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CAPITAL CONCENTRATION EFFECTS ON THE TYPE OF ECONOMIC GROWTH

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Abstract. The purpose of the research is to introduce the audience with specific features of economic growth in Latvia which is said to have experienced the "story of success" and to offer a different point of view on the traditional economic theories based on the influence of capital concentration in a particular country. The authors try to analyze the outcome of the "success story" by proving their opinion with the recent facts and basing their stand-point on the theories of well-known economists who are questioning the permanency of the growth paradigm. The essence of the economic growth must lie in the prosperity of people. The authors try to explain why the case of economic growth in Latvia differs from the situation in other EU countries. The role of inflow of foreign capital and its possible consequences, as well as the balance of payments are analyzed in the paper. The findings of the research offer the alternative to consider the flow of capital and globalization processes critically, evaluating the possible positive and negative effects on economies of the countries.

Key words: economic growth, capital concentration, balance of payments

INTRODUCTION

During the last three years economy of Latvia has been considered "a story of success", as, according to statistical data, Latvia had experienced the most rapid economic growth over the period 2011–2013. At the same time there are observed some phenomena in economy of Latvia that makes us doubt whether the chosen economic policy of the country is the right one. The goal of the paper is to investigate the specific features of economic growth in Latvia in comparison with other

EU countries. Strong relationship between economic growth and foreign trade deficit has served as the impetus for such kind of research.

The investigation is based on statistical data from Eurostat and Central Statistical Bureau of Latvia, as well as on qualitative observations about the present processes in economy of Latvia. The theoretical discussion is based on scientific publications of prominent world-famous economists starting from the classics to mainstream and alternative authors of modern economic thought.

Methodological part of the research includes discussions among the students and the academic staff of BA School of Business and Finance. Students were involved in this research work and they were asked to carry out both, quantitative and qualitative analysis of economy for the given country. Quantitative analysis contained methods of graphical comparison of data. Econometrical methods were also used (correlation analysis), but there might be traced some problems with the confidence level due to the non-sufficient number of observations. Thus, this problem has not been discussed in the paper as it needs deeper econometrical investigation and explanation.

As a result of the research carried out we have come to the following conclusions. Economic growth can no more be considered as the main objective in economy. Capital concentration, financial markets and globalization, which go hand in hand with the present paradigm of growth, over time provoke more and more threatening features, which endanger economic development and people's wellbeing. Economic growth in Latvia in the 21st century strongly correlates with foreign trade deficit. The lack of foreign investment policy could be mentioned as the reason for this situation. Foreign investments have become the main factor of economic growth, but most of them are at best brown-field investments, or even more likely speculative by nature, thus resulting in covering the foreign trade deficit. Among the EU countries one may notice significant differences in the type of economic growth. Countries with moderate economic growth do not have correlation between economic growth and foreign trade deficit (respectively, balance of payments deficit).

As with free flows of capital comparative advantage does not take place, a global tendency of forming metropolises and provinces is observed among countries. Thus the gap in economic development is permanently increasing. A possible solution may be economic localization and emulation.

THE GROWTH FETISH

Politicians, mainstream economists consider economic growth as an undisputed goal. The public opinion has been created and influenced through mass media to accept this conventional wisdom without any objections and excuses. Though in the second half of the 20th century some very influential ideas appeared by such authors as Nicholas Georgescu-Roegen, Kenneth Boulding, Ernest Schumacher, the authors of the "Rome Club report", Herman Daly, etc., which put under doubt the firmness of that belief. At present there appear more and more economists, who are questioning the permanency of the growth paradigm, such as Tim Jackson, Andrew Simms and Clive Hamilton, from whom the title of this chapter is borrowed [Hamilton 2003], and the ideas described in this book correspond greatly with the ideas of the authors of this paper.

Though the criticism of the growth paradigm did not appear only in the 20th century, modern authors, who presume to criticize the growth paradigm, are treated negatively by politicians and mainstream economists. Therefore their ideas at first are ridiculed and fatherly rebuked, then oppressed with hostility, even with a threat to their authors. It may be explained first, that like any conventional wisdom, the paradigm of growth for years has been taken without any rational considerations (except the period of its birth – the second half of the 18th century and the first part of the 19th century), and any doubts about this commonly accepted "truth" are like a heresy for the society. Second, the criticism of growth paradigm includes threat to the whole complex of economic processes, which are forming the paradigm – capital concentration, financial markets and globalization. The people who get benefit from these processes, have a tremendous power and influence on the whole society, starting with the governments and mass media. As Brazilian economist Celso Monteiro Furtado notes: "Today no one can dismiss the fantastic concentration of power that is embodied in what are called financial markets, dominated by exchange speculation. With the advance of globalization, those markets are now the most profitable. Therefore, and increasingly, the distribution of world income responds to virtual operations performed in the financial sector. This is the clearest manifestation of an emerging reality well described as *global capitalism,* the precursor of a future world system of power" [Furtado 1999].

The idea that growth paradigm is not eternal can be found in the works of almost all giants of economic thought – Adam Smith, David Ricardo, John Stuart Mill, John Maynard Keynes, Joseph Schumpeter etc. Here, clearness could be expressed with a single quote: "When the accumulation of wealth is no longer of high social importance, there will be great changes in the code of morals. We shall be able to rid ourselves of many of the pseudo-moral principles which have hag-ridden us for two hundred years, by which we have exalted some of the most distasteful of human qualities into the position of the highest virtues" [Keynes 1930].

The idea that growth concept has been a part of human nature is not true. Even in the 19th century Latvian peasants were planning their activities producing not more, but as much as necessary. The root of the word "rich" or "wealthy" in

Polish, Russian and other Slavonic languages contains the name of "God", perhaps because our ancestry considered that a wealthy person is not who has much, but who has enough. And only God knows, how much is enough, and gives it to the people, who live in harmony with God.

Still we are not denying the concept of economic growth in this paper. If economic growth is not the end, but the means for the main objective – human prosperity, then it cannot be considered as an evil. The increase of individual wealth is significant, but not the sole factor of prosperity. Increasingly the prosperity is determined by the quality of environment not in the sense of nature environment, but social, political, cultural, economical, legal, ethnical, religious environment as well. During the last hundred years economic growth was not followed by the improvement of the environment, but rather quite the reverse. This explains why growing depression, suicides, increase of cruelty and moral degradation occurs in the countries with high living standards, if measured by economic indicators of GDP and its growth. It follows that economic growth can not be considered as the sole and even the most important objective for the economy, but the quality of environment in entirety of all its dimensions at present has become even more important for human prosperity.

The main concept we are trying to explain, is that there are many types of economic growth, which significantly differ among the countries. Economic growth of Latvia can serve as a shining example. The high indicators of economic growth during the years 2011–2013 seem to prove "the story of success". At the same time former Prime Minister of Latvia Valdis Dombrovskis himself has admitted that "citizens should be allowed to feel the fruits of economic growth" [Finance.net 2014], from what one may conclude, that up to now these fruits have come in other hands.

The confusion of the goals and means has led to the result, that if economic growth is maintained by any means, it does not benefit to prosperity, but on the contrary. The economic growth of Latvia is of a different type than it is in such countries like Germany. Such an economic growth differs significantly from economic development, and, thus, it cannot be evaluated and traced as "the story of success".

ECONOMIC GROWTH, BALANCE OF PAYMENT DEFICIT AND FOREIGN TRADE DEFICIT − THE CASE OF LATVIA

The correlation between economic growth on the one hand and the foreign trade deficit or balance of payment deficit on the other hand is not a typical item for investigations. A conventional wisdom is that increase of exports will create the increase of economic growth. Though the example of Latvia indicates very clearly that there is an obvious positive correlation between economic growth and foreign trade deficit – during the periods of rapid economic growth the foreign trade deficit had reached extremely high levels, but the economic crisis had nearly balanced the foreign trade deficit. (Here it is important to point out that we are considering not exports, but net exports – i.e. foreign trade balance. As to Latvia this balance has been negative for last twenty years, we are considering net exports with the opposite sign – i.e. foreign trade deficit.) – Figure 1.

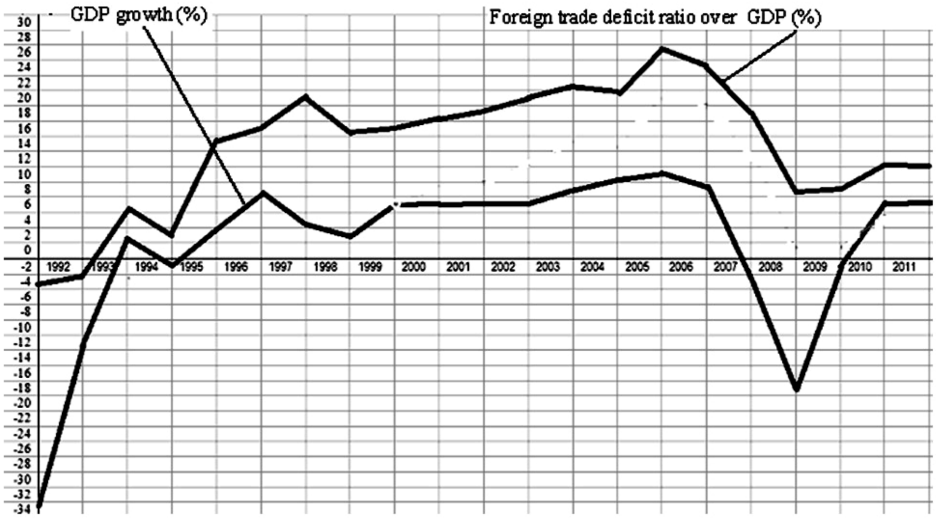

FIGURE 1. The correlation between economic growth and foreign trade deficit in Latvia

Source: Central Statistical Bureau of Latvia, www.csb.gov.lv

It is obvious from the picture, that the extremely high economic growth during the "fat years" – from 2004 till 2007, when the annual real GDP growth rate overreached 10%, was followed by even more extremely high foreign trade deficit, which reached 27.7% in 2006. If compared to the situation in the USA, which is considered to have extremely high foreign trade deficit, it was 4.2% in 2012 and 4.7% in 2013 [OECD 2014].

Economic crisis of 2008 almost balanced Latvian foreign trade, and in 2009 it was "only" 8.5%. During the same year the annual GDP growth rate was negative – minus 17.7%, which was the largest in the whole Europe, and it is hard to find a country where the GDP decrease was larger than in Latvia. The following years of "the story of success" – 2011 till 2013 with annual GDP growth rate 4–5% (one may take into consideration that this growth happened after a sharp downfall, so in 2013 Latvia's GDP still was under the level of 2007), at the same time it had reiterative increase of foreign trade deficit, which has exceeded 12%.

How to explain this phenomenon? Discussions at BA School of Business and Finance within the framework of the study course "International Business Environment" have resulted in the following. First and foremost, this is due to the inflow of foreign capital, which at the same time encourages economic activity and financing imports. Apparently the inflow of foreign capital does not have a considerable impact on the growth of exports. In fact – foreign investment stimulates the growth of imports, but growth of exports is almost not encouraged. This applies to both direct investments and loans for capital to come inside. During the years of crisis, when there was neither significant flow of foreign direct investment, nor money loans from the parent banks to distribute them in the internal market, imports fell by almost a half.

An enterprise X could serve as a typical example of such a situation. It has been sold to foreign investors with cries of delight by the Bank of Latvia and the government (foreign investors are assumed as the 'holy cow'). Furthermore, this money was spent on equipment and other capital goods from abroad (imports rise worsening the trade balance), products produced and marketed in the domestic market. Exports are not growing and the trade balance does not improve, but it is to outrun the market share for local producers, GDP figures grow, the Bank of Latvia and government sit wrist, but the effect on GNP tends to be minimal, or even negative, as the profit flows into the hands of a foreign investor, thus narrowing the profits of national entrepreneurs, who suffer from competition.

Another factor affecting the apparent correlation is that during the period of rapid economic growth households and other economic agents sentiments improve and "shopping" is observed in the case of Latvia, which in its turn contributes greatly to the growth of imports. It also goes hand in hand with the availability of funds, which mostly come from abroad.

The overall conclusion is that in the case of Latvia, foreign investments are not very productive. If they would, there could be observed a significant increase in exports, as well as reduction in the need to import, thus creating products in the domestic market. Instead it stimulates consumption, which means the consumption of imports to a greater extent.

The "wise heads" from the Bank of Latvia, Ministry of Finance, etc. detect dozens of arguments which could serve as an refutation, but, in fact, the figures about foreign trade do not lie. The figures of GDP growth indicate a "story of success", but the real values, which are based on the potential of Latvian economy, are traded off to foreigners" [Conclusions from the discussions at BA School of Business and Finance].

We should add here that the solution with direct or indirect subsidies to exports, which has been the policy of Latvian government (as well as most of other European countries) is at first risky and it can be clearly seen during the

Russian-Ukrainian crisis, where the response sanctions have significantly influenced economies of these countries, which have relied too much on exports, in this case particularly Latvia. Secondly, this is an illusory solution, because exports-imports could be regarded as a two-way street, and thus economy based on exports is non-sustainable in a long run, if we consider it in a global scale.

Latvian politicians and mainstream economists see no difference in foreign investment either it is brown-field or green-field investment. Even worse – selling of land and other environmental resources to the foreigners is greatly supported, considering that there is no difference in various kinds of foreign investment. Therefore the total flow of foreign investment is evaluated in the aggregate, not considering the structure, where green-field investments are a clear minority, most of them consisting of trading off the real national values.

The situation in Latvian foreign trade, which has had deficit (and extremely high!) for more than 20 years, is less dramatic, if we consider the exports and imports of goods and services, i.e. the balance of payment. The exports of services are higher than imports of services, thus the balance of payment deficit is less dramatic, though still negative.

ECONOMIC GROWTH AND BALANCE OF PAYMENT IN OTHER EUROPEAN COUNTRIES

Is this the above analyzed case of economy in Latvia an exclusion from general affairs, or is it possible to observe likewise regularities in other European countries? To answer this question let us consider the statistics of economic growth and balance of payments. The following table includes only these European countries, where we have observed some regularities between the processes mentioned above. Such countries as the Czech Republic, France, Italy, Luxembourg, Malta, Austria, Poland and Great Britain are not included in the table, as there one could not observe any correlation, or a slight positive correlation in the cases of Belgium, Denmark, Germany and the Netherlands, and a negative correlation in the cases of Slovenia and Slovakia. The case of Greece is not considered here, as it indicates very specific situation – the balance of payments deficit there has been extremely high, even higher than in Latvia. Generally speaking the crisis has diminished the balance of payments deficit of Greece as well, and one can observe there the same tendency as in Latvia.

As one can see from the table, we can observe positive correlation between economic growth and balance of payments deficit only in Finland and to a less degree in Sweden, and negative correlation in most of the countries included in the Table 1.

TABLE 1. Annual growth rates and balance of payments deficit in the EU countries

	20-	02	03	04	05	06	07	08	09	10	11	12	13
BG	1	4.7	5.5	6.7	6.4	6.5	6.4	6.2	–5.5	0.4	1.8	0.6	0.9
	2	–15	–18	–18	–27	–22	–25	–26	–16	–3	0	–4	–1
EE	1	6.2	8.1	6.2	8.9	10	7.3	–4.1	–14	3.3	8.7	4.5	2.2
	2	–9	–10	–9	–8	–12	–12	–5	9	10	4	0	1
IE	1	5.4	3.7	4.2	6.1	5.5	5.0	–2.2	–6.4	–1.1	2.2	0.2	–0.3
	2	22	24	22	17	14	13	12	22	23	27	29	...
ES	1	2.7	3.1	3.3	3.6	4.1	3.5	0.9	–3.8	–0.2	0.1	–1.6	–1.2
	2	–7	–8	–13	–17	–19	–20	–18	–7	–7	–3	2	8
HR	1	4.9	5.4	4.1	4.3	4.9	5.1	2.1	–6.9	–2.3	–0.2	–2.2	–0.9
	2	–17	–15	–13	–13	–14	–15	–16	–9	–1	–1	1	2
CY	1	2.1	1.9	4.2	3.9	4.1	5.1	3.6	–1.9	1.3	0.4	–2.4	–5.4
	2	–3	–2	–5	–5	–7	–11	–20	–12	–13	–9	–7	3
LV	1	7.1	7.7	8.8	10	11	10	–2.8	–18	–1.3	5.3	5.2	4.1
	2	–19	–23	–26	–23	–32	–32	–24	–3	–2	–8	–6	–3
LT	1	6.8	10	7.4	7.8	7.8	9.8	2.9	–15	1.6	6.0	3.7	3.3
	2	–10	–10	–12	–11	–15	–20	–17	–3	–3	–3	1	1
HU	1	4.5	3.9	4.8	4.0	3.9	0.1	0.9	–6.8	1.1	1.6	–1.7	1.1
	2	–3	–6	–5	–3	–1	1	1	7	7	8	8	9
PT	1	0.8	–0.9	1.6	0.8	1.4	2.4	0.0	–2.9	1.9	–1.3	–3.2	–1.4
	2	–23	–20	–23	–25	–22	–20	–24	–21	–20	–11	–2	3
RO	1	5.1	5.2	8.5	4.2	7.9	6.3	7.3	–6.6	–1.1	2.3	0.6	3.5
	2	–18	–18	–20	–24	–27	–32	–30	–16	–14	–12	–10	–1
FI	1	1.8	2.0	4.1	2.9	4.4	5.3	0.3	–8.5	3.4	2.8	–1.0	–1.4
	2	30	21	20	11	12	13	9	5	3	–2	–2	0
SE	1	2.5	2.3	4.2	3.2	4.3	3.3	–0.6	–5	6.6	2.9	0.9	1.6
	2	18	19	22	19	19	17	14	16	14	13	14	14

Explanations to the table:
BG – Bulgaria, EE – Estonia, IE – Ireland, ES – Spain, HR – Croatia, CY – Cyprus, LV – Latvia, LT – Lithuania, HU – Hungary, PT – Portugal, RO – Romania, FI – Finland, SE – Sweden.
1 – GDP annual growth rate (%),
2 – Exports of goods and services over imports of goods and services (%).
Source: Eurostat, http://epp.eurostat.ec.europa.eu/ (accessed September 26, 2014).

Though, in fact, significant differences could be observed among these countries. Ireland obviously stands outside, as it has strictly positive balance of payments, and during the years of crisis, when economic growth has failed, the balance of payments surplus has even more increased. Hungary had a negative balance up to 2006, but starting from 2007 it has become positive, and since then the balance surplus continues to increase, at the same time economic growth being low or even negative. Perhaps Hungarian case also needs some specific investigations, as the improvement of balance of payments goes hand in hand with the fact that Hungarian forint was unpegged from the euro, providing just the opposite results, as one could expect from conventional wisdoms – the exchange rate of the forint increased, but the trade balance at the same time improved.

If we look at the situation in other countries we can observe more or less the same tendency as in Latvia – the periods of growth are associated with high balance of payments deficit, and vice versa. It is less pronounced in such countries as Estonia and Croatia, where the balance of payments has equalized after the crisis; the same tendency can be observed in Spain, Portugal and Lithuania, but to a lesser extent. The rest of the countries included in the table – Bulgaria, Cyprus, Latvia and Romania have very similar regularities, like it was described considering the case of Latvia in the previous chapter.

It is interesting to point out, that analyzing the situation in the United States one can observe a similar regularity like it is in the case of Latvia, though to a lesser extent (rather like Estonia), but Japan is a typical example of the opposite tendency – growth periods are associated with larger surplus in balance of payments, but after the crisis in 2011 the balance of payments there became negative, overcoming even Bulgaria, Latvia and Romania, as well as France and Greece, which now have the largest balance of payment deficit among the EU countries.

This leads to a conclusion, that countries to a greater or lesser extent may be divided into groups according to the type of their economic growth. Surely, the feature discussed in this chapter can not be the only one criterion for such a division. Though it is quite reliable to make a conclusion that economic growth in the countries like Latvia, Bulgaria and Romania significantly differ from such countries as Denmark, Finland, Belgium and the Netherlands, and even from the Czech Republic, Hungary and Slovakia. This is more like the growth without any development, which gives a little tribute to well-being of the people and potential of economy. These countries are among the first, which meet the harming manifestations of the present economic paradigm of growth and its satellites – globalization and capital concentration.

OPPORTUNITIES AND THREATS OF CAPITAL CONCENTRATION

Capital concentration is a process whose roots go back to the XVIII century, where the great scientific and technological discoveries opened a way to large scale production, thus significantly increasing efficiency and paying a great tribute to revolutionary changes in the people's way of life. Construction of big factories, railroads etc. required such amount of capital, which was almost impossible to acquire by a single person of family. Persons with entrepreneurial spirit spent their efforts, merging their capitals. Financial markets assured that capital would flow to these industries, where it was most necessary. This was the period when the present economic paradigm was born, and certainly it was a progressive and promoting development. Whereas the capital concentration process required permanency, in the turn of the 19th and 20th centuries it was supplemented with globalization. By the time this process began to create more and more evil, and it is no coincidence, that just the 20th century witnessed the most dreadful wars in the human history. But the process couldn't be stopped, as the financial markets required sustaining the growth, otherwise they would collapse.

In the framework of conventional wisdom capital concentration still is regarded as unquestionably positive process. The increase of foreign investment uncritically is considered as a benefit. Any efforts to regulate the capital flows are perceived with hostility, arguing that the economic classics had proved the indisputable benefits from international trade and capital mobility. Most recently used arguments are based on Ricardo's theory of comparative advantage, which proves that both countries benefit, either there is no absolute advantage or none for both of them.

We are not going to cast doubt on Ricardo. Though, it is not so that Ricardo's theory is accepted without taking into account the conditions, which had been formulated by Ricardo himself. American economist Herman Daly wrote: "… modern economists seem to have forgotten one of the premises. Ricardo was very careful to base his comparative advantage argument for free trade on the explicit premise that capital was immobile between national communities. Capital, as well as labor, stayed at home, only goods were traded internationally. It was the fact that capital could not, in this model, cross national boundaries that directly led to replacement of absolute advantage by comparative advantage. … The argument for globalization based on comparative advantage is therefore embarrassed by a false premise. Ricardo would *never* argue that because comparative advantage shows that free trade in goods is beneficial, one can simply extend the argument to show that free trade in capital must yield even more benefits!" [Daly 1996].

The truth of Ricardo and Daly one can observe in real life processes in modern world. Millions of people are leaving their native countries, seeking for absolute advantage, as with free capital flows they do not have comparative advantage any more. Politicians and mainstream economists still are speaking about benefits of comparative advantage that really does not exist. But free movement of capital is beneficial for growth. It is required by financial markets, which have obtained a tremendous power and influence on global processes and governments all over the World. As it was described in the previous chapters, economic growth differs among the countries, and a lot of them, including Latvia, have little or no benefit from it on economic potential and people's well-being. It is a real possibility that such countries will become backward provinces, where gifted and talented people will not be able to put into effect their abilities, and therefore with a pain in their hearts, will leave their native country.

The alternative offered is to consider capital flows critically, evaluating the effects of them on the potential of economy, strictly separating green-field investment and brown-field investment from such investments considered as foreign direct investment, which indeed are speculative by their nature.

Polish economist, director of the IMF's European department of the time Marek Belka at the 63rd Commission Session of International Monetary Fund in Geneva, March 30, 2009 said: "I think that domestic economy and intraregional integration will play a larger role than before. We should not count on global trade to such an extent as we are counting on it now. Look at your neighbours. Look at yourself. Try to develop your own productive capacity, productive base. Don't count on generous inflows of foreign capital that will inflate your financial system or real estate sector. This is a warning for many of our East European and Central European economies that relied too heavily on these two sectors." [Belka 2009] We share this point of view.

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ODDZIAŁYWANIE KONCENTRACJI KAPITAŁU NA WZROST GOSPODARCZY

Abstrakt. Celem badań jest wprowadzenie do specyfiki wzrostu gospodarczego na Łotwie, gdzie wystąpiła „historia sukcesu". Ponadto przedstawiono inny punkt widzenia na tradycyjne teorie ekonomii, opierając się na wpływie koncentracji kapitałowej w danym kraju. Autorzy analizowali wynik „historii sukcesu", dowodząc na podstawie ostatnich faktów i opierając się na teorii ekonomi, kwestionując paradygmaty trwałości wzrostu. Istotą wzrostu gospodarczego leży w dobrobycie ludzi. Autorzy starają się wyjaśnić, dlaczego w przypadku wzrostu gospodarczego na Łotwie sytuacja jest odmienna od innych krajów UE. W pracy w tym zakresie poddano analizie rolę napływu kapitału zagranicznego i możliwych konsekwencji z nim związanych, a także rolę zmian w bilansie płatniczym. Wnioski sformułowane na podstawie badań oferują alternatywne podejście w zakresie krytycznej oceny przepływu kapitału i procesów globalizacji. Ponadto przedstawiono oceny potencjalnych pozytywnych i negatywnych skutków dla gospodarek innych krajów.

Słowa kluczowe: wzrost gospodarczy , koncentracja kapitału, bilans płatniczy