

## **BUSINESS ENVIRONMENT IN LATVIA AND ITS ASSESSMENT IN THE RATINGS OF INTERNATIONAL ORGANIZATIONS**

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**Abstract.** The quality of business environment has important influence on the social and economical development of the state. In order to follow these processes in the business environment and to analyze them, it is important to research information about ratings that characterize this business environment, the method that is applied assigning these ratings, regulation of entrepreneurship and other issues.

Globally business environment in each country is assessed by ratings assigned to by different international organizations. The most important ratings are the following: Business Environment Assessment Rating (The World Bank research *Doing Business*), Global Competitiveness Ranking, Index of Economic Freedom, Global Well-Being Index, Corruption Perceptions Index etc. The ratings (indices) that are assigned by these organizations from a very wide range of viewpoints assess the competitiveness, business environment, economical freedom, level of prosperity, corruption and other spheres.

The annual analysis of international organizations reveals which administrative obstacles; bureaucratic barriers and regulating norms create problems for entrepreneurs. Analyzing the dynamics of index data it is possible to determine in which spheres the situation has improved and where it has deteriorated. This enables the assessment of the results of the measures that have been carried out and helps to identify new problems, where finding a solution the business environment in Latvia could be improved.

**Keywords:** Ratings of International Organizations, ratings characterizing business environment, business environment in Latvia.

**JEL classification:** B10, B15, F01, F63

### **Introduction**

The comparative analysis of the ratings calculated by International organizations allows obtaining information on the countries studied and even on the countries that have demonstrated excellence in ensuring the quality business environment. The information on the business environment and its assessment methodology can be found in the methodologies developed by the companies creating international ratings, information materials, scientific publications, etc. Based on the results of experts' survey "in the EU in the medium and long-term the demand will increase for highly qualified labour force.

Analysis of dynamics of the ratings over several years shows which countries have been increasing their competitiveness over the past few years and which of those have lost their positions in the international competition facing the challenges of the market economy. National

governments are constantly working to improve the business environment in order not to lose the positions won in the competition [3].

Business environment is changing on a daily basis influenced by the company's own actions, activities of the government or, as it is in the case of Latvia, internal and external events associated with the European Union, due to continuous changes in the process of globalization as well. In the cyclic economic development of the world, any errors committed by a national government in the process of socio-economic management, pose significant challenges to the country's population and businesses. In the decisions made by the government, any neglected issue, indecision or error in the political, economic, financial or legal field have consequences. The international stock exchanges, international rating agencies, international organizations and state institutions in their developed ratings promptly provide signals to the world community. It is a responsibility of each country to analyze and evaluate this information. Countries increase their national wealth mainly in two ways: internally by entrepreneurial efforts and by export.

**Objective of the study:** to analyze the business environment in Latvia on the basis of the rating information created by various international organizations

This study is based on monographic, synthetic and analytical, logical - constructive, grouping and comparing research methods.

### **Global Competitiveness Index**

On a global scale the value of the *Global Competitiveness Index*, (GCI) is very important. It is established by the *World Economic Forum*, (WEF) in its annual *Global Competitiveness Report* published each year. *The World Economic Forum* prepares it together with *Harvard University* and co-operation with institutions in the partner countries. The *Global Competitiveness Report* reflects the results of the annual studies the world's countries position with respect to assessment of their competitiveness (rating), as defined by methodologies recognized by the *World Economic Forum*. [2] It helps to evaluate and draw attention of the policy-making institutions and the businesses to particular sectors and their dynamics of development in comparison with those of other countries.

In the *World Economic Forum report*, the national competitiveness is defined as a combination of actions of institutions, policies and factors affecting productivity in the country, while the level of productivity affects the level of prosperity that a particular country's economy can offer to its population, and return on investment received by the owners of capital.

The Global Competitiveness Index is used to calculate the 12 criteria groups (pillars), which characterize each country in the following areas: 1) institutions, 2) infrastructure, 3) The macro-economic environment, 4) health and primary education, 5) higher education and adult training, 6) goods market efficiency, 7) labor market efficiency, 8) financial market development, 9) technological readiness, 10) market size 11) business sophistication and 12) innovation [1].

Each group includes assessment of a number of factors and the overall assessment. Each assessment group characterizes competitiveness separately, while the index itself is set up as a separate assessment group average value on a scale of 1 to 7 points. The highest index is evaluated at 7 points. A country's overall place in the index depends on a weighted average value, taking into account all the individual indicators together.

With respect to the prosperity indicators, countries are divided into three stages of development. The breakdown by country also includes two transitional or inter-stages: from the first to the second and from the second to the third (see Table 1).

For prosperity assessment is used the gross domestic product (GDP) per capita. In turn, the degree of influence of production factors is assessed by the share of the primary processing products in the total export of goods and services. Countries that have more than 70% share of the primary processing products in the export of goods and services, are considered to be such which development is determined by the production factors.

**Table 1:** Breakdown of countries by stages of development according to their prosperity index, the Global Competitiveness Index 2014 - 2015

Country's stage of development	GDP per capita (USD)	Countries in total (144)	% (100)
<b>First stage:</b> development is driven by the use of production factors	< 2000	37	26
Transitional stage from the first to the second stage	2 000-2 999	16	11
<b>Second stage:</b> development is driven by the production factors efficiency increase	3 000-8 999	30	21
Transitional stage from the second to the third stage	9 000-17 000	24	16
<b>Third stage:</b> development by innovations.	>17 000	37	26

**Source:** [http://www3.weforum.org/docs/WEF\\_GlobalCompetitivenessReport\\_2014-15.pdf](http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2014-15.pdf)

The first stage includes countries whose development is driven by the use of production factors (cheap labor and natural resources). In 2014 - 2015 out of 144 countries included in the Global Competitiveness Index, this group includes 37 countries or 26% of the analyzed economies (such as Bangladesh, Ethiopia, India, Kyrgyzstan, Nicaragua, Nigeria, Pakistan, Tajikistan, Vietnam, Zimbabwe, etc.)[5].

The second stage includes countries whose development is driven by the production factors efficiency increase. This group includes 30 analyzed countries, which account for 21% (such as Albania, Armenia, Bulgaria, China, Romania, Ukraine, etc.).

The third stage includes countries whose development is determined by innovation-based solutions. This group includes 37 analyzed countries (such as Australia, Canada, the Czech Republic, Denmark, Finland, France, Japan, Sweden, Switzerland, United Kingdom, USA, etc.),

which account for 26%. From the Baltic States, this group includes only Estonia, which, with its 4.71 points takes 29<sup>th</sup> place in the ranking[6].

In the transitional stage from the first to the second stage are 16 countries, which account for 11% (e.g., Angola, Azerbaijani, Moldova, Mongolia, Saudi Arabia, Venezuela, etc.).

In turn, in the transitional stage from the second to the third stage are 24 countries (such as Argentina, Brazil, Croatia, Hungary, Kazakhstan, Poland, Russia, Turkey, etc.), which account for 16%. From the Baltic countries this group includes Lithuania with 4.51 points, which occupies 41 place in the rating, Latvia with 4.50 points taking 42 place in the rating respectively. The most competitive countries in the world are in the third stage, and of 144 countries included in the Global Competitiveness Index report of 2014 - 2015; the first place with 5.70 points takes Switzerland.

### **Economic Freedom Index**

The Economic Freedom Index (*The Heritage Foundation; The Wall Street Journal*) was created by *The Heritage Foundation* research institution together with *The Wall Street Journal*. (<http://www.heritage.org>). Since 1995, *The Heritage Foundation* has been calculating the Index of Economic Freedom (EFI) and publishing it each year in the *Wall Street Journal*. [7]

*The Heritage Foundation* was founded in 1973 in the United States of America as a research and educational organization. The mission of the privately owned *Heritage Foundation* is to promote public policies based on the principles of free enterprise, individual freedom, national systems of social protection of population, limited government, etc. The basic purpose of development of the index was to provide policy makers and investors with the information gathered on the business and investment environment and its changes in a specific country compared with the other countries studied. Latvia has been included in the studies since 1996[4].

**Table 2:** Latvia's ranking in the Economic Freedom Index, 2013-2016

<b>Index</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016 (178)</b>
<b>Overall ranking in the world by the Economic Freedom Index</b>	<b>55</b>	<b>42</b>	<b>37</b>	<b>36</b>
<i>The average annual score in percentage points</i>	<b>66.5</b>	<b>68.7</b>	<b>69.7</b>	<b>70.4</b>
<b>I. Rule of law</b>				
Property Rights	50.0	50.0	50.0	50.0
Freedom from Corruption	42.0	43.6	53.0	55.0
<b>II. Limited Government</b>				
<i>Government Spending</i>	53.6	54.9	59.2	58.4
<i>Fiscal Freedom</i>	84.4	84.6	84.6	84.8
<b>III. Regulatory efficiency</b>				

<i>Business Freedom</i>	75.7	82.5	82.1	78.6
<i>Labor Freedom</i>	64.4	68.5	61.5	59.5
<i>Monetary Freedom)</i>	78.3	79.7	83.8	84.8
<b>IV. Market openness</b>				
<i>Trade Freedom</i>	86.8	87.8	88.0	88.0
<i>Investment Freedom</i>	80.0	85.0	85.0	85.0
<i>Financial Freedom</i>	50.0	50.0	50.0	60.0

In the Economic freedom rankings of 178 world countries of *the Heritage Foundation* research institution and *The Wall Street Journal* of 2016, Latvia scored 70.4 points ranking only 36<sup>th</sup> place. The 1<sup>st</sup> place in the world's Economic freedom ranking takes Hong Kong scoring 88.6 points, followed by Singapore scoring 87.8 points, and New Zealand is on the 3<sup>rd</sup> place scoring 81.6 points. Among European countries, Switzerland with 81.0 points ranks the fourth place, Estonia with 77.2 points ranks 9<sup>th</sup>, while Lithuania with 75.2 points ranks 13<sup>th</sup> in the world. In 2016, Latvia's highest scores were in the fields of Trade Freedom (88.0 points), Investment Freedom (85.0 points), Financial Freedom (84.8 points) and Monetary Freedom (84.8 points). Meanwhile, Business Freedom scored only 78.6 points. Latvia's lowest scores were in: I. Rule of Law section - Property Rights (50.0 points) and Freedom from Corruption (55.0 points); II. Limited Government section - Government Spending (58.4 points); III. Regulatory efficiency section: Labor Freedom (59.5 points); IV. Market openness section: Financial freedom (60.0 points)[8].

## Global Prosperity Index

*The Legatum Prosperity Index* (LPI) ranking method was developed by the Legatum analytical studies Institute based in London. *The Legatus Institute* is a global financial and wealth research organization publishing the *Global Wealth Index* of the countries of the world. In the course of researches performed by the institute it has been found that the highest level of well-being in the world does not always coincide with the highest gross domestic product growth rate.

The researchers of the Legatus Institute, which is an independent research organization state that their objective in creating the *Global Prosperity Index* (GPI) is to describe in the finest detail possible the formation of wealth in the countries of the world, paying attention not only to numerical economic indicators such as gross domestic product (GDP), but also subjectively perceived personal well-being. This index focuses solely on whether the population of a country is happy, healthy and free. Therefore in measuring the wealth index, special attention is paid to such factors and such activities of both the population and government that increase wealth in the country, promote economic competitiveness and improve living conditions, namely, health care, gender equality, environmental protection, government efficiency and respect for human rights.

The index takes into account not only material well-being of the population, but also people's subjective satisfaction with their quality of life, because the authors of the index believe that people are made happy and successful not just by wealth but by democracy, personal freedom and business opportunities[9].

the Legatum Institute has been publishing Prosperity Index since 2007. In the Prosperity Index (<http://www.prosperity.com>) countries are ranked by the national wealth, economic growth, people's personal well being and quality of life.

The index is calculated by 8 wealth determining positions : 1) Economy; 2) Entrepreneurship & Opportunity; 3) Governance; 4) Education; 5) Health care system ; 6) national Safety & Security; 7) Personal Freedom and 8) Social Capital. Source: (<http://www.prosperity.com/#!/ranking>).

In 2015, the Legatum Institute compiled the latest Global wealth index where Norway is on top of the list, followed by Switzerland, Denmark, New Zealand, Sweden, Canada, Australia, the Netherlands, Finland and Ireland. In the *Global Prosperity Index of 2015*, the *Legatum Institute* collected information on 142 countries of the world where Latvia ranked 40, while neighboring Estonia ranked 31, and Lithuania 41.

**Table 3:** Latvia's rank in the world according to the Global Prosperity Index of 2012 – 2015

index	2012 (142)	2013 (142)	2014 (142)	2015 (142)
<b>Latvia's rank in the world in the <i>Global Prosperity Index</i></b>	<b>47</b>	<b>48</b>	<b>44</b>	<b>40</b>
Economy	80	73	49	48
Entrepreneurship & Opportunity	36	37	33	38
Governance	44	41	41	41
Education	28	29	34	35
Health	50	45	50	47
Safety & Security	50	45	44	40
Personal Freedom	112	96	86	73
Social Capital	86	93	90	83

Source: (<http://www.prosperity.com/#!/ranking>).

Table 3 also shows information on the wealth ratings in the Global prosperity index. The table data show that in 2015 the best ratings for Latvia are in the field of education (35<sup>th</sup> place in the world) and business opportunities (38<sup>th</sup> place). With respect to the Safety & Security Latvia is 40<sup>th</sup> in the world, while governance is listed at the 41<sup>st</sup> place in the world, Health at the 47<sup>th</sup> place in the world, and the Economy at 48<sup>th</sup> place. However, the worst indicators of Latvia are in the field of social capital, which is on 83<sup>rd</sup> place and in the field of personal freedoms - only 73<sup>rd</sup> place in the world.

### **Business Environment assessment index (*Doing Business*)**

The *World Bank's Doing Business* survey ([www.doingbusiness.org](http://www.doingbusiness.org)) is an international, comparative rating of business environment, which annually measures business regulatory and administrative procedures and their application. *Doing Business* survey is a quantitative set of indicators that measure business regulations in various countries around the world. *Doing Business* survey quantitatively measures and compares activities in different countries affecting business in the field of legislation, regulating the conditions and procedures that affect all business 'life cycle' stages: 1) Starting a Business , 2) Dealing with Construction Permits , 3) Getting Electricity , 4) Registering Property , 5) Getting Credit , 6) Protecting Investors, 7) Paying Taxes, 8) Trading Across Border 9) Enforcing Contracts and 10) Resolving Insolvency[10].

Evaluation of conditions for starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across border, enforcing contracts and resolving insolvency determines how favorable the business environment is in a country as a whole. the higher the place in the *Doing Business* index the more favorable is the business environment in the country[18].

*Doing Business* survey characterizes the business environment: the conditions a particular country offers for creation and development of a business.

Usually, achievement of high scores of the analyzed indicators, is based on lower costs, such as costs of import and export transactions, lower costs of receiving building permits or registering property, shorter time required for closing contracts, etc., lower annual tax payments and lower general tax rate compared with the other countries included in the rankings[17].

The *World Bank* (WB) has been studying the business environment in the world within the framework of the *Doing Business* project since 2004. Since the inception of this project, the World Bank measures the business environment in Latvia. The annual world countries Business Environment rating and the report on the subject are prepared based on the survey . Since 2004, when the ranking was made public for the first time the business environment has been assessed in 130 countries. In 2014, *Business Environment Index* provides information on 10 different topics of the business environment of 189 countries around the world.[11]

At the end of 2013 was published the latest *World Bank* survey *Doing Business 2014*, which ranked 189 countries of the world. The *Doing Business 2014* survey, covered the period from June 2012 to June 2013.[16] Latvia, in assessment of the overall quality of business environment in the *Doing Business 2012* study ranked 21<sup>st</sup> of 183 countries, however, in the *Doing Business 2014* study it ranked 24<sup>th</sup> of 189 countries, thus lowering the position won in 2012.

It should be noted that the *Doing Business* survey serves not only as the world's countries comparative index in certain business areas, but also is used to reflect the developments in global world markets. Particularly the *Doing Business* quantitative indicators are used for the compilation of the *World Economic Forum's Global Competitiveness Index*[15].

Annual assessments of the *Doing Business* survey make it possible to find out which administrative obstacles, bureaucratic and regulatory barriers cause issues for entrepreneurs, while the analysis of the indicators' dynamics allows to determine to what extent the problems increase or decrease over the years. Such a monitoring system for the assessment of the business environment in the dialogue with the private sector helps to analyze the effectiveness of reforms implemented and to identify new issues which elimination may improve the business environment in the country[12].

According to the *World Bank's* latest *Doing Business 2014* survey, which collected information on 189 countries, ranking of Latvia was 24<sup>th</sup>. Latvia's neighbor Lithuania ranked 17, while Estonia 22. Among the countries of the Baltic Sea region, the highest rankings for the business environment received Denmark (5<sup>th</sup> place in the world), Finland (12<sup>th</sup> place), Sweden (14<sup>th</sup> place), and Russia (61<sup>st</sup> place).

**Table 4:** Changes of Latvia's indicators over the years, *Doing Business* 2011 -2016

<b>Latvia's indicators in <i>Doing Business</i> survey</b>	2011 (183)	2012 (183)	2013 (185)	2014 (189)	2015 (189)	2016 (189)
<b>Overall ranking</b>	<b>31</b>	<b>21</b>	<b>25</b>	<b>24</b>	<b>22</b>	<b>22</b>
Percentage points in total					77,51	78,06
<u>Starting a Business</u>	52	50	59	57	36	27
<u>Dealing with Construction Permits</u>	103	109	118	79	24	30
<u>Getting Electricity</u>	115	83	89	83	62	65
<u>Registering Property</u>	56	32	29	33	30	23
<u>Getting Credit)</u>	4	4	3	3	17	19
Protecting investors ( <u>Protecting Minority Investors</u> )	60	66	67	68	46	49
<u>Paying Taxes</u>	64	62	52	49	24	27
<u>Trading Across Borders</u>	15	17	23	17	22	22
<u>Enforcing Contracts</u>	14	16	21	21	35	25
<u>Resolving Insolvency</u>	86	33	46	43	43	39

*The Doing Business* survey for the period from 2011 to 2014. It should be noted that in 2014, overall, Latvian business environment is sufficiently highly evaluated taking the 24<sup>th</sup> place amongst 189 countries of the world. The table shows the fields in the 10 aspects of the business environment, which the *World Bank's Doing Business 2014* survey evaluated, where Latvia has the leading positions and the fields where Latvia has rather unsatisfactory rating.

Consequently, it is necessary for Latvia to continue the work, especially in areas where the International comparisons show the potential opportunity to prevent obstacles to quality business environment.[14] However, in order to position the country as an attractive business and



investment economy, it is necessary to make the long term-oriented decisions on economic development[13].

### **Conclusion**

Growth of competitiveness and creation of the investment-friendly environment for Latvia is prerequisite for Latvia to increase its competitiveness and to be able to address investors with an attractive business environment, political stability and predictability of fiscal policy, creating conditions for a profitable business with a high return and attractive and growing economy.

A favorable business environment is a prerequisite for the country's economic development. The business environment is one of the most important issues of the national economic policy. Factors that stimulate economic activity and the competitiveness of businesses are in the business environment, the quality of human resources, labor market flexibility, quality transportation and communication infrastructure, access to finance, etc. Quality business environment also provides for the country's competitiveness, since the better conditions a country can create for businesses, the more investments can be expected in the economy, which in turn means new jobs and increasing prosperity of the population.

In the *World Bank's Doing Business 2014 survey*, the business environment is evaluated by 10 aspects. In order to position the country as an attractive for business and investment economy, it is particularly important to analyze the areas where Latvia's rankings are not very high.

The data obtained in the Doing Business survey make it possible to make a comparative analysis of evaluation indicators of business environments of various countries. This is particularly important for Latvia, which has declared in the Latvian National Development Plan for the years 2014-2020 that it would implement the breakthrough strategies in economics and utilize knowledge –enriched methods to boost the development of Latvian economy.

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