regulatory refinement will be key to sustaining and enhancing this competitive edge.

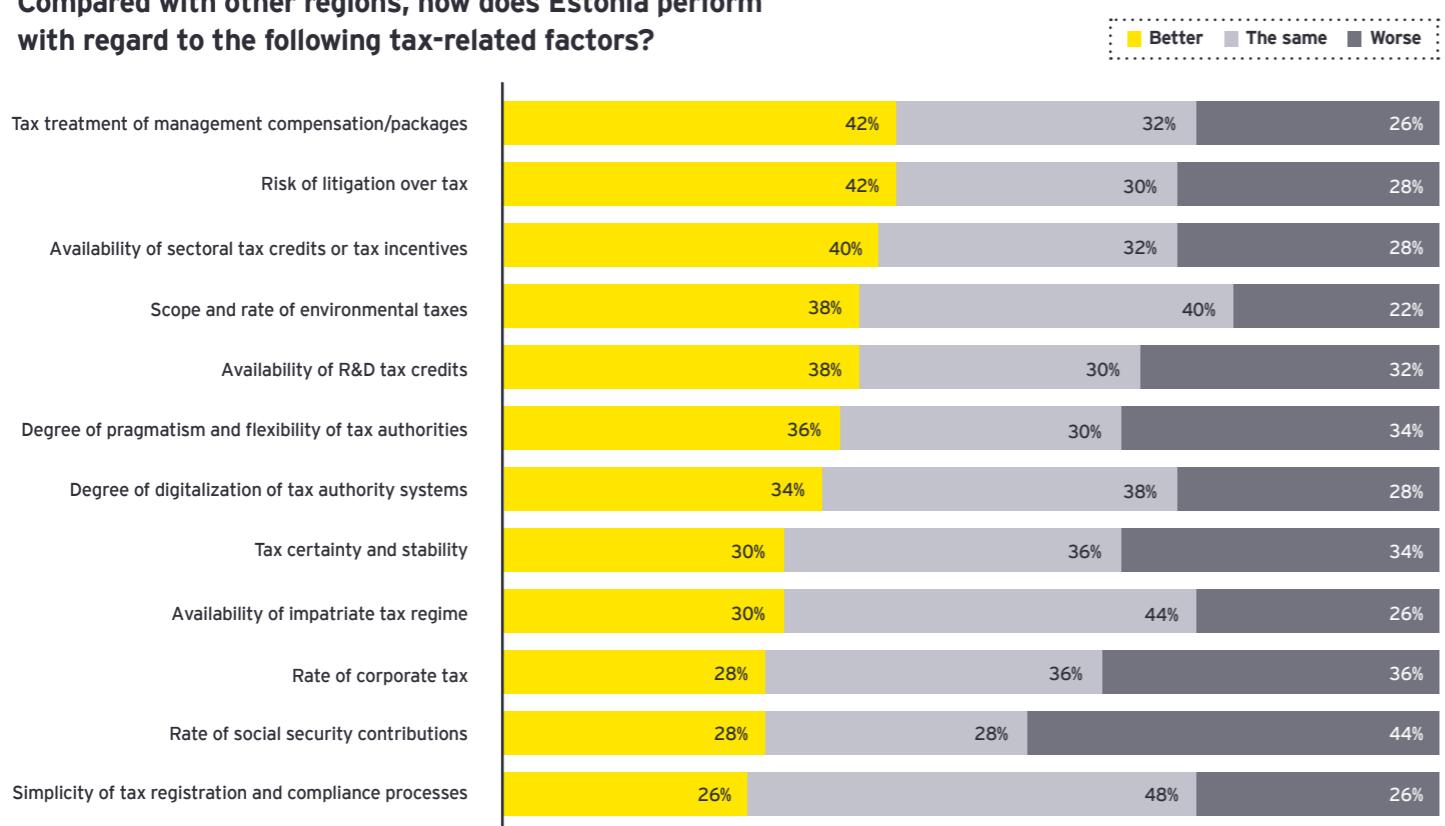


Need for competitive tax environment

The tax environment is a crucial factor influencing foreign direct investment (FDI) decisions. In Estonia, the tax treatment of management compensation/packages and the risk of litigation over tax are areas where the country is perceived to perform the best. According to the survey, 42% of investors highlight these aspects as competitive advantages for Estonia.

However, upcoming tax changes, including increases in VAT and corporate income tax, present new challenges. By enhancing tax incentives, simplifying compliance, and effectively communicating changes, Estonia can continue to attract and retain foreign investments, leveraging its strengths in transparency and predictability.

Compared with other regions, how does Estonia perform with regard to the following tax-related factors?



Conclusion

The recent challenges in attracting FDI to Estonia, along with increased competition from other countries, require immediate action from policymakers to improve Estonia's competitiveness and attractiveness. The data from the EY Baltic Attractiveness Survey underscores the importance of focusing on key areas such as supporting struggling industries, bolstering SMEs, and promoting high-tech and green investments.

To secure a prosperous future, Estonia must leverage its strengths in digital infrastructure, skilled workforce, and favorable social climate while addressing significant challenges like high inflation, geopolitical tensions, and

increased regulatory burdens. Collaboration between the government, businesses, and educational institutions will be essential to drive this transformation.

The urgency and unity demonstrated in response to recent crises, such as the COVID-19 pandemic and the war in Ukraine, must be harnessed to ensure Estonia's competitive edge in the global market. By implementing strategic initiatives aimed at improving infrastructure, simplifying regulations, and promoting sustainability, Estonia can continue to attract global investments and thrive as a dynamic and innovative economy.

Olesia Abramova
EY Estonia
Assurance Partner



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The FDI sentiment report highlights that 60% of companies plan to establish or expand operations in Estonia, reflecting cautious optimism. By addressing key areas such as reducing regulatory burdens for SMEs and investing in digital infrastructure, Estonia can continue to enhance its investment climate. The belief that Estonia's attractiveness will increase over the next three years is a testament to our ongoing efforts to create a stable and innovative economic environment.”

Methodology

The “real” attractiveness of Europe for foreign investors

The evaluation of the reality of FDI in Europe is based on the EY European Investment Monitor (EIM), the EY proprietary database produced in collaboration with OCO. This database tracks the FDI projects that have resulted in the creation of new facilities and new jobs. By excluding portfolio investments and M&A, it shows the reality of investment in manufacturing and services by foreign companies across the continent.

An investment in a company is normally included in FDI data if the foreign investor acquires more than 10% of the company's equity and takes a role in its management. FDI includes equity capital, reinvested earnings and intracompany loans.

The perceived attractiveness of Europe and its competitors by foreign investors

We define the attractiveness of a location as a combination of image, investor confidence, and the perception of a country's or area's ability to provide the most competitive benefits for FDI.

Field research was conducted by FT-Longitude in March and March-April 2024 via online interviews, with 550 international decision-makers participating.

The Baltic field research was conducted by FT-Longitude in March and April 2024 via online interviews, with 150 international decision-makers participating.



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