



## SELF-EMPLOYED PERSONS AND MICRO-ENTREPRENEURSHIP IN LATVIA

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### Abstract

World experience demonstrates that self-employment of the population in civilised forms is an important condition for the recovery of not only the economy, but also of the entire social life of the state. In Latvia the process of establishing micro business and self-employment of people in various spheres of economic activities is very difficult. One of the main reasons for this state of affairs is the lack of a coherent and consistent system of public and, above all, state support for self-employed persons and representatives of micro businesses. The objective of the article is to evaluate the state of self-employment of the population and micro-entrepreneurship in Latvia, as well as the areas for stimulating the development of this business. The novelty of the research is substantiated by the fact that similar studies of the micro-entrepreneurship cluster, self-employment of people and its impact on employment in Latvia have not previously been conducted. The object of the research: the cluster of micro-entrepreneurship and self-employed persons in the economy of Latvia. The goal of the research is to analyse the state of self-employment of the population, micro business in Latvia and to develop proposals for improving the operating conditions for enterprises in this sector of the economy. Methods of research: the analysis of statistical data and mathematical modelling. Within the framework of the research, all calculations have been performed according to the data of the Central Statistical Bureau of Latvia and according to the data of the State Revenue Service. There is a need to create a special system of state support for micro-entrepreneurship in Latvia. It is necessary to modernise the tax policy, introduce a system of tax reliefs for self-employed persons. The improvement of the banking system in the interests of micro business, the simplified procedure for obtaining loans, especially by novice entrepreneurs, are of great importance for the successful development of micro-entrepreneurship in Latvia.

KEY WORDS: self-employment, micro business, mathematical modelling.

### Introduction

World experience demonstrates that self-employment of the population in civilised forms is an important condition for the recovery of not only the economy, but also of the entire social life of the state. People who undertake independent business activity as self-employed persons and representatives of micro businesses have the opportunity to make a reality of their creative abilities, entrepreneurial spirit, and initiative, thus creating a competitive environment. Under the existing variety of forms of ownership, this allows eliminating the deficit of many types of products, improving public relations and ensuring a more complete employment of the country's population (Kochetkov et al 2016, Kareivaite 2015).

However, in Latvia and in some other countries the process of establishing micro business and self-employment of people in various spheres of economic activities is very difficult and painful. Often, its nature is deformed, acquiring a bureaucratic or criminal character. Micro-enterprises and businesses of self-employed persons do not give the results expected by society but rather cause new difficulties in economic and social life, new social anomalies (Siropolis 1990).

One of the main reasons for this state of affairs is the lack of a coherent and consistent system of public and, above all, state support for self-employed persons and representatives of micro businesses, a modern concept of its formation and development. The economic situation in the crisis and post-crisis period between 2008 and 2010 exacerbated the problem of employment. Therefore, using the potential of self-employment of the population

and micro businesses has become very effective, focusing on new forms and types of this business in order to address Latvia's internal economic and social problems, and improve the living standards of the population.

**Subject and relevance.** Analysing the state of the economy of the Republic of Latvia, as in other countries, it is possible to observe periods of recession, stagnation and economic stabilisation, when micro businesses and self-employment of people become the most acceptable form of economic activity, which has a dominant position in the market (Ivanova 2015, Kochetkov 2015). According to Lursoft, based on the annual reports of entrepreneurs in 2016, no more than 5 persons were employed in each of 82 % of enterprises in Latvia (CSB 2016). The prevalence of micro-entrepreneurship in the economy allows quickly responding to changes in the market and switching to the production of new goods and services. This business contributes to the timely satisfaction of market demand; it is able to survive under conditions of a shortage of raw materials, capital and information (Siropolis 1990).

Today, this sector of micro businesses is developing relatively slowly and controversially in Latvia. The assessment of the real state of affairs in the field of micro-entrepreneurship is very difficult because of the low reliability of information on the problems of entrepreneurs that impedes the development of this economic sector. Despite the urgency and socio-economic importance of this problem for employment of the population, management practices of the labour market and of the economy of the country as a whole, the

tools for developing the self-employment of the population have not yet been fully explored. There is little research conducted on many issues and aspects related to the nature of self-employment of people, mechanisms and forms of managing its development on the part of state bodies that are called upon to exert a positive influence on the labour market and regulate the unemployment rate, create a controlling effect on the economic system adequate to the realities of the present stage of socio-economic development of the country.

According to the laws of the Republic of Latvia, persons engaged in business are divided into employees and self-employed persons. Self-employed person is a person permanently residing in Latvia, undertaking economic activity for remuneration and registered at the State Revenue Service of the country. State registration is carried out as an individual entrepreneur or a legal entity (Law of Latvia... 2000).

Since self-employed people establish their own business, they are referred to entrepreneurs who can lead micro-enterprises where the work of hired workers can be used.

It is known that unemployment is a socio-economic phenomenon, in which part of the economically active population is not engaged in the production of goods and services. The unemployed, along with the employed, form the labour force that is offered for hiring on the labour market, but may not be demanded by employers. A potential employee may not find a worthy, in his/her opinion, job offer with the acceptable characteristics, including the offered salary – the price of labour. There is a situation in which hired labour can be replaced by self-employment.

The fundamental point that distinguishes a self-employed person from an individual entrepreneur or a company owner is the absence of hired workers. As soon as a self-employed person hires an assistant on the basis of a contract of employment, s/he actually buys labour and appropriates surplus value, and consequently passes from personal labour or craft relations to the exploitation of the labour of other people. Moreover, this person is not a self-employed person, acquiring the classic characteristics of an entrepreneur.

A person who has chosen the status of a “self-employed” person finds a job on his/her own, within his/her own business. The self-employed person finalises labour relations in the form of a contract and is responsible for his/her work, organises the labour process, performs contractual work independently, or as part of a group of self-employed persons related by kin or craft relations. Self-employed people perform entrepreneurial activities, not being entrepreneurs in the classical sense, since they do not create seized surplus value. They distribute the income received within the working group, according to their personal performance.

Despite the fact that self-employment of the population plays an important role in the economy of Latvia, there are no plans for the development of self-employment in the Socio-economic Development Strategy of the country, which impedes the effective use of the potential for self-employment. Self-employment of people is not mentioned in the National Development Plan of Latvia for 2014–2020 (National...2014). This is a

systemic drawback, since the development of the self-employment of the population is not only a way of reducing unemployment, but also of developing entrepreneurship, establishing an effective economy in the country, performing its innovative modernisation and structural reorganisation.

*The tasks of the article* are to evaluate the state of self-employment of the population and micro-entrepreneurship in Latvia, as well as the areas for stimulating the development of this business. *The novelty of the research* is substantiated by the fact that similar studies of the micro-entrepreneurship cluster, self-employment of people and its impact on employment in Latvia have not previously been conducted. *The object of the research:* the cluster of micro-entrepreneurship and self-employed persons in the economy of Latvia. *The goal of the research* is to analyse the state of self-employment of the population, micro business in Latvia and to develop proposals for improving the operating conditions for enterprises in this sector of the economy. *Methods of research:* the analysis of statistical data and mathematical modelling.

## Analysis and computations

According to the research conducted by the OECD experts, self-employment in the countries of Western Europe developed very slowly between 1970 and 1980, and then a period of steady growth began. This was due to the restructuring of many economic sectors, rising unemployment, the development of outsourcing services and quite significant tax reliefs in this area. Besides, a significant role was played by the change in the state policy in many countries, aimed at alleviating social problems by attracting the unemployed to the sphere of self-employment. To a large extent, this was facilitated by the use of state programs of development and support of self-employment, providing technical and financial assistance to those who wanted to engage in individual entrepreneurship, as well as facilitating registration procedures and simplifying accounting. Moreover, special attention was devoted to alleviating the conditions for youth and women seeking to engage in individual entrepreneurship in the form of self-employment. The growth of self-employment helped reduce the rate of unemployment and stimulated the development of micro-entrepreneurship in many countries (European 2017, Ivanova et al 2017).

The first models of programs to stimulate self-employment among the unemployed appeared in France and were aimed at acquiring general skills required to start individual activities. Thus, in 1979 France implemented pilot programs of the development of self-employment for the unemployed, based on the formation of seed funding for their individual enterprise with the help of unemployment benefits. Then, taking into account the results of the experiment, in 1980 France adopted the state program “Unemployed Entrepreneurs” (Chomeurs Createurs – CC). The French model provided for a lump sum payment of unemployment benefits, the amount of which allowed the unemployed to generate initial capital sufficient to establish an individual enterprise without employees. This model of self-employment development

was oriented towards people receiving social insurance and unemployment benefits, disadvantaged people and individuals seeking an opportunity for self-employment. The model was intended only for those who used unemployment insurance and were forcibly dismissed or were on the list of persons to be dismissed in the near future. In 1984, this list was expanded, and it included youth and people who for the first time wanted to start working. The French model provided assistance both in the creation of one's own business and in the purchase of an already existing business, as well as provided the possibility of participating in a functioning micro business as a partner.

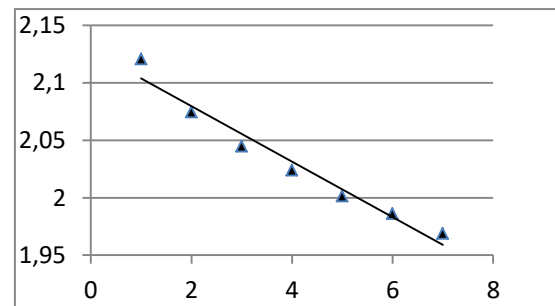
Great Britain was the second country to implement the National Enterprise Development Program (Enterprise Allowance Scheme – EAS). Participants of this program could be people receiving unemployment benefits and additional social benefits. The British model was based on periodic payments of unemployment benefits, allowing the unemployed to gradually receive the necessary qualification and establish their own business. Similarly to the French model, the British self-employment program lacks tools for compulsory selection of applicants for assistance in establishing their own business. However, there are procedures that help the applicants to critically self-assess their plans for establishing their own business. Unlike the French model, in the British model of self-employment development, assistance is provided only to those who intend to create a new individual enterprise. In the British model of self-employment development, applicants for participation in the self-employment program may be persons in the age group from 18 to the retirement age who are unemployed for at least 8 weeks, or have been notified of termination of employment. Additional co-investment from the state budget is provided if the activity of the established enterprise meets the goals and priorities of regional or local socio-economic development. During the period from 1979 to 1990 in Great Britain, active state support for micro-entrepreneurship development combined with the implementation of the national EAS program made it possible to increase the number of self-employed from 1.72 million to 3.25 million people. Their share in the total number of employed population increased from 7.2 % to 11.7 %.

By the mid-1980s, similar programs for the development of self-employment began to be applied in 17 OECD countries (Australia, Belgium, Canada, Denmark, Finland, Spain, etc.). Different countries used different criteria for determining the category of persons entitled to access to self-employment development programs. For example, in Ireland and Germany, an

applicant for participation in the self-employment development program should receive social security benefits or unemployment benefits. In Canada, the applicant should have the right to receive unemployment benefits or social security. In Spain, preference is given to the unemployed and disabled people, people who are unemployed for a long period of time, workers over the age of 45 and former emigrants who have returned to their homeland.

In Latvia, after the financial and economic crisis of 2008–2010, the total population decreased (Fig. 1, Table 1). This is due to a decrease in the birth rate in the country and the departure of a large part of the able-bodied population to work in other countries of the European Union. This partly explains the decline in the rate of unemployment in the state (Fig. 2, Table 1).

Within the framework of the research, all calculations have been performed according to the data of the Central Statistical Bureau of Latvia and according to the data of the State Revenue Service (SRS) (CSB 2017). The regression equations and graphs obtained by the calculations clearly show the trends of changes in the main factors characterising the state and development of the economic situation in the country in the period of 2010–2016 after the economic crisis (Table 1). The coefficients of determination  $R^2$  and correlation  $r$  are greater than 0.7438 and 0.8624, respectively. This indicates that the resulting equations explain almost 75 % or more variations of the factors under consideration in the specified period of time. The corresponding correlation coefficients in all cases are greater than 86 %, which indicates a strong correlation dependence of the considered indicators on time.



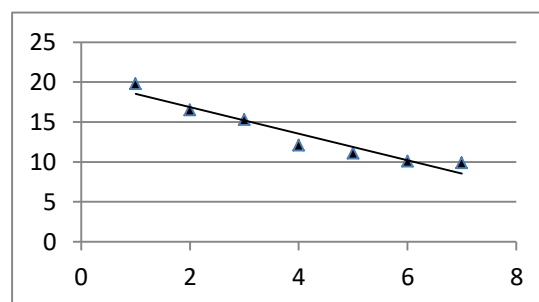
**Fig.1.** Change in the number of the total population in Latvia, 2010 – 2016. The OX axis: 1 – 2010; 2 – 2011; ... 7 – 2016; the OY axis: M.

**Table 1.** The results of computation of factor dependence

No	Dependence, years	Regression equation $y=f(x)$	R - squared	Correlation coefficient <b>r</b>	Fisher Statistics		DW statistics
					F act.	F crit.	
1.	Change in the number of the total population in Latvia, Fig. 1. (2010-2016).	$y = -0.0241x + 2.1279$	0.9634	0.9815	131.56	6.61	1.043
2.	Change in the rate of unemployment in Latvia, Fig.2. (2010-2016).	$y = -1.6679x + 20.214$	0.9255	0.9620	62.13	6.61	1.3204
3.	Change in GDP per capita in Latvia, Fig. 3. (2010-2016).	$y = 0.6607x + 8.3986$	0.9546	0.977	105.1	6.61	0.979
4.	Change in the number of employed people in Latvia, Fig. 4. (2010-2016).	$y = 5.7821x + 830.66$	0.7438	0.8624	14.51	6.61	1.4705
5.	Change in the number of unemployed people actively seeking work in Latvia, Fig. 5. (2010-2016).	$y = -18.393x + 208.44$	0.9219	0.9601	58.98	6.61	1.3583
6.	Change in the ratio of the number of self-employed persons to the number of active unemployed persons in Latvia, Fig. 6. (2011-2016).	$y = 0.0827x + 0.4476$	0.9144	0.9562	42.71	7.71	1.7346

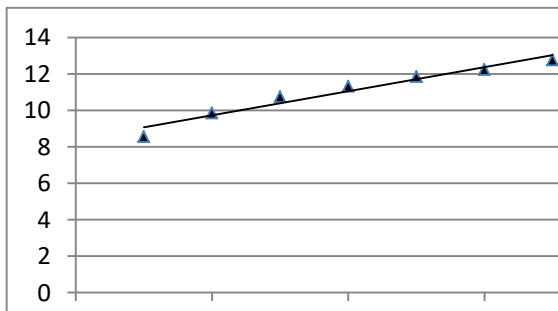
The verification of the obtained regression equations for consistency according to the Fisher criterion has demonstrated that in all cases the actual values of the criterion Fact are greater than the critical values for the considered Fcrit conditions (Table 1). Therefore, the hypothesis H0 on the insignificance of the regression equations is rejected, the equations are considered reliable, statistically significant, and can be used for analysis in the period under consideration.

The dependences studied in the research relate to time-varying series. Therefore, the regression equations obtained have been checked for the presence of autocorrelation of the first order residues by the Durbin-Watson (DW) criterion at the significance level  $\alpha=0.05$  (Table 1). For half of the considered trends (No. 4; 5; 6), it has been established that the DW criterion lies in the zone  $d_U < DW < 2$  and there is no autocorrelation. In other cases (trends No. 1; 2; 3), the criterion falls into the zone of uncertainty  $d_L < DW < d_U$ . However, the graphical analysis of the residuals has also shown a lack of autocorrelation. Therefore, the observed trends of changes in the factors under consideration can be used for analysis and obtaining of practical conclusions.

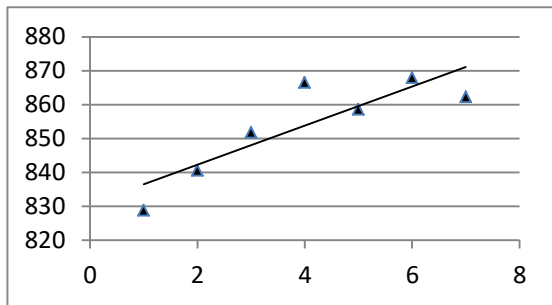


**Fig.2.** Change in the rate of unemployment in Latvia, 2010 – 2016. The OX axis: 1 – 2010; 2 – 2011; ... 7 – 2016; the OY axis: %.

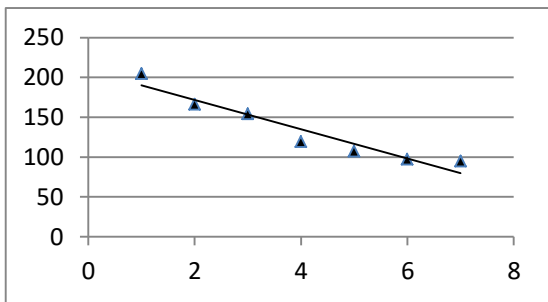
During the financial and economic crisis, the GDP of Latvia was decreasing. However, since 2010, GDP per capita has been steadily increasing (Fig. 3). There is a way out of the crisis, production volumes are increasing, and new enterprises are being established. This leads to an increase in the number of employed people in Latvia (Fig. 4). People find work and the unemployment rate decreases. There is a decrease in the number of active unemployed, i.e., those who do not go abroad in search of earnings, but actively seek and find acceptable jobs in their homeland (Fig. 5).



**Fig.3.** Change in GDP per capita in Latvia, 2010 – 2016. The OX axis: 1 – 2010; 2 – 2011; ... 7 – 2016; the OY axis: thsd €.



**Fig.4.** Change in the number of employed people in Latvia, 2010 – 2016. The OX axis: 1 – 2010; 2 – 2011; ... 7 – 2016; the OY axis: thsd.

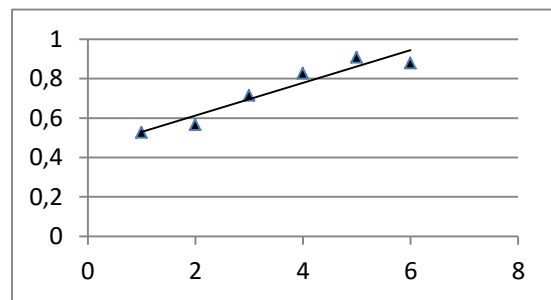


**Fig.5.** Change in the number of unemployed people actively seeking work in Latvia, 2010 – 2016. The OX axis: 1 – 2010; 2 – 2011; ... 7 – 2016; the OY axis: thsd.

If one considers the ratio of the number of self-employed persons to the number of active unemployed in Latvia, one can say that this ratio increased in the period under consideration (Fig. 6). This was mainly due to a decrease in the number of active unemployed, since the

number of self-employed persons in the period under consideration was slightly changing (Fig. 7).

The total number of people employed in micro-entrepreneurship ranged from 9.7 % to 10.4 % in the period from 2011 to 2016, i.e., about 10 % of all employed in Latvia. The variation in the number of self-employed persons was 6 %: the smallest number was 83322 people in 2016, and the largest number was 88558 people in 2014. Despite the fact that the number of self-employed persons in the country decreased by 6 % from 2014 to 2016, income taxed by micro-enterprises and self-employed persons increased during these years (Table 2). Income to the state budget of taxes from this activity increased by 3.85 times in 2016 in comparison with 2014.

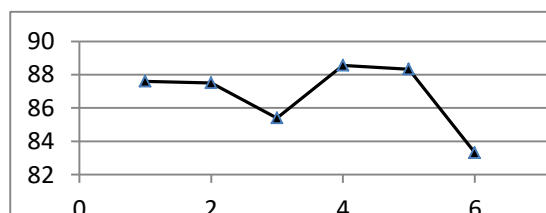


**Fig.6.** Change in the ratio of the number of self-employed persons to the number of active unemployed persons in Latvia, 2011 – 2016. The OX axis: 1 – 2011; 2 – 2012; ... 6 – 2016.

The economy grows and develops not only thanks to the presence of large business structures, but a significant role in this process is played by micro-entrepreneurship and self-employment of the population. Micro-enterprises positively affect the level of employment in the country, the rate of economic growth and tax revenues to the budget. There are a number of problems on the way to the development of micro-entrepreneurship, the elimination of which would allow such enterprises to compete successfully not only in the domestic but also in the external world market. The main internal problems of micro businesses (lack of necessary economic knowledge, qualifications of employees, proper amounts of financial resources, etc.) can, to a large extent, be resolved through effective management by chief executives.

**Table 2.** Number of employees at micro-enterprises and income from their activities

Year	2014	2015	2016
Number of employees	88558	88329	83322
Turnover or income, thsd. €	532835.9	567522.9	612906.2
Paid taxes, thsd. €	13073.8	17671.2	50357.3



**Fig. 7.** Change in the number of self-employed persons in Latvia, (2011–2016). The OX axis: 1 – 2011; 2 – 2011; ... 7 – 2016; the OY axis: thsd.

External problems are more significant, threaten to liquidate business and often cannot be eliminated by the actions of enterprise's senior management. Surveys of micro business representatives have demonstrated that the main external problems are the following:

- instability of the tax legislation and the size of the tax burden;
- the possibility of obtaining loans;
- the difficulty of acquiring modern technological equipment at a reasonable price.

There are other less important external problems, which also have a negative impact on the conduct of micro businesses, for example, a lack of the necessary support of this business from the state. It is very difficult to obtain the necessary financial resources for novice entrepreneurs. Most of them do not use borrowed funds due to the lack of opportunity to obtain favourable loans.

Micro-enterprises, compared to large businesses, are characterised by a large proportion of living labour costs per unit of output. At such enterprises, labour-intensive work is often performed by workers holding an average and low level of qualification. To maintain the necessary level of competitiveness, entrepreneurs are forced to save on wages and intensify the work of employees. This causes difficulties in attracting highly qualified specialists to work. A majority of micro-enterprise employees work on a permanent basis, while in more developed EU countries temporary employment is common in such enterprises.

For the successful development of micro-entrepreneurship and self-employment of the population in Latvia, it is necessary to improve the banking system in the interests of micro businesses, to reform the mechanism of relationships between the players of this business and banks.

## Conclusions

The sector of self-employed population and micro-entrepreneurship is an integral part of the socio-economic system of Latvia; it provides relative stability of market relations, thanks to its flexibility demonstrates a prompt response to constantly changing environmental conditions. Self-employment of the population and micro businesses play an important role in increasing the number of jobs and solving problems of employment, especially in those areas where the problem of unemployment is still unresolved. The opportunities of the self-employed population as representatives of micro-entrepreneurship are neither exhausted, nor even used in any serious way in Latvia.

To solve the problem of accelerating the country's economic growth, eliminating the imbalance in the development of the territories, combating poverty and developing innovations, it is necessary to stimulate the population of the country to register their own activities, create new micro-enterprises, increase their competitiveness, and increase the employment of workers in this sector of the economy.

The development of micro businesses should become one of the priority areas of the country's economic development, since it plays an important role in ensuring the stability of economic development, increasing the flexibility and adaptability of the national economy to changing external and internal conditions. There is a need to create a special system of state support for micro-entrepreneurship in Latvia. It is necessary to modernise the tax policy, introduce a system of tax reliefs for self-employed persons.

The improvement of the banking system in the interests of micro business, the simplified procedure for obtaining loans, especially by novice entrepreneurs, are of great importance for the successful development of micro-entrepreneurship in Latvia. This will be facilitated by lower interest rates for loans, easing banking requirements, eliminating bureaucracy in the banking system and, as a consequence, the opportunity for entrepreneurs to invest in the development of enterprises.

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