

**STRATEGIC ADVANTAGES AND COMPETITIVENESS
ADVANTAGES OF LATVIA, IN THE CASE OF TIMBER INDUSTRY**

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Annotation: *This paper will study the manufacturing competitiveness of Latvia taking the example of the wood industry. The theoretical knowledge of competitiveness will be analyzed together with the official data of reports and scholarly literature. By calculating Revealed Comparative Advantage, and shows the advantages in the industry of Latvia compared to other economies. Explaining the process with help of competitive theory. Moreover, the article gives reasons for resource sustainability. At the end of the article there is given suggestion for diversification in export to increase the amount and product types of the export.*

Аннотация: *В этой статье будет рассмотрена конкурентоспособность в производстве Латвии на примере лесопромышленной промышленности. Теоретические знания о конкурентоспособности будут анализироваться вместе с официальными данными отчётов и научной литературы. Рассчитывая выявленное сравнительное преимущество, показывает преимущества латвийской промышленности по сравнению с другими экономиками. Объяснение процесса с помощью конкурентной теории. Кроме того, в статье приводятся причины устойчивости ресурсов. В конце статьи приводятся советы по диверсификации экспорта для увеличения объёма и видов товара экспорта.*



Anotatsiya: Ushbu maqola Latviya ishlab chiqarish raqobatbardoshligini yog'och sanoati misolida o'rganadi. Raqobatbardoshlik nazariy bilimlari rasmiy hisobotlar va ilmiy adabiyotlar ma'lumotlari bilan birga tahlil qilinadi. Ko'rsatilgan taqqoslovchi ustunlikni hisoblash orqali Latviya sanoatidagi boshqa iqtisodiyotlarga nisbatan afzalliklarni ko'rsatadi. Jarayonni raqobat nazariyasi yordamida tushuntirish. Bundan tashqari, maqolada resurslarning barqarorligi uchun sabablar keltirilgan. Maqola oxirida eksport miqdorini va tovar turlarini oshirish uchun eksportni diversifikatsiya qilish bo'yicha taklif berilgan.

Key words: Competitiveness, timber industry, Revealed Comparative Advantage (RCA), agriculture, value added product, competitive advantage.

Ключевые слова: Конкуренентоспособность, лесная промышленность, выявленное сравнительное преимущество (RCA), сельское хозяйство, продукт с добавленной стоимостью, конкурентное преимущество.

Kalit so'zlar: Raqobatbardoshlik, yog'och sanoati, taqqoslovchi ustunlik (RCA), qishloq xo'jaligi, qo'shimcha qiymatli mahsulot, raqobat ustunligi.

Introduction

Competitiveness is the capability of a country to manufacture and export goods or services to the international market that meets the international market standards without worsening or reducing the real income and living standards of citizens. Price and cost advantage are no longer the only elements of competitiveness in the globalized economy but rather productivity, innovation, technological ability and institutional strength (Porter, 1990; Krugman, 1994). In the case of small open economies like Latvia, the competitiveness is a major factor of sustainable economic development and inclusion into the European and global markets.

Latvia is an example of the most successful economies in Eastern Europe as the country was rated 66.98 points on the World Economic Forum Global Competitiveness Index (GCI) in 2019 (World Economic Forum, Global Competitiveness Report 2019). Correspondingly, the IMD World Competitiveness Ranking (2024) shows that Latvia made a jump in the list of the 51st to the 45th place as the result of the increase in digital competitiveness and export



diversification (IMD, 2024; Invest in Latvia, 2024). These optimistic trends are indicative of the structural shifts in the Latvian industrial policy, particularly its orientation at the innovation, value-added production, and management of resources on the basis of sustainability.

The wood processing and forestry industry is one of the most competitive and export-oriented sectors in Latvia and has traditionally been the key element in the national economy. According to the Central Statistical Bureau of Latvia (CSB), the wood industry was the leading export sector in 2022 (almost 20-percent), and the industry employed more than 30,000 individuals (CSB Annual Report 2023). The presence of a high level of forest resources in the country along with effective production technologies and entry into the markets of the EU offers a high comparative advantage. Nevertheless, Latvia, according to Zemitis and Jansons (2019) in their academic monograph Sustainable Forestry and Industrial Competitiveness in the Baltic Region, continues to struggle with raising the proportion of high value-added wood products and moving towards digital and eco-efficient models of production.

The wood industry in Latvia is experiencing new threats of changing world demand, reduced volume of timber trade, and environmental policies. To provide an example, reported by the Latvian Public Media (LSM, 2023), the export of wood products in Latvia decreased by nearly 20 percent during the first part of 2023, indicating the worries of the market in Northern Europe and Asia. This scenario explains why strategic industrial policies are required to create a balance between economic efficiency, environmental sustainability, and technological advancement.

This paper will study the manufacturing competitiveness of Latvia taking the example of the wood industry. The theoretical knowledge of competitiveness will be analyzed together with the official data of reports and scholarly literature. This is aimed at finding significant elements that affect the competitiveness of Latvia in the industrial sector and the policy suggestions that can be made on the enhancement of sustainable development on the global markets.

Main body

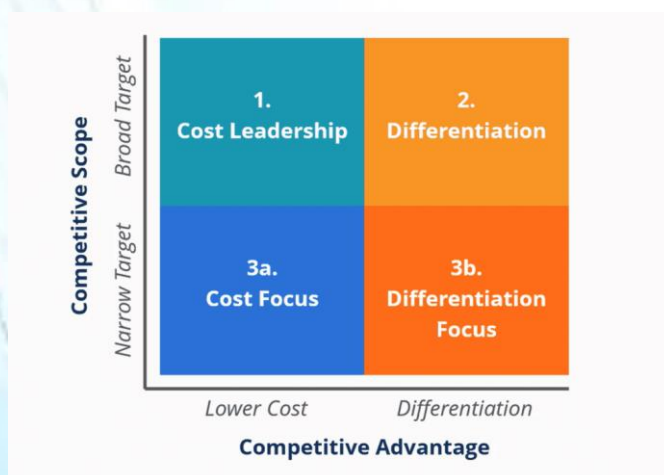
Theory of competitive Advantage:

The document identifies three major competitive approaches that companies can pursue, namely, Cost Leadership, Differentiation, and Focus.

Cost Leadership: Cost leadership strategy aims at being the lowest cost producer or supplier of products or services. This approach is enforced by making average quality goods at cheaper and competitive prices compared with the similar goods. The firms that adopt this strategy are interested in attaining high volumes of sales but with low profit margins per unit so as to be able to maximize their profit. In order to be successful, the companies need to consider the most effective ways of manufacturing, as well as to communicate their value proposition, and it is hard to duplicate their cost structure.

Differentiation: A differentiation approach is based upon the production of unique good or services that are not similar to the ones offered by other companies. Companies that use such a strategy need to work on research and development (R&D) to improve and ensure the uniqueness of their products. These businesses can easily compel the consumer to pay more by offering some products that have strong value propositions that can be created, thus leading to a better profit margin.

Picture 1¹ Competitive Advantage



Focus: In the focus strategy, the attention is on the identification of a niche market and serving it through the development of products, which specifically meet the needs of that niche. There are two variations of this strategy:

¹<https://www.google.com/imgres?q=competitive%20advantage&imgurl=https%3A%2F%2Fcdn.corporatefinanceinstitute.com%2Fassets%2Fcompetitive-advantage-1>



- Cost Focus: Aims at becoming the lowest cost producer in a certain niche market.

- Differentiation Focus: Involves the provision of specific value-added products or tailor-made products within a very limited market segment.

On the whole, these strategies are representative of various strategies that companies can adopt to achieve competitive advantage and serve various needs of the market.

Overview of Latvia's economy

Latvia was centrally-planned country, but regaining its independence motivated to market-oriented structure. During Soviet Union regulation Latvia bloomed both in agriculture and industry. In 1990, in the period of Soviet Union, the agriculture equaled nearly 20 percent, while industry was about 43 percent of GDP. After the collapse of the Soviet Union the industry sector suffered and decreased to 12%².

In 2004 Latvia joined the EU and adopted the unique currency, euro, in 2014. It was the impulse to open the Latvian market for foreign investment and privatization of some bigger sectors³. This transition of the economy led to the increase the share of service sector, although the shares of agriculture and industry faced decline. As an example, the share of agriculture fell by 1.3 percent, from 3.2 % in 2000 to 1.9 % in 2016⁴.

Nowadays, agriculture, forestry and fishing take comparatively small share of GDP. According to database The Global Economy agriculture takes around 4.1% of GDP. Moreover, in 2023 service sector was the leading with the 61.56% of GDP, while agriculture was about 4% and industry 22.34%⁵.

Export of Latvia: by sectors

Total export of Latvia in 2024 equals \$19.74. The three most exported products in Latvia are: Wood and wood products, wood charcoal; Electrical,

² https://www.mongabay.com/reference/country_studies/latvia/ECONOMY

³ <https://www.britannica.com/place/Latvia/Economy>

⁴ https://www.oecd.org/en/publications/innovation-agricultural-productivity-and-sustainability-in-latvia_9789264312524-en/full-report/component-5

⁵ <https://www.statista.com/statistics/375583/latvia-gdp-distribution-across-economic-sectors>

electronic equipment and Mineral fuels, oils, distillation products⁶. Wood and wood product is mostly exported product in 2022 with the share of 165 of total export, following with electronics 10%.

Latvia exports mostly wood and machinery & electronics. Below the details of both sectors will be provided.

Graph 1: Export of Machinery & electronics and Wood



Source: OEC.world⁷

From the data its clear that the competitiveness level of wood export is higher relatively to mach & elec. Latvia took the first place in exporting of wood in its region in 2023 and the second plce in export of mac & elec. Top destination in

⁶ <https://tradingeconomics.com/latvia/exports-bycategory#:~:text=The%20top%20three%20export%20commodities,fuels%2C%20oils%2C%20distillation%20products.>

⁷ <https://oec.world/en/profile/bilateral-product/electrical-machinery-and-electronics/reporter/lva>



agriculture is UK (\$697 mln) and in industry sector is Lithuania (\$578mln). Share of Latvia in wood export in the world equaled almost 2%(rank 16/223) and share of mach & elec export 0.054% (rank 56/226).

Startegic and competitiveness advantages

The timber industry in Latvia plays a crucial role in the national economy, serving as one of the main employers and exporting 20% of all exports. 30% of the manufacturing sector consist of timber industry. These days the sector faces many challenges, but still Latvia chooses to improve the sector, especially high value-added products. Kristaps Klauss, Vice-President of the Latvian Forest Industry Federation (LFIF), highlights that active exporting is vital for many companies' stable growth in Latvia, as it facilitates market expansion and boosts competitiveness⁸.

According LFIF the industry is relied highly on constructions, and 50% of Latvian wood is used for construction in Europe, North America and Asia. As the result of these the export of the timber is decreased, as the world construction trend is slowed down between 2023 and 2024. However, Latvia keeps the trend of investment and employees. Latvia chooses not to quit , but to diversify its market.

In 2024 Latvia expanded export partners up to 107 countries, which helped to stay stable in the market and prevented from negative influence of fluctuation. Main partner countries were United Kingdom, Germany and Denmark, in 2024.

Graph: 1 Export of wood⁹

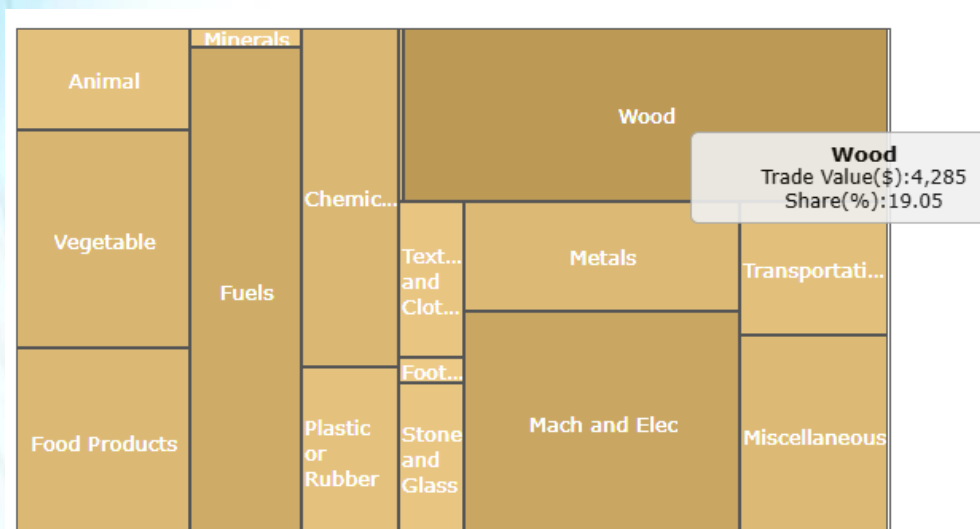
⁸ <https://business.gov.lv/en/news/timber-industry-latvia-challenges-and-future-prospects>

⁹ <https://wits.worldbank.org/CountryProfile/en/Country/LVA/Year/2022/TradeFlow/EXPIMP/Partner/WLD/Product/All-Groups>



The graph above shows the 10 main wood export partners of Latvia in 2022. 20% of wood was exported to UK, which was the number one partner in wood export. Followed by Sweden a little bit more than 10%, and Germany about 8.5%.

Graph: 2 Export products¹⁰



In the graph 2 demonstrates export products of Latvia. According to the graph wood was the most exported product in 2022 with about 20% of total export. Then Machinery and electronics with almost 14%, next is fuels with around 12.33%.

Empirical analysis: Revealed Comparative Advantage (RCA) for Latvia's wood industry (2021)

RCA - Revealed Comparative Advantage - is an economic indicator used to measure how competitive a country is in exporting a specific product compared to the rest of the world.

¹⁰ <https://wits.worldbank.org/CountryProfile/en/Country/LVA/Year/2022/Summary>



Definition: RCA shows whether a country is specialized in exporting a certain good — meaning it exports that good relatively more than the world average.

Formula 1:

$$RCA_{ij} = \frac{(X_{ij}/X_{it})}{(X_{wj}/X_{wt})}$$

Where:

- X_{ij} - exports of product j by country i
- X_{it} - total exports of country i
- X_{wj} - world exports of product j
- X_{wt} - total world exports

Interpretation of the formula:

If $RCA > 1 \rightarrow$ Country i has a revealed comparative advantage in product j (exports more than the world average share).

If $RCA < 1 \rightarrow$ Country i has a revealed comparative disadvantage in product j . In the case of Latvia:

- $X_{ij} - 3.173$ bln
- $X_{it} - 16.49$ bln
- $X_{wj} - 482$ bln
- $X_{wt} - 27300$ bln

$$RCA_{ij} = \frac{(3.173/16.49)}{(482/27300)} = \frac{0.193}{0.018} \approx 10.72$$

Result interpretation: 10.72 means that Latvia's wood industry is more than 10 times specialized than the world average.

Value-added and other uses wood products

Latvia also has another option to be more competitive, and this called value-adding. By enhancing the product's physical state, the cost of the product increases. As an example, application of wood in heat and bioenergy production can be one of the drivers for both economic and environmental advantage. Almost half of the Latvia consists of forests which means sustainable wood resource is available.



On the other hand, not every tree can be used for construction purposes. So, some part of wood is waste, to preserve waste, logs can be used for heating and bioenergy production. Which means no wood is wasted. Wasted wood can also be used for energy purposes. By converting low quality wood into energy and heat, Latvia can decrease reliance on import of fuels (fossil fuels)¹¹ Moreover, cross-laminated timber also can be a great option to diversify wood products, sawn wood, plywood.

Advantages of Latvia in forestry

Here comes the question, How Latvia keeps wood supply? - Sustainability Certifications. The forests stay sustainable due to regeneration strategy, afforestation and conservation. Forest management incorporates the protection of areas. Certifications (e.g. sustainable forest management) serve to enter into more lucrative markets particularly in the EU and other environmentally conscious jurisdictions. This put Latvia at an upper edge than producers who might not have such qualifications¹².

Policy Framework, Institutional Support. Latvian Forest Industry Federation, state forest managers (e.g. "Latvijas Valsts Meži" as well as trade and investment promotion agencies are the institutions that are involved in the export coordination, regulation and development of the sector. The amount of foreign direct investment in the industry is substantial particularly in the processing of wood and the production of pellets signifying that there is external assurance over the Latvian forestry industry.

Conclusion

To sum up, Latvia's export is well diversified into agriculture and industry. However, timber industry is relatively developed. Latvia shows a strong and sustainable comparative advantage in wood industry, more in depth, the RCA index clearly presents that Latvia is almost 11 times higher than world average.

¹¹ "Possibilities to Use Latvia Wood Resources for Heat Energy Production" by **Ligita Bite, Gunita Mazure, and Kristaps Makovskis**

¹² https://cdn.pefc.org/pefc.org/media/2024-03/071214ee-df04-4a85-b251-7223681c6a0d/09d96e7a-4abc-5346-862c-74e9324c8e0d.pdf?utm_source=chatgpt.com



Latvia has already started implementing advanced technologies for harvesting and machinery for added-value products, and legislation for harvesting to keep the supply. Nevertheless, to keep the pace and increase export, would be better to diversify export products by adding-value and using wood in other purposes. Moreover, developing industry sector can lessen the risk dependence on wood, as the electronics sector does exist. Based on this, the long-term competitiveness of Latvia resides on its ability to convert its natural advantages into innovation-based development. Value chains can also be reinforced, technological upgrades promoted, and diversification to knowledge-intensive industries may be used to stabilize the export performance and cushion the economy against shocks in the international commodity markets. Latvia can build a more balanced, robust, and forward-looking export base by utilizing its traditional competencies in the wood-processing sector and developing new areas.

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