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## How to get things going

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By TBT Staff



**Eva Berlaus, Managing Partner,**  
Sorainen law firm

RIGA - Latvia is finally free of the shackles, and the support, of the 3-year IMF- and European Union-led international loan program, with closing documents between all involved parties signed in December. The program was a success, preventing the economy and banking system from sinking into total collapse.

The country now needs to think hard about not only starting to repay these and other government loans coming due, but managing a transition from its current state of economic stabilization, to generating strong and sustainable growth across sectors.

Not that the economy is doing badly. Just the opposite, in fact. Latvia's GDP growth was above 6 percent, year-on-year, in the third quarter 2011, as "economic processes remained robust," says Finasta in its latest quarterly Outlook. Even domestic demand was strong last year. But the economy is still overly dependent on exports for growth and jobs, and much of these exports go, worryingly, to eurozone countries.

"The debt-burdened euro area is putting weight on its economic growth and on the demand for Baltic exporters as well. Given the expectations that this trend may persist, the economy will lose support from its last year's driver; thus we remain very cautious regarding GDP growth in the next quarters," warns the report.

With the eurozone economy showing signs of weakening, projections for Latvia for 2012 are being revised downward. With storm clouds on the horizon, TBT turned to some of the leading figures in the business and academic community to hear what they believe needs to be done to steer through the turbulence ahead.

Here are their prescriptions for the question: "What is the single 'big idea' to get Latvia's economy growing?"

### **Morten Hansen**

*Head of the Economics Department at Stockholm School of Economics in Riga*

... does not exist. If there was a button where it said: 'Press for growth and convergence,' it would have been pushed already. Growth and convergence require good policy and good institutional development. And vision!

But the standard Latvian narrative (everything is so bad/gloomy/pessimistic and can only get worse) is not fully true. The last two elections have reduced the political influence of oligarchs; similar developments have taken place in the banking industry. In the Ministry for Education and Science, arguably the ministry with the biggest layer of dust and the biggest need for reform, there is finally a minister with sweeping new ideas. The stabilization of the economy has been successful in terms of budget consolidation and regaining of competitiveness. All these issues (and more) are conducive for future growth.

On a slightly more populist note, one could mention that over the years endless amounts of 'National Development Reports,' 'Convergence Programs,' 'Competitiveness Reports,' etc. have been produced. But where is the full implementation?

On an even more populist note, the government could consult the World Economic Forum's Global Competitiveness Report and check by how many (and it is in many!) structural and institutional indicators the country is ranking poorly – and do something about it.

And on the most populist note, trying to answer the question of the Single Big Idea to Get the Latvian

Economy Growing Again: Be more Estonian!

**Robert Cottrell**

*Journalist and owner of Robert's Books*

Abolish income tax for the under-25s.

- You would deter young people from leaving Latvia, and would attract young people back.
- You would attract young people from other countries, turning Latvia into a youth-driven economy.
- You would attract foreign investment from companies wanting a share of that youth-driven economy.
- Reducing youth unemployment would increase social stability.
- The economic growth from investment and employment would protect and create jobs for older workers too.
- Latvia would seize the world's attention, with a good-news story that's going to be a talking point for years.
- Yes there would be a small initial cost in terms of lost tax revenues. But it would be made up soon by the higher tax-take across the board from a growing economy.
- And you could do the whole thing with a single line of legislation: "The tax rate for persons under 25 is 0 percent."

**Eva Berlaus**

*Managing Partner, Sorainen law firm*

I suggest there is no single idea, as growth of the economy requires many things simultaneously. However, at this point in time the following two issues seem to be the most important. First, it is the stability and long-term planning of government policies that have an impact on business. We all understand that we live in difficult times, and because of the economic instability outside Latvia, it might be difficult for the Latvian government to make any long-term plans in advance. On the other hand, it should still be possible to reject any sudden changes, for example, in the taxation system, and to have a clearly communicated strategy for the government's policies in the case of different scenarios for development of the global economy, at least for the next five–ten years.

Second and most important – the government should do all that it can to support development of new business, from small to large. There are already quite many good initiatives, for example, the POLARIS process. However, there is a lack of clear communication from the government about the strategy as to what businesses will be supported and how, a lack of coordinated action by all governmental institutions, a lack of enough frequent and available information on progress with each of the initiatives and the analysis of results, and also a lack of a single point of information for all the initiatives – existing and planned ones.

Working with both local businesses and foreign investors, I can see that the lack of information and understanding is on both sides. From the investor's point of view Latvia has quite a lot to offer; nonetheless, there should be a clear message about the stability (or at least the government's intention to ensure it) and much more advertising of the benefits to do business here.

**Ivars Geidans**

*Chairman of the Board, Merks*

It is too early to call the positive changes in Latvia's economy in 2011 as steady, stable and growing tendencies, which could be a witness to growth in the construction and real estate areas. Investors' and real estate buyers' moods were more optimistic in the beginning of the 2011, but now uncertainty about the future of Europe's economic progress, and the possibility of a second crisis, makes big construction investors and some real estate buyers wait.

Construction is a service business, which can be developed only when a country's economy has enough resources and demand. It cannot be promoted on its own by using artificial means. In the first half of the year we received a lot of positive signals from production companies and banks about new investments, also in construction. Now in Europe is the debt crisis, bank investment restrictions and a weakening of growth in our main export markets, which make us look at perspectives for 2012 more warily.

In general, the construction and real estate market in Latvia has not recovered after the events of 2008, when the market, so to say, stopped. Stagnation in all real estate market segments has continued until now.

In spite of general stagnation, however, there are several positive signals in real estate this year.

For the economy as a whole, state policy has to be directed towards the mobilization of investment into sectors which are able to use our country's advantages and wealth, compared with other countries which don't have these advantages - nature, undeveloped land, a good climate, fertile soil. The geographical position of our country has auspicious conditions for transit and for conducting financial services.

### **Janis Kajaks**

*LBAS expert on economic issues*

### **Egils Baldzens**

*LBAS deputy chairman.*

*Free Trade Union Confederation of Latvia (LBAS)*

We believe that in order to get Latvia's economy growing, it is necessary to fulfill a number of conditions: there must be a business friendly environment (including tax policy), a sufficiently high level of employment, decent working conditions and adequate remuneration for a well done job. However, any great achievement starts with establishment of a good and solid foundation, and one of the main foundations for the country's economic development is the state budget and fiscal policy.

LBAS believes that the state budget can be an effective tool to boost economic growth only when it is created not only for a one year period, but if the so-called medium-term budget planning or medium-term budgetary framework (MTBF) is used, when the budget is planned for at least the next three years.

LBAS together with the Employers' Confederation of Latvia, Latvian Chamber of Commerce and Industry, Latvian Association of Local and Regional Governments and Latvian Academy of Sciences proposed the idea of a MTBF in April 2010 already. Our idea was also supported by representatives of the IMF and EC, as the MTBF is being used in several European and other countries around the world with good success; for instance, it is being used in the UK, Finland and Australia.

Unfortunately, the Latvian government has postponed realization of this idea several times, initially promising to start MTBF from 2012, but, according to the declaration of our present government, now only from 2014.

In our opinion, MTBF would ensure the following benefits or advantages:

- it would be easier to reduce the budget deficit, and even reach a completely balanced state budget in the nearest future, without any tax increase and substantial expenditure reduction.
- it would be easier to understand and calculate the results of the country's fiscal policy not only in a one year perspective, but also in the medium term.
- there would be a chance to reduce the relatively high tax burden on the labor force more quickly.
- we could ensure a more efficient and more effective spending of the state budget.
- the country's fiscal discipline would be strengthened by realizing that the current year's financial result will have direct consequences for the financial results in the next years.
- the state budget would be aligned more closely with Latvia's medium-term strategic development plans and economic development prospects.
- Latvia's economy in general would develop faster and more predictably.

### **Peteris Treimanis**

*Investment Director, Baltcap Management Latvia*

Just one word: Entrepreneurship. People in Latvia need to open their own businesses, or promote further their existing businesses. There's no other solution. People need to be active in the market. Through entrepreneurship we will increase the general economic and living standards. People must do business – from the big enterprises down to the individual tailor. If we count small- and medium-sized businesses per capita, as compared to, say, Germany, Latvia is lagging behind. People don't want to own their own enterprises; instead, they want to work in a big company.

They need to acquire skills, have patience, learn something well. It has to be part of the culture, introduced in schools, the family. The government should provide proper marketing programs; these can be simply through TV, radio advertisements, promoting entrepreneurship. Municipalities can help with legal and financial advice – free of charge. Additional taxes paid by these businesses would give extra income to the municipalities.