



Weekly Briefing

Lithuania Economy briefing:

**Lithuania voices its support for the international free trade to fuel
economic growth**

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Lithuania voices its support for the international free trade to fuel economic growth

Until recently the traditional approach taken by Lithuania was to closely follow the international economic agendas set by the major economies in the EU and the NATO countries. In directly aligning with the political economic blocks that dominate the global economy Lithuania pegged its future to the anticipation that the growth would favour the more advanced economies and thus trickle down affecting the national economy and driving the exports. This scenario has worked for the last 10 years since the financial global crisis: during this period the economy has recovered thanks to the newly discovered export markets and public and private investments which led to the increased productivity and the modernization of industry and service economy.

However, the economic analysis and forecast reports from the leading banks in Lithuania released towards the end of the third quarter have started indicating that Lithuania is in a position where a further growth can be slowed down or even jeopardized by several factors that need to be taken into account when planning a sustainable growth. Though the GDP growth in 2018 is estimated by the Bank of Lithuania to reach 3,2% (down from 3,9% in 2017), the pressures on the economy has increased. The national bank reported almost 10% increase of labour costs on average in terms of salaries (in some sectors such as IT and services the increase of salaries within the first 9 months was 14,8%), while the labour force has decreased due to the demographic changes (outmigration, aging society, etc.). The additional pressure was the remaining a relatively high unemployment rate which stood at 8,2%.

When comparing the factors which drove the GDP growth in 2017 and 2018, the national bank came to the conclusion that the growth in 2018 was sustained largely by the increase of exports. The share of exports in the structure of the GDP growth has risen from 5,7% in 2017 to 13,7% in 2018. The

realization that the future growth path depends on the increase of the exports has called for the re-evaluation of the overall approach taken toward the international trade and the formulation of the directions for the policies that would address the challenge that lies ahead: how to align Lithuania's economic and political commitments to the major economies and their policies with the growing need to pursue the policies of the free trade globally according to the national economic interests.

Until recently Lithuania's position in relation to the ongoing reshaping of the global economy following the increased protectionists policies introduced by the major international actors and economic blocs was to stay aside of these developments and not to get involved directly.

The reports issues by the banks in Lithuania which play a key role in shaping the national economic agendas point out to the reassessment of the positions in this respect and could set a precedence for a new, more brave and reinvigorating policy in that respect. Two policy directions could be identified and singled out as the important trend setters: first, the support for the international free trade and an unregulated access to the global economy voiced by the domestic economic actors, second, a critical position formulated in relation to the increased efforts of the EU to centralize by coordinating the foreign affairs and the taxation policies.

Though Lithuania has always saw itself as a proponent of the free trade, this position was largely related to the political rather than strictly economic agendas of the country. A free trade was purported by the main geopolitical allies and it was wedded to the idea that a free trade is a pre-condition and a necessary attribute of a free economy which in turn has been seen traditionally as the corner stone of the liberal democracy. The protectionist policies introduced by the major economies have changed this perception if not the beliefs.

Thus, characteristically, an important public opinion influencer, an analyst at one of the largest banks in Lithuania (Swedbankas) Nerijus Mačiulis, whose

opinions and, more importantly, the responses to them often serve as a litmus test for the policies to come, had put it clear that there is a risk that the economic cycle of the past decade will end in a hard landing, with unwise economic policies being one of the biggest negative factors. Further, he argued, that US trade wars with China or the European Union are particularly unfavorable for Lithuania as an open economy. "Lithuania remains the EU's most open economy. That openness is a positive thing, but in the context of trade wars, this is a weakness. It is our interest as Europeans and Lithuanians that trade wars -- either between the US and China or between the US and the EU - should not get into full swing," he was quoted by a news agency.

The economist was put on the record saying that "the US administration's protectionist policies and trade spats with China" are stirring up global tensions, adding that trade liberalization of the past several years has helped to reduce poverty in the world, but that era is drawing to an end. "Unwise, stupid economic policies are probably one of the greatest risks. Trade restrictions will have negative effects on economic growth worldwide".

These statement have been reinforced by the opinion made by another bank (Luminor) which also raised concerns about the existing developments related to the aforementioned trade wars. "Currently still strong exporters will keep following the development of Donald Trump's trade wars with concern. They could breathe a sigh of relief only in case Europe managed to avoid getting caught in the cross-fire", Luminor was quoted.

The news agency ELTA further reiterated such positions reporting that the increasingly uncertain external environment raises concerns about export growth sustainability: "The trade war brought in new variables that are hard to predict and can seriously disrupt the global economic situation and shake the economic confidence foundations which had been so carefully built by the central banks' unprecedented expansionary measures. These trends already have a negative effect on the exporting sector's business expectations in the EU, i.e. the main market for Lithuania".

The comments from the bank analysts still wait for the endorsement from the official policy bodies, yet it is very likely that Lithuania can shed its reluctant position and become a more vociferous advocate of a free trade. Such a position would align Lithuania with the countries such as Singapore which has been seen by many policy makers in Lithuania as a certain model that could be partly followed. The National Bank of Lithuania introduced a regulatory sandbox model in Lithuania for financial technologies (Fintech) modelled on a similar initiative undertaken by the Monetary Authority of Singapore. The central banks of Lithuania and Singapore have signed an agreement on cooperation in the field of financial technologies back in March.

The second policy direction indicating a more vigorous position of Lithuania in addressing the political and the economic forces at work is related to Lithuania's more critical position towards the centralization efforts of the major powers in the EU. Lithuania's Ambassador in Brussels Ms Jovita Neliupšienė who was put on the record saying that Lithuania would not back proposals to give EU bodies new powers to decide on tax and foreign policies. "Integration in the foreign policy should be given a very careful consideration. We haven't yet forged a common understanding over the 60 years of EU existence," the Ambassador said. As in the case of the bank reports this signal was directly linked to the national economic interests: "There are also issues concerning our pragmatic interests, such as taxes (...). We are talking about national economies and the interests of a specific business," the highly influential Ambassador said signalling that a more pragmatic approach in economic diplomacy is coming.

Both signals (the one coming out of the banks and the other one from the diplomats) indicate that Lithuania might be on a shift in changing some of the assumptions on which its international economic agendas have been formulated so far. And this comes by realization that the political agendas might not always go hand in glove with the economic ones, and that the national economic

interests should be taken into consideration, especially when the country has an ambition and the determination to become a Singapore in the Baltics.