

# Future of Latvian economy: Challenges and Opportunities

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# Time to think more about long-term challenges (= opportunities)

## **Many economic challenges resolved over the last 5 years:**

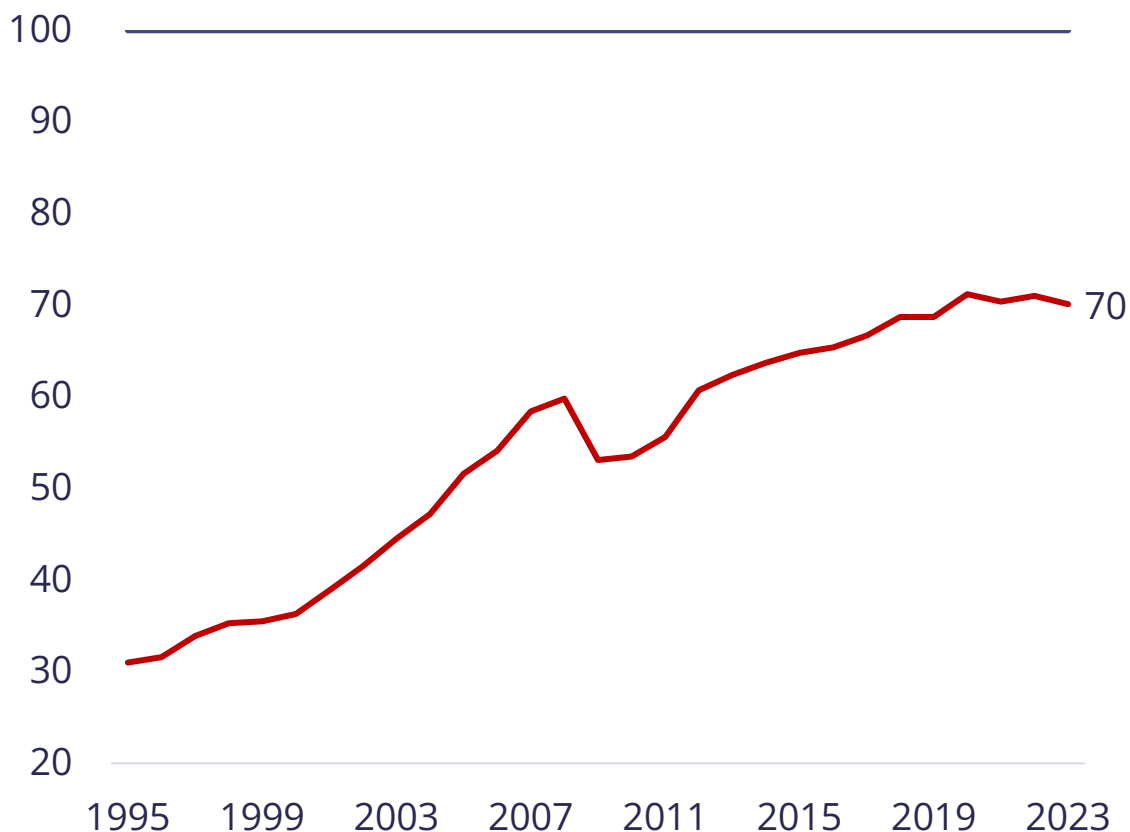
- Covid-19 pandemics – economic output and income now exceed pre-pandemic levels; unemployment remains low.
- Energy crisis, high utility bills and inflation upswing to 20% - inflation is back to 2% and ECB is in a process of lowering interest rates again.
- Migration turned slightly positive since 2022 (also excluding Ukraine refugees).

## **Some negative trends:**

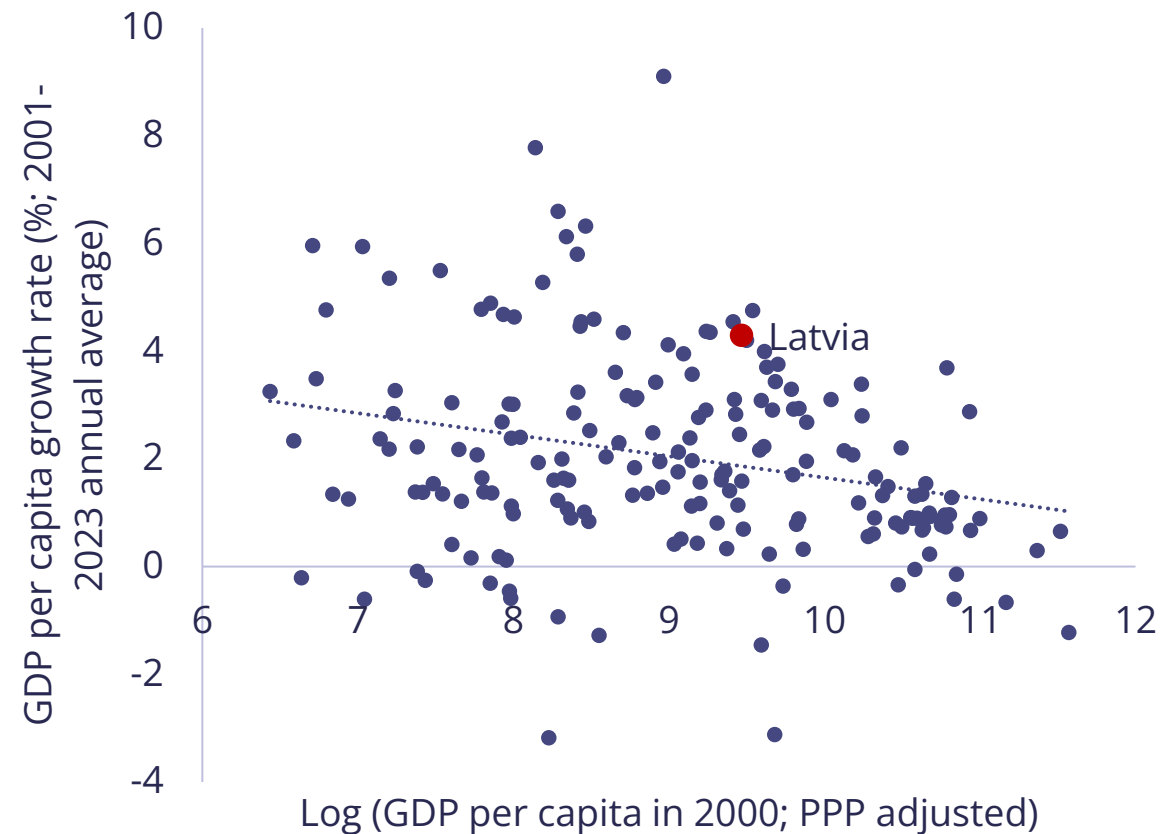
- While state support programs were inevitable (and rather effective) in the short run, we see a loosening of the fiscal stance in the medium term: high budget deficits (about or more than 3% of GDP) for five years in a row (+ projected for 2025-2026).
- Clear move towards more income redistribution, but not so big progress in improving social lifts (better education etc.) and opportunities to earn.
- Wage growth exceeding labour productivity => lower competitiveness of exporters.
- Brain drain continues - immigrants often have lower qualification than emigrants.

# Latvian economic growth – extraordinary success story ...

**Gross Domestic Product per capita in Latvia**  
(% of EU-27 average; purchasing power parity adjusted)

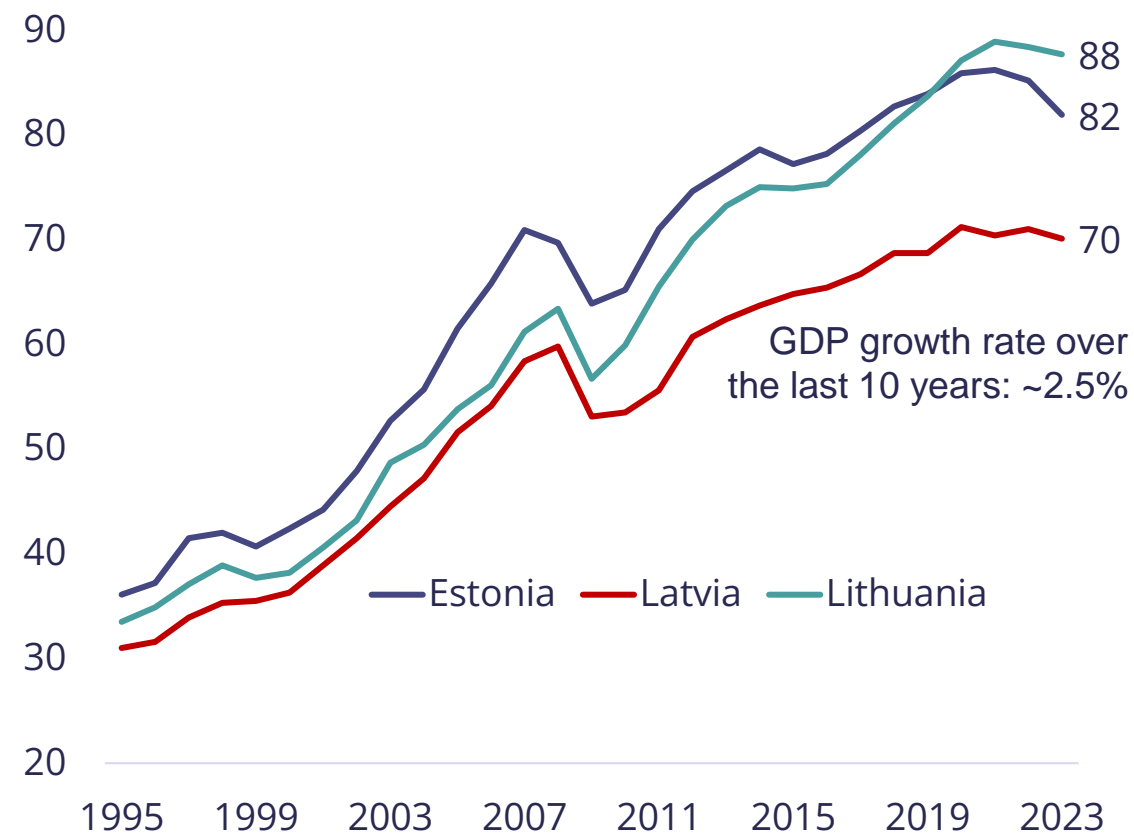
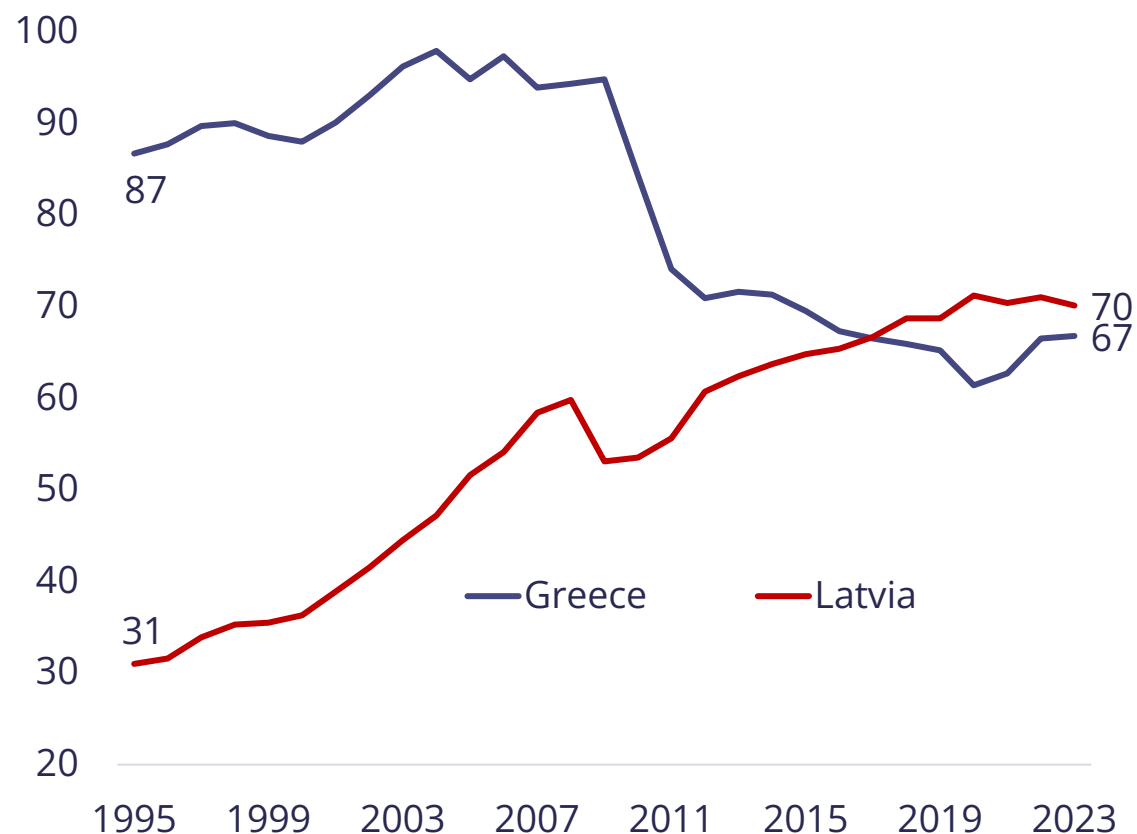


**Global income convergence picture (2000 - 2023)**




# ... unless we compare ourselves to Lithuania and Estonia

**Gross Domestic Product per capita** (% of EU average; purchasing power parity adjusted)



Do you believe Latvian economic growth rate can double to 5% per year?

- Yes
- No



# How to double Latvian economic growth rate to 5%

## **Human capital:**

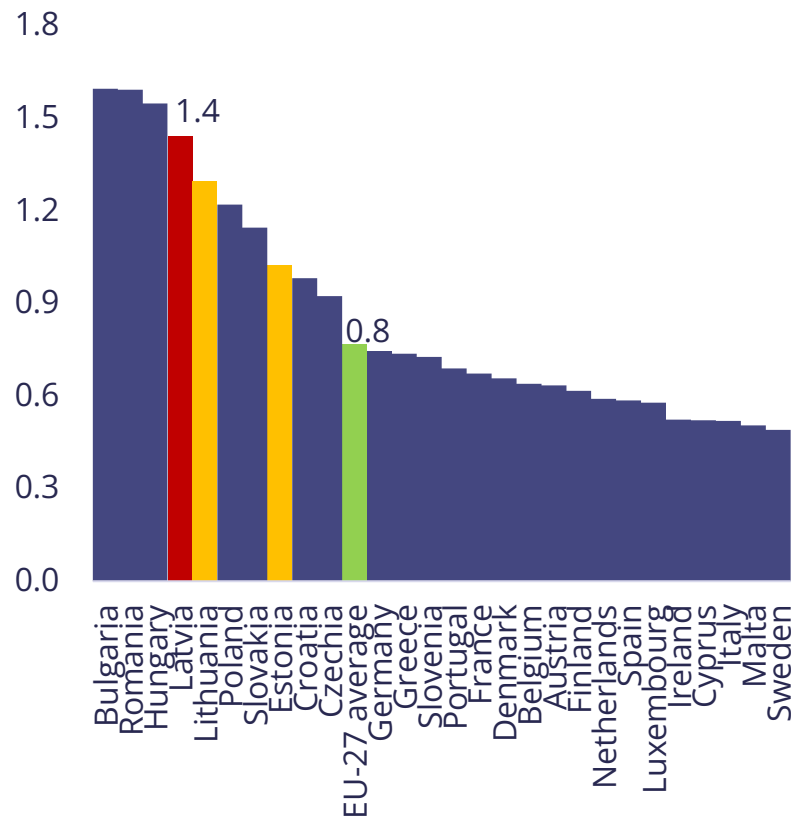
- Activate internal labour reserves,
- Raise the quality of education and healthcare,
- Attract qualified migrants.

## **Investments, innovation and technologies:**

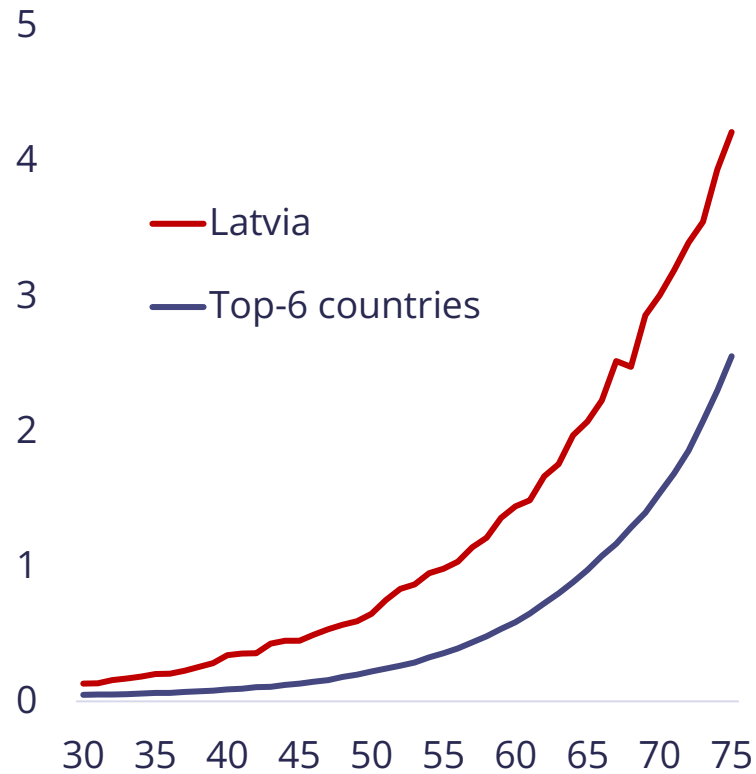
- Foster investments in R&D and new housing,
- Activate credit and capital markets,
- Develop a know-how to produce high value-added products.

# Eliminating premature mortality is more promising than birth rate increase

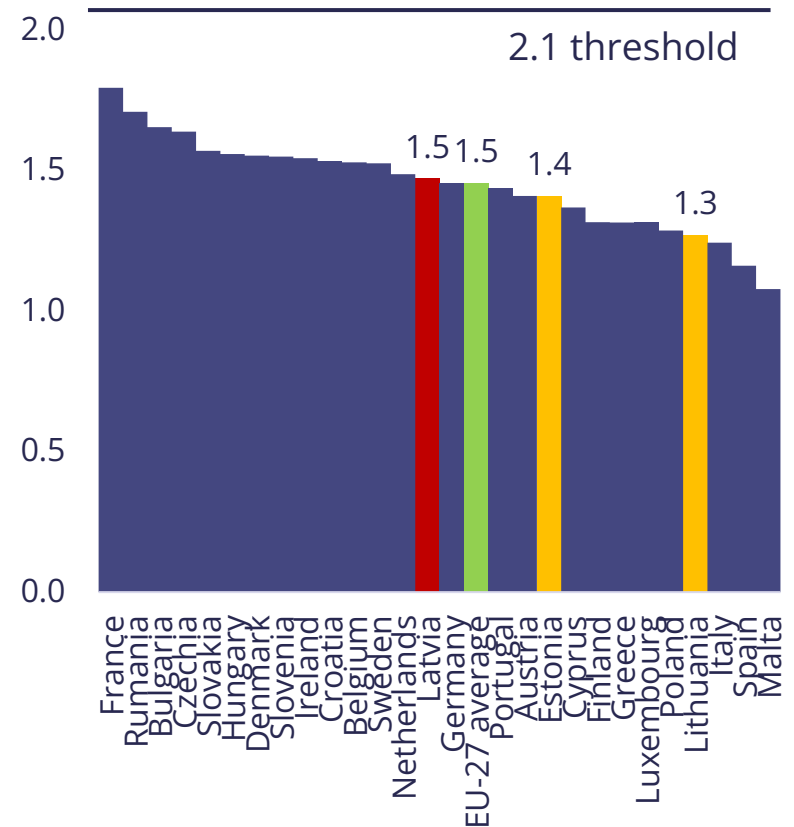
**Probability to die at the age of 60 in the EU countries** (%; 2018-2022 average)



**Probability to die at a specific age** (%; 2018-2022 average)



**Fertility rate in the EU countries** (in 2022)



Excess mortality has a non-negligible impact on the economy.  
Substantial gains, if Latvian healthcare system would have improved  
already in the beginning of 2000-ties

### Population

**4 000**

Number of saved  
lives every year

**60 000**

Latvian population today  
would be larger by this  
amount

### Employment

**40 000**

there would be more  
employed people

### Economic growth (GDP)

**0.2% every year**

faster economic growth  
rate would be achieved

**4%**

bigger GDP in Latvia  
would be

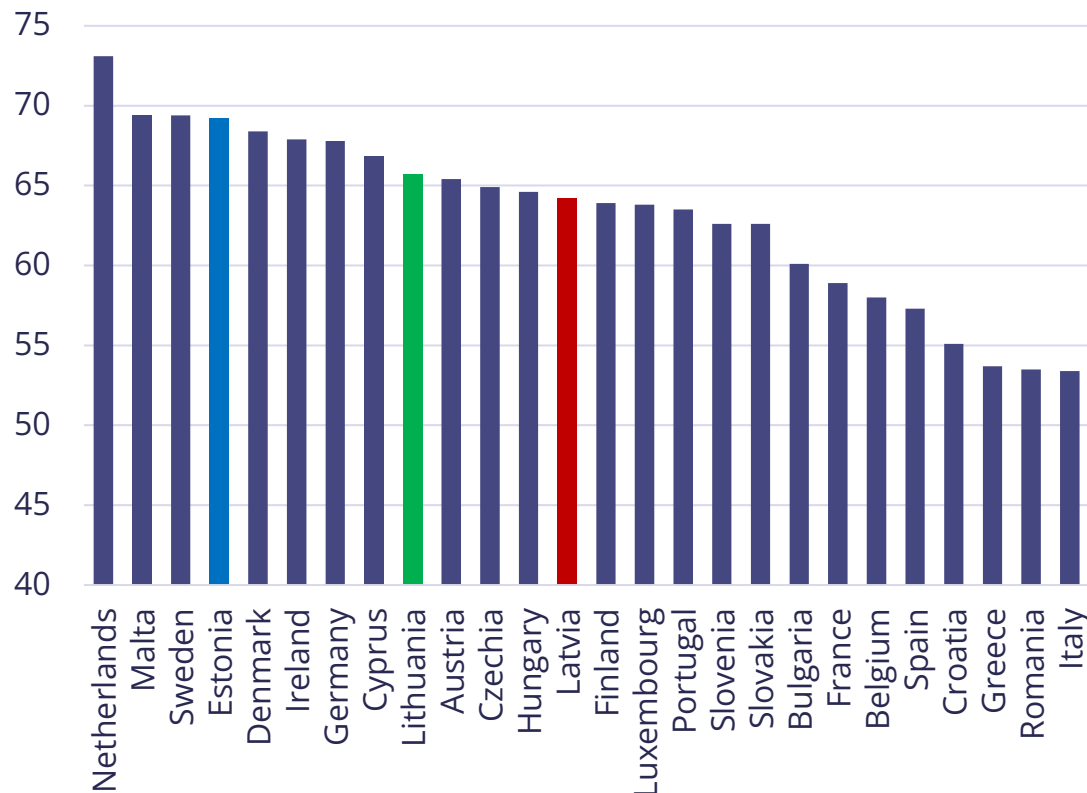
Macroeconomic impact assessment of excess mortality in Latvia is based on comparison of mortality rates for each cohort (until age 65) between Latvia and a group of 6 peer countries (Belgium, Denmark, Germany, France, Netherlands, UK) over 2002-2019 (before Covid-19 pandemics).

Source: author's calculations based on Eurostat data.



# Internal labour reserves are still substantial and should be activated

**Employment rate in the EU countries**  
(%; age 15-74; in 2023)



Source: Central Statistical Bureau of Latvia data; Latvijas Banka staff calculations. For details see Krasnopjorovs O. (2019). «Anatomy of labour reserves in the Baltic countries: a snapshot 15 years after the EU accession». Bank of Latvia Discussion paper #2/2019. [https://datnes.latvijasbanka.lv/papers/discussion/dp\\_2\\_2019-en.pdf](https://datnes.latvijasbanka.lv/papers/discussion/dp_2_2019-en.pdf)

**Internal labour reserves in Latvia**  
(thousand people; in 2023)

Age	Men	Women
15-19	11.3	12.8
20-24	3.5	2.7
25-29	1.2	0.6
30-34	3.4	0.5
35-39	2.5	0.2
40-44	3.2	1.8
45-49	4.3	3.3
50-54	6.1	3.7
55-59	6.2	3.1
60-64	3.5	
<b>Total</b>	<b>45.1</b>	<b>28.7</b>
	<b>73.8</b>	

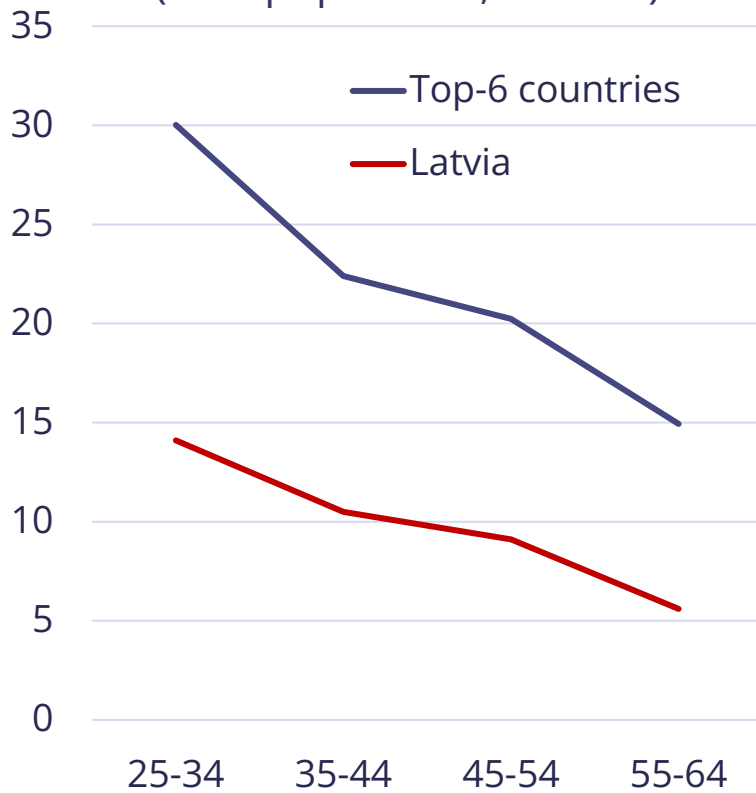
**Young people:**  
low prevalence and prestige of professional education and apprenticeships.

**Upper-middle-aged men:**  
outdated education, low prevalence of lifelong learning, low digital skills, rapidly deteriorating health condition.

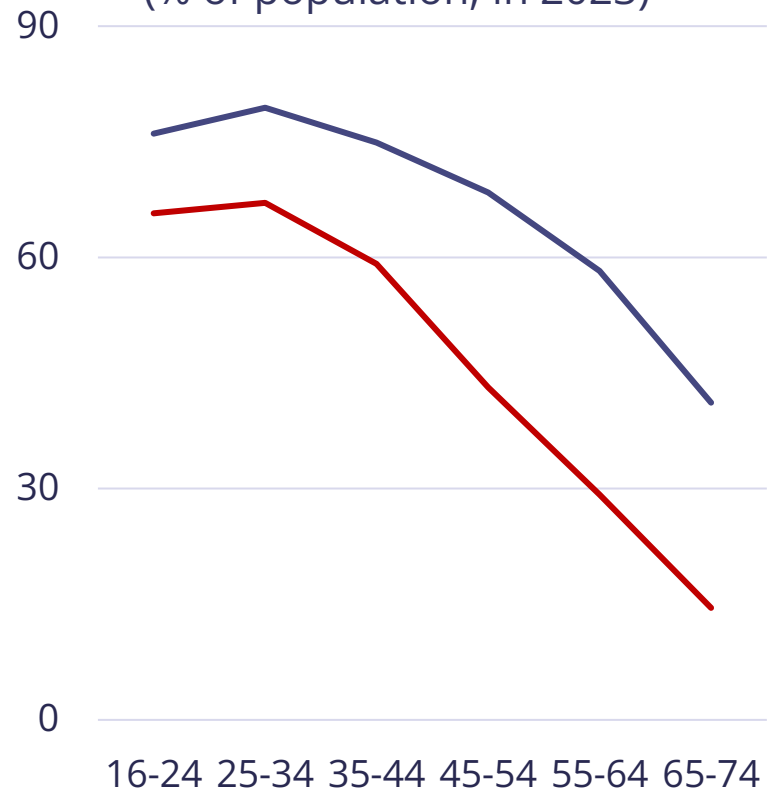
Internal labour reserves reflect additional employment if employment rate in a given age group would reach the EU-6 average. EU-6 countries are Germany, Denmark, Netherlands, Estonia, Sweden and Czechia.

# Lower prevalence of lifelong learning, lower digital skills, rapidly deteriorating health condition

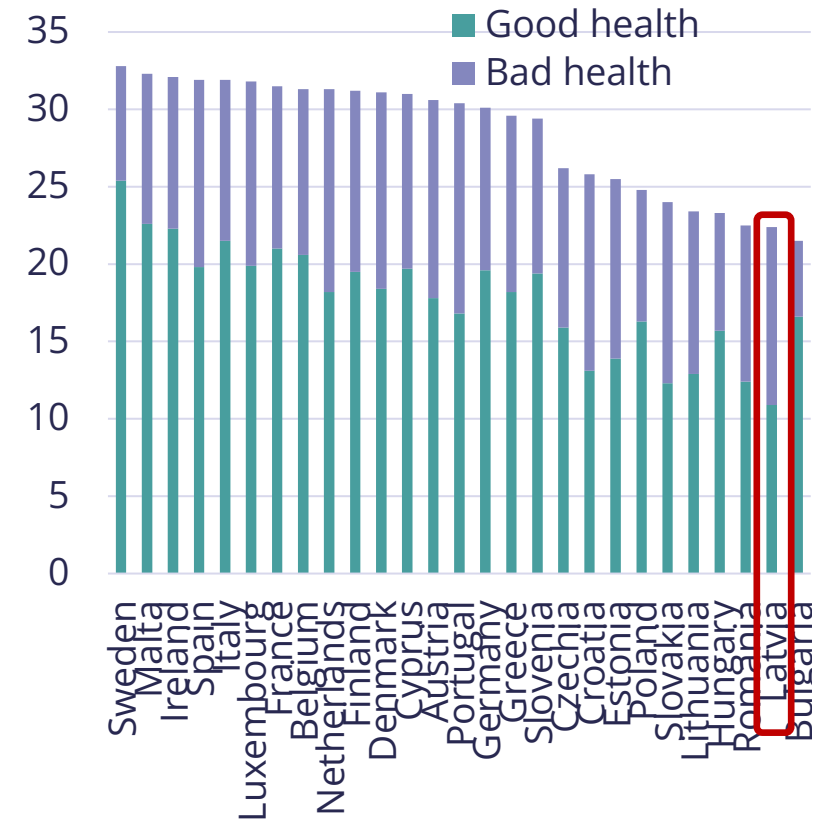
**Participated in education or training in the last 4 weeks**  
(% of population; in 2022)



**Population with digital skills at least at the basic level**  
(% of population; in 2023)



**Life expectancy of 50 years old men** (in 2021)



EU6 countries are Germany, Denmark, Netherlands, Ireland, Sweden, Estonia.

Source: Eurostat data, author's calculations.

# Immigration: quality is more important than quantity

- Globally there is no relation between population (or population density) and prosperity (or economic growth rate).
- Latvia has similar population density as Estonia or USA (and bigger population than Estonia).



Only high-skilled immigration would boost prosperity of a country



**High-skilled immigrants are needed, but rare**

(Quality of life in Riga lags behind majority European cities)

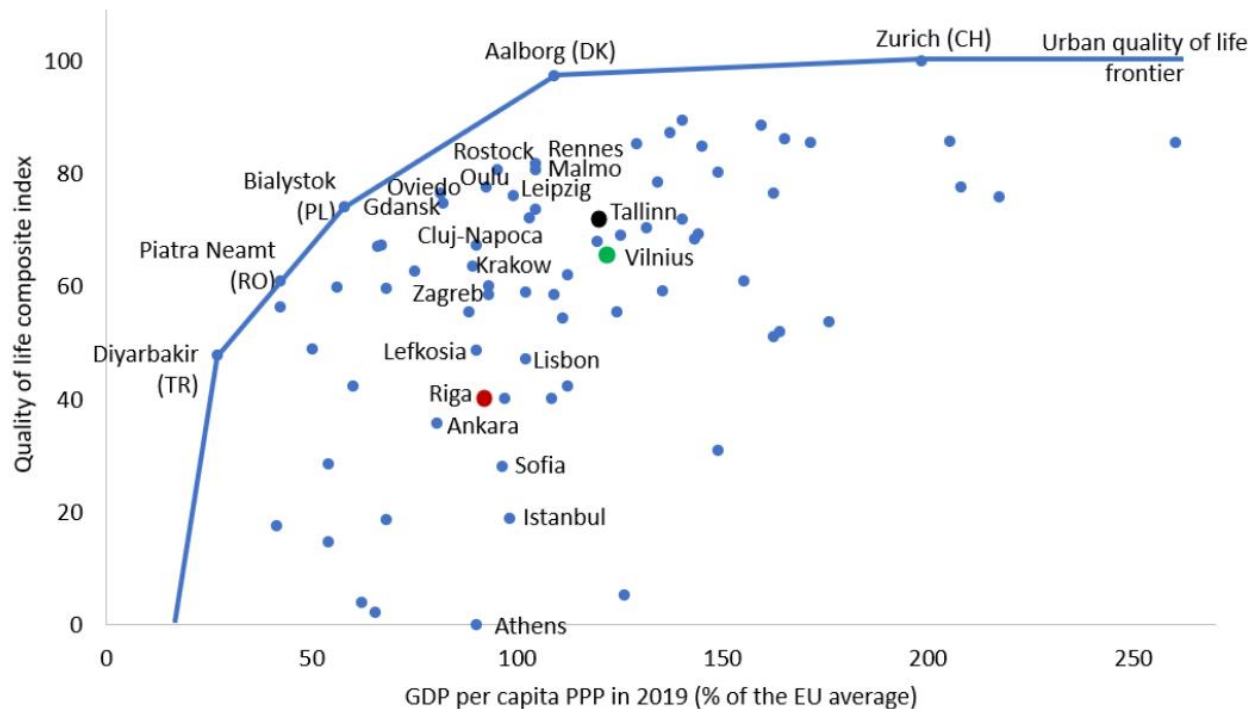


**Low-skilled immigrants want to enter, but are not demanded**

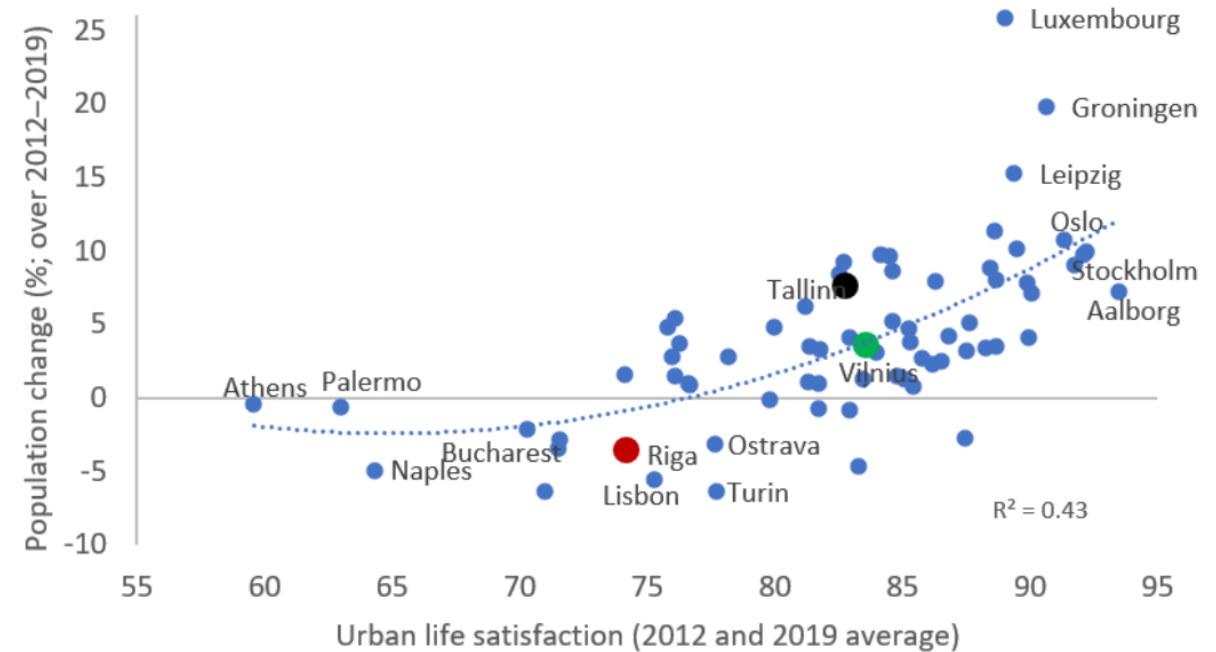
(in Somalia, Niger, Afghanistan etc. majority of population cannot read in any language)

# Perceived quality of life in Riga does not yet lead to mass immigration of highly qualified and creative people

**Gross Domestic Product per capita and quality of life satisfaction in European cities (in 2019)**



**Urban life satisfaction and population change in the European cities**



The quality of life index reflects several dimensions from the European Commission 2019 survey: safety, trust in people around, environmental pollution, infrastructure, governance, public transport, good place to live for different population groups. 0: worst score among European cities; 100: best score.

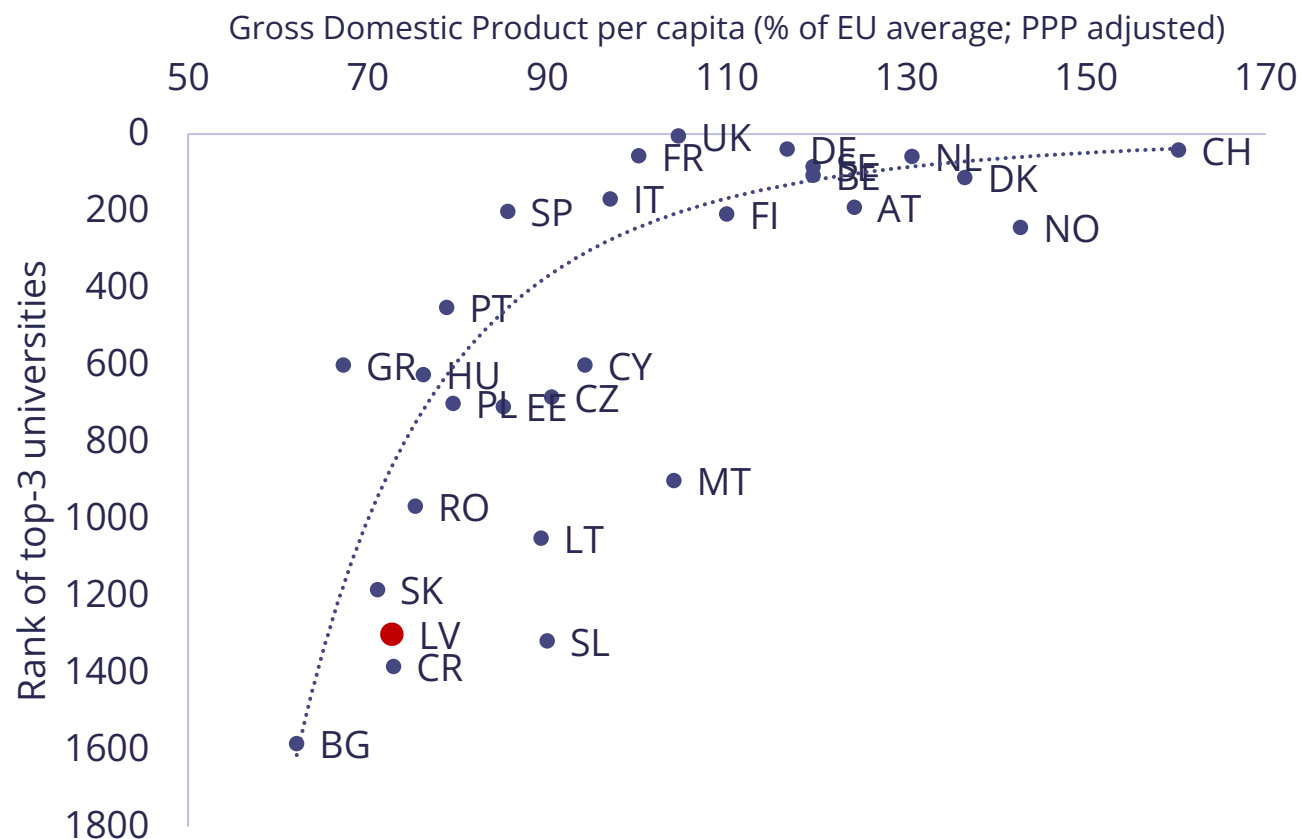
<sup>12</sup> Source: Krasnopjorovs Olegs (2022). «Ready for the next 820? Looking for the keys to paradise of Riga city». Latvijas Banka Discussion Paper #2/2022. [https://datnes.latvijasbanka.lv/diskusijas-materiali/DP\\_2\\_2022\\_Riga\\_12\\_04.pdf](https://datnes.latvijasbanka.lv/diskusijas-materiali/DP_2_2022_Riga_12_04.pdf)

# There is still large room to increase the quality of education

Average rank of top-3 universities according to Times Higher Education rating (in 2024)



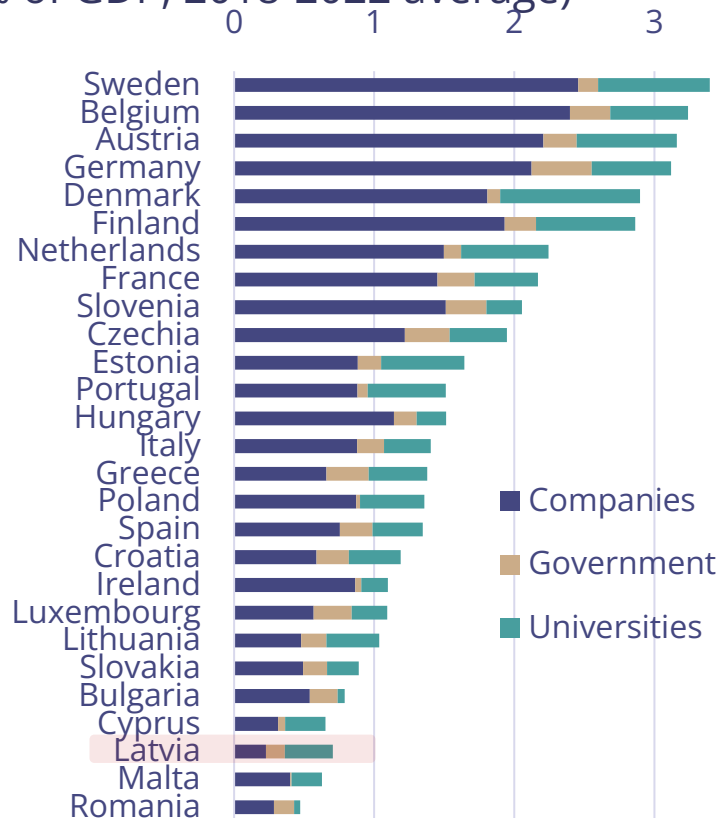
Rank of top-3 universities and income level of a country



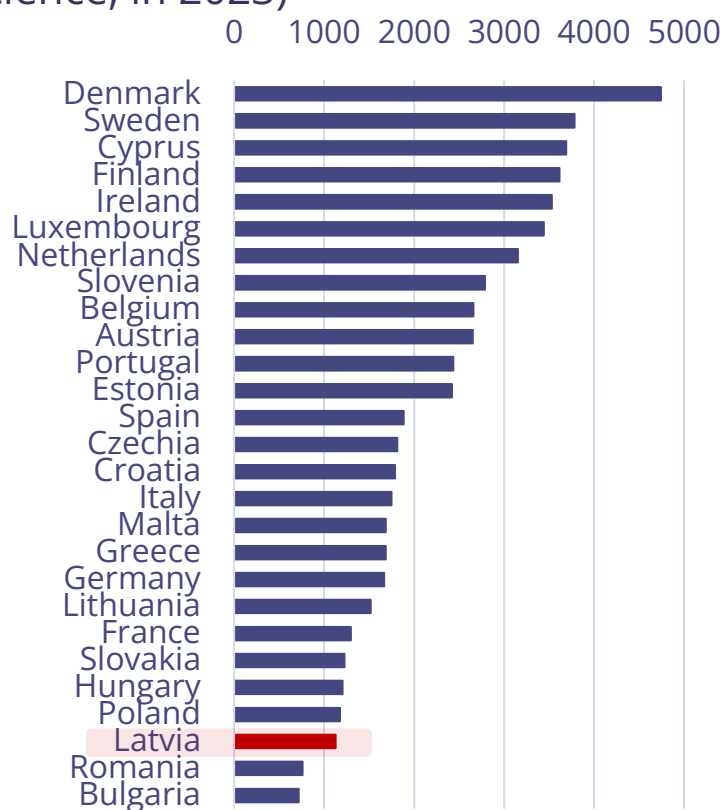
A total of 1906 universities from 108 countries are included in the rating. Green - high place in the ranking (UK), red - low place in the ranking (Bulgaria).

# Both corporate investments in R&D and research outputs are low. What is a cause and what is a consequence?

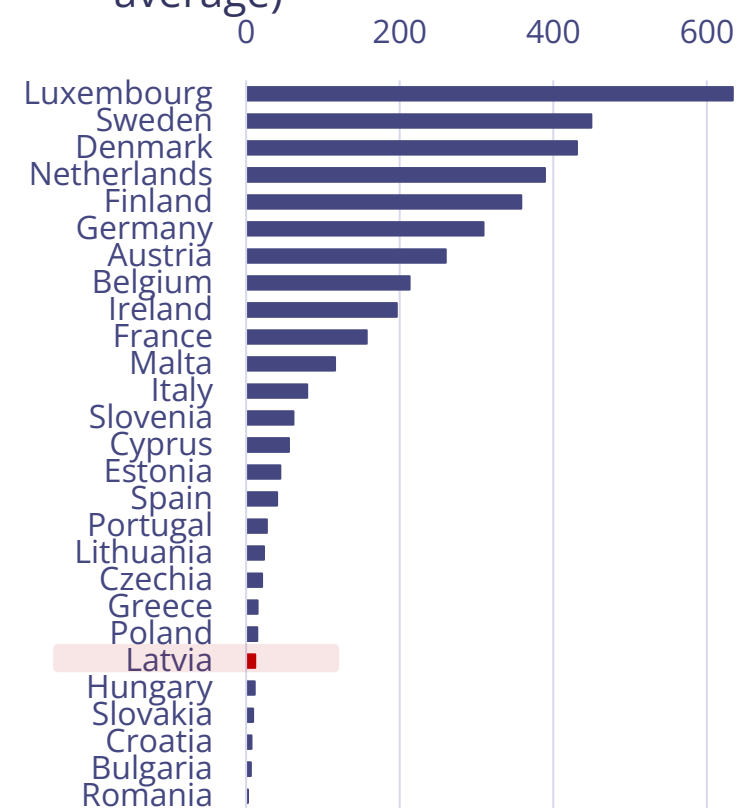
**Investments in research and development**  
(% of GDP; 2018-2022 average)



**Number of scientific publications in English** (per million population; Web of Science; in 2023)



**Number of patents** (per million population; 2018-2023 average)

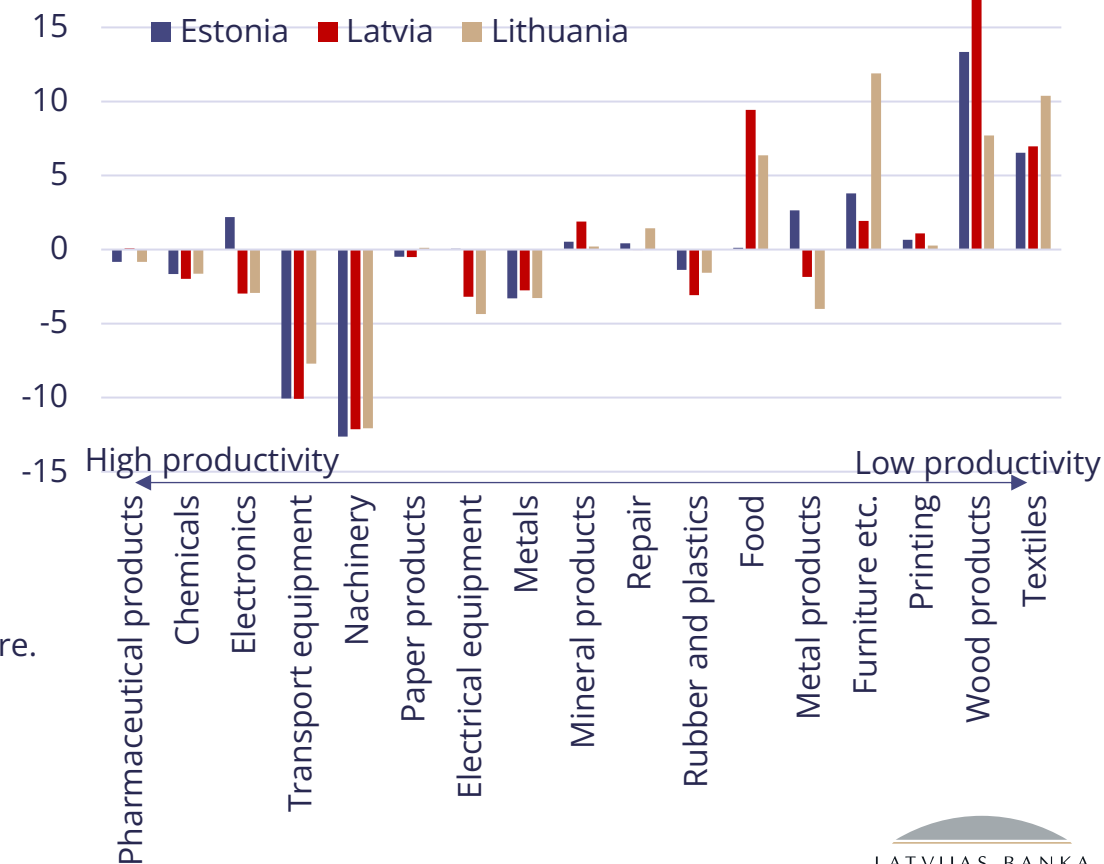


# Know-how to make complex high-value-added products is crucial to raise productivity and economic growth

**Number of products with high export potential\* in the most complex product groups (in 2020)**

Product group	Germany	Estonia	Lithuania	Latvia
Chemicals and pharmaceuticals	86	26	38	25
Machinery and vehicles	111	47	51	35
Electronics and electrical appliances	26	18	8	6

**Employment differentials with Germany by manufacturing sub-sectors (percentage points; in 2021)\*\***

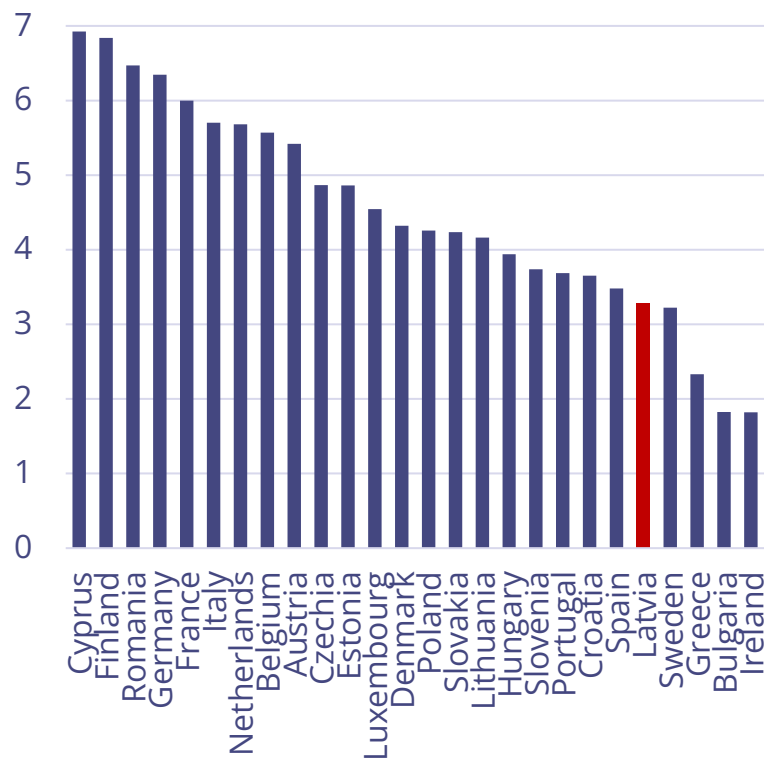


\* Products' share in exports of the respective country is bigger than its global export share. This reflects RCA (revealed comparative advantage index) is larger than 1.

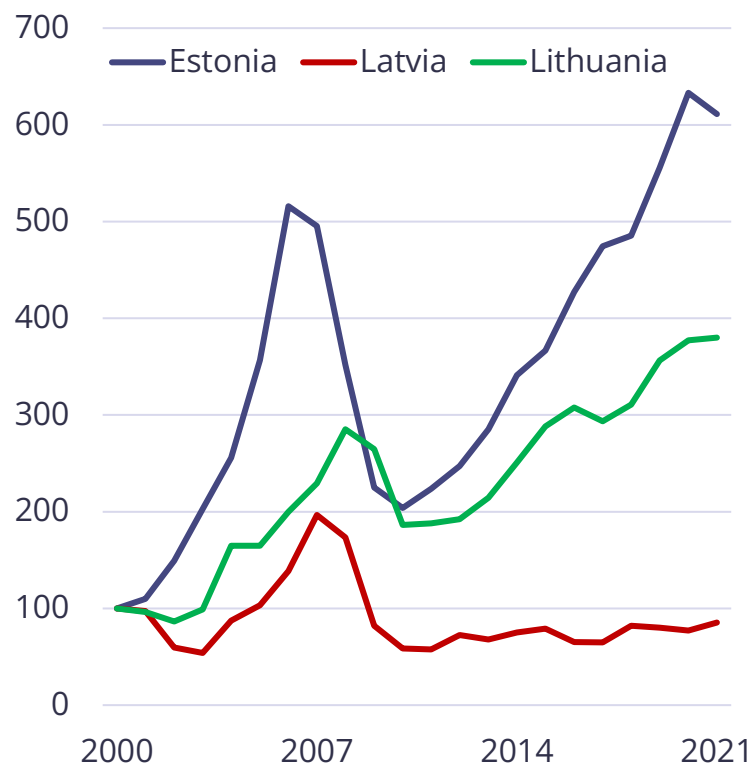
\*\* Manufacturing sub-sectors are ranked by labour productivity in descending order (EU27 average, over 2019-2021).

# New housing construction stagnates, and many people are squeezed into overcrowded housing

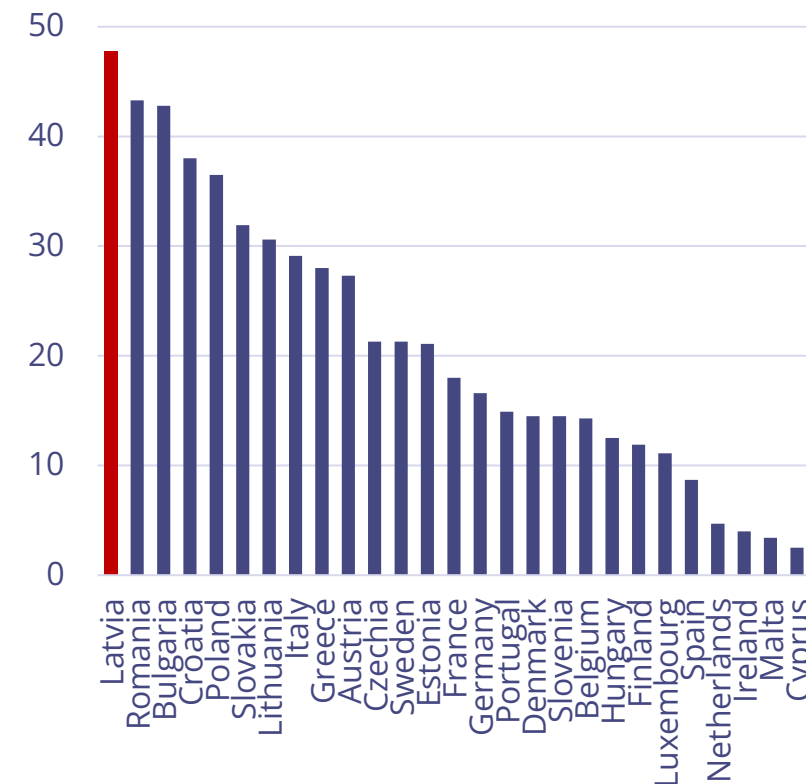
**Household investments (% of GDP; 2012 – 2022 average)**



**Investments in new housing (index; year 2000 = 100; in 2015 year prices)**



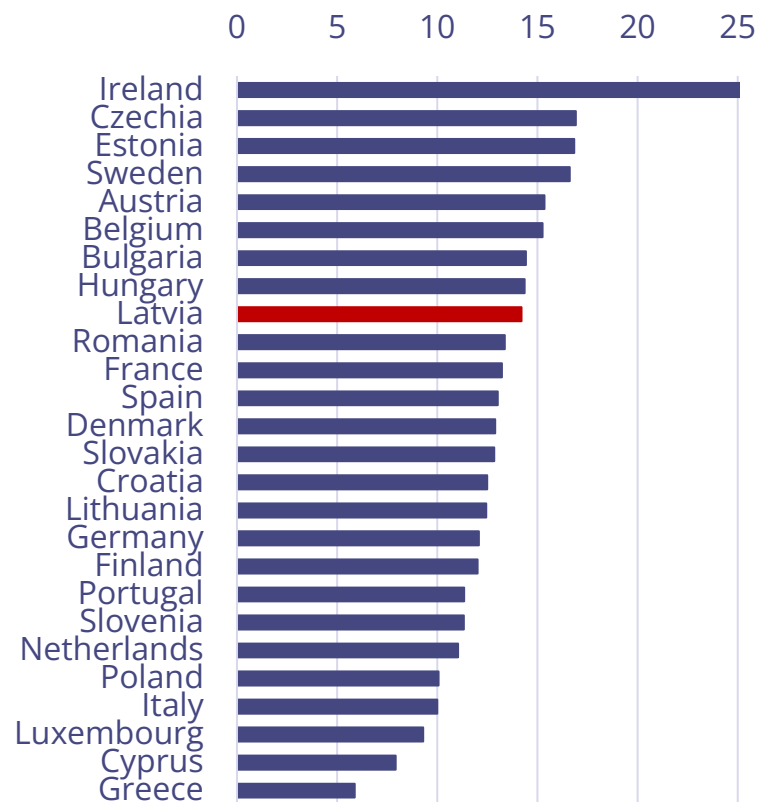
**Live in overcrowded housing\* (% of urban population; in 2023)**



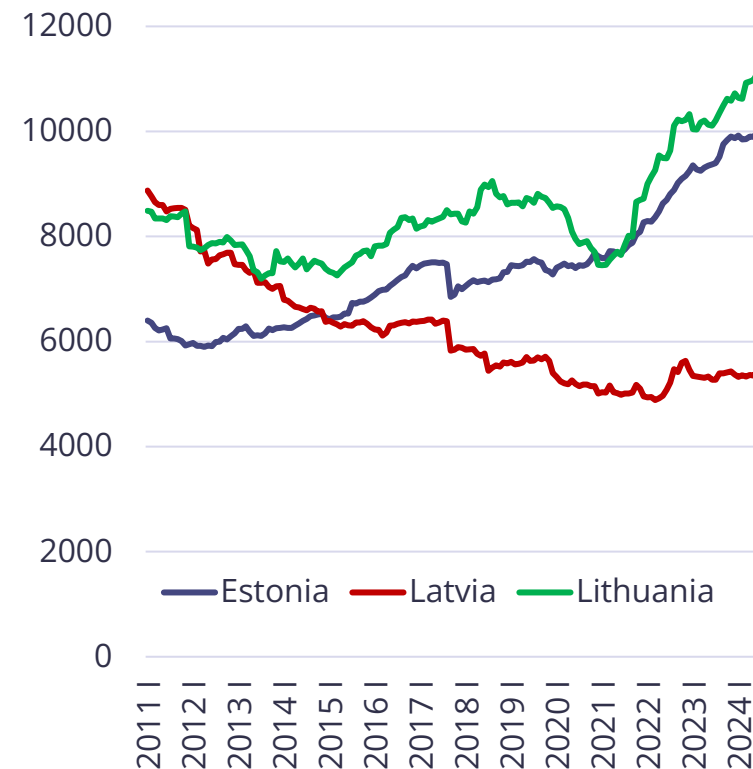


# Corporate investments could have been higher with more active bank lending and stock market

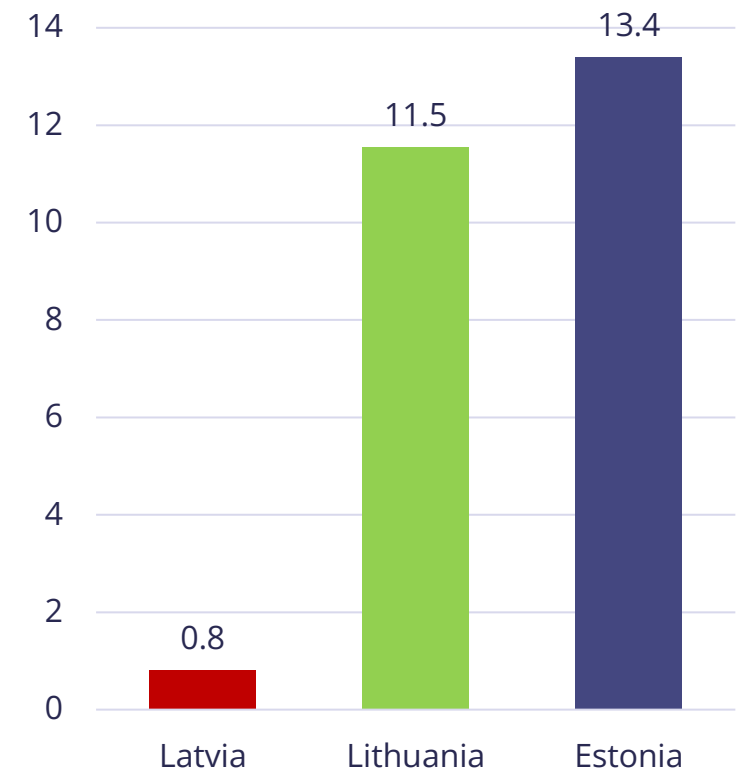
**Corporate investments**  
(% of GDP; 2012–2022 average)



**Loans to non-financial corporations** (million euro)



**Stock market capitalization**  
(% of GDP; September 2024)

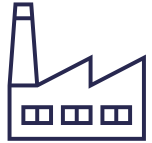


Which Baltic country will show fastest economic growth rate during the following 5 years?

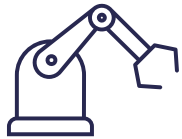
- Estonia
- Latvia
- Lithuania

# Wouldn't low-skilled immigration be cheaper boost to economic growth than investments into the human capital, technologies and innovation?

## Old economic paradigm



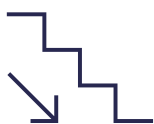
Country is like a big factory which main aim is to maximize output (economic growth rate).



People are like machine tools, subject to depreciation.



Just as machine tools should be replaced to maximize output, people can also be "written off" at age 65 or even less.



Population ageing and labour shortage slows down the economic growth rate.

## New economic paradigm



Economic output serves people, not the other way around.



The size of the economy (economic growth rate) is just a tool to improve the quality of life.



Population ageing is an important achievement of human civilization, meaning we can live longer and healthier (=broader self-realization opportunities) for each of us.



Finally, the level of income is sufficient to focus on the main thing – maximizing self-realization opportunities of each member of society.



# Our country, our bank

How exactly these measures will double Latvian GDP growth to 5%:

<https://www.makroekonomika.lv/raksti/ka-panakt-noturigu-latvijas-tautsaimniecibas-izaugsmi-cilvekkapitala-specinasanas-cels>

For questions and comments:

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