
Evaluation of Latvia-China Trade Potential

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Abstract:

International trade always has been a source of wealth for countries engaged in the process. Lately, European Union (EU) and Latvia is facing new challenges in for of trade restrictions and protectionism with the trade partners. One of the latest cases of Russian asymmetric sanctions in the form of food trade embargo left EU with difficult task of trade redirection and more intense local market competition.

With the UK leaving EU case on the horizon all EU countries are facing the same problem – where to find new markets with high demand potential. The largest EU economies, Germany, France, Italy, Spain and Netherlands have already expanded their trade all over the world to diversify the risk of being too much dependant on several trade partners. This is also the case for Latvia – there is necessity to find new potential markets.

The aim of the research is to evaluate Latvia - China trade potential in terms of Latvia's export opportunities. Methods used in the research: Study of the literature on the export market evaluation and trade data analysis. Research involves usage of potential export market evaluation with Decision Support Model. Research is very topical in context of Latvia's necessity of market diversification since Russia has food trade embargo (since August 7, 2014) and it is unclear future about trade regulations with the UK with the process of UK leaving European Union (BREXIT).

Keywords: *China, export, international trade, market, Latvia*

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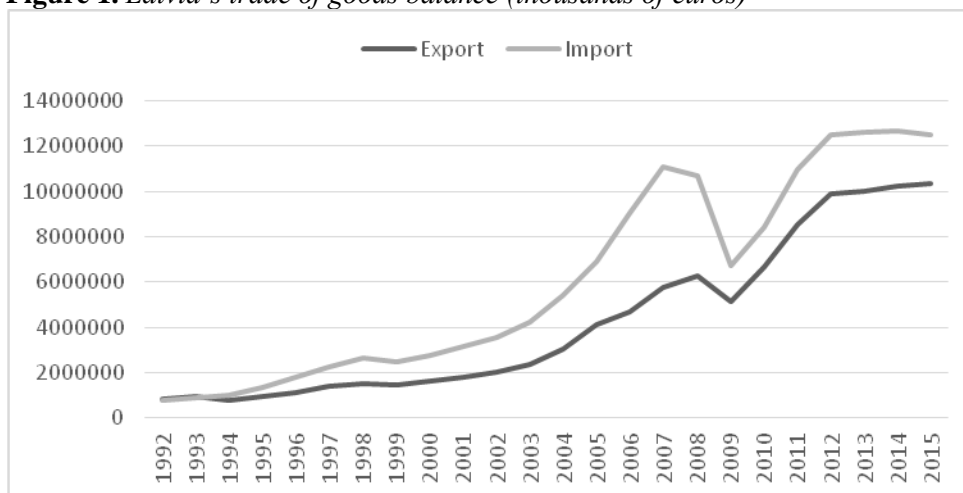
1. Introduction

It is very uncertain times for the international trade. Russian food trade embargo, unclear negotiation outcomes from the BREXIT, unclear future of the TTIP (Transatlantic Trade and Investment Partnership) and many others. Also, recent G7 Summit showed negative trends for the international trade in terms of market protectionism. These events are affecting and will affect the future of the trade strategies for European Union (EU) countries and Latvia. There is an urgent necessity of risk diversification and search for new export markets.

2. Latvia's Trade and Recent Challenges

Last time Latvia's trade balance was positive in the early 1990's, since then Latvia has experience only negative trade balance (Figure 1).

Figure 1. Latvia's trade of goods balance (thousands of euros)



Source: Latvian Statistical Bureau, authors

This situation is directly related to the situation that Latvia is small and open economy and a fact that many industries still struggle to find its competitive advantage to compete on the global stage (Ivanova *et al.*, 2017; Priede, 2011; 2013; Priede and Neuert, 2015; Priede and Skapars, 2012; Thalassinos *et al.*, 2013) and necessity for some structural changes (Duguleana and Duguleana, 2016).

There have been several shocks for Latvia's trade in the last 10 years. World's financial crisis in 2008 made a major impact on Latvia's economy with a 18% GDP drop, but at the same time it influenced local markets purchasing power that led to sharper decrease in imports. And as a result, after 2008 Latvia's trade deficit has reduced. Also, monthly data since 2007 till February 2017 verify this information (Figure 2).

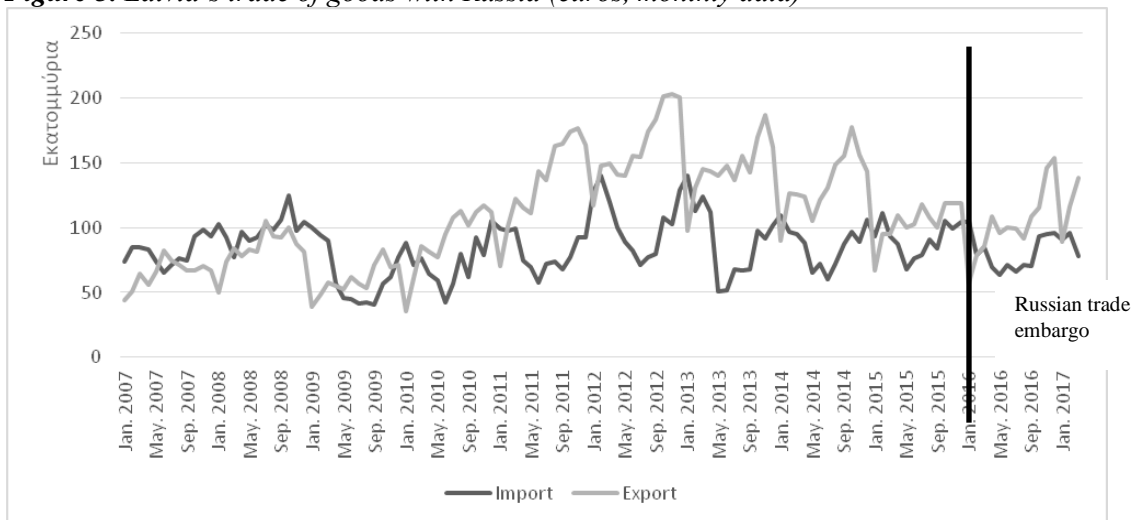
Figure 2. Latvia's trade of goods balance (euros, monthly data)



Source: Eurostat, authors

But another shock in the Latvia's trade was on August 7, 2014 when Russia announced food trade embargo with EU and other countries (Figure 2). This only meant a new challenge for Latvia's entrepreneurs since Russian market was closed for food products (Figure 3).

Figure 3. Latvia's trade of goods with Russia (euros, monthly data)



Source: Eurostat, authors

As we can see in Figure 3, trade with Russia continues in other product groups, but it still was significant impact on the trade and Latvian entrepreneurs. General director of Employers' Confederation of Latvia (LDDK) Līga Meņģelšone after Russia's decision to start embargo said, that now Latvian industries must come together with the government and ministers to find a solution and switch to other markets. She noted that the reorientation should not be left only to the entrepreneur's shoulders, but a joint plan is needed. The new shift will be a long and expensive process, she noted. Meņģelšone also admitted, that most of the companies, including time

honoured confectionery manufacturer “Laima” has already diversified the risks and doesn't export to Russia more than 10% of its production. However, for some Latvian companies Russia was one of the biggest export markets. As these companies were looking for some other trade partners, China occurred as a desirable export market (Feng and Viksne, 2016).

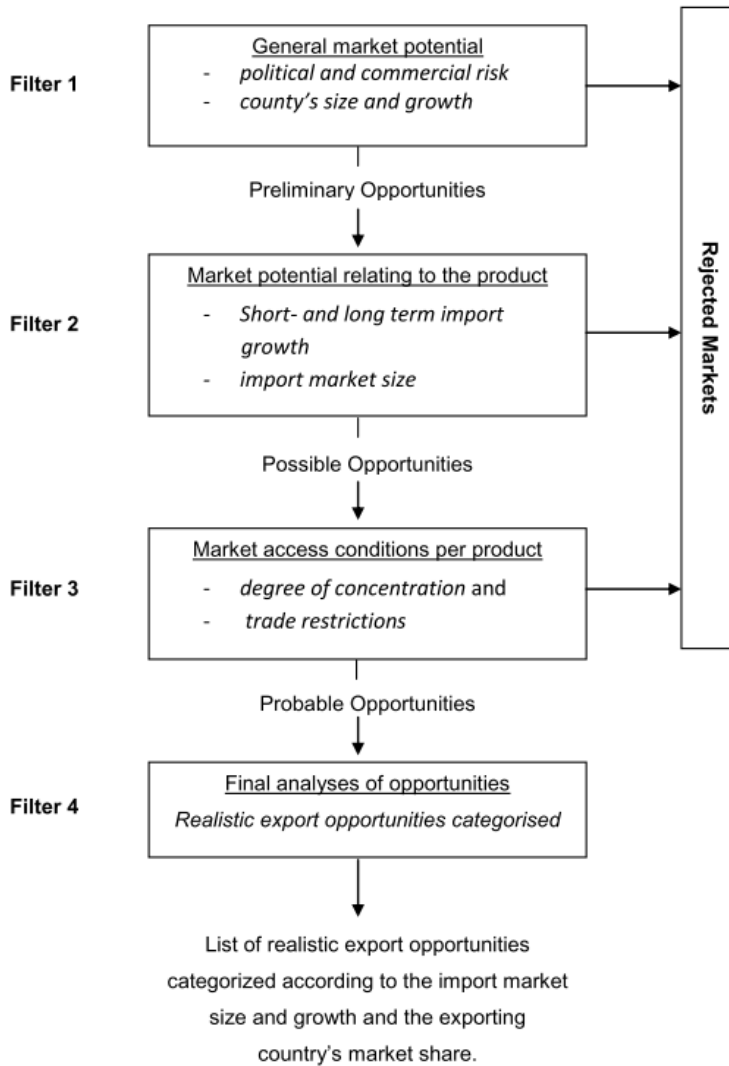
According to Boston Consulting Group (2009), China will be the biggest trade market in the coming five years. Latest data of post-economical financial crises of 2014-2016 shows that China's share in imported products consumption rose to 31.4%, and become the leading market since the beginning of the 2011 (Li and Kambele, 2012). Together, China is becoming the destination for 36.8%, (Zhou and Wang, 2014) of world high end brands. On the background of this scenario, it is extremely vital for Latvian goods producers to know and understand the consumers behaviors of Chinese specially the affluent Chinese, and new consumers of Latvian brands. For decades, branding and marketing research have been based on a concept of consumer behavior that is deeply embedded in a linear notion of marketing activities. This notion has been expressed in different forms, including steps in the selling process, Gertner (2011), adoption of innovation, Zhang and Leeflang (2014), the hierarchy of effects, Chu and Sung (2011), and competitiveness measurement, Bulis and Skapars (2012).

Although this concept has been challenged from time to time, Kozlinskis and Losane (2011), it has endured as a key organizing framework for brands building and marketing strategy. However, confronted by change, technological advancement, competition and the unpredictability of Chinese market, today's brands building has been compelled to seek a deeper understanding of the connection between brands and consumers, Dickson, Lennon, Montallo, Shen and Zhang (2004). In turn, this had led to the search for new approaches and tools that will help marketing researchers understand the interaction among attitudes, emotions and brand choice, Mooij and Hofstede (2011).

3. Decision Support Model and Latvia – China trade potential

A small but growing literature addresses the question of how to identify opportunities for exporters for an overview we refer to Decision Support Model (Cuyvers, 2004; Cuyvers *et al.*, 2012; Cuyvers *et al.*, 2017; Steenkamp *et al.*, 2009; Halisek, 2016). The bulk of this literature focuses on attempts to segment export markets or focus on the decisions of firms entering export markets. The Decision Support Model (DSM) methodology is used many studies. And it was developed on similar methodologies in the international market research. It consists of consecutive steps (filters) which select markets and products based on the most recent statistical data, in such a way that it leads to a list of product: country combinations of realistic export opportunities. The methodology is summarized in the Figure 4.

Figure 4. *The basic methodology of Decision Support Model*



Source: (Cuyvers, 2004; Cuyvers et al., 2012)

In step 1 of the DSM, countries that hold too high political and/or commercial risk to the exporting country and do not show adequate size or economic growth are eliminated. The rationale for this is that, with the 241 countries of the world as a starting point, step 1 enables the researchers to eliminate uninteresting countries in order to concentrate in detail on a more limited set of products to be exported. Countries that lack general potential are therefore eliminated in this step. In step 2 an assessment of the various product categories for the remaining countries is done to identify potential products that show adequate export size and growth. According to Cuyvers (1995), if a product is selected on the basis of size and growth in the potential market, it does not absolutely mean that markets can be easily penetrated.

In step 3 trade restrictions and other barriers to entry the market are considered to further screen the remaining possible export opportunities. Two categories of barriers are considered in this step, namely, the degree of concentration and trade restrictions, Cuyvers (2004). In the last step of this model, the realistic export opportunities that were identified from step 1 to 3 will be categorized.

3.1 General Market Potential in China

China's GDP growth in 2016 was 7.7 %, and international estimates predict that China is on the track to become the world's biggest economy within the next ten years, with an internal market of 1.38 billion potential consumers by the end of 2016. The 16+1 format is an effective instrument for cooperation with China, complementing both Latvia's bilateral dialogue with China and the joint EU-China dialogue within the Strategic Partnership; therefore, Latvia is actively engaged in the work of the format. "China's Super Consumers" have now gone beyond mimicking the patterns of more established Western shoppers to being the trendsetters and innovators.

3.2 Market Potential Related to Products

Product safety scandal and low-quality brand image have scared Chinese consumers away from lots of domestic products. In large cities in China, most people will often pay a premium for German, French, or Italian brands to ensure quality, especially for important healthy items such as baby formula. Getting attention from their products' appeal, some Chinese products register their headquarters in Germany, Italy, or France and brand their packages as "Originally Imported". This has made it increasingly difficult for consumers to discern domestic from foreign brands, and they thus turn to famous and leading brands instead. Latvian companies can take advantage of this phenomenon to develop their resource to ensure Chinese consumers know their products are original from Europe.

3.3 China Market Access Conditions

Entering China's market, the market-entry costs are high – both the fees involved in mandatory certification and the resources required. In this area, particularly high concerns are product registration, product expiry dates and labelling. In order to enter the Chinese retail market, food products must receive a hygiene certificate from the local government where the product will be sold. Another problem is inconsistencies in the interpretation of regulations among officials at different product entry locations and whether they loosely or more strictly apply fines and penalties. Regulations tend to change with some frequency and without a warning. Adjusting these regulations can be expensive and time-consuming.

3.4 Final Analysis of Opportunities

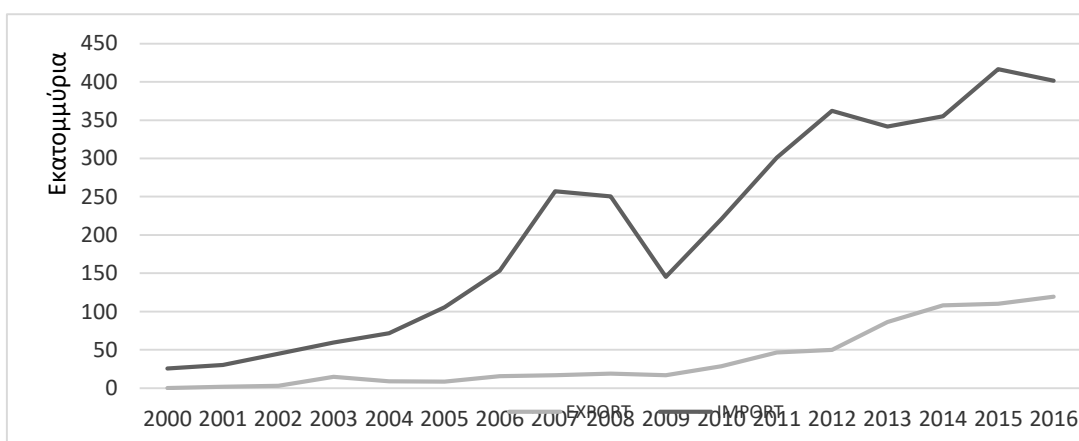
In 2016, the volume of exports of goods to China amounted to 107.2 million EUR which is by 27.3% more than in the year of 2015. The main goods exported to China are electronic equipment (18%), wood and wooden products (34%), metals and metal products (20%), machinery and mechanisms, and agricultural and food

products (10%). In the coming few years, Latvia will still continue exporting cosmetics, plastics, plastic articles, pharmaceuticals, paper, paper items, rubber, rubber articles, iron, steel, fertilizers.

4. The Overview of the Latvia-China Trade Dynamics

The economic relations between Latvia and the People's Republic of China are regulated by economic cooperation agreement, which entered into force on 1st December, 2004. A Joint Intergovernmental committee was founded to oversee the agreement and related issues. In February 2016 the Minister of Economy of Latvia Arvils Ašeradens had a meeting with China's National Development and Reform Commission chairman's alternate Ning Jizhe, accompanying officials and a business delegation to discuss bilateral expanding cooperation and investment attraction issues. In September 2016 the Minister of Economy of Latvia, during his working visit in China, discussed the Latvian economic cooperation expansion options with high-level Chinese officials, as well as opened and participated in "Latvian days" in China. On his visit the minister was accompanied with more than 30 Latvian businessmen from transport, food, textile design, wood processing and other industries. 11 Latvian companies from the wood industry took part in this visit. From 2006 till 2016 Latvia's export to China has grown 7.4 times, import has grown 2.8 times. Although the amount of export is increasing every year, it's still lower than import. Latvia's export to China in 2016 was 1.22% or 117.7 million euro from the total amount of export. Import from China was 3.61% or 401 million euro. The relative statistics data is shown in Figure 5.

Figure 5. Latvia's trade of goods with China (euros)

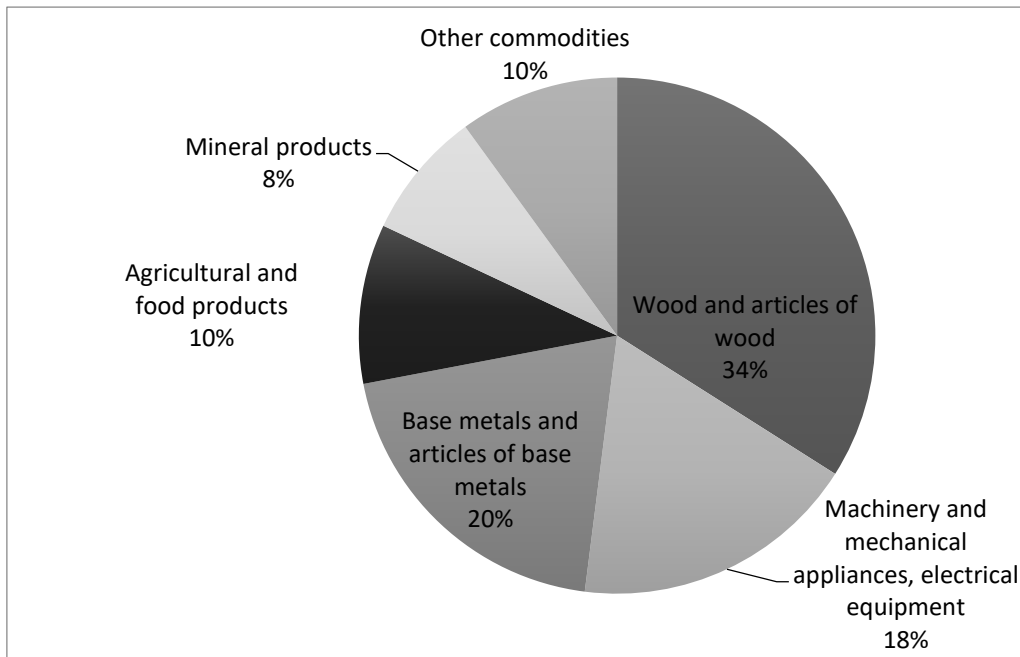


Source: Eurostat, authors.

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mechanisms, and agricultural and food products (10%). The relative data of statistics is shown in Figure 6.

Figure 6. Latvia's goods export structure to China, % (year 2016).



Source: Ministry of Foreign Affairs of Latvia, 2016.

At the same time the import from China to Latvia increased not even two times and was valued a little more than 354 million EUR in 2016. This fact can be beneficial for Latvian farmers and food producers. Also, this is an opportunity to boost other commodities and show a good export potential case to some Latvian companies and maybe even some other local products retailers in Latvia. In 2014, for example, Latvia as the first of the Baltic countries had the permission to start the export trading of milk products to China. From 2010 to 2013 the sales of imported milk products in China increased 13 times, leading to 194.9 thousand tons of sold products.

5. Conclusion

China is a highly developing country and an experienced potential trading partner, has the world's largest population and is in its earlier stages of internationalization. The Authors think Latvian food producers will have a better access to Chinese market in the coming years. Also, Latvian food companies will have more chances to export their production to such a large country that has a rapidly growing food market. Economic relations with China take on increasing importance. In the post–

crisis time, the coming new challenges in the global economy new fields and channels for cooperation bring more and more opportunities.

Even the most different economies can create synergy and opportunities for development. Since joining the WTO in 2001, China has reduced tariffs on a wide range of imported products, but sanitary and phytosanitary restrictions (and, to some extent, labelling) continue to limit access to the market. Meanwhile, the new Food Safety Law that was approved in October 2015, requires stricter monitoring and supervision methods, tougher safety standards, and the recall of substandard products with harsh punishments for offenders.

Enforcement of regulations is not very well planned, creating confusion for exporters. Latvian companies which seriously think about entering China's market must evaluate their resources regarding time and money that the companies need to spend in order to make all the necessary papers to start exporting their products. Not only the strict and often changing export rules, but also the language can serve as an obstacle, because all the paper work must be done not only in English but also in Chinese language.

As many researchers thought, Decision Support Model has the lack of direct conversion schemes between the trade coding systems; unavailability, unreliability and aging of data for some countries (especially large countries) and the lack of greater product-specificity, but this model attempted to address as many of the limitations identified in previous studies as possible.

And it stated that their model provided a significant improvement over earlier ones by capturing total rather than export demand, and the authors also assigned weights based on company strategy to develop total score country attractiveness scales that combine the two trading partners. On one hand, if a Latvian company has an offensive strategy it will focus more on markets that are easier to penetrate and high trade barriers would carry a bigger weight. On the other hand, if a Latvian company has a defensive strategy it will focus on markets with high demand potential, even though it may take more effort to penetrate those markets.

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