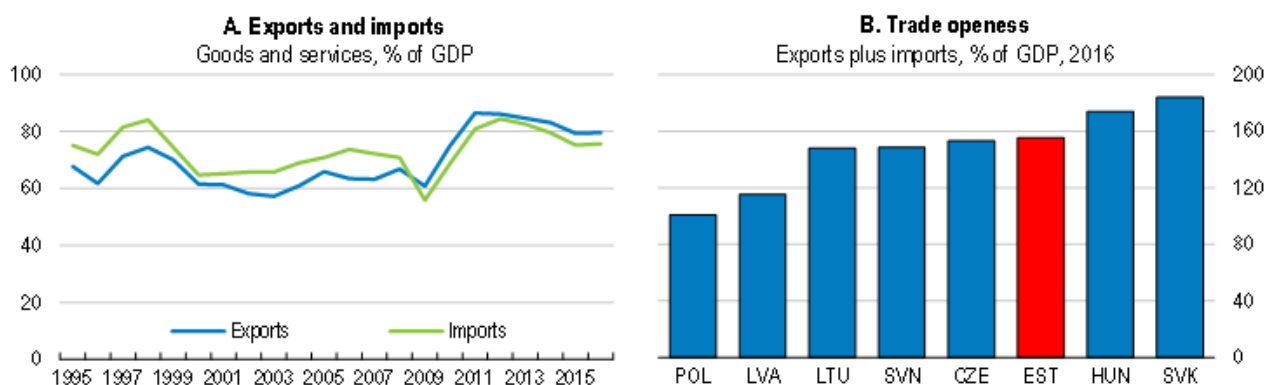


As Estonian exporters lead the way, policy needs to adapt

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International trade plays an important role in the Estonian economy (Figure 1). Around a half of the private sector employment is sustained by foreign demand, twice as much as the OECD average. By another measure, over 40% of the value added created in the economy is linked directly or indirectly to exports, largely in the services sector. Yet, value added per worker produced in Estonia and consumed abroad remains low, even if comparable to its EU peers.

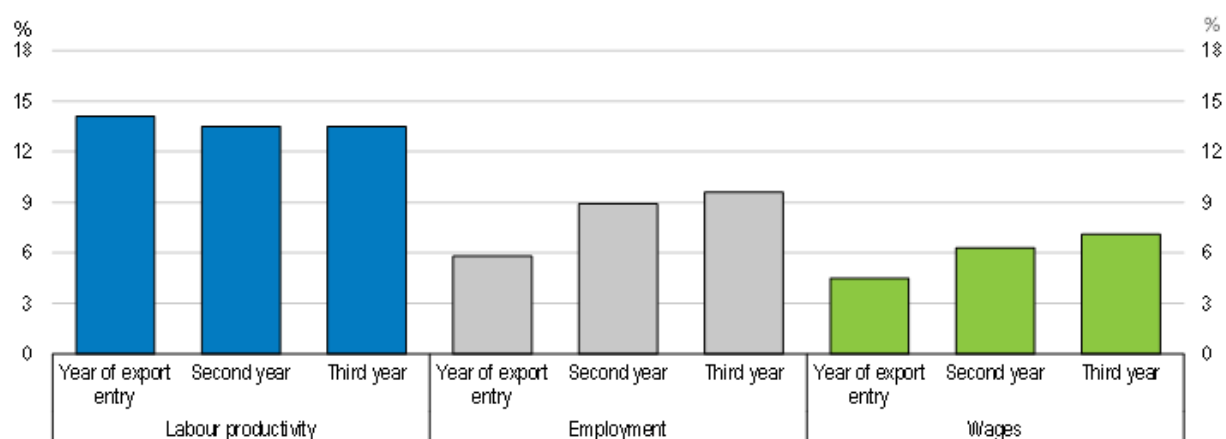
Figure 1. Estonia displays high trade intensity



Source: OECD Economic Outlook 101 Database.

International trade and foreign direct investment can serve as a ladder for climbing up the value added chain as they are major channels of technology diffusion and productivity growth. Exporters display higher productivity and innovation than companies oriented on the domestic market, and this is true in Estonia too, as new research shows (Benkovski et al, 2017, *forthcoming*) (Figure 2). Exporters are faced with tough global competition and have to meet international standards.

Figure 2. **Businesses that start exporting perform better**



Note: This figure describes the transition of average labour productivity, employment and wages of export entrants (the treated) and matched non-exporters (controls) before and after the export entry. The horizontal axis indicates the time after export entry. 0 corresponds to the year of entry.
 Source: Benkovskis et al (2017), Export and productivity in global value chains: evidence from Latvian and Estonian firms, *OECD Economics department working paper*, forthcoming.

To increase export potential and value-added drawn from trade, innovative capacity and transfer of knowledge from highly productive firms to the rest of the economy need to improve. For the moment, innovation of the typical Estonian firms is limited as spending on business R&D is low. In this vein, nurturing cooperation between the researchers and business is crucial, as highlighted in the new *Economic Survey of Estonia* (OECD, 2017). The new industrial policy green paper, initiated by the business community and focused on digitalisation of traditional industries is welcome. It has the potential to improve the productivity and innovation capacities of these sectors. Furthermore, policy efforts should concentrate on strengthening adult education and allowing for immigration of talents, since shortage of skilled labour is starting to show as a major obstacle for further business growth and investment. This can also help with improving the innovative capacities.

By giving access to a wider variety of goods and services at cheaper prices, international trade raises well-being and consumers' purchasing power. It also means fast transmission of global shocks, requiring a robust social safety net and adjustment policies. To ensure that all benefit from opportunities created by globalisation, the Estonian

policymakers should focus on two policy areas. Firstly, those who can work need to have the right skills and incentives to participate in the labour market. Secondly, those who are out of the labour market should be supported by an effective and adequate social safety net, conducive to upskilling and maintaining work incentives. This means for instance increasing the level of subsistence of benefits and relaxing eligibility conditions for unemployment benefits, not least to improve participation in active labour market measures.

References:

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