Problematic Issues of Competitiveness in Latvia

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The article deals with problematic issues of competitiveness in Latvia in the context of Latvia having joined the European Union and other international organisations (WTO, OECD and others). Along with the positive aspects Latvia is facing more severe conditions of competition in all spheres after joining these organisations, as during the recent years competition has been intensifying both in Europe and throughout the world. The results of investigations into competitiveness of countries are used for considering the prospects of economic development of the countries and for their comparison. To a certain extent strategic conditions of a country within the system of international division of labour are determined by the level of its macro economic competitiveness. To estimate the level of competitiveness of Latvia the model of the Organisation for Economic Co-operation and Development (OECD) was applied. According to the results of these calculations macro economic competitiveness in Latvia is sufficiently high. However, according to the data of a number of competent international organisations it has been found that concerning a number of indices Latvia lags behind not only the advanced European countries, but also behind its neighbouring countries – Lithuania and Estonia. As a result its real competitiveness is much lower than that of Lithuania and much worse than of Estonia. Latvia should do much especially in the field of public development of the country, which will promote its competitiveness.

Keywords: macro economic competitiveness, technotronic labour force, public services, civil society.

Introduction

Beginning with the year 1996 the gross domestic product (GDP) of Latvia has been steadily growing. So for example, for the period of three years (2000-2002) GDP increase has been the fastest in Europe and amounted to 21%. It is estimated that having joined the European Union (EU) Latvia will reach the average standard of the economic development of the present EU member-states in 20 years, provided the present rapid rate of the development of economics is maintained (average 6% per year). As to the neighbouring countries (Lithuania and Estonia) the rate of the growth of GDP has been somewhat lower in the recent years. For reference, according to the data of the second quarter of 2004 the following rate of growth was fixed in developed countries: the USA – 2.5%, in the EU countries 3.6% on the average; in Germany – 1.9%, in Hungary – 4%; in Estonia – 5.9%, in Lithuania – 7.3% and in Latvia – 7.7%.

At present the process of Latvia as a country of transition economy getting integrated into the world economic system is going on. This process is determined by Latvia meeting certain requirements of being a member in a number of international organisations, such as IMF, EU, WTO and others. Fulfilling entrance requirements to these international organisations is one of the criteria for the readiness of Latvia for international integration. For example, Latvia has already joined the EU; therefore Latvia has to satisfy all Copenhagen criteria to be a member of this Union. During the recent years one of the tendencies has been the growing competitiveness both in Europe and throughout the world. After joining the EU a lot of problems of European economy have turned into problems for Latvia too, a considerable increase of competitiveness has occurred. A number of specialists consider that the term “competitiveness” is not applicable when talking about countries, as they do not compete among themselves like huge companies and corporations. Therefore the results of competitiveness study among countries are usually used for evaluating the prospects of economic growth of countries and for their correlation.

The object of the research is competitiveness of Latvia, which is compared with the competitiveness of its neighbours – Lithuania, Estonia and other countries.

The novelty of the research paper lies in the fact that for the first time the competitiveness model Organisation for Economic Co-operation and Development was used for the analysis of macro economic competitiveness of Latvia – a new member of the European Union.

The aims of the study were to establish the level of macro economic competitiveness of Latvia in comparison with other countries and make conclusions.

Calculations and Analysis

The strategic position of any country within the international arena is determined, first of all, by its macro economic competitiveness in the international system of labour division. In this connection calculations and analysis of a country’s macro economic competitiveness is of considerable interest, the aspect is dealt with in the present paper concerning Latvia. The methodology of OECD (Organisation for Economic Co-operation and Development) was used for calculations of the competi-
tiveness level (Gubanov, 2002):
\[
C = 0.5 \left[-(I - 15) + (I - 15)(U - 15) - (U - 15)S + SY\right],
\]
where 
- $C$ = level of competitiveness, units;
- $I$ = index of consumer prices;
- $V$ = GDP index;
- $U$ = unemployment rate in the country;
- $S$ = relation of the sum of current balance of payments and currency reserves in the country and the volume of the latter.

In the formula the “minus” sign is used in case when the rate of inflation growth or decrease of GDP exceeds 15% per year. The results of the calculations of the competitiveness of Latvia based on the data of the Central Statistical Bureau of Latvia as well as for comparison of the competitiveness levels of some other countries (Gubanov, 2002) are given below in Table 1.

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>GDP, %</th>
<th>Inflation, %</th>
<th>Unemployment, %</th>
<th>Saldo payment balance, % GDP</th>
<th>Competitiveness C, units</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>2001</td>
<td>7.8</td>
<td>1.0</td>
<td>5.0</td>
<td>0.3</td>
<td>127.3</td>
</tr>
<tr>
<td>Japan</td>
<td>1994</td>
<td>1.1</td>
<td>0.7</td>
<td>2.7</td>
<td>2.7</td>
<td>111.3</td>
</tr>
<tr>
<td></td>
<td>2001</td>
<td>-3.2</td>
<td>-0.8</td>
<td>5.0</td>
<td>2.1</td>
<td>60.9</td>
</tr>
<tr>
<td>Latvia</td>
<td>1994</td>
<td>2.2</td>
<td>35.9</td>
<td>6.5</td>
<td>5.5</td>
<td>104.8</td>
</tr>
<tr>
<td></td>
<td>2001</td>
<td>7.7</td>
<td>3.0</td>
<td>7.8</td>
<td>-9.7</td>
<td>92.4</td>
</tr>
<tr>
<td>USA</td>
<td>1994</td>
<td>4.4</td>
<td>2.7</td>
<td>6.5</td>
<td>-2.0</td>
<td>71.3</td>
</tr>
<tr>
<td></td>
<td>2001</td>
<td>0.2</td>
<td>2.7</td>
<td>4.9</td>
<td>-4.1</td>
<td>42.2</td>
</tr>
<tr>
<td>Russia</td>
<td>1994</td>
<td>-16.0</td>
<td>350.0</td>
<td>12.0</td>
<td>3.5</td>
<td>-2161.1</td>
</tr>
<tr>
<td></td>
<td>2001</td>
<td>4.9</td>
<td>20.9</td>
<td>12.0</td>
<td>11.3</td>
<td>-48.0</td>
</tr>
</tbody>
</table>

The level of macro economic competitiveness exceeding 120 units is considered to be high. The data given in Table 1 serve as a proof that in 1994 macro economic competitiveness of Latvia was approaching the competitiveness level of Japan, but in 2001 remained higher than that of some developed countries (the USA, Japan) despite the fact that it had decreased.

In 1994, regardless of high inflation, the growth of GDP and saldo balance of payments in Latvia was positive. This was the last year when the balance of the current year had a “plus” sign. In succeeding years it had a “minus” sign. However, the reserves of golden currency of the country were built up. Therefore the parameter S in the formula remained positive. In the year 2001 parameter S decreased more than three times in comparison with 1994, as the negative balance of the current account constituted more than international reserves (about 0.6) of the country. Only due to the growth of the international reserves more than two times in the period between 1994 and 2001 parameter S remained positive. In 2001 Latvia had the highest negative balance of payments among the countries mentioned above. The total sum of the state debt kept growing. According to the data of the Central Statistical Bureau of Latvia the total sum of the state debts of Latvia reached almost 1.430 million dollars by mid 2003 (56% being foreign debts), this constituted more than 30% of GDP for the first half of this year. In comparison with the end of 2002 the state debt increased by 9.6% only during the period of half a year. A natural question arises: is Latvia on one and the same list regarding its competitiveness with such developed countries as the USA and Japan?

In 2001 GDP increase in Latvia was higher than in many other countries and practically reached the level of China where the growth was 7.8%. However, for a fairly long time already western experts in economic growth have been oriented not so much towards the quantitative growth, but towards qualitative priorities and evaluate a number of indices taken as a whole. During the last ten years economy of Latvia has switched over from producing goods to giving services: from the total volume of GDP service industry comprises about 70%, but manufacturing industry and building only about 20%. It is generally acknowledged that the basic and most important is competitiveness of goods and their production, but services cannot serve as basis for competitiveness in principle. This is the reason why the social-economic condition of the country is unsatisfactory taken as whole, the unemployment keeps growing. According to the data of European Statistical Bureau Eurostat in 2003 unemployment rate in Latvia was one of the highest in Europe – 12.3%.

According to Human Development Index (HDI) presented in “Account of National Development – 2003” of the UNO Development Programme Latvia occupied the 50th place, lower than other new member states of the European Union. When determining the HDI index life-span, people’s education and the level of income per capita are taken into consideration. The average gross wage and the average level of pensions in Latvia were the lowest among the new member states of the EU in 2004, and the country is experiencing a severe demographic crisis (Kočetkov, 2002). For example, in 2002 the average gross wage in Latvia constituted about 280 dollars, but the average pension about 100 dollars. In the Czech Republic these indices were 475 and 225 dollars respectively, but in Poland even higher – 560 and 235 dollars. Therefore evaluated according to HDI Poland takes the 35th, but the Czech Republic – the 32nd place. Since 1991 the natural population growth in Latvia has been unfavourable. In the year 2001 it constituted (-) 5.7 persons per 1000 inhabitants, which is one of the highest negative indices in the
The rate of increasing the turnover of foreign trade is quite rapid. However, there exists an acute problem of the deficit of trade balance. In the first half of the year 2003 import of goods exceeded export by 78.5%. This fact vividly shows orientation of the national economy of Latvia towards rendering services basically to foreign capital: export of raw materials, transit services, clearance sale of national wealth and industries. In its turn foreign capital in Latvia, like in many other newly developing countries, pursues the aims of secondary justification of expenses through bringing in morally and physically outdated equipment capacities, which are out of use in the developed European countries, as they do not fully satisfy the requirements of the present day concerning environmental and labour protection. Foreign capital is mainly attracted by sufficiently qualified but poorly paid labour force in Latvia. The main item of Latvian export is timber and to a lesser extent finished products (more than 35% of the whole export according to Central Statistical Bureau). The main articles of import are machinery and equipment. In terms of competitiveness of economics with the purpose of reaching higher indices accelerated growth of industrial production on technotronic level (completely computerised), highly technological production distinctive in high value added are needed. This is the only way to change the structure of GDP in the direction of decreasing the share of services and increasing the output of goods. However, there practically do not exist or are only in minor amounts technotronic labour forces. In 2002, according to the calculations of Eurostat, 7.4% of working force were engaged in the field of higher technologies on average, but in Latvia the index was only 1.9%, thus occupying the third place from the end in Europe. In Lithuania this index is 2.6%, in Estonia – 3.4%. For comparison – in Germany 11.4%. Therefore, it comes as no surprise that labour productivity is two times smaller than in the “old” developed EU countries.

The above said taken into consideration as well as the fact that in the recent 10-12 years almost all big industrial enterprises functioning in the Soviet times were closed down we can say that the country is in the condition of deindustrialisation. This condition determines social-economic crisis in the country as a whole as well increasing of unemployment. If in advanced Western countries the number of the unemployed grows due to modernisation of the production process, due to introduction of more sophisticated equipment of technotronic level, then in Latvia unemployment keeps growing because the factories and plants are closed down. Therefore Latvia, despite its sufficiently high index of macro economic competitiveness, cannot be regarded as a developed country of higher development of capitalism, as it is economically, technologically and in many other ways fully dependent on the latter (their investments, transit of goods etc). Thus Latvia, like most of the newly developing countries, can be classified as a country of lower capitalism providing industrial production and raw materials, but not as an industrial-technological country. Countries of lower level of capitalism depend on developed countries of highly developed capitalism practically in all aspects and are exploited by them.

The rate of GDP growth in Latvia is high only in reference to the GDP growth in the countries of the European Union. However, to call it a rehabilitative rate, with the fall of GDP in 1994 in comparison with 1990 more than two times, is impossible. Recovery of economics after a shock of some kind develops at a more rapid rate. For example, the recovery rate of the USSR economics after World War II reached up to 25% per year. The insufficiently high rate of recovery of the economics of Latvia can be explained by the fact that it is mainly maintained by the growth in service industry, but not by manufacturing more goods and all the more not on the basis of technotronic technologies. There is practically no development of industry on the basis of technotronic working force. On the contrary, there are examples of foreign investments of obsolete ecologically unsafe equipment being imported, which do not meet the requirements of labour protection today. Besides, as to the volume of the attracted foreign investments Latvia lags behind not only its neighbours (Estonia and Lithuania), but practically behind all new member countries of the EU. For example, by the end of 2002 foreign investments in Latvia constituted only 4.6% of its GDP, but in the Czech Republic this index reached almost 51%. As its main reasons experts name economic risks, first of all deficit of payments and unpaid credits.

Thus we can say that Latvia experiences quantitative growth of economy basically on account of the growth of volume of services and that there is no qualitative growth based on neoindustrialisation and advanced technologies. Here lies the basic contradiction determining the high rated level of the competitiveness of Latvia according to the OECD methodology and the low real level of the development of the country. Only manufacture of scientifically based production of high quality with great value added can ensure real economic prosperity, strengthen its competitiveness in the world market and improve the living standards of the population. In developed Western countries economic growth basically occurs on account of this. Therefore in the last account of Global Competitiveness Report for the period 2004-2005 experts of the World Economic Forum placed Latvia in the 44th place, far from the leaders. When evaluating the competitiveness attention was focused on the condition of macroeconomics, technological infrastructure and the quality of work of the governmental structures. It should be mentioned that Lithuania occupies the 36th position in this rating, but among the East European countries the best achievement is in Estonia – 20th position (3, 2005). Thus Estonia possesses the highest level of competitiveness among the countries of Eastern Europe.

The index of competitiveness is calculated on the basis of the analysis of more than 100 factors: macro economic data, quality of governmental institutions, efficiency of the bank system, the developmental level of technologies, bases of taxation and legislation, conditions in labour market and others. All these factors are considered to be the driving force of economic growth in medium length and long-term perspective. The main advantages in competitiveness of a present-day developed country are closely linked with human a personality and with everything that determines human activity. Stable political democracy, education, care of public health, housing services, fields of infrastructure
should be mentioned among them. Developed countries set
development of human potential as their priority. At the cur-
current moment priorities are not separate branches of national
economy but institutions connected with the personality de-
velopment and influencing the condition of economics
through a human being. Economic development of any
country is determined by the condition of its political, judi-
cicial institutions, development of civil society.

Unfortunately, in the sphere of development of civil
society Latvia lags behind practically in all indices both as
compared to the old and new member states of the EU. In
1995 the so-called Wealth of Nations Triangle Index was
proposed with the purpose of determining the condition of
developing countries concerning generally accepted norms
and standards of human development. According to this
index in 2004 Estonia occupied the 6th place, Lithuania –
the 9th and Latvia – the 10th (4, 2005). The developed
Western countries are not evaluated in this rating. To calcu-
late this index development of economy, social environment
and infrastructure of information were taken into account.
The Index of Economic Freedom is highly important for
evaluation of economy. Economic freedom means abolish-
ing restrictions on production, distribution and consumption
of goods and services imposed by the government. Evalua-
tion is based on 50 indices, data concerning taxes, tariffs,
regulation of banking, hidden trade, monetary-credit policy
and other factors. In this field Estonia takes the 4th position,
Latvia – 23rd, but Latvia only the 28th (5, 2005).

The existing Corruption Perceptions Index places the
countries according to the degree of prevalence of corrupt-
ion among government officials and politicians. It pre-
sents the opinion of experts and businessmen from different
countries of the world concerning the given country;
surveys and studies are conducted by 12 independent or-
ganisations. According to the corruption index Estonia was
placed in the 31st position, Lithuania in the 44th and Lat-
via in the 57th (6, 2005).

Surveys dealing with evaluation of corruption are car-
ried out not only among businessmen and experts but also
among ordinary citizens of countries. So for example, in
Oktober 2005 the results of corruption studies in 159
countries were published, they were carried out by the in-
dependent international organisation Transparency Interna-
tional basing on inquiries among ordinary members of
population. Among the EU countries Latvia takes the last
but one place from the end – the 54th place in the world
rating; Lithuania takes the 44th position, the best among the
Baltic countries is Estonia taking the 27th place. No doubt,
such a negative situation exerts a disturbing impact on the
development of business.

The unfavourable business climate in Latvia is men-
tioned as one of the main reasons of the country lagging
behind in its development as compared with its neighbouring
countries – Lithuania and Estonia (7, 2005). A simple ex-
ample can be given. In order to get the property registered in
Latvia, according World Bank, one needs 54 days, but in
Latvia only 3 days. Registration expenses in Latvia amount to 2.1% of the value of the property, in Lithuania –
0.8%, but in Estonia even lower – 0.5%. It is natural that
foreign investors draw their own conclusions as to where the
best place for their investments is. According to a number of
Latvian experts and leading businessmen the government of
Latvia is more involved in politics than in taking care of
economic development and of business sphere. As a result,
all this exerts a negative impact on human development in
Latvia, leads to its lagging behind its neighbours.

According to Eurostat Latvia takes the last place in the
EU concerning its GDP per inhabitant. This index is only
43% from the average value in the EU – 25 in 2004. In
Latvia this index was 48%, but in Estonia – 51%. Some
recent statistical indices according to Eurostat and CSB of
Latvia are given in Table 2.

### Recent statistical indices

<table>
<thead>
<tr>
<th>Index</th>
<th>Latvia</th>
<th>Lithuania</th>
<th>Estonia</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gross Domestic Product (GDP)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1st quarter of 2005, millions of EUR</td>
<td>2622</td>
<td>4254</td>
<td>2321</td>
</tr>
<tr>
<td>per one inhabitant, in 2004 EUR</td>
<td>4742</td>
<td>5218</td>
<td>6703</td>
</tr>
<tr>
<td><strong>Salary per month, EUR</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1st quarter of 2005, gross</td>
<td>322</td>
<td>368</td>
<td>475</td>
</tr>
<tr>
<td>minimal</td>
<td>114</td>
<td>159</td>
<td>172</td>
</tr>
<tr>
<td>old age pension, average</td>
<td>114</td>
<td>114</td>
<td>157</td>
</tr>
<tr>
<td>On social needs and pensions in % from GDP</td>
<td>14.3</td>
<td>15.2</td>
<td>14.3</td>
</tr>
<tr>
<td><strong>Foreign trade</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>export (FOB):</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>total</td>
<td>1908</td>
<td>4186</td>
<td>2850</td>
</tr>
<tr>
<td>in EU countries – 25</td>
<td>1470</td>
<td>2862</td>
<td>2253</td>
</tr>
<tr>
<td>import (CIF)</td>
<td>5435</td>
<td>3697</td>
<td>2801</td>
</tr>
<tr>
<td>total</td>
<td>3042</td>
<td>5435</td>
<td>3697</td>
</tr>
<tr>
<td>from EU countries – 25</td>
<td>2220</td>
<td>3156</td>
<td>2801</td>
</tr>
<tr>
<td><strong>Foreign investments</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Saved provisions, total at the end of the</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1st quarter of 2005 in million EUR</td>
<td>3484</td>
<td>5078</td>
<td>9023</td>
</tr>
<tr>
<td>per one inhabitant, in EUR</td>
<td>1511</td>
<td>1209</td>
<td>6698</td>
</tr>
<tr>
<td>investments made in 2004</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>in billion EUR</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The data included in Table 2 point to the fact that according to a number of significant indices Latvia lags behind its neighbours – Lithuania and Estonia. This backwardness should be considered essential since 15 years ago all three countries started their independent development within the new market economy practically in equal conditions. However Lithuania and Estonia have been more successful in making use of the opportunities given to them for free development, because they focused more attention on the development of economics.

In the UNDP Human Development Report ratings of the countries are calculated according to 30 points: average length of life, literacy, women’s role in society etc. Experts and scholars from different countries of the world participate in compiling the report to order of the UNO programme of development. Estonia takes the highest position among the Baltic countries – 36th, Lithuania is in the 41st position and Latvia in the 50th (8, 2005). Thus Estonia has reached the highest index of competitiveness and the level of public development. Lithuania – is in the second place, but Latvia in the last position. Taking the above in account Latvia is losing in the battle of competitiveness for foreign investments to its neighbours – Lithuania and Estonia.

According to Eurostat in September 2005 the average level of annual inflation in the 25 countries of the EU was 2.5%. At the same time the corresponding index for Latvia was almost 3 times higher (7.4%). According to the projection in the spring of 2006, when inspection of fulfillment of Maastricht criteria will be carried out in the countries that are planning introduction of Euro currency, the level of annual inflation must not exceed 2.6-2.8%. From among the three Baltic countries only Lithuania has real chances of introducing Euro in 2007. In Estonia and Latvia the estimated inflation for the year 2006 is 3.9% and 6.4% correspondingly. Therefore Euro might be introduced in these countries not earlier than in 2008 and 2009. The inflation index of Lithuania about 2.3% is one of the lowest in the EU. Lithuania also meets other economic criteria for joining the Euro zone.

According to competent government officials, Prime Minister and Chairman of the Bank of Lithuania, the country is ready for introduction of Euro. Introduction of Euro will increase attractiveness of Lithuania for investments, for alignment of trade connections, and will diminish economic risks. Accelerated growth of the living standard of the population and gross domestic product will occur. About 10 million Lits economy will be reached based on the currency change. Thus Lithuania will become a full-fledged member of the economic and monetary union of Europe in a period of less than two years; this will relevantly increase its compatibility in European and world markets.

Thus the priority of economic policy for the nearest future in Latvia should be measures promoting competitiveness of Latvia:

- creating conditions for increasing people’s competitiveness, improvement of educational systems, of health and social care, reducing poverty, perfection of pension system;
- perfection and development of institutions of civil society;
- modernisation of economics on the basis of technnotronic labour forces, strengthening the role of scientific research, stimulating innovative development;
- integration of economy into international commercial activities.

In order to carry out the above-mentioned enterprises the government should undertake the leading and organisational role.

**Conclusion**

Despite the relatively high rate of economic growth Latvia can be classified among the industrial countries of lower level of capitalism as the country experiences growth without development. It finds itself in the stage of deindustrialisation with a very low level of development of technnotronic labour forces. Competitiveness of Latvia, based mainly in service industry, does not provide high rating in comparison with industrial-technological countries of higher capitalism. As to its competitiveness and the level of civil development Latvia lags behind its neighbours – Lithuania and Estonia.

**References**


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**Konkurencingumo problemas Latvijoje**

Santrauka

Nuo 1996 metų BVP (Bendras vidaus produktas) Latvijoje didėja 6-7 % kasmet. Latvijos kaimyninių šalių, Lietuvos ir Estijos, BVP sieinaugis pastaraisiais metais buvo mažesnis. Latvija šiuo metu integruoja į pasaulinę ekonomikos sistemą, į ją įstojo į daugumą tarptautinių organizacijų (EU, WTO, OECD ir kt.). Šiuo metu didėja konkurencingumas tarp Europos Šąjungos šalių, tiek visame pasaulyje. Valstybės padėtis tarptautinėje arenoje išryškėja remiantis jos makroekonominių konkurencingumo galimybių lygiu tarptautinėje baro paskirstymo sistemoje. Šiame straipsnyje atlikti makroekonominių konkurencingumo galimybų lygio apskaičiavimai Latvijoje pagal OECD modelį. Jų rezultatai liūdų apie tai, kad Latvijos makroekonominio konkurencingumo galimybės yra gana didelės. 2001 metais konkurencingumas sudarė daugiau kaip 90 vienetų, o tai priėrgo ir netgi viršijo daugumos išsvyruojančių Vakarų šalių lygi. Tačiau tenka pabrėžti, kad šiuo metu vakarų analitikai labiau atsižvelgia ne į kiekvieną, bet į kokybinius rodiklius ir pateikia bendrą šalies konku-

Raktažodžiai: makroekonominis konkurencingumas, technokratinė darbo jėga, viešasis ap\ntarnavimas, pilietinė visuomenė.

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