

## Labour productivity

### RE-INVIGORATING LABOUR PRODUCTIVITY GROWTH IN LATVIA

- ▶ Better access to education and affordable housing would help strengthen the skills of the workforce, increase labour mobility and reduce skills matches.
- ▶ Evaluating EU-financed programmes to enhance research and science-industry cooperation, and providing sustainable funding for the most effective ones, would strengthen innovation.
- ▶ Limiting the size of the large informal sector would reduce unfair competition and improve incentives for formal firms to invest in innovation and expand.
- ▶ Promoting productivity catch-up of lesser-performing regions would boost national growth and inclusion. Measures to improve the functioning of the metropolitan governance of Riga would also stimulate productivity.

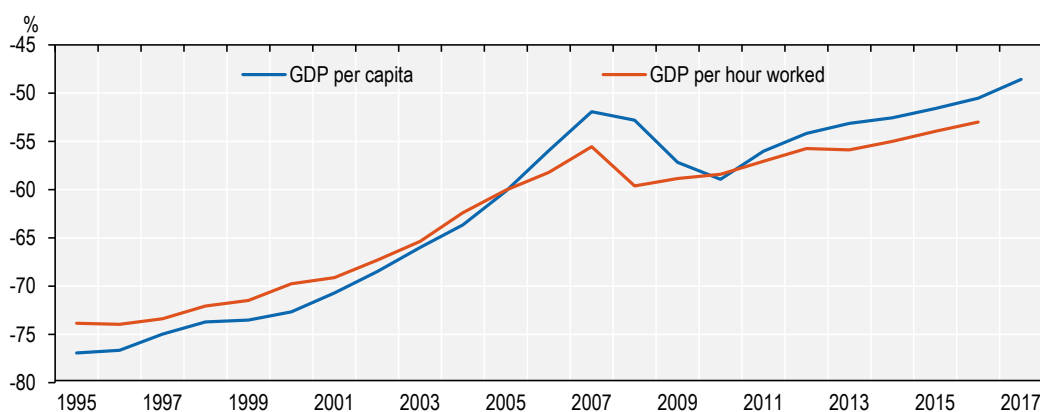
#### What's the issue?

Labour productivity growth has eased since the global financial crisis, slowing economic convergence to other OECD countries (see Figure). Exports and participation in global value chains are relatively weak and exporting firms tend to specialise in low-tech products. Skills shortages and mismatches are holding back the adoption of modern technologies and management practices, as does the large informal sector with firms specialising in small-scale production often with backward technologies to avoid detection. Poor access to vocational and higher education for low-income students and to affordable housing in the Riga region (with the strongest job growth) are holding back skills development and better skills

matches. Investment in R&D, innovative activity and science-industry cooperation are weak. Productivity is not sufficiently broad-based, which hampers inclusiveness. Spatial differences in productivity (GDP per worker) are high, with Riga being almost twice as productive as the least performing region. Latvia is therefore mid-range among OECD countries in terms of spatial productivity gaps. The productivity gap between large firms and smaller firms is also large. Small and medium-sized enterprises in Latvia are about 70% less productive than large firms, a gap that is larger than in Estonia (54%) or Czech Republic (60%).

#### Catch-up process with leading OECD countries has slowed

Gap in labour productivity and GDP per capita vis-à-vis the upper half of OECD countries<sup>1</sup>



1. Percentage gap with respect to the weighted average using population weights of the highest 17 OECD countries in terms of GDP per capita and GDP per hour worked (in constant 2010 PPPs). Source: OECD (2018), OECD National Accounts Statistics and Productivity Statistics (database).

### Why is this important for Latvia?

Re-invigorating productivity growth will be key for Latvia to catch up faster with higher living standards in other OECD countries, as emigration and ageing are contributing to a rapid fall in the working-age population.

Reforms have helped to raise the quality of vocational education, but here is a lack of work placements for vocational students and many low-income students lack the financial resources to participate. Latvia is working to improve quality standards, incentives and controls in higher education. Yet, young people from low-income families are often excluded because they cannot cover their living expenses and scholarships are only based on merit, not on income. Many workers cannot find affordable housing that would allow them to move and take up a job that fits their skills. This holds back better skills development and inclusiveness, while income inequality and poverty are high.

Many programmes from EU Structural Funds support basic research, commercialisation and science-industry cooperation, but funding is thinly dispersed among different measures.

Building on past efforts to enhance the efficiency of court procedures and reduce their length, while improving training of insolvency administrators and other law enforcement officials to deal with fraud would help better protect property rights and lower barriers to firm entry and exit. As a result, these measures would make entrepreneurship more dynamic, and make it easier for Latvian firms to benefit from integration in global value chains to develop markets and adopt new technologies.

Reducing the size of the informal economy – estimated at some 20-25% of GDP – would limit the allocation of labour and capital towards firms that do not comply with regulations and tax laws, improving incentives for domestic and foreign firms to invest in innovation and expand. To this end, it is necessary to lower the costs of formality, including taxes on low-wage workers, while enhancing its benefits through more effective corruption control and better access to social services.

### What should policy makers do?

- ▶ Develop better financial support for students from low-income backgrounds.
- ▶ Carefully evaluate programmes supporting basic research, research commercialisation and science-industry cooperation, gear up the most effective ones and ensure sustainable long-term financing through domestic budgetary funds.
- ▶ Develop the private rental market and invest in social housing by providing more funding, improving the clarity of rental regulations and the effectiveness and speed of dispute settlements.
- ▶ Improve the specialisation of judges and the training of insolvency administrators and other law enforcement officials, and strengthen the budgetary independence of the budgetary independence of the Corruption Prevention and Combating Bureau (KNAB).
- ▶ Reduce labour taxes on low wages, enhance access to affordable healthcare by limiting out-of-pocket payments and ensure higher pension adequacy.
- ▶ Promote regional development policies to improve the business ecosystem for firm productivity across the country and create a platform to coordinate policies of all municipalities where most residents commute to Riga.



### Further reading

OECD (2017), *Economic Survey of Latvia*.  
<https://doi.org/10.1787/25222988>

OECD (2018), *OECD Reviews of Pension Systems: Latvia*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264289390-en>

OECD (2018), *Opportunities for All. A Framework for Policy Action on Inclusive Growth*, OECD Publishing, Paris.  
<https://doi.org/10.1787/9789264301665-en>