

ASSESSMENT OF THE ECONOMIC DEVELOPMENT OF LATVIA AND UKRAINE

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Abstract. The global financial crisis and the ensuing global recession not only adversely affected global growth and poverty, but also presented constraints and challenges to public policy. Even though the world economy is slowly returning to growth, the recovery was difficult and lasted for almost 10 years. Preparing for the future requires an assessment of the consequences of the crisis and future challenges. Since 2010 economic growth in Latvia has been one of the fastest in the EU (from 2011-2018, GDP, on average, increased by 3.5% annually), however in 2019 economic growth has moderated. Growth opportunities are limited both by the uncertainty in the external environment (“trade wars” on the global economy, the outcome of Brexit, slower growth in EU countries, etc.), and the existing economic structure, which also negatively affects the competitiveness of Latvian producers. In the competitiveness rankings regularly published by the World Economic Forum (WEF), Latvia lags far behind other new EU member states, incl. other Baltic States.

The economy of Ukraine currently is in very difficult environment: carrying out the Anti-terrorism activity in the eastern part, occupation of Crimea, the uncertainty in the system of political processes, the economic instability and other factors slow down its development. The deepening of the political and economic crisis in Ukraine, on the one hand, and transformational processes towards expanding European integration, on the other hand, daily create new challenges that domestic economic entities have not encountered before, and which are difficult to predict.

The aim of the research is to carry out a comprehensive assessment of the dynamics of macroeconomic indicators of the social and economic development of the national economies of Latvia and Ukraine over the past 10 years (from 2010 to 2019) and identify the factors influencing it, to improve the forecasting of further trends and the planning of anti-crisis measures.

As a result of the study, possible directions of economic policy were identified to improve the economic structure of Latvia and Ukraine in order to promote their sustainable development and competitiveness in the world market.

Keywords: *economics development, GDP growth, competitiveness, Latvia, Ukraine.*

JEL code: E60, O10, O11, O50

Introduction

The country's economy is one of the most important components of displaying the living standards, and its development creates favourable socio-economic conditions for the life of the population. The implementation of strategic plans for socio-economic development of the country and forecasting the expected results first requires a thorough study of the dynamics of the main macroeconomic indicators, identifying trends in the functioning of the economic system and destabilizing factors inhibiting the development of the national economy. Unfavourable political and economic conditions in Ukraine (slow economic dynamics, long military conflict, significant debt obligations, low investment attractiveness, distrust in government, high level of corruption, negative assessments of world rating agencies regarding the development prospects of the Ukrainian economy), significantly influenced the production and economic activities of the residents.

Transformation processes and Ukraine's accession to the WTO have led to an increase in the openness of the national economy, an intensification of international competition influence, changes in demand and supply in the domestic commodities markets, increased vulnerability to the effects of crisis phenomena not only of the entities of foreign economic activity, but also of each enterprise. In addition, the European orientation of Ukraine requires adaptation not only the legislative framework, but also of strategic goals for the development of the Ukrainian economy, financial, fiscal and budget policies. Therefore, the experience of Latvia, which in the past, like Ukraine

was part of the USSR, and now is a full member of the EU, is useful and interesting for Ukraine, seeking to obtain a similar status.

The research problem is to assess the competitive advantages of Latvia and Ukraine by revealing the strengths and weaknesses of both countries.

The aim of the study is to carry out a comprehensive assessment of the dynamics of macroeconomic indicators of the social and economic development of the national economies of Latvia and Ukraine over the past 10 years (2010-2019) and to identify the factors influencing it, in order to improve the forecasting of further trends and the planning of anti-crisis measures. To achieve the aim of the research the following tasks were determined: analyse the main macroeconomics indicators of countries, choose the competitiveness of Latvia and Ukraine, their strengths and weaknesses based on The Global Competitiveness Index-2019 (GCI) Rankings, to identify the following aspects that limit the possibilities for development of Latvia and Ukraine and to make recommendations for the improvement of the economic structure of both countries.

The methodological and information base for the study is represented by research papers, periodicals materials, legislative acts, official statistical publications, departmental materials, and online resources.

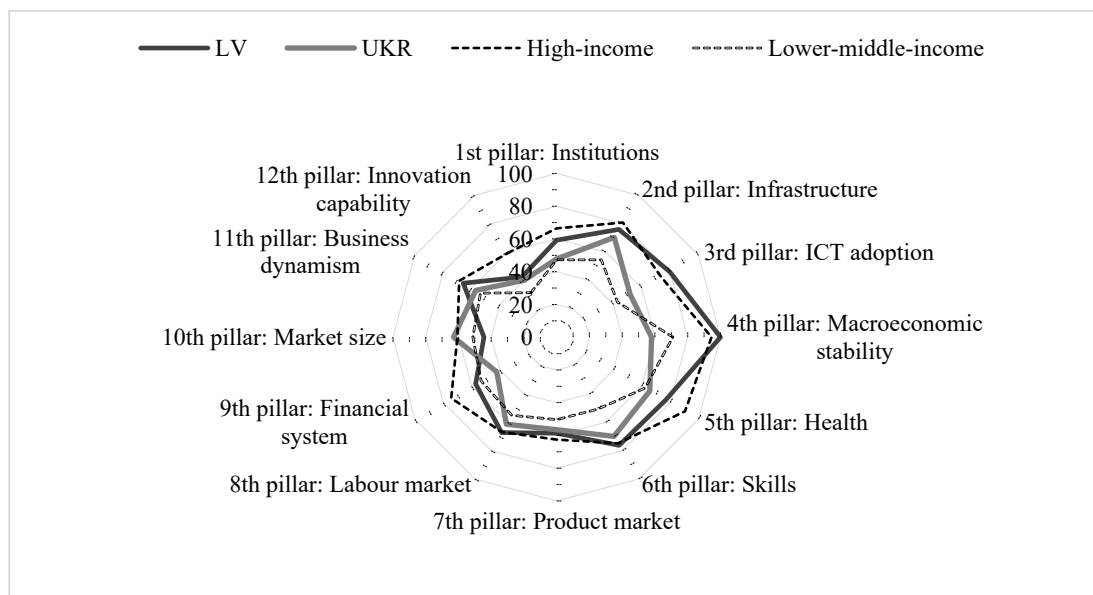
In analyses there are used different qualitative and quantitative analysis methods, such as scientific literature and empirical research analysis, modelling tables, charts and schemes, calculations of average and relative values, grouping, comparisons and other.

Research results and discussion

The economy of Ukraine is a relative small (a share in world GDP is only 0.29%) and commodity-dependent economy (a significant part of the Ukrainian GDP is the export of resources and commodities with low added value). The deindustrialization (reduction of output and employment in the industrial sector, the degradation of the technological, production and organizational structure of industry) that the country has gone through over the past 27 years and the lack of a state strategy for new industrialization leave it in the status of a commodity-dependent economy with cheap labor and low quality of life (the share of the IT industry and innovation sectors in its GDP is still very low). Despite the fact that Ukraine is one of the largest countries in the centre of Europe in terms of occupied territory and population, its domestic market is poorly developed due to low solvent demand of the population.

Over the past almost five years, the Ukrainian economy has been in a state of deep systemic crisis, which has led to a slump in the standard of living, a mass outflow of Ukrainian citizens to other countries, an exacerbation of the socio-demographic crisis and the risks of socio-political upheaval and increased threats to the integrity and sovereignty of the state.

An integral indicator of the state of the entire Ukrainian economic system is its low Global Competitiveness rating and its impressively low index components (Table 1). According to GCI-2019 Rankings (WEF, 2019), Ukraine ranks 83rd, while Latvia is 41st among 141 countries (see Figure 1).



Source: author's construction based on GCI Report 2019

Fig. 1. The GCI Score of Latvia and Ukraine

The components of this index indicate that Ukraine has significant institutional problems, an unstable macroeconomic environment, insufficient development of the financial market, and others. However, the most important advantage of Latvia's competitiveness in the GCI rating is macroeconomic stability. At the same time, there are a number of common problems for Ukraine and Latvia, in particular of an institutional nature: social capital, government ensuring policy stability, efficiency of legal framework in challenging regulation; infrastructure problems such as quality of roads; imperfection of the tax system; problems of the efficiency of the labour market functioning and labour migration; complexity of innovation transfer and some others (See Table 1).

Table 1

The Global Competitiveness Index of Latvia and Ukraine in some detail in 2019

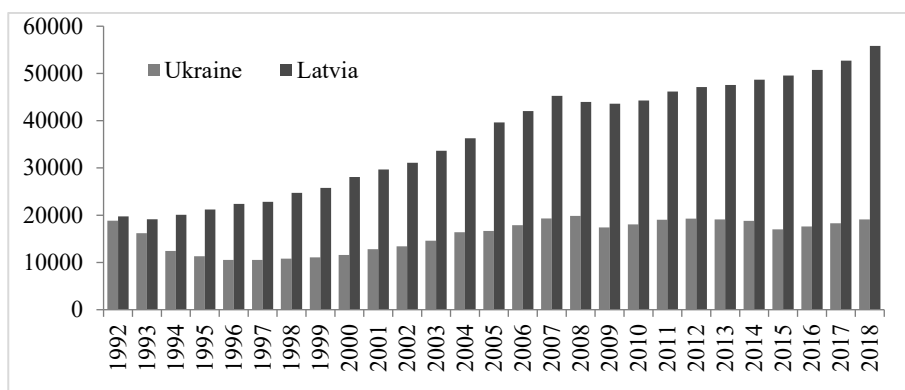
Index Components	Latvia	Ukraine	Index Components	Latvia	Ukraine
Institutions	47	104	Labour market	28	59
Organized crime	38	110	Flexibility of wage determination	10	110
Terrorism incidence	42	132	Ease of hiring foreign labour	113	65
Social capital	112	118	Workers' rights	26	93
Judicial independence	74	105	Labour tax rate %	114	124
Incidence of corruption	39	104	Financial system	85	136
Property rights	52	128	Financing of SME	55	112
Strength of auditing and accounting standards	59	118	Market capitalization % GDP	111	112
Government ensuring policy stability	96	115	Soundness of banks	74	131
Efficiency of legal framework in challenging regulations	86	88	Non-performing loans (% of gross total loans)	78	139
Infrastructure	43	78	Credit gap %	134	1
Quality of road infrastructure	95	114	Banks' regulatory capital ratio (% of total risk-weighted assets)	31	120
Efficiency of air transport services	15	101	Market size	95	47
Efficiency of seaport services	34	78	Gross domestic product (PPP \$ billions)	97	48
Macroeconomic stability	1	133	Imports of goods and services (% GDP)	29	44
Inflation %	1	131	Business dynamism	40	85
Debt dynamics	1	114	Insolvency recovery rate (cents to the dollar)	57	129
Product market	47	57	Growth of innovative companies	48	109

Distortive effect of taxes and subsidies on competition	50	104	Companies embracing disruptive ideas	47	102
Extent of market dominance	46	89	Innovation capability	54	60
Prevalence of non-tariff barriers	19	91	Diversity of workforce	102	59
Complexity of tariffs	113	66	State of cluster development	60	96

Source: author's construction based on GCI Report 2019

Although Latvia's positions in the GCI rating have improved, in recent years the cost competitiveness indicators have declined. Labour costs increase at a higher rate than productivity, real effective exchange rate (REER) appreciates, and only a moderate rise has been observed in Latvia's export market share in world exports. Pressure of rapidly rising costs increases the risk of weakening competitiveness and remains a serious threat to sustainable economic growth. To maintain competitiveness in the long-term, Latvia and Ukraine must improve its productivity. Productivity has an impact on business competitiveness and is a key driver of economic growth and welfare of people. Over time, the country's capacity to improve living is almost entirely dependent on its ability to mobilise available resources and increase output per employee, so only increasing productivity can increase the welfare of people and maintain high standards of living in long term. Productivity allows country to sustain high level of salaries, stable and strong national currency and high level of capital return and by them high level of life standards (Jekabsone S., Skribane I, 2019).

Although Latvia and Ukraine differ by size, population, geographical location, and the availability of natural resources, countries also share many similarities. In the early 1990s, both countries regained their independence and embarked on ambitious reforms towards the development of a market-based economy. In the early years of transition, productivity levels in Latvia and Ukraine were essentially the same (see Figure 2).

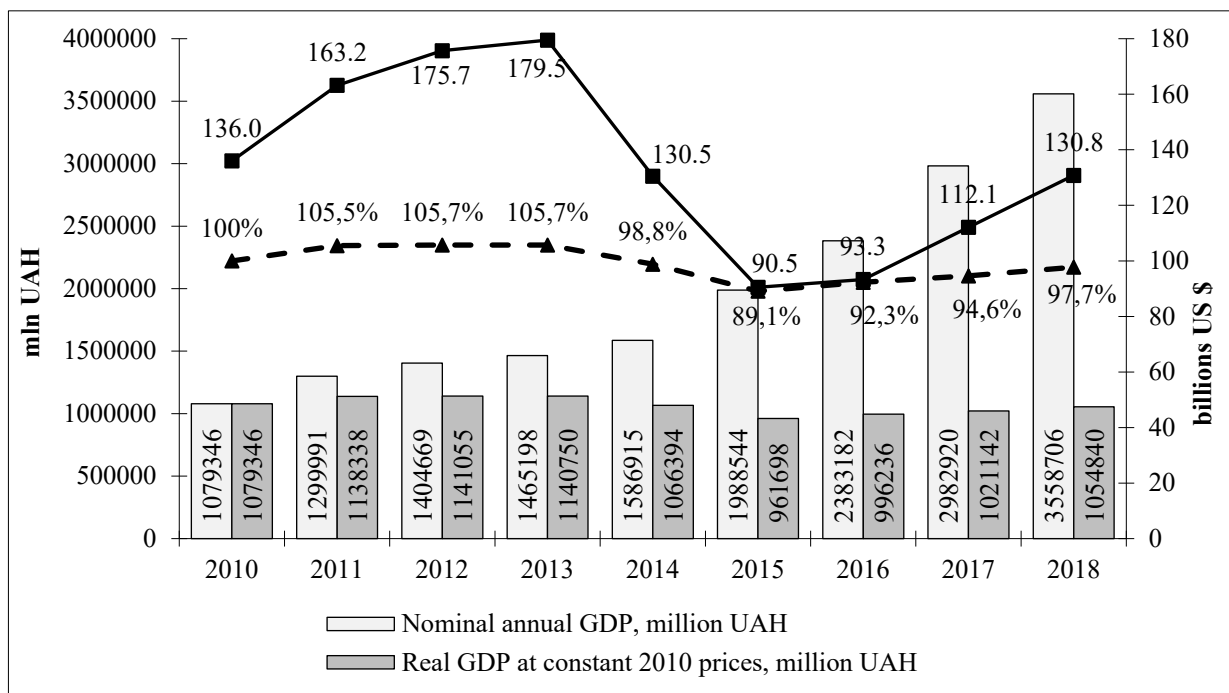


Source: author's construction based on World Bank databases

Fig. 2. GDP per person employed (constant 2011 PPP \$)

According to the World Bank data, GDP (PPP \$) per person employed in 1992 in Latvia and Ukraine was 19.7 thousand and 18.8 thousand dollars (only by 5% lower), respectively. However, in the following years, productivity dynamics in Latvia were much more rapid than in Ukraine. In 2018, productivity in Latvia was almost three times the level of Ukraine. Thus, income level and living standards within the countries were affected accordingly.

Thus, according to the State Statistics Service of Ukraine, the nominal GDP in 2018 amounted to 3558706 mln UAH, which is 19.3% more than the previous year, and 229.7% more compared to 2010 (see Figure 3).



Source: author's construction based on the data of the State Statistics Service of Ukraine

Fig. 3. Dynamics of the nominal and real GDP of Ukraine in 2010-2018

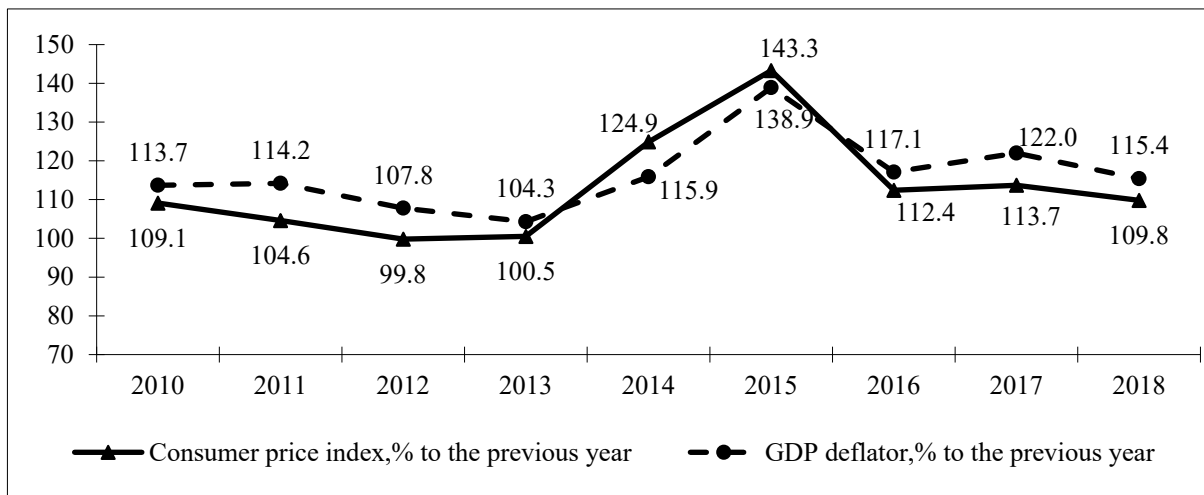
However, this growth is not evidence of the socio-economic recovery of the national economy, but rather confirms the protracted recession and stagflation. Comparing the real GDP in 2018 in prices of 2010 directly to the actual GDP in 2010, we note that it even decreased by 2.3%. The reason was the involvement of Ukraine in the geopolitical conflict, which in turn led to the destruction of the established ties, the structure of the country's economy and the principles of building production relations and income distribution.

The years 2014-2015 were particularly difficult, characterized by the deployment of a military-political conflict with Russia, the loss of production capacities, intersectoral and logistic relations in the interregional and foreign economic space, limited access to energy raw materials, the devaluation of the national currency, and the growth of investment risks. In 2014, the economy entered into a state of stagflation crisis (an annual decline in GDP of 6.6% was observed, combined with an inflation rising to 24.9% at the end of the year). Due to a number of incorrect actions by the economic, financial and monetary authorities, the stagflation crisis sharply worsened in 2015: GDP fell to its lowest level, inflation reached a galloping level (60.9%) in April 2015, and at the end of the year it amounted to 43.3%. The national currency devalued more than threefold. According to research Ukrainian economy development conducted by the Razumkov Center, stabilization of the economic situation is forecasted in 2021. Real GDP is expected to grow by only 0.5% in 2019, by 1% in 2020, and by 2.9% in 2021. At the same time, the inflation rate in 2019 is projected at 10.7%, in 2020 - at 8.3%, and in 2021 - at 7.4% (Yurchyshyn V., 2018).

The level of inflation is determined by price indices, in particular the consumer price index, which reveals a change in the value of a fixed consumer set of goods and services in the current period relative to the previous one. An analysis of its dynamics over the last decade indicates that, after the global financial and economic crisis of 2008-2009, its gradual decline to 98.8% in 2012 was observed. Unfortunately, the crisis of 2008-2009 practically destroyed the investment and purchasing power of Ukraine, and the country entered the crisis of 2013-2014 in an extremely weakened state, having no enough time to restore it. The years 2014-2015 are characterized by a slump in GDP, especially in dollar terms, a rapid increase in prices and a decline in the standard of living of the population.

2016 was distinguished by gradual signs of overcoming the negative consequences of the crisis. The growth of real GDP compared to the previous year was 2.3%, which was achieved due to the revival of domestic investment and

consumer demand. The recovery in economic activity was also reflected in the growth of real average monthly wages by 9% and the increase in the volume of households' final consumer spending by 2.1% (at constant 2010 prices). During 2018, a positive trend in the growth of the physical volume of GDP retained (it increased by 3.3% compared to 2017) and the inflationary pressure weakening (inflation index decreased by 3.9%). Despite another increase in real wages (its growth rate in 2018 was 12.5% compared to 2017), inflation is restrained due to the still low purchasing power of the population and the unsatisfactory financial condition of domestic enterprises (see Figure 4).

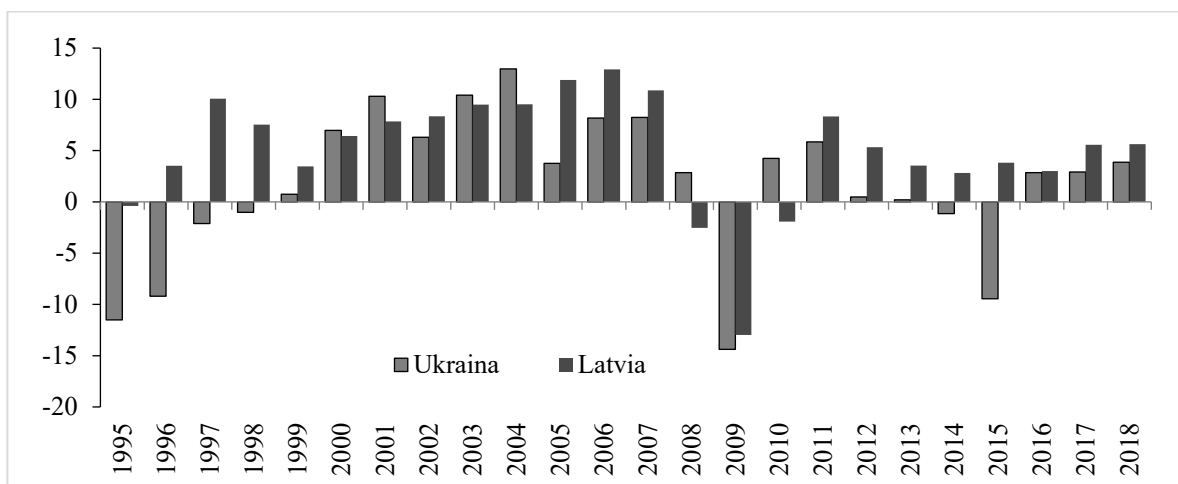


Source: author's construction based on the data of the State Statistics Service of Ukraine

Fig. 4. The dynamics of fluctuations in the price indices in Ukraine in 2010-2018

For comparison, the inflation rate in Latvia in 2018 was 2.6%, which is 0.3% less than in 2017. The highest inflation rate in Latvia was observed in 2008 during the global financial crisis reaching 15.3%. Subsequently, the situation stabilized and in 2010 there was a deflation of -1.2%.

GDP per capita is one of the most accurate ways of assessing the economic development of a country, and also allows comparisons of economies of different magnitudes. Between 2000-2013, relatively similar trends in GDP per capita changes can be observed in Latvia and Ukraine. Both countries suffered severe losses during the global financial crisis. (see Figure 5).



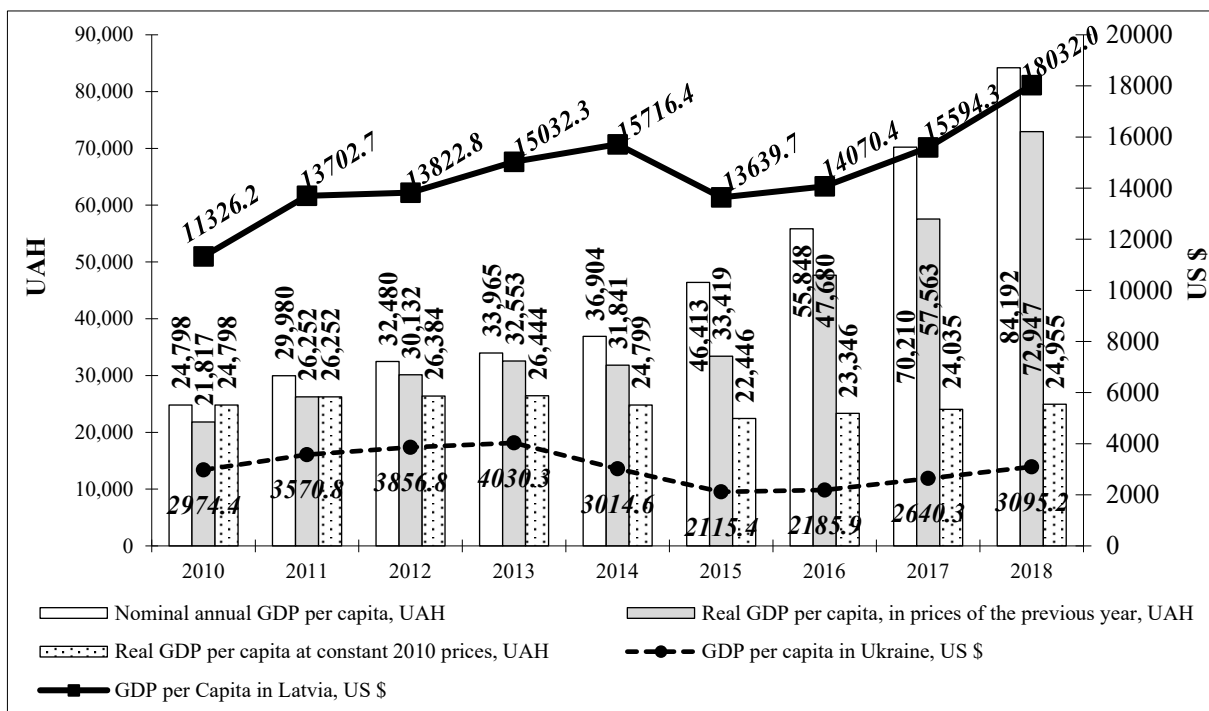
Source: author's construction based on World Bank databases

Fig. 5. GDP per capita growth (annual %)

In 2015 in Ukraine real GDP (in 2010 prices) fell by 9.5% and reached its lowest level of 22446 UAH per capita (State Statistics Service of Ukraine, 2019). In 2016-2018, there is some improvement in GDP per capita in Ukraine, which is due to both a slight increase in real GDP and a decrease in the population. Over the past year, the number of citizens of the country have become 168 thousand less. In 2017, the backlog of real GDP per capita to 2010 was only

3%, therefore, the national economy emerged from the recession and entered the recovery phase, and almost reached its status in 2010.

It is inappropriate to compare the physical volumes of the nominal and real GDP of Ukraine and Latvia, since the Ukrainian economy is larger than the Latvian economy. Despite the fact that Ukraine produces only 0.29% of world GDP, Latvia is an even smaller economy; its world GDP is only 0.04%. However, a comparison of these two countries in terms of GDP per capita shows that the well-being of the Latvian population is significantly higher than the welfare of an average Ukrainian, since GDP per capita in 2018 in Latvia is 18032 US \$, while in Ukraine it is almost 6 times less - only 3095.2 US \$ (see Figure 6).



Source: author's construction based on the data of the State Statistics Service of Ukraine and Latvia

Fig. 6. The dynamics of GDP per capita in Ukraine and Latvia in 2010-2018

Under the rating of the world countries in terms of GDP per capita, Ukraine ranks 130th out of 192 economies of the world, while Latvia occupies 50th place (IMF, 2018).

In accordance with the research presented by the group of scientists in the Doctrine of Sustainable Development of Ukraine until 2030 (Kharlamova G. and etc., 2018) and our own findings, the main factors of the GDP loss and the development restraining of Ukrainian economy are the following:

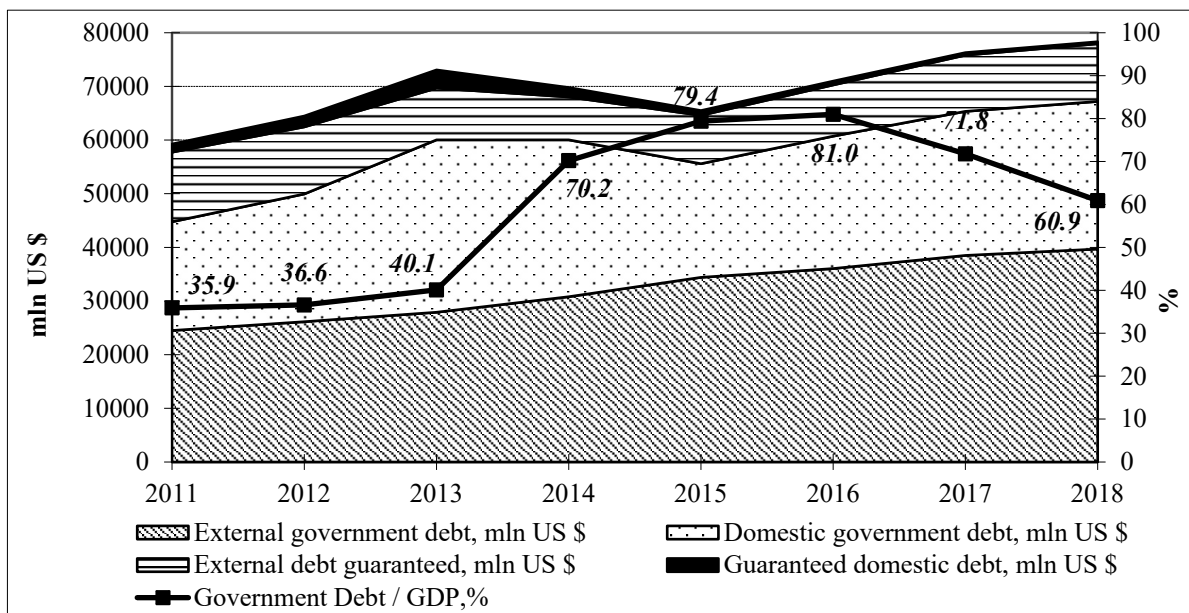
1. *The war in the East of Ukraine and occupation of Crimea* has the negative impact on the national economy (25% of GDP lost).
2. *The share of the shadow sector* in the national economy is estimated at 50-52% , although, according to official data, the integral indicator of the shadow economy in 2018 was 30% of GDP, that is 2% less than in 2017, which was the lowest level since 2009 (Ministry for Development Economy, Trade and Agriculture of Ukraine, 2018).
3. *The extent of corruption caused* by the shadow economy reached 14% of GDP (depending on the industry).
4. *The improper outdated pension system* puts significant negative pressure on the national economy. In 2018, the expenditures of the Pension Fund of Ukraine amounted to 358,604.6 mln UAH (Pension Fund of Ukraine, 2019), which is 10.1% of GDP (for comparison in 2015 - 13.4%).
5. *Government debt and government-guaranteed debt*, which has been showing over the past years an upward trend due to the high foreign exchange risk of external debt, the unstable situation with the refinancing of the previous

years' debts, as well as the growing pressure of debt payments on the public finances, inefficient and inappropriate use of borrowed funds. The turning point in Ukraine's rapid accumulation of public debt was the 2008 global financial crisis, which was exacerbated by the 2014 political events.

As of December 31, 2018, the total debt of Ukraine amounted to 21168627.1 mln UAH, which is 5 times more than in 2010, partly due to the significant increase in prices and devaluation of the national currency. In dollar terms, government debt growth was more moderate and amounted to 1.4 times. As of December 31, 2018, Ukraine's total debt was 78323 mln US \$ (The national debt of Ukraine, 2019), with external debt amounted to almost two-thirds - 64.4% of the total public and government-guaranteed debt. The major creditors of Ukraine are the United States and the IMF. That generates the dependence of state economic policy on foreign investors.

One of the key indicators of the country's debt sustainability, which characterizes the level of debt burden on the state economy and its solvency, is the ratio of total government debt to GDP, the limit value of which is set in the Budget Code of Ukraine at 60%, and which is the one of the requirements for countries-member and countries-candidate for accession to the European Union. Since 2014, this indicator has crossed a critical point (see Figure 7), and reached its highest value of 81% in 2016, since public debt is growing at a much faster rate than GDP.

Relatively GDP, the total government debt in 2018 amounted to 60.9%, which is critical value for national security. According to domestic and foreign studies, the economically safe level of government and government-guaranteed debt for Ukraine is about 35% of GDP. This conclusion is based on statistics on the occurrence of defaults in countries with emerging markets (IMF researches) and on the Ukraine's own experience, which has twice failed to independently fulfil its debt obligations when they approach the level of 30-35% relative to GDP, in particular: in the late 90s, which led to several restructuring of domestic public debt and the restructuring of external public debt, and in the late 00s, which led to the request for assistance from international financial institutions (the amount of financing assistance was the second largest in the world after IMF assistance for Hungary).



Source: author's construction based on data of the Ministry of Finance of Ukraine

Fig. 7. Dynamics of the State and Guaranteed Debt of Ukraine in 2010-2018

6. Energy import dependence of Ukraine and high energy intensity of GDP exceed 3-5 times the global average and developed countries level. When the world average energy intensity of production in 2018 was 0.116 TOE (tons of oil equivalent) per 1 thousand international dollars of world GDP, in Ukraine this indicator was 0.238 TOE and was the worst among all countries in the world. For comparison, a similar indicator in Poland amounted to 0.097 koe/\$, in the Central Europe countries and the Baltic countries - on average 0.105 koe/\$, in France - 0,086 koe/\$,

in Japan - 0,079 koe/\$, in China - 0.131 koe/\$, in the USA - 0.176 koe/\$ (Global Energy Statistical Yearbook, 2019).

There are several more problems, in addition to the identified in the Doctrine of Sustainable Development of Ukraine, that hinder the development of the Ukrainian economy:

7. *Dependence of the Ukrainian economy on the raw materials export and production of commodities with low added value*, as well as a high share of consumer goods imports against the backdrop of the reduction of the domestic market and national production. In 2018, exports of Ukrainian goods and services amounted to 57,118.4 mln US \$, or 108.6% compared to 2017, imports - 62944.5 mln US \$, or 114.3%. The negative balance of foreign trade amounted to 5826.1 mln US \$, which is 2.3 times more than the negative balance of 2017 (-2501.1 mln US \$) (State Statistics Service of Ukraine, 2019). At the same time, exports of goods increased due to high volumes of supplies of grain, oils and fats, ferrous metals. The export commodity-dependent economy model leads to a loss of value added, to slow growth of real GDP and, as a consequence, to deepening of the poverty of the population: exports of raw materials and commodities with low added value → equity disinvestment → low wages → underdeveloped domestic market → dominance of imported final goods → permanent balance of payments, currency and banking crises → conservation of a weak economy → deepening poverty.

8. *The aggravation of the socio-demographic crisis*, the depth and permanent nature of which indicate that the country has reached the critical risk limit for the self-preservation of the nation, the reproduction of human and intellectual capital. This demographic situation is an acute national security problem. According to the State Statistics Service of Ukraine, the population decreased by almost 10 million people from 1991 to 2018. Particularly aggravation of the demographic crisis falls on the period from 2014 to 2018 (more than 3 million people), including the temporary occupation of Crimea and parts of the Donbas, exacerbation of mortality and decrease in the birth rate. According to the 2018 demographic estimate, the mortality rate was 15.54; Ukraine ranks third in the global population mortality rating (The World: Deaths Per 1000, 2018).

In the context of globalization and growth of human capital mobility, under the high wage differentials between Ukraine and more developed countries, the significant scale of population migration is observed, primarily labour migration (mostly illegal). According to experts, the integrated estimate of migrant workers in 2015 - 2017 is 4 million, which is 16% of the total employable population. There are about 2.6 - 2.7 million people are outside the country simultaneously. The largest labour migration is observed to Poland, Russia, Italy, Czech Republic, USA, Belarus and to others developed countries. Labour migration abroad significantly reduces the amount of labour resources in Ukraine, creates an acute shortage of working class, and therefore is a strong deterrent to GDP growth in the country.

The massive outflow of youth (students, school graduates) to study abroad is another acute systemic demographic problem, fraught with great risks for the future reproduction of the nation. According to the results of sociological surveys of school graduates, almost 70% of respondents express a desire to go to study abroad.

9. *Poor quality of life, high poverty, low solvency of the population*. According to the analytical report and scientific publications of the M.V. Ptukha Institute of Demographic and Social Research (Comprehensive assessment, 2018), during 2017 - 2018, the level of relative poverty was growing by the national criterion (75% of the median of total expenses) - by 1.3%, as well as by the criterion using the EU equivalent scale (60% of the median of total income) by 0.9 %.

The medium monthly salary of an average working Ukrainian was approximately 385 US \$ in 2019. However, it should be noted that there is a significant gap between the income quintile groups of the population. Thus, in 2018, the share of the population with per capita equivalent total monthly income below the average level in Ukraine amounted to 60%, below the actual minimum subsistence level (3236.52 UAH or 119 US \$ at the 2018 average

exchange rate) - 29.3%, below the legislatively established subsistence minimum (1725.67 UAH or 63 US \$ at the 2018 annual average) - 1.7%.

Limited solvency demand hinders the development of domestic industries aimed at the needs of the domestic market. The gap between the Ukrainian population incomes and its expenditures on the purchase of goods and services is rather small, meaning that Ukrainians spend almost all their monetary resources on current consumption. Therefore, the opportunity to accumulate savings is low, that in turn reduces the prospect of additional investments and an increase in demand for more expensive goods, including long-term used, travel, real estate, etc. The lowest share of expenditures on purchasing goods and services in the annual income in the period 2005-2017 was 76% in 2010, and the highest - was 89% in 2017. According to preliminary results of 2018, the share of Ukrainians' expenses in their income is on average within 85%.

Analyzing the structure of consumer aggregate expenditures of Ukrainian households over the past 5 years, it is clear that they spend more than 50% of their income on food purchases. This is quite high compared to developed countries. According to the US Department of Agriculture, in 2018, Ukraine is in the top-10 countries with the highest spending on food. For comparison, consumers in the US in 2017 spent on food about 7% of their income. In Europe, the least money is spent on food by residents of Luxembourg (8.7% of their income), in the UK and the Netherlands - about 10%, in Austria, Switzerland, Finland - up to 12%.

10. *Systematic missteps in the areas of monetary policy, currency and banking regulation, investment policy.* The inaccessibility of long and, recently, short financial resources for business development minimizes the role of credit sources in financing current activities and investment projects of domestic enterprises.

The high degree of depreciation of fixed assets in production and a low level of investment and innovative activities preserve the technological backwardness and commodity-dependent status of the domestic economy. Investment activity often comes down to restoring the existing structure of the production base and not even in full. Wear and tear level of fixed assets is gradually growing. According to the latest data from the State Statistics Service, the depreciation level of fixed assets in industry was 69.4%, in particular in the processing industry - 76.4%.

Foreign direct investment in capital in 2018 amounted to 32291.9 mln US \$ (including 24742.7 mln US \$ from the EU). This is 2.2% more than in the previous year, but 28.8% less than in 2010. At the same time, the net inflow of foreign direct investments into Ukraine amounted to 2.4 billion US \$, which is 0.2 billion US \$ less than in 2017. More than half of FDI (58% or 1.4 billion US \$) were directed to the real sectors of economy. Investments in the financial sector accounted for 42% of the total, almost half of which were banking sector operations to reissue debt into authorized capital. However, at present, their volume is much smaller than necessary and does not allow development and even renewing outdated and worn-out fixed assets and intangible assets.

The unfavourable investment climate is confirmed by a number of obstacles identified in Doing Business's 2019-2020 ranking, where Ukraine ranks 64th among 190 countries in the world, and includes the quite low positions by the following criteria: solving insolvency problems - 146th place; connection to energy supply systems - 128th place; conditions for foreign trade - 74th place; enforcement of contracts - 63rd place. For comparison, Latvia ranks 19th in the overall ranking of countries (Doing Business, 2019).

The assessment of Latvia's economic development trends over the last ten years reveal that the large macroeconomic disproportions have been eliminated and risks of economic vulnerability reduced. Currently, macroeconomic stability is sustained - low government debt and inflation, balanced budget and balance of payments, which remains an important prerequisite for long-term economic development. However, Latvia's competitiveness is significantly weakened due to institutional deficiencies, insufficient quality of infrastructure and business development, and low innovative capacity.

In recent years, productivity dynamics in Latvia have exceeded the level of EU average. Between 2011-2018, productivity has increased by 23.4% (EU-28 - 6.4%), and productivity gap has narrowed by nearly 12 percentage points. However, Latvia still significantly lags behind highly developed countries in the EU. In 2018, GDP per person employed in Latvia reached 48.9% (69.3% based on PPP) of the EU average (Eurostat, 2019).

The largest productivity gap for Latvia remains with the EU-15 (old EU MS). Also, several of the EU-15 countries are important trading partners of Latvia. Therefore, bridging the productivity gap can be a key prerequisite for maintaining competitiveness in the EU's single market, particularly given the accelerated process of wage convergence in recent years.

Long-term development trends indicate that productivity dynamics in Latvia have moderated. During the post-crisis period (2011-2018), productivity annual growth rates have been approximately three times lower than before the crisis (1996-2007). As productivity dynamics are slowing down, convergence rates also decline, thus posing risks of entering the middle-income trap.

The low level of productivity is largely determined by scarce investments in R&D, the weak innovative activities of entrepreneurs, and inefficient allocation of existing resources. Also, the lacklustre participation of entrepreneurs in global value chains remains an important factor hindering potential productivity gains. In Latvia, the workforce is mainly concentrated in low productivity sectors, and the process of labour force transition to higher productivity sectors is slow (Steinbuka, 2019). The problems of inefficient deployment and allocation of resources are also stressed in studies by IMF (IMF, 2016) and the EU (EC, 2018). Also, research in Latvia illustrate the potential to raise productivity by more efficiently allocating the existing resources (Benkovskis, K., 2015).

Productivity growth is significantly constrained by the low level of R&D investment in the private sector. Currently, spending on R&D in Latvia substantially lags behind the set target rate of 1.5% of GDP. In 2018, investments in R&D reached EUR 186.2 million or 0.63% of GDP (CSB database). In 2011-2018, investments in R&D amounted to 0.6% of GDP (in 2018 – 0.63% of GDP), and their annual dynamics were moderate. However, spending on R&D by entrepreneurs constitute only $\frac{1}{4}$ (or 0.15% of GDP) of total R&D spending. In this respect Latvia significantly lags behind the average level in the EU, where entrepreneurs provide more than half of total R&D investment.

The low level of R&D investment and weak innovative activities of entrepreneurs in the private sector can largely be attributed to the existing economic structure and institutional deficiencies. Latvia's current economic structure can be characterized by a low proportion of economic activity concentrated in industry and R&D intensive sectors. In addition, small and medium sized enterprises (SME) represent a large share of total enterprises in Latvia.

The above-mentioned structural barriers not only accentuate the private sector's low capacity for R&D investment, but also their low demand for R&D research. Only one fifth of total amount of company investment is devoted to research in universities and scientific institutes. This, in turn, illustrates the lack of cooperation between universities, scientific institutes, and private sector companies.

In a market economy, the economic structure is determined by a competitive advantage. The dominance of low- and medium-low-tech sectors within the economy is an indication that relatively low labour costs still remain a significant competitive advantage for entrepreneurs in Latvia. Although recent improvements in the economic structure can be observed, structural changes occur only gradually. As a result, the existing economic structure is increasingly becoming an important barrier to investment in identifying and developing our competitive advantage.

The inefficient allocation of resources and the robustness of structural changes can largely be attributed to institutional deficiencies (e.g., legislation, state aid, economic and political institutions, etc.), which, in turn, does not ensure a more efficient functioning of the market for products and resources (incl., labour market). This allows low-productivity companies to maintain and increase their market share, thus limiting potential productivity gains and

increased convergence towards the EU.

A today's world is an era of technology transformation – most commonly referred to as the 4th Industrial Revolution. Thus, it is increasingly important to be prepared for the new competitiveness challenges, i.e., to be able to respond flexibly to technological innovation. The development towards an innovation and knowledge-based economy is constrained by several factors. To overcome these obstacles, coordinated state intervention, which would minimize the costs associated with the inefficient allocation of resources and strengthen the country's competitiveness, is required.

Conclusions, proposals, recommendations

Although Latvia and Ukraine differ by size, population, geographical location, and the availability of natural resources, countries also share many similarities - in the early 1990s, both countries regained their independence and embarked on ambitious reforms towards the development of a market-based economy and now there are a number of common problems for Ukraine and Latvia, in particular of an institutional nature.

So, according to the analyzed overall macroeconomic criteria, the national economy of **Ukraine** can be qualified as relatively small, open, commodity-dependent, highly energy-consuming and energy-dependent. Ukraine has a rather low economic recovery rate, hampered by a wide range of unresolved problems, in particular:

- the loss of production capacity, infrastructure and the violation of economic intersectoral and logistic ties due to a military-political conflict;
- trade restrictions by the countries-members of the Customs Union, especially the Russian Federation;
- limited availability to energy raw materials;
- accumulated systemic imbalances;
- the structure of production focused on the export of low processed products;
- high tear and wear level of fixed assets, which makes it difficult to increase the competitiveness of manufactured products;
- maintaining excessive regulatory and tax pressure, in particular, targeting the fiscal system to maximum fees without taking into account the interests of taxpayers;
- low level of savings and investments, low investment attractiveness;
- lack of public and business confidence in authorities;
- large-scale migration of population and others.

In order to solve specified problems in Ukraine it is necessary to create conditions for transition to sustainable economic growth, which will be based on expansion of investment demand, strengthening of competitiveness of the Ukrainian economy, increase of efficiency of resources utilization and scientific and technological potential. To overcome the demographic crisis in Ukraine, it is necessary to build a migration policy aimed at strengthening the competitiveness of the economy and the quality of life, improving labour productivity and attractiveness of the labour market for population and migrants. It is necessary to implement a systematic policy to increase the motivation for the return (and attraction) of workers from abroad, to create conditions favourable for the assimilation of people.

The transition to economic growth requires an expansion of domestic production, and it is important to focus on the national consumption in order to reduce import dependence. Creating new workplaces and rising household incomes will scale up the purchasing power of Ukrainians, while an increase in the goods volume will slow down price rising. Increasing export volumes of products with a higher processing level will improve the financial and economic situation of Ukrainian producers and scale up the GDP. At the same time, saturating the market with cheap financial resources, transforming debt policy, capital recovering in priority sectors, and creating a favourable investment climate will stimulate an increase of business activity and financial stability of the country.

The most important advantage of **Latvia's** competitiveness is macroeconomic stability, at the same time the cost competitiveness indicators have declined and Latvia have large productivity gap compared to highly developed countries in the EU (in 2018, GDP per person employed in Latvia reached just 48.9% of the EU average).

The reliance on the low- and medium-low-tech sectors and the large share of microenterprises within the economy constitute major barriers to moving towards innovation and knowledge-based economy and reducing the productivity gap.

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