

Latvia: The Economy

Latvia is a competitive location for new investments. It has access to the larger markets of Scandinavia, Estonia and Lithuania, as well as a solid network of contacts in the former Soviet Union (i.e. Russia and the Commonwealth of Independent States). A pro-business attitude is reflected in the rapid establishment of market economy structures, the development of Western markets and the economic integration of Latvia into Europe. A free trade agreement between Latvia and the European Union will come into effect January 1, 1995.

Economic Reform

1991 Latvia commenced its economic separation from the rest of the Soviet Union. Due to separation costs and compounded by the transitional costs of reform and restructuring, Latvia has gone through a severe economic recession over the last three years. 1994, the first signs of economic improvement are evident.

The government commenced restructuring certain facets of the economy by reorganizing the Latvian industry. First, All-Union (i.e. Soviet) enterprises in Latvia were restructured. Next, a new ministry responsible for the coordination of industrial policy was created; and a *Privatization Department* was established within the *Ministry of Economy* to undertake the de-monopolization of the industrial sector.

Output

Real GDP fell by 8.3% in 1991 and by 33% in 1992. (The *Östekonomiska Institutet* estimates that real GDP contracted by almost 20% during 1993.) However, the *European Bank for Reconstruction and Development (EBRD)* has been more optimistic, suggesting that output may have actually grown during 1993.

Industrial output contracted by almost 35% in 1992 and a further 36% in 1993 due to the sharp deterioration in the terms of trade associated with the need to pay world market prices for energy imports, and the non-fulfillment of quotas agreed with Russia for trade in 30 key commodities. Industry has been particularly badly hit by the *Bank of Latvia's* high interest rate policy which has not only raised the cost of borrowing but also contributed to the appreciation of the currency and made it difficult to export Latvian goods to world markets.

The *International Monetary Fund (IMF)* believes Latvia may achieve positive GDP growth during 1994, provided the economy can utilize effectively the foreign finance that is available.

Inflation

Price liberalization also began in 1991. As a result, inflation increased by 959% between December 1991 and December 1992. By mid-1992 less than 8% of the goods and services that comprise the consumer price index were subject to price controls.

By March 1993, tight monetary policies in conjunction with the re-introduction of the pre-war Latvian currency, the lat, the monthly inflation rate had fallen to 24%. The monthly inflation rate for 1994 will probably average around 2% to 3%.