

Chapter 6

How Is the Crisis Affecting the Competitiveness of Countries?

The Case of the Baltic Countries and the Global Crisis

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ABSTRACT

The chapter focuses on the relation between the economic crisis and competitiveness on a national and regional dimension. The Baltic countries (Estonia, Latvia, and Lithuania) have experienced one of the biggest GDP contractions during the Global Crisis so far. Hence, identifying and assessing changes in the relative competitiveness as a consequence of the economic downturn has sparked many interests. The international competitiveness and economic crisis intermingle with one another. The international cases selected for the purpose of this research (Estonia, Latvia, and Lithuania) were to demonstrate clear and unquestionable evidence that crisis affects the international competitiveness of countries. One may believe that such a deep and painful financial and economic crisis as the current one—in the case of the Baltics—has to leave some permanent and explicit traces on a country's competitiveness. Thus, the results of this research may surprise a little. It may be generally concluded that a short-term crisis, even if severe, does not have a negative long-term

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influence on the international competitiveness as long as a proper anti-crisis policy is implemented. Sharing a number of structural, institutional, and performance features caused the crisis to undermine the competitiveness of the Baltic States in a similar manner (through macroeconomic stability channel). This in turn caused the applying of an analogue crisis management policy with the fundamental tool of fiscal policy tightening by an increased downward flexibility of wages and prices.

INTRODUCTION

The *subprime* crisis¹ (named the Global Crisis as well, Roubini & Mihm, 2010; Orłowski, 2011) has affected different aspects of the global economy. Regions, countries, companies have been hit by dramatic and unprecedented events in the financial markets and the broader economy. A lot has been written about the causes, symptoms and consequences of this crisis (Shiller, 2008; Taylor, 2009; Mayes, Pringle & Taylor, 2009; Gorton, 2010; Roubini & Mihm, 2010; Friedman & Posner, 2011; Mundell, 2011; Orłowski, 2011). This paper aims at contributing to this broad and multifaceted discussion by concentrating on the impact of the *subprime* crisis on the competitiveness of the economy.

A main goal of this paper is to identify and assess changes in particular in the relative competitiveness of three Baltic countries (Estonia, Latvia and Lithuania) in consequence of the global economic downturn started in 2007. The rest of the paper is organized as follows. The first section is devoted to a brief presentation of the general background for both the concept of competitiveness and the Baltic economies as the region under examination. Section 2 briefly examines the causes and symptoms of the global economic crisis and its channels of potential impact on the Baltic economies. In section 3 we provide an overview of the crisis management policy in Baltics. The next two parts of the paper (sections 4 and 5) present and discuss selected economic measures of competitiveness (examples are GDP development, labor market changes, international trade development) and the descriptive competitiveness measure of the Baltic countries in 2007-2012 (i.e. Global Competitiveness Index). The paper closes with the conclusion.

BACKGROUND

The assessment of the crisis impact on competitiveness should be preceded by a clear indication of what is meant by ‘competitiveness’ in this paper, especially as there is no unique definition of this term and the concept still seems to be elusive. The understanding of it depends among other things on the level of analysis (whether

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