

# Impact of Social Environment on Economic Development in the Baltic States

B. Zvirbule, I. Vilka

**Abstract**—The Baltic States regained independence and started the pathway from command economy to market economy and entered European Union at the same time. Latter internationally recognized evaluations for the countries are diverse. The present diversity of the Baltic States' Economic Development is a subject of interest because of the similarities – all three are small, open economies, countries have similar geographic location and initially likewise historical and political backgrounds. This article explains relationship between social environment, business environment and economic growth. It argues that the elements of social environment underlie more successful economic development. It researches the causes, why Estonia has performed better in economic outcomes and development. The article analyses selection of socio-economic indicators of all three Baltic States – Latvia, Lithuania and Estonia for the time period of ten years to include the influence of economic cycles.

**Keywords**—Baltic States, economic development, economic growth, level of education, social environment.

## I. INTRODUCTION

THE economic science provides different concepts to explain economic growth and the countries all around the world are looking for the best policies to strengthen economic positions as well regionally as globally. Traditional economics explains growth through efficient allocation of resources and evaluates economic growth by annual increase of GDP or likewise.

Not all regions and countries are equally successful in terms of economic growth or economic development because of various causes. Economic development at the first glance uses the income per capita to define the developing world. Initially economic development focused onto the structure of the economy and employment, later the scope widened and economies are viewed as social systems including both economic and noneconomic factors [1]. Amartya Sen suggested "Economic growth cannot be sensibly treated as an end itself. Development has to be more concerned with the lives we lead and freedoms we enjoy" [2]. Development economics has several objectives and one of these is expanding the range of economic and social choices available [1]. Authors research social environment as background for sound and stable economic growth. Authors therefore test time series of socio-economic indicators and their statistical relationship to find, if there is a correlation that could prove impact of social environment on economic outcomes.

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The aim of the research – to measure impact of the social environment elements on economic growth of the Baltic States and describe the influence character of mentioned elements.

The paper is structured as follows. Section I discusses the differences in economic development of three Baltic States. Section II gives an overview on relationships between business environment, social environment and economic growth, analyses the possible causes and consequences. Section III includes empirical data analysis to explain argument that elements of social environment may underlie success in economic development as Estonia's case. For empirical analysis and to reach the aim of the research authors use statistical correlation method.

## II. ECONOMIC DEVELOPMENT IN THE BALTIC STATES

Development economics mostly focuses on the poorest two-thirds of the world's population, which comprise 82 percent of the world's population [3]. All three Baltic States may be classified within the group of upper-middle-income countries according to the level gross national income per capita.

Comparative economic development allows measuring and making quantitative comparisons across countries. Behind the differences of economic growth or income level there are factors and various causes defining performance of countries both economic as well as in terms of nation development.

Three Baltic States regained independence and started the pathway from command economy to market economy at the end of 20<sup>th</sup> century, entered European Union at the same time. Internationally recognized evaluations for the countries are diverse at the moment and there are certain differences in economic indicators presently as well. According to Human development index 2011 evaluation all three Baltic countries are included into the group of very high human development; human development index 2011 ranks Estonia - 33, Lithuania - 40 and Latvia - 43 [4]. Global competitiveness index 2011 – 2012 ranks Estonia - 34, Lithuania - 44 and Latvia – 64. Latest global competitiveness report points out that

„Estonia and the Czech Republic remain the best performers within Eastern Europe. [...], the countries' competitive strengths are based on a number of common features. They rely on excellent education and highly efficient and well-developed goods, labor, and financial markets, as well as their strong commitment to advancing technological readiness, particularly in the case of Estonia. In addition, Estonia's 33rd rank reflects solid institutions and well-managed public finances" [5]. The Corruption Perceptions Index ranks countries according to the perception of corruption in the public sector and latest evaluation in 2010

presents following order for the Baltic states Estonia - 26, Lithuania – 46 and Latvia – 59[6][4][6].

Estonia has been more successful in macroeconomic policy implementation and was permitted to join euro zone as of 1 January 2011. Estonia committed to neo-liberal non-interventionist economic policies (often implying no-policy policy) in Estonia since 1992 [7].

The authors hypothesize, that under Estonia's economic success may lay different attitude towards economic development, which includes both economic growth and social development.

Economic growth as such may provide the resources for the development of other areas such as education system, research and development, infrastructure, sustainable attitude environmental etc. thus creating favorable environment for entrepreneurship development and a valuable framework for the sustainable economic development.

Scientists refer to social development as phenomena, which may follow, if a country succeeds in terms of economic growth. That apparently does not happen ultimately, i.e. Kuwait very high per capita GDP, but lower HDI rank[8].

### III. RELATIONSHIP BETWEEN BUSINESS ENVIRONMENT, SOCIAL ENVIRONMENT AND ECONOMIC GROWTH

Never before has been the business environment so volatile and dynamic as it is today. Never before the challenges of managing a business successfully have been as daunting as they are now. Never before there were as many opportunities to strike and prosper as they are seen now [9].

Entrepreneurship is an activity, which takes place under certain conditions. The business environment can be classified as internal or external. As main difference according to F.Chernilam is the ability of the manager to keep control over internal environment and [10].

F.Chernilam divides the external environment in micro and macro environment. Macro environment is characterized by economic factors, social and cultural factors, demographic factors, political or governmental factors, environmental, technological and global factors [10]. Authors B.M. Richman and M.Copen suggest that the concept of "business environment" includes all external forces which may significantly influence the operations. Various elements of the business environment overlap partly or converge; besides they may happen to be external and therefore are not under direct control of the firm's management. Elements are to be taken as certain set of values, under which company will operate in certain state and these may differ by countries [11]. According to W.F.Gluck and L.R.Jauch business environment includes external factors that may create options or threats for the firm. By classifying factors in certain groups socio-economic, technologic, competition, relations with cooperation partners and policies implemented by governments may be identified as the most important areas [12]. K.Aswathappa points out environmental and international environments as external impact areas as well [9].

Socio-economic environment is one of the most important elements in the external business environment. Scientific

literature within field of economics provides various approaches for the analysis of social environment and elements forming social environment.

K.Aswathappa researches socio-cultural environment, i.e. by combining social and cultural elements. Social and cultural environment refers to the influence exercised by certain factors which are beyond the company's gate. Such factors include people's attitude to work and wealth; role of family, marriage, religion and education; ethical issues and social responsiveness of business. Social and cultural environment is highly relevant for a business unit as the variety of goods it produces, the type of employees it gets and its obligation to society depend on the cultural milieu in which the firm operates [9].

F.Chernilam points out, that the socio-cultural fabric is an important factor that should be analyzed while formulating business strategy. The cost of ignoring the customs, traditions, taboos, tastes and preferences of a people could be very high [10]. The buying and consumption habits of the people, their language, beliefs and values, customs and traditions, tastes and preferences, education are all factors that affect business[10]. Demographic factors such as size of the population, population growth rate, age composition, life expectancy, family size, spatial dispersal, occupational status, employment pattern affect the demand for goods and services [10].

L.L.Steem suggests the more educated the society becomes, the more inter-dependent it becomes, and the more discretionary the use of its resources, the more marketing will become enmeshed in social issues [13].

Authors identify the importance of the social environment within the economic development research and as a set of factors influencing economic activities and business environment.

The output results depend on economic activities. There are a great number of indicators which evaluate the performance of the national or regional economy. These indicators can be divided into three categories: investments, competitiveness and occupation of the population [14]. In the first category there are considered the gross domestic product (GDP), the growth of GDP, GDP per capita, inflation, cost of the consumption, consumer price index. The other two categories contain elements regarding the productivity and the occupation level of population. The number of economically active units of certain scope, the structure of the economy, people active in a certain branches may be analyzed as well.

Authors identify the importance of socio-economic factors, i.e. demographic patterns, size of the population, population growth rate, age composition, life expectancy, family size, spatial dispersal, occupational status, employment pattern, ethical issues and social responsiveness of business, people's attitude to work and wealth, role of family, marriage, consumption habits of the people, their language, beliefs and values, customs and traditions, tastes and preferences, education. For the further research and analysis of economic development authors choose such economic indicators: GDP per capita, external balance of goods and services, consumer price index; demographic differences by proportion of the

population at workable age and tertiary education enrolment for characterizing the social environment and potential labor resources for the business activities.

#### IV. EMPIRICAL DATA ANALYSIS

Authors intend to find out whether and to what extent social environment impacts economic development. To characterize economic differences in the researched area authors examine economic indicators, i.e. GDP per capita, external balance of goods and services and consumer price index.

General economic growth trends and wellbeing of inhabitants are represented in Fig.1.

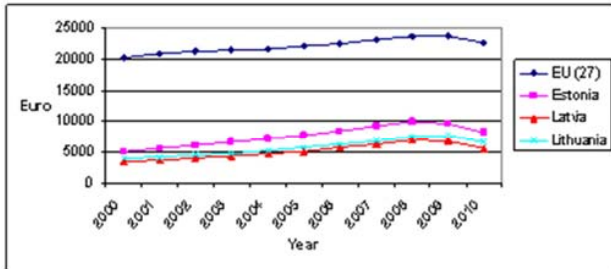


Fig.1 Gross domestic product per capita, the Baltic States and EU average 2000-2010 [15]

GDP per capita reflects that economic growth rates are similar in all three Baltic States, but Estonia keeps leading positions. By authors' opinion this may be explained by differences in social trends, such as consumer preferences, which are reflected in external balance of goods and services and consumer price index dynamics, and the quality of the society at the workable age.

External balance of goods and services represents the potential of economic growth through exports, but as well the consumers' preferences for local or imported goods.

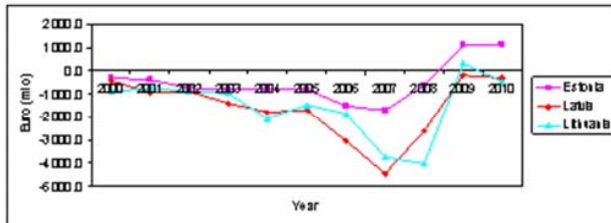


Fig.2 External balance of goods and services, the Baltic States 2000-2010 [15]

Fig.2 reflects sharp differences in Estonian external balance of trade as of 2007, when Baltics was affected by global financial crises. Obviously Estonia captured the opportunities to strengthen export positions in external markets at the same time keeping the politic objective to fulfill Maastricht criteria and join the Eurozone. Latvia and Lithuania has a predominance of imported goods and services, which may be explained by industrial sector's inability to offer alternative to substitute the imports. As mentioned in Section III in this case the consumption habits, tastes and preferences may determine choice of local production instead of imported.

Consumer price index characterizes most precisely the relations between inflation and internal demand. Inflation growth alone would not create significant disparities. It could be reasonably explained by sharp alterations in market demand.

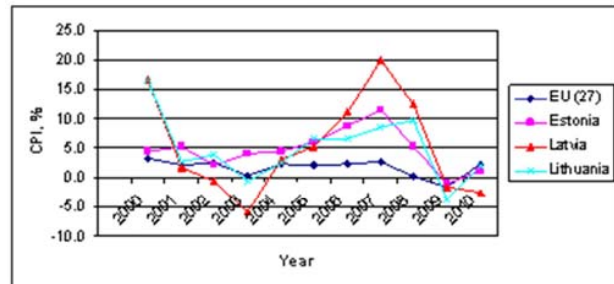


Fig.3 Consumer price index dynamics, the Baltic States and EU average 2000-2010 [15]

Consumer price index dynamics reflects stable average market demand in European Union countries. There are more apparent fluctuations in the Baltic States indexes' compared to average EU index, which may be caused by the increasing market demand during the period of fast economic growth. The most volatile dynamics is in Latvia. Estonia more successfully follows European pattern. The curves representing Latvian and Lithuanian consumer price index dynamics shows possibly uncontrolled market demand because of easily available and cheap financial resources.

Population at workable age represents economic growth potential and sustainability of social security system.

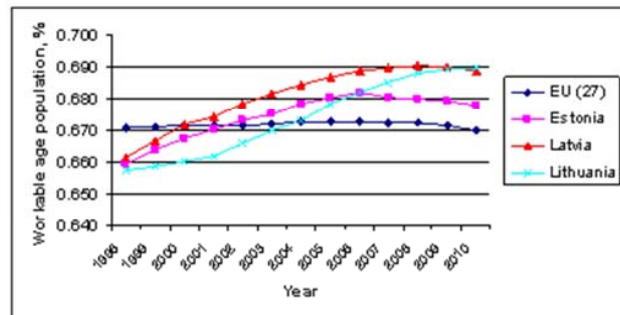


Fig.4 Population at workable age, the Baltic States and EU average 1998-2010 [13]

Population in Lithuania is 3,3 million, in Latvia 2,2 million, but in Estonia 1,3 million in 2010 according to Eurostat data [15]. During the observed period both Latvia and Lithuania faced more intensive migration, according to statistical data the total number of inhabitants decreased by 6% and 7% accordingly. The share of people at workable age keeps constantly growing in Lithuania, but decreasing in Latvia during the last years. Figure 4 in contrary to previous depicts smaller number of Estonian population as well workable population, which may mean weaker positions in terms of labor resources and thereby economic growth potential. To explain, how Estonia managed to achieve better economic performance in terms of GDP per capita with

smaller labor resources simultaneously, authors prospect qualitative aspect of workable resources.

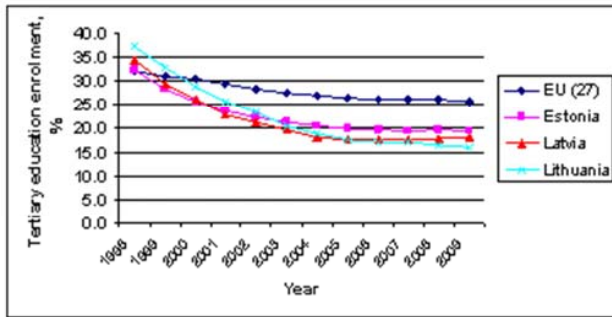


Fig. 5 Tertiary education enrolment, the Baltic States and EU average [13]

The dynamics of tertiary education enrolment in Latvia and Lithuania is much alike.

The higher tertiary enrolment ratio identifies the possible causes of Estonian wellbeing and economic growth potential because of qualitative advantages despite smaller labor resources.

Finalizing empirical analysis authors have successfully specified plausible explanation for disparities of economic development in the Baltic States though initial preconditions for economic growth and development were equal at the turn of the centuries.

#### V.CONCLUSION

The authors' initial hypothesis that under Estonia's economic success lay different attitude towards economic development, which includes both economic growth and social development have proved as plausible.

Authors identify the importance of the social environment within the economic development research and as a set of factors influencing economic activities and business environment.

Quantitative economic growth indicators do not explain the background of present economic disparities between the Baltic States. The qualitative indicator chosen by the authors - tertiary education enrolment indicates the impact of social environment on entrepreneurial environment and succeeding potential for economic growth. More quality indicators of social environment ought to be researched to explain the causes of disparities more accurately.

Authors found that social indicators may underlie Estonia's economic development success, i.e. quality of the society.

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