THE IMPACT OF THE EU STRUCTURAL FUNDS ON THE DEVELOPMENT OF LATVIAN NATIONAL ECONOMY

Maija Šenfelde, Uldis Kamols
Technical University – Riga, Latvia

ABSTRACT

Latvia as a member state of the European Union has access to financial aid from the EU Structural Funds, which is an instrument for implementation of the EU regional cohesion policy. The total funds accessible to Latvia in the Structural Funds framework to which the beneficiaries will be able to apply are made up of financing from the EU Structural Funds and co-financing from the national budget of the Republic of Latvia and budgets of local governments.

Over the recent years Latvia has witnessed rapid and consistent economic growth. Since 2000 the increase of the average gross domestic product (GDP) in competitive prices accounted for 7.4% per year, while in 2004 it reached 8.3%. In 2005 the positive trend continued and in the first half of the year GDP rose by 9.5%.

Such rapid development substantially exceeding the growth of the EU 15 member states as well as other new member states have ensured gradual approach towards EU average living standards. In 2004 in Latvia GDP per capita according to the purchasing power parity standards reached 43% from the EU-25 average showing considerable progress during the recent years. However, the Latvian indicator is still the lowest in the EU, although the economic development shows positive tendencies. Moreover, there exist distinct disparities among regions in their economic and social development. The Riga region makes up more than a half of GDP. In 2002 the share in GDP of the Riga region accounted for 67.8% [3].

The growth of GDP is based on stable and rapid development of internal demand determined by the increase of the share of private consumption and gross capital formation. Private consumption is growing due to the increasing individual income, employment rate, and dynamic growth of crediting and decreased interest rates. Updating of plants and equipment and rapid increase of construction contribute to the high rate of growth of investments.

Over the recent years growth in exports has been comparatively high, still the volume of exports is considerably lower than the volume of imports.

The growth of national economy is rather stable, showing rapid increase in private service industries, manufacturing and construction.

Starting from 2000 the number of employed persons is increasing, notwithstanding the unfavourable demographic factors testifying the continuing decrease in the number of population of Latvia. From 2000 to 2004 the number of employed persons has increased by 8.2%, now reaching 1017.7 thousand people. The increase of employment is closely connected with the rapid development of national economy and increased demand of labour force as well as restructuring of employment policy in specific branches. The share of job seekers among economically active population has reduced from 14.4% in 2000 to 10.4% in 2004. At the same time the number of economically active population has increased too that has been partly influenced by raising the pension age [3].

The main problems in the Latvian labour market hindering further improvement of the current situation are linked with very distinct differences regarding employment and unemployment issues in different regions of Latvia. There is high rate of unemployment in more distant regions from Riga, especially in Latgale, while there is shortage of labour force requiring some specific skills in Riga. Another crucial labour market problem in Latvia is high unemployment rate among young people, among persons seeking job after childcare leaves, among people with poor Latvian language skills and other socially alienated high- risk groups of population. There exist also problems linked with a relatively high rate of hidden employment in some branches of national economy, consequently, reducing social insurance benefits and not allowing to cut the tax burden, thus leaving a negative impact on the persons with low incomes. Some groups of labour force experience qualification inadequacies, which do not comply with the labour market requirements. Another essential issue is the immigration of workforce to other EU member states caused by low remuneration of labour.

The demand for skilled and highly skilled labour force is growing in Latvia. This prerequisite significantly affects the capacity of development-focussed branches to influence the GDP rate. Insufficient quality of education at all educational levels as well as lack of Cupertino among educational and research institutions and the labour market lowers the potential of the educational system to increase the employment opportunities of the labour force. In turn, the persons with low qualification and insufficient

education are subject to high risk of unemployment leading to bad social consequences.

The programmes offered by three educational sectors, i.e., basic vocational, higher education and further education, the quality of these programmes and territorial location directly influence the development of human resources and labour force in Latvia.

Since the 1990s agriculture, forestry and fishing have undergone a range of restructuring processes. Transition from planned economy to market economy is still felt in rural areas. However, some of the Latvian rural territories have experienced the development of new farms, have attracted investments to introduce new technologies in farms and have developed modern management practices. Thus, competitive and modern farms have been built, the production of which is focussed on those areas of agriculture in which Latvia could have some preferences (e.g., production of milk, rape, grain).

Some of the agriculture and food processing industries are trying to actively address the issues of competitiveness and quality. However, they are in the beginning stage yet, and are often stimulated by foreign investors. Many of the food processing plants have not yet reached the standards allowing their products to compete in the international markets. Many small food processing plants face the existence of cheaper and higher quality products in the domestic market. A range of products have a low value added and are focussed on the export to CIS countries.

One of the most positive sides of agriculture is that it produces healthy products. Active agriculture and low utilisation of different fertilisers enables to retain high biodiversity and friendly environment. The above mentioned advantages enable to develop rural tourism as well as production of healthy agricultural products, if sufficient investments are provided for human resources, infrastructure and the development of production.

Woodland is an integral part of agriculture and rural economy, providing also seasonal employment opportunities. Latvian wood products are of high quality, recognised in the global market. However, management in some small forest exploitation companies is not always adequate which calls for ensuring appropriate training in this field. .

Small farms do not promote the development of agriculture as a branch of national economy. Natural (subsistence) economy dominates in this kind of production. In 2001 67% of the total number of farms supplied only their own needs. Only 13.2% of the farms produce more than a half of their production for market needs.

The experience of many EU member states shows that the unemployment rate in agriculture is rapidly increasing. Modernisation and advanced technologies in agriculture lead to the reduction of employment in this field. However, 273.2 thousand people living in rural areas (i.e., 45.6% of the total number of rural population) are still employed in agriculture. The scarcity of employment opportunities, especially in small farms, tells on a low productivity level. Therefore, in order to ensure adequate subsistence means for rural population, the development of a competitive agricultural and food processing industry as well as restructuring of rural economy should be considered a priority [2].

In the sector of fishery the reduction of fishing quotas will directly influence the existence and operation of the fishing fleet. The investments attracted by this sector are not very big due to the limited fishing opportunities in the Baltic Sea. In this sector small fishing craft owners dominate, mainly operating in the Baltic Sea. In coastal fishing the scarcity of employment and insignificant economic performance are the main threats for suspending operations. The products have low value added and are mostly oriented on the market in CIS countries. The drop in output, negligible revenues and passive economic activity have lead to poor performance, especially in the territories where previously fishing has been the dominant industry.

Metal industry may be considered as one of the main traditional "old economy" branches of Latvia. Taking into account its export share this industry occupies an important place in the national economy. More than 90% of its output is exported, mainly to the EU member states. The sector is dominated by the company *AS Liepajas metalurgs* . In 2001 the total exports of this company constituted 66 million lats, i.e., 5.25% of the total Latvian exports. For further successful development of this sector investments should be attracted both for research and new opportunities to produce new and competitive products.

Several other industries show better growth opportunities. The leading industries are wood processing, food processing and textile industry. These sectors are based on export, the productivity of the labour force is high enough and they constitute a comparatively large share of the GDP. Nevertheless, to retain the productivity some supporting measures should be taken, paying most attention to investments in human resources.

A significant market for food production is the CIS and the Baltic countries where the price level is comparatively lower than in the EU countries. To enhance access to new markets support is needed

for promotion of new technologies, production and marketing as well as development of human resources.

The export of wood products is the leader in the total export structure of Latvia and it is also a significant factor for decreasing the negative balance of foreign trade. Despite the high price of the raw materials wood products are with low value added, mainly, logs, timber products and low value furniture are exported. By developing and restructuring the sector on the whole and involving other related branches, items with higher value added should be produced. This integral approach could include designing services, construction, building materials, transport, research and development, power sector and development and training of human resources.

Machine building and textile industry are branches oriented to export and they have similar problems. They mostly compete with other low labour cost industries. Besides the textile industry provides employment for women, especially in those rural territories where employment opportunities in agriculture are scarce.

Rapid development of service industries ensures opportunities for sustainable and balanced economic growth. Retail development provides both job vacancies and growth of investment rates.

Since 1995 the most significant growth was observed in construction, but also financial services and retail sector continue to expand.

Transport and cargo transportation constitutes a significant part of services. Taking into consideration the growing competition in the Baltic Sea region in order to ensure competitiveness all opportunities provided by the unique geographic situation of Latvia should be considered. It is necessary to improve the infrastructure for ensuring better movement of goods, thus acting as a vital transit link between east and west.

From 1995 till 2001 the increase in construction has reached 9% per year. The export of construction services has increased by 200%, in 2001 constituting 10 million lats. It is expected that this increase will be retained, moreover, it could leave a positive impact on other related businesses due to increased demand of new housing and big public infrastructure projects provided with the help of the EU co-financing. As a result the demand for labour force with specific skills for this sector will grow as well.

Latvia offers many-sided tourism opportunities. Nowadays this branch is underdeveloped but it certainly opens up new opportunities. The greatest number of foreign tourists arriving to Latvia visit Riga due to the development of "cruise" tourism. In turn, countryside tourism has very big growth opportunities, because today capacities of this sector have not been fully utilised. Over the last few years investments have been made into developing infrastructure for winter sports (cross-country and slalom), nevertheless this kind of tourism is open for further improvements. Tourism occupies an important role in creating the overall image of the country as well as it may create new job vacancies, especially in rural areas with more specific economic problems.

Today the potential of tourism is also affected by such factors as:

- high travel costs to Latvia;
- no strategy for integral tourism development;
- underdeveloped infrastructure for tourism and insufficient human resources [2].

One of the most significant prerequisites of the development of national economy is adequately developed transport, information and communication, environmental and social infrastructure.

The infrastructure of transport in Latvia incorporates road and railway networks, oil and oil product trunk pipelines, ports and airports.

The inflow of the EU structural funds is a factor positively affecting the growth of the Latvian national economy.

Having entered the EU Latvia as one the least developed EU regions may become actively involved in the implementation of the EU regional policy, making use of the financial aid offered by the EU for its economic and social development. For the period starting from 2004 to 2006 the biggest financial instruments through which Latvia receives financial help from the EU are the EU structural funds and the Cohesion Fund. In addition to that Latvia receives additional financial resources within the framework of the EU initiatives *Equal* and *Interreg.* It is possible to apply for the funding of the above mentioned financial sources till 2006 and use them till 2008, but within the framework of the Cohesion Fund till 2010. This period complies with the *EU multi-year financial plan 2000 to 2006.*

Taking into account that in 2004 Latvia's GDP per capita constituted only 40% of the EU average, from 2007 to 2013 Latvia may apply for financial resources from the structural funds as well as from the Cohesion Fund [5].

The total financing of the structural funds and the Cohesion Fund in the EU budget and grant-assistance to the member states depend on the decision of the EU Council of Ministers within the EU multi-year financial framework for the period from 2007 to 2013.

These financial resources may considerably improve the potential rate of growth as well as the

real process improving the competitiveness of Latvia. Fast growth in most cases discloses the shortages of the existing infrastructure and testifies that additional investments should be made in human resources, research and elimination of territorial disparities. The increase of investments required for the growth rate of Latvia, including more financing from the structural funds, and proper planning would allow in the next ten years to increase the GDP rate per capita and reach 70% of the EU average, taking into account the purchasing power parity standards.

Throughout the period from 2007 – 2013 the main task of the structural funds and the Cohesion Fund is to assist in promoting more rapid economic growth of the country with the aim to approach the average living standard of the EU member states. This may be measured as a desire to reach the EU average GDP per capita. To reach it in the period from 2007 to 2013 Latvia should try to retain a stable GDP growth rate of 6 –8% per year. To this end, the employment rate should reach 65% already today [5].

With the aim to reach the other EU member states it is necessary to implement the national development strategy with the support of structural funds advancing well-educated, creative and enterprising people. National economy, based on education, science and competitive enterprises, becomes a priority. Thus, in the period from 2007 to 2013 the support, provided by the structural funds and the Cohesion Fund, primarily, will be directed towards education and training of population, enterprise technological advancement and flexibility, as well as towards the development of science and research in order to promote knowledge-based economic development of the country.

Latvia is supported by four EU structural funds: the European Regional Development Fund (ERDF), the European Social Fund (ESF), the European Agriculture Promotion and Guarantee Fund (EAPGF) and the Fishery Management Financial Instrument (FMFI).

Within the framework of the European Regional Development Fund support is provided for the development and accessibility of transport system, information and communication technology development as well as the development of education, healthcare and social infrastructure. The projects dealing with water supply and household waste infrastructure development, asphalt-paving of gravel roads, renovation of asphalt-paved roads and reconstruction of bridges will be implemented, as well as projects concerned with further development of the infrastructure and equipment for the institutions of social care and projects for developing information systems or public communication and information access centres.

With the assistance of the ESF employment, education and further education issues are addressed and social alienation reduced. These activities include promotion of training and retraining of employees, active employment measures for the unemployed, training courses for start-ups in entrepreneurship and self-employed people, provision of subsidised working places and a bigger choice of social rehabilitation programmes offered. Throughout the period from 2004 to 2006 the ESF pays more attention to the development of entrepreneurship and self-employment issues, to the development of study programmes for science-and-technology intensive branches and broadens opportunities in adult education and training, offering professional advancement courses.

The EAPGF supports investments in agriculture enterprises, improvements in food processing and marketing, development, promotion and restructuring of rural territories and development of forestries. Support is also provided for new farmers for such activities as purchasing of new agriculture production facilities as well as IT technologies and software for agriculture, building, reconstruction and renovation of production facilities and structures, looking for new markets for selling agriculture products, enhancement of marketing research, state and common use reclamation system development, support for creating additional employment opportunities, investments in forestry, increasing the economical and environmental value of forests, clearing of overgrown arable land, activities promoting the development of local rural areas, organisation and management of training courses and making of business plans.

The FMFI, in its turn, supports investments in balancing the intensity of fishing, renovation of the fishing fleet and modernisation and upgrading of fishing boats, improvement of aquaculture product processing and marketing, as well as social and economic measures, promotion of new markets and support for processing enterprises. Within the above mentioned framework such activities as reduction of the intensity of fishing, modernisation of fishing boats, support for fish processing, modernisation and introduction of new technologies for aquaculture enterprises and development of advanced port infrastructure are supported. There exist also support schemes for those fishermen, who are forced to leave fishing industry due to write-off of their fishing boats as well as support for projects promoting market-oriented production, support for developing production facilities and promotion of their activities.

To improve the economic and social environment in Latvia several hundreds of million euros will

be made available for Latvia through the EU structural funds (see Table 1).

Up to 31 December 2005 Latvia succeeded in attracting 69% from the total amount of the funding available for the projects of the EU structural funds.

Table 1. Funding of the EU structural funds for the period of 2004 to 2006 (mln euro)[4]

Funds	EU funding	Latvia's funding	Total
ERDF	368.88	120.51	489.72
ESF	138.56	44.13	182.82
EAPGF	93.25	47.29	140.62
FMFI	24.31	18.55	42.89
Total:	625.00	*230.5*	*856.06*

Table 2. Funding attracted to the projects of the EU structural funds [3]

Funds	Structural funds mln.euros	Funding attracted mln.euros	Funding requested %
ERDE	375107182.09	258776711.57	69.0
ESF	132745001.45	74200220.83	55.9
EAPGF	91848188.12	81330379.45	88.5
FMFI	24334874.30	14042683.31	57.7
Total:	624035245.96	428349995.16	68.6

Although the resources attracted leave an impact on the total demand in the country, thus to some extent also influencing the rate of inflation, when evaluating the situation in Latvia today we have to admit that now the most crucial thing is to foster the economic growth and use the resources available as effectively as possible.

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