

# Competitiveness of the Baltic States within the International Ratings

Ilze Stokmane

**Abstract**—Baltic competitiveness is quite controversial. In a situation with the rapid structural changes, economy develops in balance very rarely - in different fields will always be more rapid changes in another more stagnation.

Analyzing different economic indices developed by international organizations the situation in three Baltic countries are described from a different competitiveness positions highlighting strengths and weaknesses of each country.

Exploring the openness of the economy, it is possible to observe certain risks included in the reports describing situation of competitiveness where government policies competing in the tax system, the rates of labour market policies, investment environment, etc. This is a very important factor resulting in competitive advantage.

Baltic countries are still at a weak position from a technological perspective, and need to borrow the knowledge and technology from more developed countries.

**Keywords**—Baltic countries, Baltic region, competitiveness, indices of competitiveness.

## I. INTRODUCTION

**M**ACROECONOMIC and microeconomic situation in the country can be analyzed at the global level when assessing general competitiveness of the country, tendencies of economic development, and driving forces of economy in comparison with other countries. However, regional development of the country and assessment of its factors of influence are not less important

As soon as the country enters in the international circulation policy makers are engaged with state's development planning, opposition, electorate and media worry about loss of competitiveness as a result of a particular decision, and economists post factum conclude that monetary or fiscal policy in a particular period enabled increase or loss of competitiveness [1]. This tendency is familiar in every country operating in the international market. However, the most well-known products are indices of competitiveness - complex indicators calculated according to selected criteria and state's competitiveness success measurements. They allow to rank a country in a particular position in comparison with the entire world and to assess development within a period of time.

Traditionally in economy by index we understand changes of the particular indicator within a period of time [2]. The index within the context of this study is a complex indicator calculated on the basis of mathematical compilation of

selected simple or complex indicators. A rating traditionally is a sequence of particular objects depending on value of the particular parameter, indicator or index (a term "rank" is used to describe such a serial number).

The results of international studies can be described in two ways: from the view of international and state policy. Therefore, certainly the studies have wide international publicity. High indicators create a positive image of the country, institution, field or another object, increase value of the brand, authority of particular institution and person.

## II. INTERNATIONAL RATINGS OF COMPETITIVENESS

### A. Global Competitiveness Index

The Global Competitiveness Index (GCI) included in the Global Competitiveness Report [3] compares macro and microeconomic indicators describing competitiveness.

Retaining the idea of a "pillar" the GCI is based on 12 pillars or factors determining global competitiveness of the country. These factors can be relatively divided into three basic groups where each of them is more leading contributor of competitiveness for a particular country depending on the level of development. In general, countries are divided into five groups depending on the level of their development. There are three large basic groups – resources (1), productivity (2) and innovation (3) based economy; and two transition periods – from resources to productivity (1-2) and from productivity to innovation (2-3) based economy.

Apart from Baltic countries (Estonia, Latvia, Lithuania) there are also such countries as Russian Federation, Poland, Hungary, Croatia and others falling within the group of transition period from productivity to innovation economy (2-3), however, countries directed by innovation economy (3) are Scandinavian countries which are close neighbors in Baltic Sea Region, also such post soviet countries as Czech Republic, Slovak Republic, Slovenia, and one of the biggest emigration destination for inhabitants of Baltic countries – Ireland. There are many other advanced countries in this group (3). In 2009 Estonia also was evaluated as innovation based economy.

In the Report on Global Competitiveness Index assessment Latvia is lower than Lithuania and Estonia, and in 2012 it was ranked 55<sup>th</sup> of 144 countries reflected in the Report [3], Estonia was ranked on 34<sup>th</sup> place (it is ranked in first thirty's also in previous five years), and Lithuania – 45<sup>th</sup>. Latvia within a year has increased 9 positions concerning competitiveness assessment by the World Economic Forum (142 countries in all are included in the latest publication, in the previous one - 144); Estonia and Lithuania lost 1 position. Besides, at the top of the Global Competitiveness Report

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assessment there are not at all countries dominating with a low cost and price level, effective real rate systematically decreasing and positive trade balances.

TABLE I  
RANKING OF GLOBAL COMPETITIVENESS INDEX FOR THE BALTIC STATES IN 2012

Indices and sub-indices	Estonia	Latvia	Lithuania
Global Competitiveness Index	34 (-1)*	55 (+9)	45 (-1)
Index			
Basic requirements	26 (+1)	54 (+12)	49 (0)
Institutions	30 (-1)	59 (+7)	60 (+2)
Infrastructure	41 (-1)	64 (-3)	40 (+3)
Macroeconomic stability	20 (+1)	46 (+47)	75 (-2)
Health and primary education	27 (-1)	45 (+4)	39 (+7)
Efficiency enhancers	31 (+5)	48 (+6)	46 (+2)
Higher education and training	25 (-2)	42 (-8)	26 (0)
Goods market efficiency	31 (-2)	47 (+13)	56 (+8)
Labor market efficiency	10 (+6)	27 (+20)	65 (-11)
Financial market sophistication	39 (+2)	52 (+8)	87 (+2)
Technological readiness	25 (+2)	38 (+8)	33 (+1)
Market size	96 (+4)	91 (+4)	74 (+5)
Innovation and sophistication factors	33 (+4)	68 (-4)	47 (+3)
Business sophistication	51 (+2)	71 (0)	56 (-2)
<b>Innovation</b>	30 (0)	64 (-5)	43 (+5)

\* Ranking change comparing to previous year

When analyzing sub-indices and factors (Table I) of the Global Competitiveness Index, we can see similar results: Latvia's performance is comparatively good in such areas as labor market efficiency, technological readiness and university education and training, but problem areas are innovation, business excellence (business quality development level), market scope and infrastructure. Especially large rating differences among the Baltic States are concerning innovation and excellence indicators, where Estonia is 33<sup>rd</sup> in comparison with Latvia which has 68<sup>th</sup> position and with Lithuania which has 47<sup>th</sup> position. Significant difference is observed also in labor market efficiency. When all groups are compared Estonia is a leader with almost fifty percent higher results and more except the indicator of market scope.

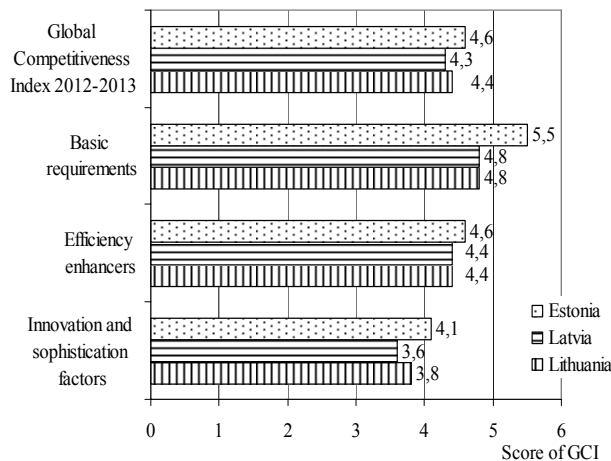


Fig. 1 Global Competitiveness Index and sub-indices of the Baltic States in 2009

Although according to the ratings Estonia is a visible leader already for several years within the group of the Baltic States, however, when comparing values of sub-indices (Fig. 1) the situation in the Baltic States is similar concerning many indicators. To calculate the index a scale from 1 to 7 is used where 1 is the worst possible situation and 7, in its turn, the best one.

A similar situation is when analyzing also the indicators of the group factors. The greatest differences within the groups can be noticed in the indicator of Macroeconomic stability where the difference is 1.4 points. Fewer differences can be observed in the indicator of the health and primary education where the difference is only 0.2 points (Fig. 2).

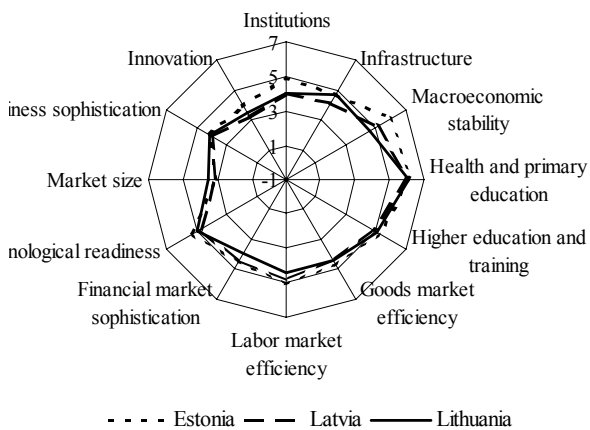


Fig. 2 Sub-indices of Global Competitiveness Index in 2012

Carrying out more detailed analysis of the factors differences of the indicators are even more visible. For example, within the area of availability of scientists and engineers Latvia is ranked one hundred tenth with an indicator 3.5, at the same time Estonia is the sixty ninth with 4.0 points, and Lithuania is the fifty ninth with 4.2 points.

When making political decisions it is necessary to know if those differences are statistically important, i.e., are there actual differences in the area of availability of scientists and engineers in three Baltic States.

Considering indicators forming the factors more detailed it is possible to conclude that the Baltic States have competitiveness advantages in such areas as follows: in term of governmental debt (Estonia (EE) is on 6<sup>th</sup> place in ratings among the group of 144 countries), child mortality in the Baltic States is not high in comparison with the other countries included in the Global Competitiveness Report (comparing statistical data of 144 countries – EE is 28<sup>th</sup>, Latvia (LV) 48<sup>th</sup> and Lithuania (LT) 35<sup>th</sup>), in term of number of students in secondary schools (comparing statistical data EE 19<sup>th</sup>, LV 51<sup>st</sup> and LT 39<sup>th</sup>), in term of number of university students (comparing statistical data EE 27<sup>th</sup>, LV 34<sup>th</sup> and LT 16<sup>th</sup>), the Internet access in schools is sufficiently ensured in order to enable development of the regions (EE 2<sup>nd</sup>, LV 32<sup>nd</sup> and LT 23<sup>rd</sup>), it is relatively easy to start a business in the Baltic States without performing many complicated procedures (EE is 29<sup>th</sup> in the rating, LV is 20<sup>th</sup> and LT is 47<sup>th</sup>), in terms of trade weighted tariff rate (all the Baltic States are ranked on 6<sup>th</sup> place among 144 countries), customs procedures in Estonia and Lithuania also are not considered as complicated, thus, it favorably influences business activities in the regions (EE 15<sup>th</sup>, LV 67<sup>th</sup> and LT 44<sup>th</sup>), high ratings are given to the Estonia and Lithuania also due to flexible salary calculation (EE 5<sup>th</sup>, LV 48<sup>th</sup> and LT 8<sup>th</sup>), also in terms of salary and productivity when assessing the labor market the Baltic States have comparatively high ratings (EE 8<sup>th</sup>, LV 26<sup>th</sup> and LT 23<sup>rd</sup> out of 144). One more contributory factor in the Global Development Index is the high number of employed women in the Baltic States (EE 20<sup>th</sup>, LV 16<sup>th</sup> and LT 9<sup>th</sup>) which furthers regional development.

There is also a description of problem factors for each country in the Global Competitiveness Report; respondents were asked to assess 15 given risk factors, choosing 5 of them which in their opinion are problem indicators for business development in the country.

The biggest changes in the inquiries of the Estonian business persons occurred to assessment of educated workforce which in 2012 was acknowledged as the biggest risk factor for business activity development.

The major obstacle of business activity in Latvia according to the opinion of business persons is tax rates, enormous bureaucracy and lack of financial accessibility followed by ineffective tax legislation and huge tax load.

The major changes in the inquiries of the business persons in Lithuania like in Latvia occurred to inefficient government bureaucracy which in 2012 has been acknowledged as the biggest risk factor for business activity development. The second largest risk factor is tax rates followed by ineffective tax legislation.

Comparing business environment in all three Baltic States according to survey done in Global Competitiveness Report the biggest problem in 2013 is mentioned inefficient government bureaucracy, ineffective tax rates and low access

to financing.

Despite methodological imperfections of index calculations all indices (including sub-indices) point out a high level of correlation among the Baltic States with Estonia as their leader. It is a stable and relatively unchangeable result which has already been defined from the starting point – regaining of independency.

In general after assessing the areas included in the Global Development Index the Baltic States should pay more attention to furthering innovation and market scope.

#### *B. Index of Economic Freedom*

To further competitiveness freedom of action is essential which is ensured by state's legislation. The Heritage Foundation defines economic freedom as forced activity of the government and no restrictions in production, allocation or consumption of goods and services above the necessary for protecting population and freedom as such [1]. When economic freedom decreases also economic grows suffers.

According to studies [4], [5] the main components of economic freedom are person's freedom to choose, voluntary exchange, freedom of competitiveness and protection of an individual and property.

On a state's scale the government has to restrain from activities restricting those freedoms, and their observance has to be ensured. Economic freedom decreases if taxes, expenses set by the government, and regulating measures replace individual freedom and freedom of a company to choose, voluntary exchange and market coordination.

The index of economic freedom is calculated on the basis of 50 independent economic variables characterizing various significant business environment areas [6]. They are grouped into 10 large categories characterizing the most important factors influencing economic freedom.

The index of economic freedom is not based on original statistics, but on derivative materials and information published in the publications of several international organizations (World Bank, World Trade Organization, Economist Intelligence Unit, International Monetary Fund, OECD, etc.), as well as in the official publications of each particular country [6].

Unlike the World Economic Forum Report the emphasis is not put on the given positions to the countries, but on value of country's index and its changes within a period of time.

Out of 185 countries ranked in the report by the Heritage Foundation in 2013 [6] only 5 were classified as "free" countries (amount of points 80 and more), 30 countries were classified as "almost free" (amount of points from 70 to 79.9). The major part of the countries was included into the contingent groups - "averagely free" countries (50) with the amount of points from 60 to 69.9, and "rather non-free" countries (59) with the amount of points from 50 to 59.9. In the rest of 33 countries "depressed" (or non-free) economy can be observed where the total number of points in the Index of Economic Freedom made less than 50. In total 8 countries were not ranked.

Estonia and Lithuania are to be considered as "mostly free"

countries followed by the Index of Economic Freedom calculated by the Heritage Foundation in its annual report. Latvia, in its turn, is to be included in the group of “moderately free” countries where such countries as Italy, France, Belgium, Slovakia, Slovenia, Hungary, Portugal, Poland and others are also included.

Soon after establishing the Index of Economic Freedom Estonia has already got in a higher contingent group than Latvia and Lithuania. In 1998 Estonia was already assessed mainly as a country of free economics (except of year 2000), whereas Lithuania is considered as such since 2004, but Latvia is still assessed as averagely free country.

Estonia concerning the calculated Index of Economic Freedom is with certainty in top during the period of time from 1996 until 2013.

The ratings of the Baltic States assessing according to the Index of Economic Freedom (IEF) in 2013 have increased in comparison with the previous year: Estonia by 2.1, Latvia by 1.3 points, but Lithuania by 0.6 points.

Considering the rating table of the IEF within the scale of the world and Europe Estonia is a leader in comparison to the other Baltic States and within the European level it has the high 4<sup>th</sup> place. Estonia with reference to calculation of the Index of Economic freedom has the high 13<sup>th</sup> place on the world's scale. It would be helpful to adopt good practice from such European countries as Denmark and Switzerland which are among the first ten countries on the world's scale.

The most rapid decline for Estonia was in 2000, mainly, when the indicator of government expenses decreased; both state and local governments' expenses were calculated in percentage of the GDP.

There was also a decline for all the Baltic States in 2005 – for Estonia the biggest decline was concerning the indicators of fiscal freedom and corruption combating; for Latvia the indicator of government expenses has considerably decreased, but for Lithuania decline in the index was mainly due to decrease in government expenses of the GDP, as well as due to corruption combating index calculated mainly on the basis of the Corruption Perception Index which since 1995 has been calculated by the Transparency International, a specially established institution for observing corruption and combating it.

The decline of IEF scores for Estonia was continuing also in 2006 where next year 2007 has raised to the highest score ever for Estonia with score of 78 (out of 100). The decline was also continuing during 2008 till 2010 and 2012.

Latvia economy has decline in IEF score ratings during period 2009 to 2012 and in 2013 has almost returned to level of IEF score of 2009.

Lithuania has decline of economic freedom during 2007 and 2009 and in 2013 is close to 2004 score which was the highest for Lithuania.

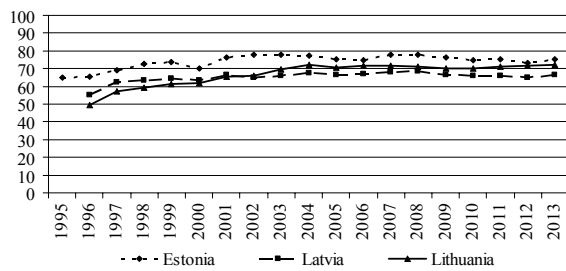


Fig. 3 Rankings of Index of Economic Freedom in Baltic States

The level has improved for all countries since 1996 when all Baltic States for the first time were included in the survey.

According to the index (Fig. 3) the most rapid growth of economic freedom has demonstrated Lithuania (by 22.4 points), Latvia has demonstrated growth by 11.5 points, and Estonia by 10.1 points (comparing scores in 2013 and 1995/1996).

When considering the components of the index in detail for the Baltic States in 2013 (Fig. 4) it is possible to track down areas still causing the main economic.

Comparing the components of the IEF index for the Baltic States it can be concluded that a situation in Estonia is considerably better in areas of investment freedom, ownership and trade.

Latvia, in its turn, has to decrease government expenses and focus more on issues of corruption combating.

A situation in Lithuania in terms of “freedoms” selected by the IEF is more like that of Estonia although additionally the situation in ownership area has to be improved, as well as in corruption abatement.

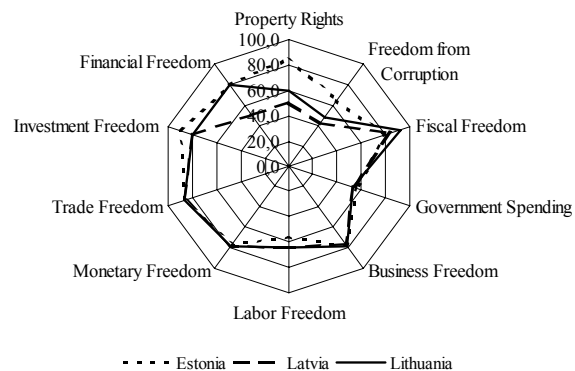


Fig. 4 Factors of Economic Freedom in Baltic States in 2013

Previously included figures demonstrate the areas which have to be improved in the Baltic States – the Estonian government has to pay more attention to labor force legislation alignment (in 2013 56 points of 100), the Latvian government has to strive to diminish the burden of corruption (42 points of 100) and more attention has to be paid to solving issues of ownership (50 of 100), as well as state's expenses have to be reduced (53.6 of 100). Lithuania has to pay more attention to

such issues as corruption abatement (48 points of 100) and government spending (53.6 of 100). Concerning indicators below the threshold of 60 points the Baltic States are to be considered as “rather non-free”.

Practically only four of 10 factors pointing with certainty to free economy in the Baltic States are fiscal and trade policy.

### C. Database Doing Business

The database “Doing Business” unlike other indicators discussed in this paper does not calculate general index to compare countries mutually. It is an interactive data base with opportunities within a particular theme and according to various factors to select information and assess an indicator of the country of interest in comparison with the average indicator of the particular region and average indicator of the OECD countries. The indicators reflect direct and indirect costs stated in laws and regulations for realization of business activities, and they can be used to analyze specific conditions furthering or hindering investments, productivity and development. Legal aspects are dealt with in the data base that is an attempt to describe legal formalities and compare them by numeric information.

The first report of the data base “Doing Business” was published in 2004, and there were 5 groups of indicators included on 133 countries. In 2013 information was already on 11 groups of indicators in 185 countries [7].

Data used in the data base “Doing Business 2013” are for June 2012 (except for the data for paying taxes refer to January– December 2011).

Assessing the ratings of the Baltic States in general concerning ensuring and furthering business environment it can be seen that they are rather high in comparison with economies of the surveyed countries of the world (EE 21<sup>st</sup>, LV 25<sup>th</sup> and LT 27<sup>th</sup> position).

given to positions related to processes and procedures that can be done quickly and are cheap, for example, property registration, getting credit, quick and cheap execution of import and export transactions, etc).

In comparison with 2012 Estonia has lost 2 positions in the general rating in 2013, Latvia - 4 positions, Lithuania has lost 1 position (Table II). The biggest problems are concerning issues of labor relations, investors’ protection and dealing with legal issues to terminate business activities.

Examined legal indicators point out that a business person has to perform 4 procedures within 16 days to start business activities in Latvia, and costs will be approximately 2.3% of the Gross National Product (GNP) per an inhabitant in comparison with 1.6% of the GNP per an inhabitant in Estonia, 1.1% in Lithuania and 4.5% in the OECD countries on average. Thus, in absolute values, to start a business in Latvia it is more expensive than in Estonia and Lithuania, but cheaper than in the OECD countries. To start a business in Estonia 5 procedures during 7 days have to be performed, and in Lithuania - 7 procedures within 20 days.

Costs for receiving credits and legal procedures, as well as procedures for investors’ protection are commensurable with the OECD level. As a result of legal procedures for terminating business activity in Latvia in situations of bankruptcy creditors can recover approximately 59.8% of liabilities, OECD average 70.6%, accordingly this indicator in Estonia is 38.5% and in Lithuania - 51%.

With reference to assessment by legal offices and experts Latvian legislation of microeconomic environment officially is of equal value to other Baltic States and mostly number of procedures, time and costs do not differ much from the OECD countries. Therefore, it can be said that legislation is not a hindering factor of micro-economic competitiveness. It does not surpass though other countries.

TABLE II

RANKING OF DOING BUSINESS THEMES IN BALTIC STATES IN 2013

<i>Branches</i>	<i>ESTONIA</i>	<i>change over the year</i>	<i>LATVIA</i>	<i>change over the year</i>	<i>LITHUANIA</i>	<i>change over the year</i>
Doing Business	21	-2	25	-4	27	-1
Starting a Business	47	-3	59	-9	107	-4
Dealing with Construction Permits	35	-1	113	-4	48	-1
Getting Electricity	52	-2	83	0	75	+1
Registering Property	14	-2	31	+1	5	0
Getting Credit	40	-2	4	0	53	-1
Protecting Investors	70	-4	70	-4	70	-4
Paying Taxes	50	-6	52	+10	60	-3
Trading Across Borders	7	-3	16	+1	24	+2
Enforcing Contracts	31	-1	24	-8	14	+1
<b>Resolving insolvency</b>	<b>72</b>	<b>+4</b>	<b>33</b>	<b>0</b>	<b>40</b>	<b>0</b>

The World Bank has ranked the Baltic States in the assessment of the data base “Doing Business 2013” among more than 180 countries of the world as the countries where it is rather easy to start business activities (higher assessment is

### III. RESULTS

Differences of states’ economies and governmental approaches are demonstrated in the analyzed reports included in the paper where governmental policies mutually compete with the tax system and rates, labor market policy, investments environment, etc. These are very essential factors of which advantage of competitiveness derives.

Latvia’s position is the lowest in the largest and most quoted index reports in comparison with the other Baltic States.

Among the Baltic States Estonia has the first place according to all values, having especially high indicator in the Index of Economic Freedom, followed by Lithuania and Latvia.

Characteristic features of the Baltic States in assessment of competitiveness index are as follows:

- 1) common advantages in terms of students of secondary schools, universities and of those who want to study; the Internet access is ensured at the sufficient level in schools in order to further regional development; it is rather easy to start a business in the Baltic States and it does not require many or complicated procedures,

- 2) at the same time the major disadvantages pointed out in the Reports of competitiveness are scantiness of public financing and inexpedient usage of finances for the needs of administration, distrust towards governmental structures by inhabitants, poor quality of educational system, lack of scientists and engineers, a link with business activities is missing for science to develop, also business persons allocate comparatively small amounts of funds for research and development that explains poor development of production clusters.

Inflation was admitted as the most urgent problem by business persons in the Report on Global Competitiveness in 2008-2009. With reference to Report on Global Competitiveness in 2012-2013 business entities of the Baltic States have changed their opinion and by assessing the situation in their countries emphasize that at present the government has to think more seriously about:

- 1) financial accessibility to enable business activities,
- 2) reducing bureaucracy and training qualitative labor force,
- 3) tax legislation alignment reducing threats of corruption and improving infrastructure of the country.

There is no one particular generally credible indicator of competitiveness and innovation. The emphasis is put on various social and economic areas in each of discussed complex indicators in the paper, and the results of inquiries also have great significance.

Competitive development policy of the Baltic States has to solve several problems and challenges:

- 1) in economy: there is significantly lower income in the Baltic States than on average in the EU, aging labor force and bigger dependency on the primary sector;
- 2) in social area: higher level of unemployment, reduction of social tension, low density of population and decrease of number of inhabitants as a result of natural and mechanic movement. It can increase risk of emerging such problems as poor approach to basic services, social isolation and narrower selection spectrum of employment.

Business environment is one of the most important competitiveness furthering factors when the country creates circumstances where a business person can easily and efficiently work.

Nowadays competitiveness singles out value of education, knowledge and intangible contribution, as well as technological infrastructure.

#### IV. CONCLUSION

Competitiveness often is considered as the main indicator of political success or failure, and its determination at the regional level sometimes can be rather problematic. It is important to remember that an industrial region will never directly compete with an agricultural region or financial centre, thus, determination of competitiveness of such regions is problematic.

Creating the strategy of state's development a discussion on state and regional competitiveness is unavoidable. Instead of making plans how to outdo other countries it would be more helpful to agree on principles and measurements of sustainable

development to raise public prosperity using the principle of mutual partnership.

Economists explain current aggravation of competitiveness in the world due to open economy where step by step pulling down economic barriers among the regions various international organizations have to be established with a purpose to agree on mutual rules concerning trade and investment flow direction among the countries in order to prevent recurrence of severe protectionist policy which caused the global economic crisis.

In order the Baltic States and business persons could develop and compete it is necessary to find new collaboration partners, as well as to further incoming foreign capital in the Baltic States. To further competitiveness new ways have to be searched by using innovative tools and creative approaches. One of the methods at present being undervalued and insufficient used for planning regional development by the Baltic States is regional marketing which requires a clear view on the strong points and enables supply of investments. Besides, investments mostly have a multiplier impact – the first investments further influx of the next investments which, in its turn, is the result of territorial development.

Regional marketing will enable more rapid growth of the country not only in short-term, but as a result of purposefully executed marketing arrangements positioning the Baltic States would be possible in Europe by offering true values proved by the time to local and potential inhabitants and maintaining identity of countries.

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