THE INVESTMENTS IN LATVIA AND THE INVESTMENT SYNERGY

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Abstract

Attraction of investments to national economy may create positive environment to overcome challenges of the economic crisis, structural changes within the national economy, facilitate regional development and technological progress, which further serve as grounds to steady economic growth. Investments and their volume, structure and recurrence entail, to a certain extent, public economic development, increase of employment, increase of the taxable revenue basis, infrastructure development and improvement of economic activity, etc. Investments play a definite role in national economy and in shaping human culture and values. The socio – economic world consist from many different individual units, in which nature of each part depends to some degree on its relationships and its surroundings. The investment processes can be characterized as open, unsteady and nonlinear. The synergetic nature of which appears when external parameters reach a critical margin. Therefore it is necessary to create the management system of investment process.

Key words: investments, environment of investments, investment synergy.

Introduction: Investment environment in Latvia

The management system of investment process is created, building upon the results of analysis of investments in various industries, taking into account various geographic, demographic, political, social, economic, etc. factors, as well as factors of internal and external environment. Information about the impact of various factors on the investment process plays a great role. The changes made may bring the system to a condition where it requires being constantly adjusted. That is the reason why investment environment needs to be identified and evaluated. The content of the investment process management is determined according to its goals. An investment management goal is considered as reached when the actual result corresponds with the expected.

Investment inflow plays a significant role in national economy, stimulating the national economic development. Attracting investments under the global competition is a tough and complex mission, as competition is tight not just among businesses and regions, but economies as well.

Accession of Latvia to the European Union had become a significant factor for boosting the investment flow. The primary drivers to make investment volumes bulging were the cheap financial resources, nourished by the high tide of foreign capital as well as improvement in financial status of a great number of companies under the comparatively low tax burden and due to high domestic demand, etc. Within the timeframe between 2004 and 2007, investment volumes in Latvian national economy swelled almost twice. The annual investment growth tempo in Latvia within this timeframe exceeded the average annual investment growth tempos in European Union countries nearly four times. Then, in 2008, the investment volumes started to shrink.

Analysis of non-financial investments reveals that non-financial investments in the 1st quarter of 2008 were LVL 545,9 mln, 2nd quarter – LVL 672,7 mln, 3rd quarter – LVL 744,9 mln, and LVL 864,6 mln in the 4th quarter. Non-financial investments in 2009 have shrunk in comparison to 2008: by LVL 197,7 mln in the 1st quarter, by LVL 247,3 mln in the 2nd quarter, by LVL 342,1 mln in the 3rd quarter, and by LVL 339 mln in the 4th quarter. Considerable further reduction of investment volumes was there in 2010 as well: non-financial investments were LVL 171,5 mln in the 1st quarter, which represents a mere 49% of the non-financial investment volume in the 1st quarter of 2008, non-financial investments were LVL 267 mln in the 2nd quarter, representing 63%, and non-financial investments in the 3rd quarter were LVL 384.9 mln, representing 96% of the respective period.

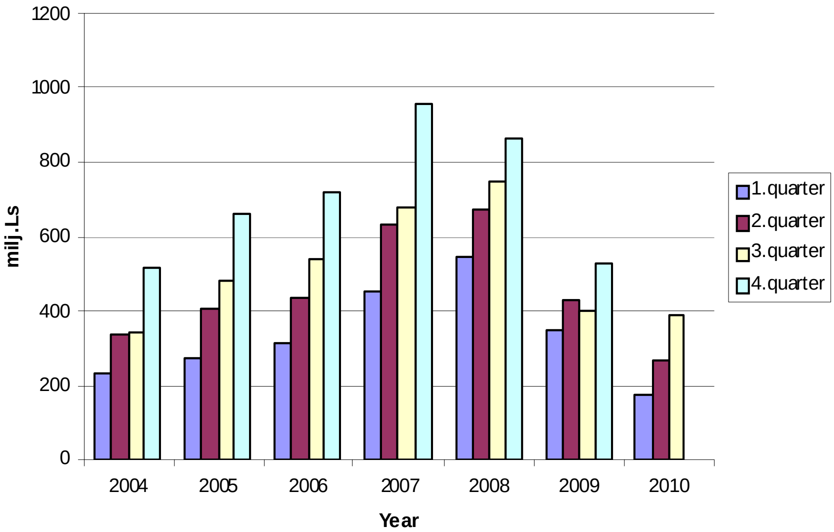

Fig. 1. Non-financial investments in Latvia

1. The main factors affecting volume of the investments.

The four major investment volume affecting factors are used as the fundament for building investment environment in Latvia: expenses for replacement of capital funds due to to their physical or technological wear and depreciation, loan interest rate of borrowed capital, company wait time to investment, when appropriate market situation is reached, and rise in demand. The investment climate in the country is also affected by the following factors: the geographic position of the country, development of energy and transport infrastructure, overall economic situation, political situation and legislation, demographic situation, tax policy un monetary policy, qualification of labour force, education and its price, facilities to introduce new technologies and innovations, and other factors.

An investment-friendly environment profile has the geographic position, as well as development of energy and transport infrastructure as the primary focus of investor attention. Frequent and unexpected supply disruptions may break up the regular flow of production process, puts strain on compliance with contractual deadlines, inflates expenditure, reducing the profit respectively. Prices for railway, seaport, water supply, public transport services, telecommunication safety, workforce and other production factors also bear vital importance.

Investments into capital assets may change by gradually replacing older technologies by more advanced ones. According to the research of J. Schumpeter, this process may be regarded as formation of a new cluster of combinations, in lieu of the previous cluster of combinations.

A cluster can be a cooperation model of similar or related enterprises that are located within a definite geographic territory, sharing a common market, technologies or know-how, suppliers, employers and supporting organizations.

For the new combination to develop, it takes to make investments into capital assets, which, if obtained, would provide the necessary production capacity. It means production capacity to produce goods with climbing demand expected. In this case, redistribution of investment resources is based on relocation of efficiency, from the old combination to the new one, as a new (improved) product cluster has emerged – with an increasing term of expiry and new improved technology. Thus, the profitability of investments also rises. For instance, relocation of resources towards the new combination may be observed in the case of replacement of refrigerator trucks to refrigerator trucks of a new construction, with improved air temperature maintenance cycle, to improve the quality of delivery of short expiry term products, as well as using new trucks of reduced CO_2 and CH emission volumes, granting them the permission to use roads or times previously prohibited, thus reducing time and air pollution costs.

Analysis of auto freight services reveals that Latvian transport companies have had a time of extensive changes. Within the timeframe of 2006 and 2007, the volume of freights had an upward trend. While in the period of time from 2008 to 2009, these volumes had considerably decreased.

Table.1.The volumes of auto freight (thousand tons)

	2006	2007	2008	2009
Total volume of auto freight	**54 187**	**59 905**	**54 459**	**37 820**
domestic freights	47 544	51 533	46 298	31 595
international freights	6 643	8 372	8 161	6 225

As we can see from the chart, the majority of cargo freights are domestic, and international freights comprise approximately 15% of the total volume. In 2009, freight volumes have had a very steep drop, reducing by 30% if compared to 2008. Domestic freights have had the most dramatic fall, although international freights have also had a drop by ~ 25%.

The assets of the analyzed transportation company primarily consist of capital assets (from 70 to 80%) and approximately (30 to 20%) working capital. Trucks wear out fast, therefore the company requires recurrent financial capital injections. In 2008 and 2009 the demand for cargo services also reduced, thus aggravating the economic conditions of enterprises in the industry yet further.

According to data of the Road Transport Administration of Latvia, there were 3 509 international road carriers operating in Latvia as of 1 January 2010. This number has shrunk, if compared to 2009, as there is a large ratio of companies gone bankrupt.

The analyzed road transportation company was searching for effective decisions how to resolve the problem and survive under the conditions of economic crisis. The company found a way of relocation of investment resources. In this particular case, the company channelled its capital to start new operating activities, i.e. for procurement of a van for carrying lesser loads over smaller distances, and, to increase load dispatching within Riga City.

A rather frequent case is that small and medium enterprises in Latvia lack investment resources for procurement of new capital assets. With prices for borrowed capital hovering, small and medium enterprises tend to avoid borrowing capital. As a result of that, only investment projects with a high profit margin see implementation. Another aspect that matters is a company's waiting time to investment, forecasting market situation and demand.

With investment resources scarce, it is of the utmost importance to stick to the "major key parameter" concept of competitiveness when planning and implementing various investment policy measures. Placing the correspondence of the key (primary) parameter of a particular product or type of production to market requirements at the top of the decision making criteria list. There are times in investment project development, when the financial parameters of an investment project overshadow the significance or outstanding qualities of the product, especially when being measured against other rival products.

2. The main principles of investment management.

It should be remarked that the traditional economic theory is far from being universal. It is expanded by the synergetic economics, as it addresses the aspects that the traditional theory overlooks. It attempts at explaining a number of other economic phenomena. Although, claiming that the synergetic economics solves all economic problems would be an overstatement, it still allows forecasting and interpreting some dynamic economic processes, which may not be interpreted by models and methods of the traditional economics.

One of the principles of investment management is to attain steadiness of investment management. The problem here is the innate instability of investment processes, as well as their qualities of being open and nonlinear, the synergetic nature of which appears when external parameters reach a critical margin. It means that a systemic approach needs to be combined with the synergetic nonlinear, unstable and spontaneous. Therefore, decision making within some industries affect the decision making in others, and inflow of new investments in one industry may contribute to the development of related industries.

Development in synergy is related to instability and non-linearity. Therefore these processes trigger changes, which lead the structure to the point of bifurcation. It finds itself in a state of uncertainty, where any stimulus drives it along one of many potential routes.

One of the primary tasks of system management is to guarantee stability of the system. Usually it is the result of focused activities of individuals. It is advisable to focus on any potential changes in the future, closer and further, rather than concentrating on errors of the past. Rather than developing a mechanism for maintaining stability of the system, it is more advisable to opt for a natural, flexible approach (response) to any contingencies that might entail problems of various sorts. Solving some problems seems to spawn new problems, as it sometimes appears, as the old ways and methods may not always work for any problem.

As management of investment process is a specific function, it is implemented by means of certain systemic elements. The system, in its operational process, falls into the managing institute and the system to be managed. The managing institute encompasses all those elements, which are in charge for producing or creating new material (mental) values or new goods (services). The managed system, in turn, contains all those elements that are in charge for focused operation of the process.

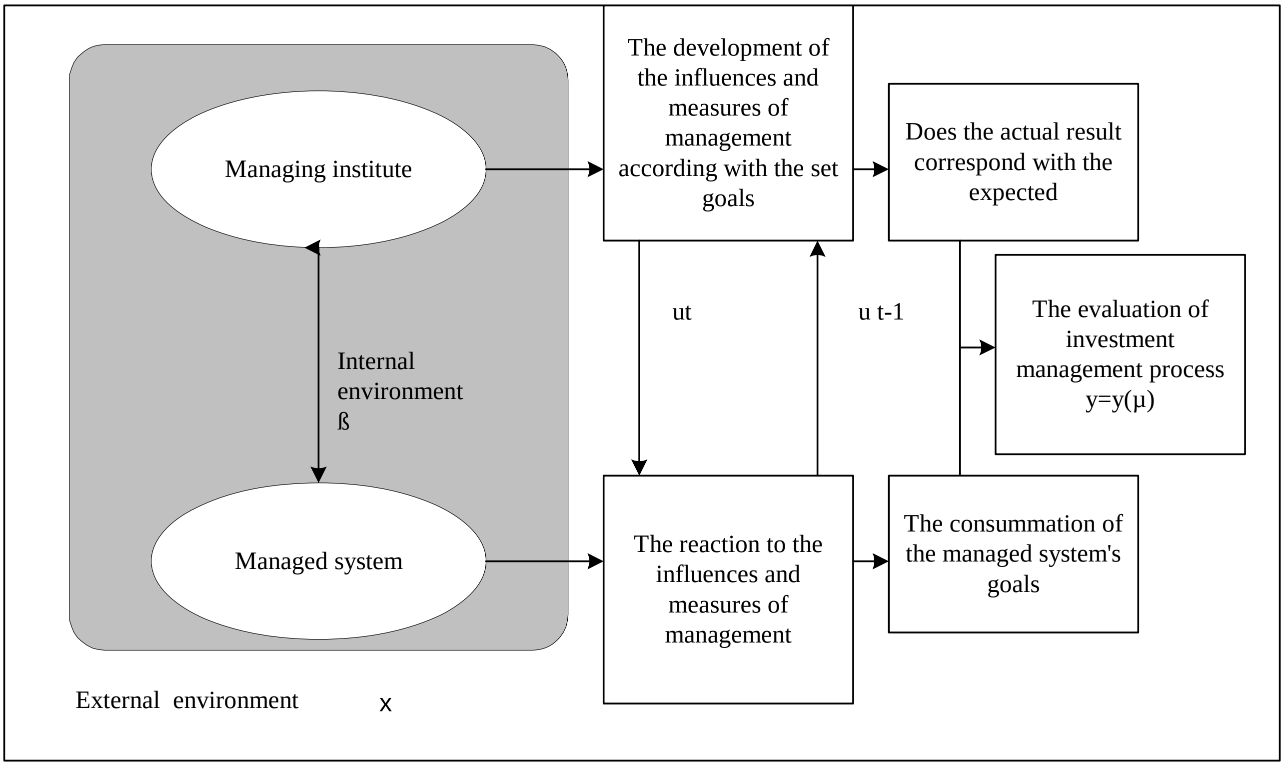

Fig. 2. The main rules of managing investments

The managing institute, via fiscal and monetary policy, creates conditions affecting the appetite for investing. The overarching mission for the managing institute is to identify the major goals and milestones for the system managed, as well as introduce the adopted decisions and measures. A system, which is affected by internal and external changes, is called the managed system (managing object). At times, the managing institute identifies certain goals, develops regulations, laws, fields measures, but the managed system responds to that in a way differing from what the managing institute had expected. Thus, attainment of the managing institute's goals and the expected results is jeopardized.

Managing influences and measures of are focused towards getting the management system functions to facilitate reaching the set goals. Influence of the managing institute onto the managed object is regarded as a process, which may change the amount of influence u_t.

Thus, for instance, the price for renewable energy in Latvia (wind, small water-power plants, biogas), established by the managing institute, has not affected the goal established by the managing institute. The produced amount of electric energy under the tender as established by the Cabinet of Ministers, instead of an independent regulator, therefore costs more than the respective market price. The price of those businessmen in Latvia, who had gained the rights to sell the renewable energy resources under the mandatory procurement plan of electric energy, exceeded the average international price of imported kWh by 82%. Thus the renewable energy resources cost LVL 37,5 mln more to all the energy consumers in 2007 than the respective imported electric energy would have.

As the picture demonstrates, the output position of the managing institute u_t where the managing influence within any moment of time t depends on input positions affecting it. Management measures and influences primarily depend on the managing institute goals and qualities and capabilities of the managed system (γ). The goal of the managing institute is to develop managing influences u_t. Managing goals may differ. It should be taken into account that the goals of the managing institute should not contradict the goals of the managed object, although each is driven by its own goals ("homo economicus" concept).

Factors of external environment (x) also affect the influence of the managing institute, development of measures and implementation. For instance, regulation of monopoles, when setting the price of natural gas is related to market prices of oil and oil products, therefore it may not be forecasted to a high level of credibility.

Foreign investments are likely to flow in a country of small market in the case it allows to produce cheaper goods with the "major key parameters" and higher quality. In that case, part of the output could be sold to local households, and the rest of the produced goods could be sold to households abroad. We could say, the effect of the external environment may be predictable as well as random.

Rules of managing may be generalized in the following equation:

$$u_t = f(u_{t-1}, \gamma, \beta, \alpha, \delta) \quad (1)$$

where:

u_t – managing institute output position;
u_{t-1} – managed system output position;
f – function of the particular management system;
γ – parameters of the managing institute;
β – qualities of internal environment as functional dependence on the external environment;
x – qualities of external environment;
δ – random factor [1].

The management effect is produced by development regulations of managing influence, taking into account the goals of the managing institute, and qualities and opportunities of the managed system (γ), degree of internal environment effect (β) and the random (unpredictable) factor (δ), as well as other conditions.

Investment management goal is reached, when the actual result corresponds with the expected. In order to measure the efficiency of investment management, two results need to be identified – the actual result y and the estimated result y' – as it should be. Each position has a number of parameters that allow measuring the management system functioning result. In many cases, part of the determiners of the result y' are assumed as fixed; then the actual result y will depend on some variable indicators μ, i.e. $y = y(\mu)$.

We may have an initial impression that human efforts in stabilization of investment processes are vain. Instability, inability to forecast, large impact of nonlinear structures' input data may cause doubt in the necessity of managing. But the research in management and chaos theory decision making have arrived at a conclusion that the effect of human influence is not just possible, it is essential. The decisive thing is – when and how that influence is exerted.

To identify the internal environment condition of investments as the managed system, the major factors affecting the investment environment are analysed.

1) geographic position is one of the crucial factors in attracting foreign investments. In considering an investment project, the potential investors are looking at the area of the country, neighbouring states, transport infrastructure incl. access to sea. In some cases, considering investments into tourism or some specific industry, investors pay large attention to the aspects of climatic conditions. A well-developed infrastructure may increase and speed up investment project development and implementation. The reason for that is the fact that sustaining production with the required resources and distribution of the produce requires a well-developed transport infrastructure. If production volumes is not the primary focus of the entrepreneur, but building feeder routes and installing trunk power lines and subunits is also placed within its care, it

considerably swells the project costs and that investment project may turn out to be unprofitable. To stimulate the investing appetite, entrepreneur and the public should be furnished with well-developed power supply and transport infrastructures; 2) resources, their quality, availability and prices considerably affect production within a country, that includes qualification of workforce, market needs compliance and price (remuneration for work); 3) investors are interested in the economic situation within a country, as growth in domestic household consumption, which entails subsequent growth of demand may stimulate increase of the respective supply on domestic and foreign companies' part. Investors are primarily interested in such macroeconomic indicators as the volume of the current and estimated inflation, as well as exchange rate fluctuations (pegging of LVL to the SDR currency basket can sometimes reduce the international competitiveness of some products). Investment volumes are also affected by confidence to national policy and trust in the better future. Trade policy also affects the circulation of export and import in the beneficiary country, its costs and level of impediment. It is vitally important for transactional corporations, as they use foreign equipment for export to streamline production output and distribution on international scale. 4) tax policy is a powerful economic instrument, by means of which the government can influence some particular economic processes within the country, eagerness of entrepreneurs for business, as well as influence investing activity. 5) political situation and legislative climate within the country. Usually investors would be looking for more stability in a country regarding political and legislative areas. Frequent change in the government poses potential investors uncertainty in the future. A significant aspect is steadiness of the current legislation, particularly the one governing the realm of business. A volatile legislation and options for different interpretation of laws entails uncertainty in the future, which again may impede investment attraction; 6) demographic factors play a great role on investing decision making. Demographic situation affects the volume of consumer needs, their structure and market capacity. As one of the drivers of economy is the population number growth, allowing businessmen enlarge their domestic production output and services volume; 7) introduction of new technologies and innovations materially affects the replacement of fixed assets and production efficiency. A tough challenge is that businessmen have trouble finding cooperation partners in the area of innovation. Latvian research and industrial companies have failed to form clusters, comprising respective competent research institutions and line companies, operating in the area of innovations, and the production of which would be innovative.

Conclusions

The primary factors affecting the investment environment have considerable impact onto investment structure, volume and investing time. Investments play a significant role in fostering economic growth, as investments are the portion of the gross domestic product, which is being channelled for investing into both the strategic and portfolio capital, seeking to secure the potential capital growth in the future. Therefore, the requirements are to continue implementation of structural reforms within public administration, improvement of business and investment environment, particularly relieving small and medium enterprises. Some laws on taxes, levies would need to be revised, as well as shadow economy countered. Attraction of EU structural funds, public and private investments, foreign investments, could activate some industries of national economy, granting households and businessmen the required belief in long-term development prospects of Latvia, forming a sustainable domestic market and sustaining the export of Latvia.

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