Business Is Hot in the Baltics

By Steven Butler

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Rokas Grajauskas gets paid to watch the economies of the Baltic states of Estonia, Latvia and his home country, Lithuania. And he takes his job as an analyst for the Copenhagen-based Danske Bank quite literally. Outside his steel-and-glass office tower in downtown Vilnius, he watches a thicket of cranes over new construction sites and a wide highway jammed with traffic. "It's very nice for me to look out the window and see how the economy is running," he only half jokes, as he otherwise crunches numbers in an effort to crystal-ball the future.

What do the numbers show him? That the Baltic states — those formerly poor nations that hug the eastern Baltic Sea and were part of the Soviet empire — are thriving, showing the highest growth potential in the European Union. One of the latest signs that the boom in these countries can continue comes from the global companies — such as AIG, Barclays, NASDAQ and Western Union — that are setting up service centers here, even relocating from India. They're hiring young professionals, mainly those under 30 and who tend to speak English, says Grajauskas.

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No wonder the Baltic states are the envy of the region. Reima Rytsola, who manages investments at the Finnish pension fund Varma, recognizes it when he visits these neighboring nations. "They are so dynamic," he says, especially compared to older European countries that are encumbered by all sorts of rules and practices that get in the way.

And yet, getting to that point of dynamism has been painful. The three countries, small and open, soared in an investment boom in the years before the financial crisis, sometimes achieving China-like growth rates of more than 10 percent, with wages also rising. As it turned out, stagnation under Soviet rule left a hidden benefit: gorgeous ancient cities ripe for restoration and redevelopment. Visitors to Estonia's capital of Tallinn a decade ago enjoyed a restored medieval town — a U.N. heritage site — thriving with tourists visiting small shops and beer halls, surrounded by a modern city and a construction surge. Riga and Vilnius boast similar historic sites.

But the financial crisis swiftly brought these countries to their knees, with each economy shrinking by nearly 15 percent in 2009. They faced a hard choice: to restore competitiveness by letting their currencies sink in value, which would make exports cheaper but also stoke inflation. Or, to impose austerity — what economists call internal devaluation. And that's what they did, in a short, sharp shock, firing government employees, slashing wages and pensions, and letting the private sector follow suit.

In doing so, they became the poster child for austerity, and there are certainly lessons to be learned for the rest of the continent, amid the economic devastation of southern European countries and overall anemic growth elsewhere. "You do the tough steps early — it's painful — and then you get growth," says Douglas Bandow, a senior fellow at the Cato Institute, a D.C. think tank. By 2011 and 2012, the Baltic states were by far the fastest-growing economies in Europe, while Greece, Spain, Portugal and Italy watched their economies continue to shrink. The austerity reflected an overriding will to hold their currencies steady against the euro, which all three countries have now adopted.

It wasn't just about economics, though. "It's as much about independence from Russia as the economic prospects," says Thaddeus Best, a senior Europe analyst at BMI Research, a financial analysis firm in London. That made tough-love economics politically easier to swallow. The Baltic states just did what the European Union and the International Monetary Fund told them to do — unlike Greece, which is fighting tooth and nail to stay afloat. And by fully joining the EU, they've likely reduced the chances that they'll be sucked back into Russia's orbit, like Ukraine in the south. They've also turned into model NATO members, upping military spending and military cooperation.

Even so, these countries are now hitting headwinds, unable to escape their geography. Lithuania's exports to Russia, for example, are dominated by agriculture and were off by 35 percent in January and February, says Grajauskas, as the Russian economy contracted under falling oil prices and sanctions. Estonia's major trade partner to the north, Finland, has suffered a recession for three years. And collectively, the Baltic buddies are coping with aging populations.

Still, their long-term future looks bright. They're expected to grow in the 2 to 3 percent range this year, which is still above average for the EU, and financial experts see growth accelerating in the next few years as economic headwinds diminish. Grajauskas plans to stick around in Vilnius to continue enjoying what he says is a great modern city, with wonderful restaurants costing less than half of what you'd pay elsewhere in Europe. "It's one of the reasons foreigners come here," he says. "Good quality for a good price."