International trade, foreign direct investment and global value chains

2017

LATVIA

TRADE AND INVESTMENT STATISTICAL NOTE

International trade and foreign direct investment (FDI) are the main defining features and key drivers of global value chains (GVCs). However, despite their strong complementarities, the two flows are typically presented and treated separately in the statistical information system. Drawing on new and improved measures of trade and investment, this country note provides relevant statistical information from OECD databases on trade, investment, the activities of multinational enterprises (MNEs) and global value chains (TiVA). It sheds new light on the trade-investment nexus by highlighting the interrelationships between trade and FDI, their economic impact in the context of GVCs, and the role of MNEs as the main directors of these flows. The data are as of 1 May 2017. More information and country notes are available at www.oecd.org/investment/trade-investment-gvc.htm.

Over one-third (36% in 2014) of economic activity (GDP) in Latvia depends on foreign markets, around the same as in Poland and Sweden. Foreign-owned firms play a substantial role in GVC integration accounting for over 40% of Latvia’s gross exports. Latvia’s inward investment (equivalent to 52% of GDP in 2015) was much larger than its outward investment (5%). Under a broader notion of international orientation that captures the impact on national income of exports and sales through foreign affiliates, Latvia’s international orientation was equivalent to almost one third (32%) of GDP in 2014.

Considering both trade and investment through this broader perspective can also shed new light on Latvia's most important partner countries. For example, while most partner countries supply Latvian consumers mainly through trade, Swedish and Finnish enterprises do so approximately evenly between trade and sales by foreign affiliates. Furthermore, when considering both trade and investment rather than trade alone, Estonia passes Poland, and Sweden leap-frogs Italy, France and the United Kingdom on the list of most important partner countries because of their more extensive investment links with Latvia.

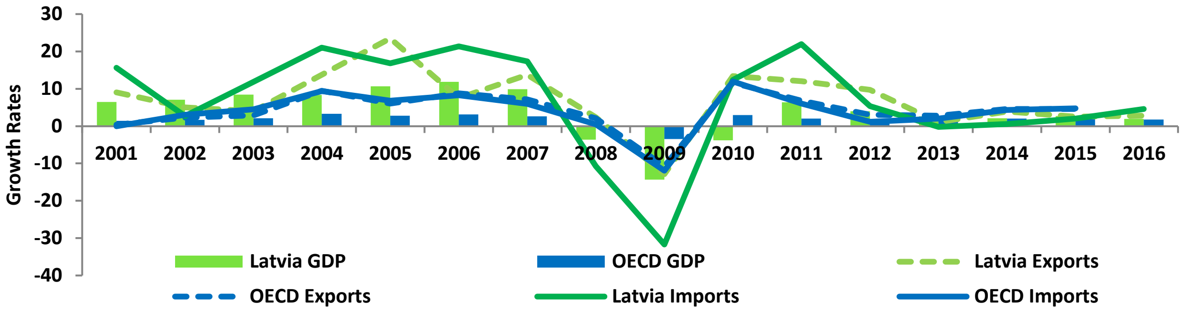
The top manufacturing exporting industries in Latvia are wood products (WOD), food and beverages (FOD) and fabricated metals (FBM). Each of these industries has substantial amounts of value added by foreign-owned firms. The wood and food products industries both have relatively low import content of exports, reflecting the high value added created in Latvia. Latvia has one of the highest services content in its exports at 62%, and this is correlated with a relatively high share of its inward investment going to the services sector.

Trade and investment in Latvia

Growth in trade has been more subdued since the global and euro crises

Like many OECD economies, Latvian trade contracted significantly at the height of the global crisis and again (albeit to a lesser extent) during the euro crisis. Latvian trade growth was above the OECD average in the pre-crisis years, but since 2013 has been just below OECD rates. This possibly reflects in part the effect of sanctions on Russia by the international community. In 2016, export growth was 2.8%.

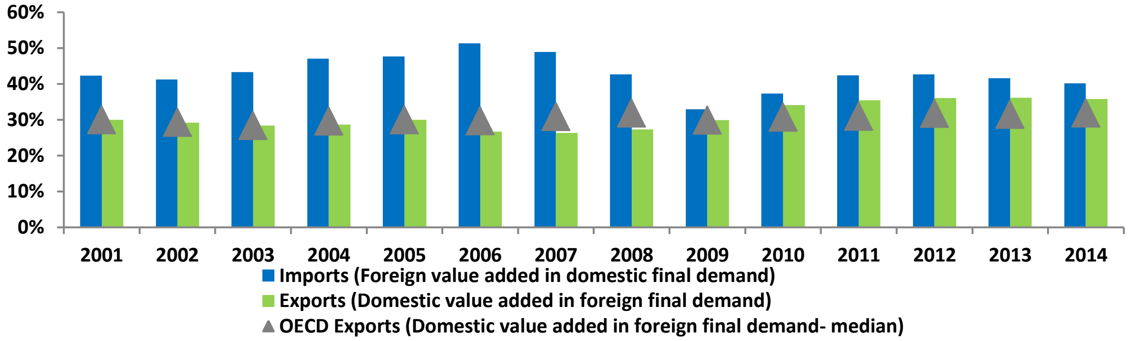
Figure 1. Growth rates of trade and GDP for the OECD and Latvia, 2001-2016



Source: OECD SNA

Gross exports amounted to USD 160 billion in 2016 (66% of GDP), and gross imports to USD 159 billion (65% of GDP). Gross trade figures, however, overstate the 'real' contribution of trade to the economy. In value-added terms, exports contributed 36% of total GDP in 2014, consistent with previous years, and above the OECD median (grey diamond). The contribution of direct and indirect imports to domestic final demand measured 40% of GDP in 2014.

Figure 2. Trade in value added terms, imports and exports, 2001-2014

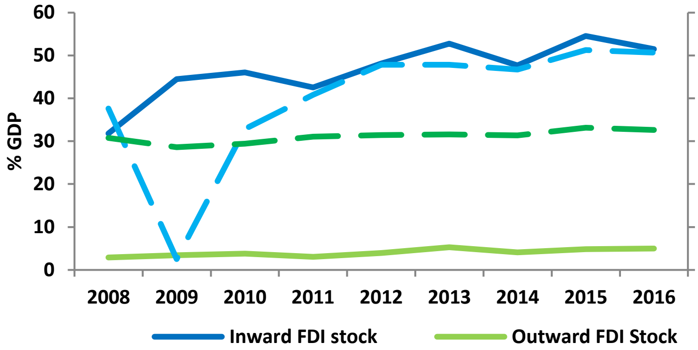


Source: OECD-WTO Trade in Value Added Data

Investment is more inward than outward

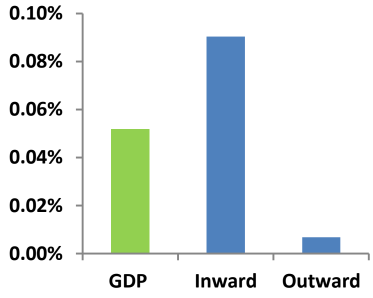
Inward FDI stocks have been growing relative to GDP since 2008, equivalent to 52% of GDP in 2016, and FDI remains inward orientated as over the same period outward FDI has remained broadly equivalent to 5% of GDP (Figure 3). In 2015, Latvia's share of the OECD total inward FDI stock (0.08%) was higher than its share of GDP (0.05%), and its share in outward stock was 0.01% of the OECD total, lower than its share of GDP (Figure 4).

Figure 3. FDI stocks and income as a share of GDP total



Source: OECD FDI Statistics (BMD4)

Figure 4. FDI stocks and GDP as a share of OECD total, 2015



Source: OECD FDI Statistics (BMD4)

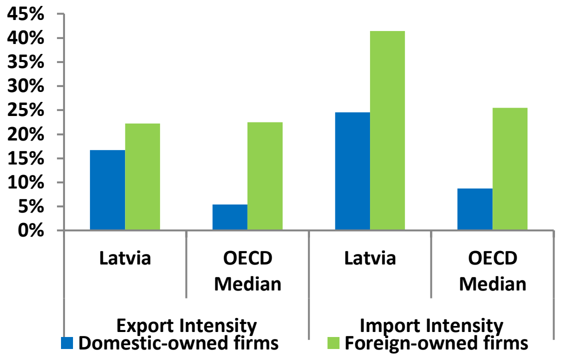
Foreign-owned firms directly sustained 19% of jobs in the private sector in 2013….

Reflecting the substantial inward investment compared to other OECD economies, foreign-owned enterprises accounted for 19% of jobs in the private sector in 2013 and 32% of private sector value added produced in Latvia, excluding the agriculture and finance sectors.

... and are more export intensive than domestically owned firms

On average, foreign-owned firms in Latvia are more export intensive (share of exports in turnover) than domestically owned firms, and their export intensity is at the OECD median. The import intensity of foreign-owned firms (share of imports in purchases) is significantly higher for foreign-owned than domestic firms, and higher thanthe OECD median.

Figure 5. Export and import intensity of domestic and foreign-owned enterprises

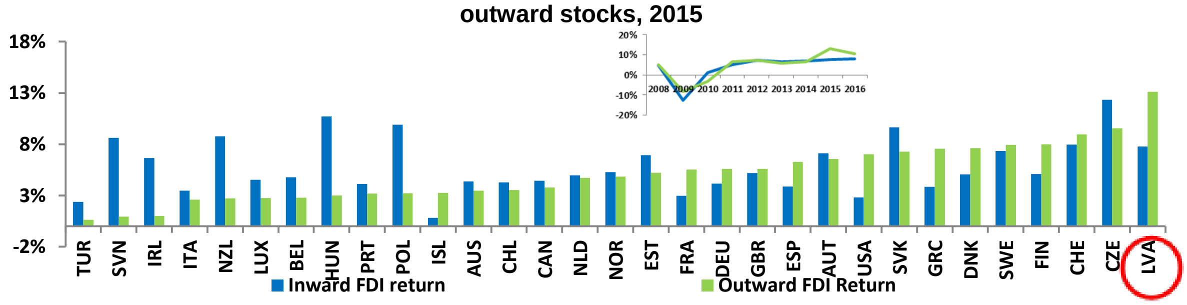


Source: OECD AMNE and Trade by Enterprise Characteristics (TEC) statistics (2011)

Domestic MNEs provide important channels to penetrate foreign markets via affiliates…

In 2015, Latvia received USD 170 million in income from its outward investment, equivalent to less than 1% of GDP. Latvia's rate of return at 13.1% (green bar) on its outward FDI was the highest in the OECD, and the highest rate for the period (see chart insert). On the other side, the return to foreign investors in Latvia was7. 8% in 2015, also at the upper end of OECD countries.

Figure 6. Return on investment, income receipts and payments as a share of inward and outward stocks, 2015

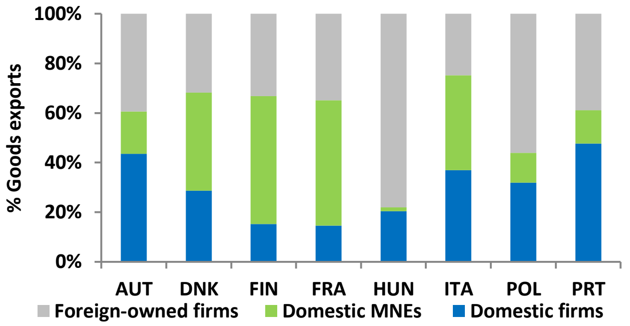


Source: OECD FDI Statistics (BMD4)

…and via exports

Looking at a selection of European economies, MNEs play a significant role in GVC integration. In some countries it is through the activity of MNE parents, while for other it is foreign-owned firms. In each country with available data, at least half of all goods exports are conducted by MNEs.

Figure 7. Goods Exports by firm type, the role of MNEs

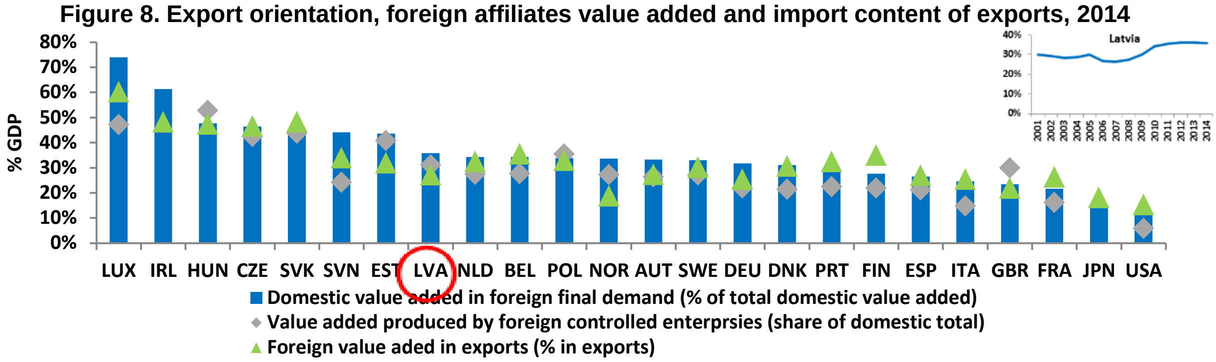


Source: OECD TEC statistics (2011)

Latvia's export orientation is above the OECD median

Exports (in value added terms) contribute around 36% of Latvian GDP, this is relatively high compared to other OECD economies, but comparable with Poland and Sweden. It may in part reflect high levels of inward investment contributing to their GVC integration as measured by the import content of exports. Export orientation has increased since the crisis (see insert chart).

Figure 8. Export orientation, foreign affiliates value added and import content of exports, 2014

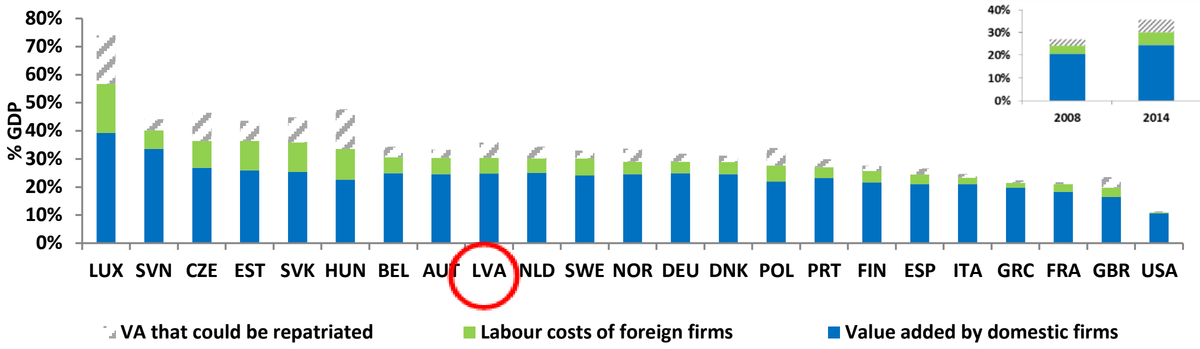


Source: OECD-WTO Trade in Value Added Data and OECD AMNE statistics

Not all of the domestic value added content of exports sticks in the economy…

Gross export figures overstate the real economic impacts of trade to the exporting economy, but TiVA estimates can also overstate these impacts as the profits earned by foreign-owned firms through exports are repatriated if they are not reinvested. Figure 9 illustrates the importance of these flows across countries by showing the value added in exports of domestically-owned firms (blue bar), wages paid by foreign-owned firms (green bar), and profits of foreign-owned firms (grey bar), which in practice can be repatriated. Excluding these profits Latvian exports contain 31% of value-added that remains in the economy. So, 15% of Latvia's exported domestic value added represents profits and a further 15% wages by foreign-owned firms reflecting high levels of inward investment. The share of value added that remains in the economy has increased since 2008 (see insert chart).

Figure 9. Exports by ownership and their contribution to income, as a share of GDP, 2014

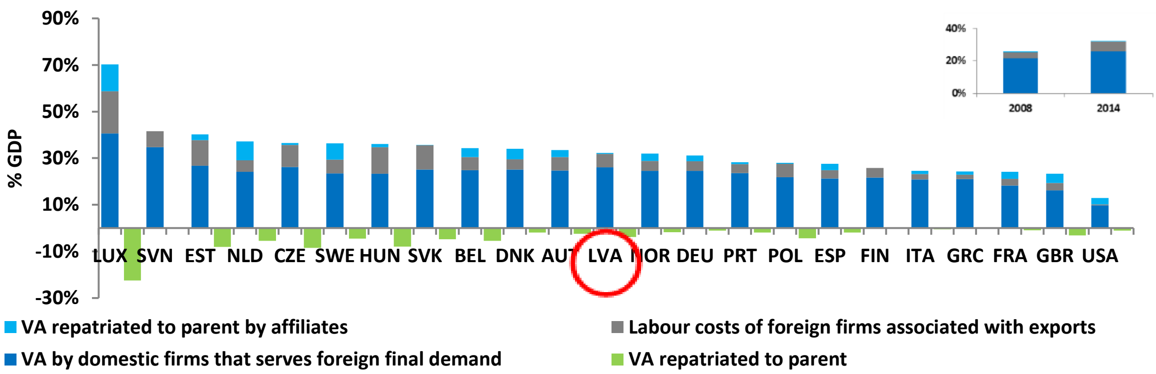


Source: OECD-WTO Trade in Value Added Data and OECD AMNE statistics

Taking a broader view by including the income of foreign affiliates can provide a more complete picture of the international orientation of the Latvian economy

Firms serve foreign markets by exporting or by selling through their foreign affiliates. Figure 10 takes a broader view of an economy's international orientation by taking account of both trade and investment. The chart begins with the domestic value added in exports that remains in the economy – exports of value added by domestic firms (blue bar) and wages paid by foreign-owned firms associated with exporting (grey bar) – and adds to it the profits that domestic MNEs receive from the activities of their foreign affiliates as measured by FDI income receipts (light blue bar). The income payments made to foreign parents are presented for information purposes (green bar). For Latvia this broader measure (32%) is lower than the export orientation measure from TiVA (36%) because Latvia is a net inward investor of FDI. Latvia remains closer to the middle of OECD countries using this measure, and this has increased since 2008, due to increases in both exports of value added and wages paid by foreign firms (see chart insert).

Figure 10. Supplying markets through trade and investment: a broader perspective, 2014

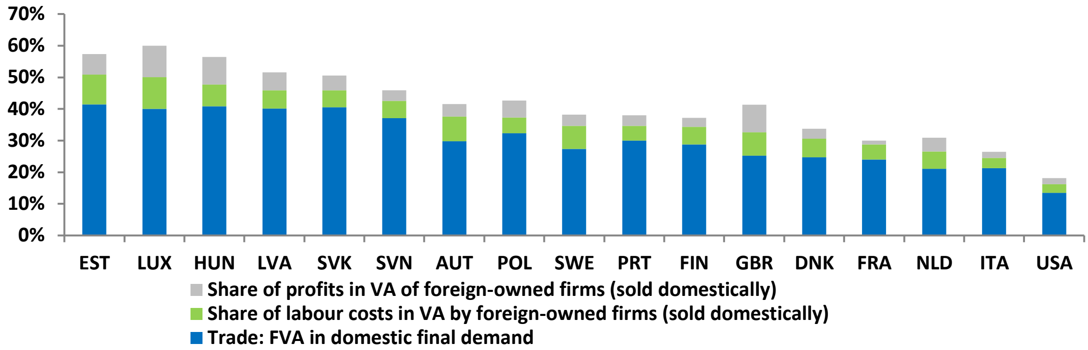


Source: OECD-WTO Trade in Value Added Data, OECD AMNE and OECD FDI (BMD4) statistics

This broader perspective can also shed light on how foreign firms serve the Latvian market

Foreign producers supplied products and services for Latvian final consumption equivalent to 52% of GDP in 2014, the majority is through trade (foreign value added in Latvian final demand equals approximately 40% of GDP), but value added generated by foreign affiliates in Latvia for domestic (non-export) sales (Figure 11) accounts for a substantial 11% of GDP. Although some of this value added can be repatriated to foreign parents (6%) the share is similar to other countries with substantial inward investment (grey bar).

Figure 11. How foreign firms serve your market: a value added perspective, 2014



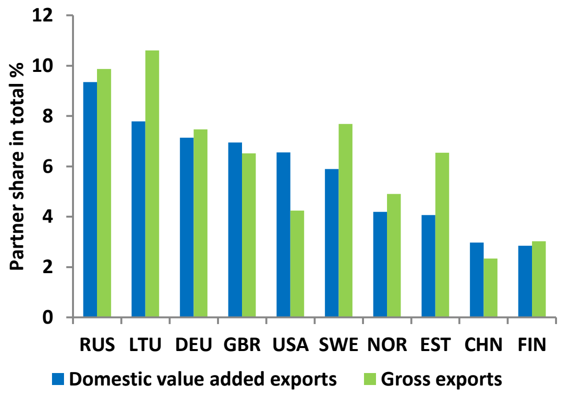
Source: OECD-WTO Trade in Value Added Data, OECD AMNE and OECD TEC statistics

Trade and investment by partner country

Trade measured from a value added perspective better reflects the bilateral relationships

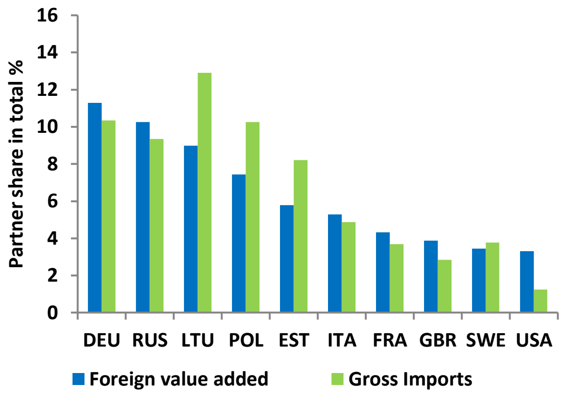
Gross bilateral trade figures can disguise the true nature of trade interdependencies, particularly between final consumers in one country and producers at upstream parts of the value chain. This is evident for the bilateral relationship with the United States, value added figures show it is a more important partner than Sweden, Norway and Estonia. On the import side, value added data shows that Lithuania is the third most important trading partner rather than the most important as suggested by gross data.

Figure 12. Exports: gross and value added terms, by partner country, 2014



Source: OECD-WTO TiVA Data

Figure 13. Imports: gross and value added terms, by partner country, 2014

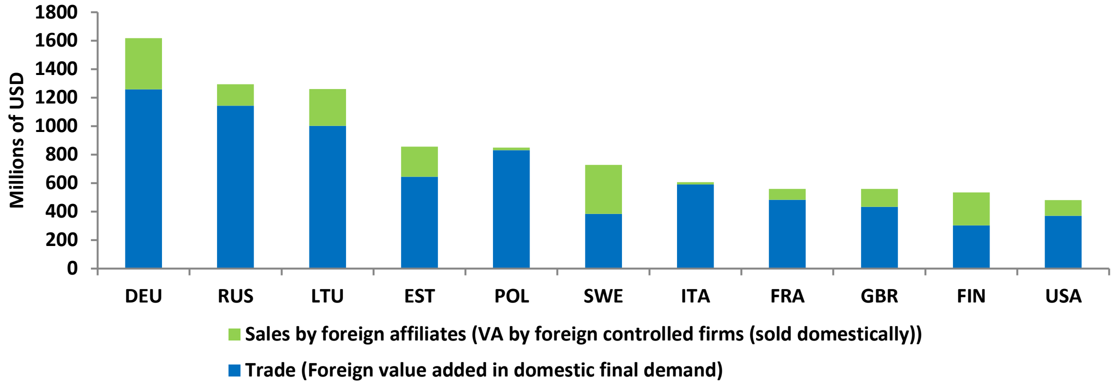


Source: OECD-WTO TiVA Data

…and interdependencies are further revealed when looking at the broader notion of ‘trade’

Foreign firms can serve an economy though trade or sales by foreign affiliates; bringing the trade and investment perspectives together can shed a different light on who a country's most important partners are (Figure 14). Substantial variation exists across countries in how they supply the Latvian market. For example, while most partner countries supply Latvian consumers mainly through trade, Swedish and Finnish enterprises do so approximately evenly between trade and sales by foreign affiliates. Furthermore, considering both trade and investment rather than trade alone, Estonia jumps ahead of Poland, and Sweden leap-frogs Italy, France and the United Kingdom.

Figure 14. Supplying the Latvian market via trade and investment: Top 10 partner countries, 2014



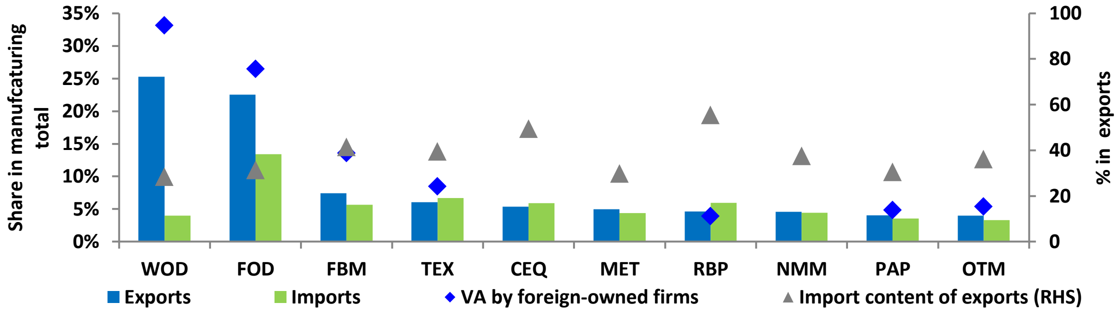
Source: OECD-WTO TiVA Data and OECD AMNE statistics

Trade and investment by industry

Inward investment helps shape Latvia's GVC integration

The top manufacturing exporting industries in Latvia are wood products (WOD), food and beverages (FOD) and fabricated metals (FBM). The import content of exports is relatively high across these industries–illustrating the role that importing plays in supporting exports and indicating the degree of GVC integration in these industries. The role of foreign-owned firms differs across Latvian industry, reflecting the importance of foreign investment for certain industries.

Figure 15. Top exporting manufacturing industries in Latvia, 2014

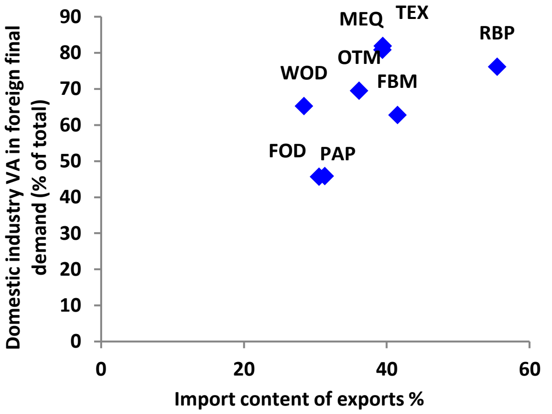


Source: OECD-WTO Trade in Value Added Data and OECD AMNE statistics. See page 10 for a description of industry codes.

Exports and imports go hand in hand…

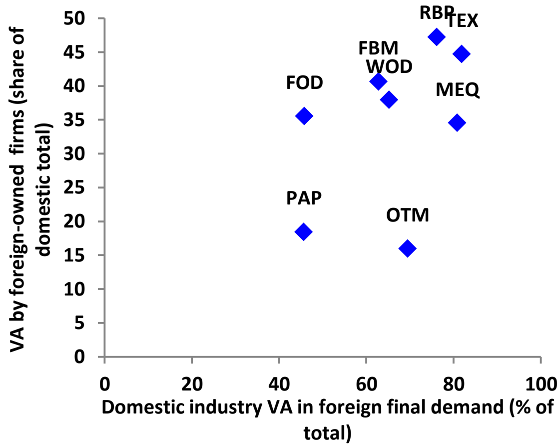
Across most industries there is a strong correlation between higher import content of exports and a higher share of their domestic value-added being exported (export orientation) illustrating the strong complementarity of exports and imports.

Figure 16. Import content of exports and export orientation, 2014



Source: OECD-WTO TiVA Data and OECD AMNE statistics

Figure 17. Foreign-owned firms and export orientation, 2014



Source: OECD-WTO TiVA Data and OECD AMNE statistics

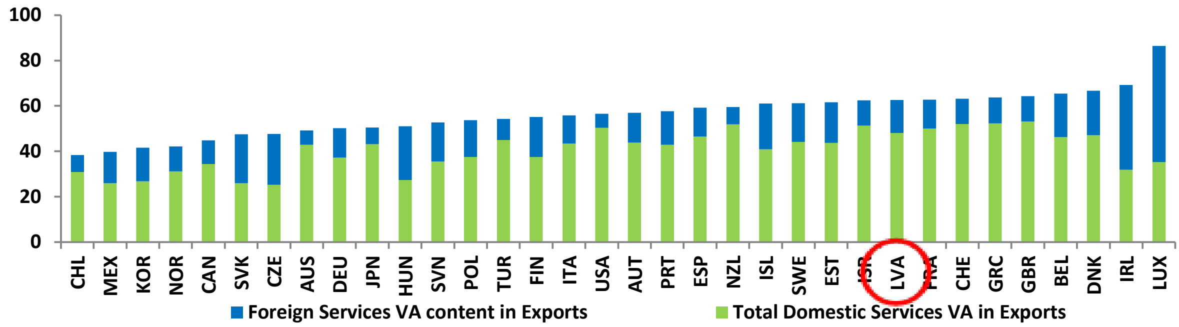
…and investment and export orientation can also go hand in hand

At the same time strong complementarities can exist between inward investment and import content of exports (Figure 17). For Latvia, the industries where foreign-owned firms produce more of the value added are often those that have a higher export orientation. Figure 18, gross trade in goods by enterprise ownership and industry cannot, be produced for Latvia due to data availability.

Service industries play an important role in the export orientation of an economy…

Typically, services account for a large share of the value added in the economy but conventional gross trade statistics understate this as they cannot reveal the contribution that the upstream services industry plays in the production of goods exports. Accounting for this contribution, the services content of Latvia's total exports of goods and services was 62% in 2014 (Figure 19), above the OECD median of 57%.

Figure 19. Services content of gross exports for OECD countries, 2014

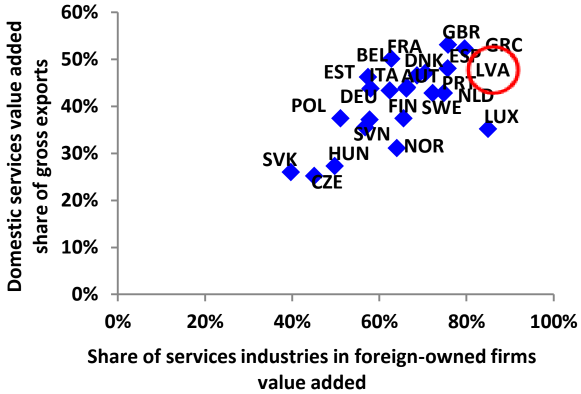


Source: OECD-WTO TiVA Data

…and so inward FDI in the services sector can be an important channel for export success

Greater foreign investment in the services sector is associated with higher services content in exports. For Latvia, the share of investment in services is at the higher end for OECD economies which could contribute to the relatively high services content in exports.

Figure 20. Share of services industries in foreign-owned firms' value added and domestic services value added share of gross exports, OECD countries, 2014



Source: OECD-WTO TiVA Data and OECD AMNE statistics

Links and data sources

Guide to the trade and investment statistical notes
www.oecd.org/investment/Guide-trade-investment-statistical-country-notes.pdf

Activity of Multinational Enterprises - AMNE www.oecd.org/sti/ind/amne.htm

OECD Benchmark Definition of Foreign Direct Investment - 4th Edition (BMD4)
(see Chapter 8 for information on the intersection of AMNE and FDI data)
www.oecd.org/investment/fdibenchmarkdefinition.htm

Foreign Direct Investment (FDI) Statistics www.oecd.org/investment/statistics.htm

Trade by Enterprise Characteristics - TEC
www.oecd.org/std/its/trade-by-enterprise-characteristics.htm

Trade in Value Added - TiVA
www.oecd.org/sti/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm

Annex: Further data requirements

To make this note as informative as those of other OECD countries, more detailed data about Latvian trade and investment are needed. More complete data on trade by enterprise characteristics (TEC) would greatly benefit the analysis, facilitating the production of figures 7 and 18.

Table of industry codes

Industry Type	Ind Code	Industry Description
Primary Industries	**AGR**	Agriculture, hunting, forestry and fishing
	MIN	Mining and quarrying
Manufacturing	**FOD**	Food products, beverages and tobacco
	TEX	Textiles, textile products, leather and footwear
	WOD	Wood and products of wood and cork
	PAP	Pulp, paper, paper products, printing and publishing
	PET	Coke, refined petroleum products and nuclear fuel
	CHM	Chemicals and chemical products
	RBP	Rubber and plastics products
	NMM	Other non-metallic mineral products
	MET	Basic metals
	FBM	Fabricated metal products except machinery and equipment
	MEQ	Machinery and equipment n.e.c
	CEQ	Computer, electronic and optical products
	ELQ	Electrical machinery and apparatus n.e.c
	MTR	Motor vehicles, trailers and semi-trailers
	TRQ	Other transport equipment
	OTM	Manufacturing n.e.c; recycling
Services	**EGW**	Electricity, gas and water supply
	CON	Construction
	WRT	Wholesale and retail trade; repairs
	HTR	Hotels and restaurants
	TRN	Transport and storage
	PTL	Post and telecommunications
	FIN	Finance and insurance
	REA	Real estate activities
	RMQ	Renting of machinery and equipment
	ITS	Computer and related activities
	BZS	Research and development & Other Business Activities
	GOV	Public admin. and defence; compulsory social security
	EDU	Education
	HTH	Health and social work
	OTS	Other community, social and personal services
	PVH	Private households with employed persons