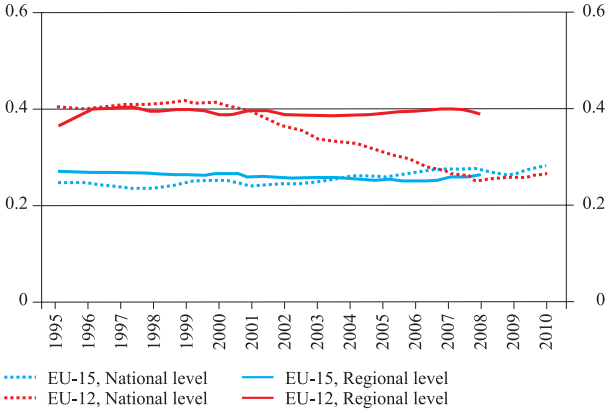
# 3. In Focus

## Global crisis triggered structural convergence

At the Bank of Latvia annual conference *"Global Challenges and Local Opportunities: Achievements and Prospects in the Baltic States"*, the results of a research on the process of structural convergence in Latvia and in Europe were presented. The research was conducted by Aleksejs Meļihovs and Igors Kasjanovs, two economists of the Bank of Latvia. It involved estimation of β- and σ-convergence in Europe as well as of the structural convergence process in the Latvian economy.

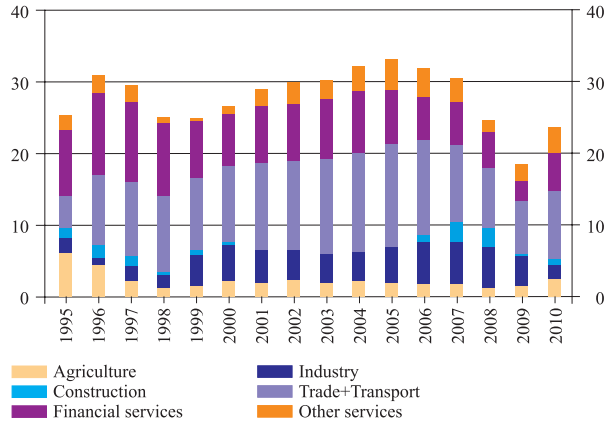
**σ-convergence process in the EU**




Income convergence can be defined as a process in which countries of a group become more similar to each other in terms of income (or GDP). While β-convergence focuses on detecting any potential catching-up processes, σ-convergence simply refers to reduction of regional disparities over time. The two concepts are, of course, closely related. The research revealed that β-convergence was present in Europe both at national and regional levels, although historically it was notably slower at the regional level. In the period from 1995-2008, for example, the average β-convergence speed in EU-27 was 2.7% and 1.7% at the national and regional levels respectively. The research also proved that the β-convergence process in the EU relied mostly on the convergence of the new Member States. So, for example, the average β-convergence speed in 1995–2008 was 4.3% in EU-12, while no β-convergence at all was observed in EU-15. It must be noted that the β-convergence speed increased already in the pre-accession period and even more after the accession.

Meanwhile, σ-convergence was also observed in the EU, but it was halted by the onset of the financial crisis in 2008. As in the case of β-convergence, σ-convergence also relied mostly on the convergence of the new Member States. More in-depth data analysis revealed that the σ-convergence process in Europe was observed only at the national level in the new Member States. There was no σ-convergence in EU-15 and at the regional level.

**Krugman index measuring the structural difference between the economy of Latvia and EU**




The term of structural convergence is used to describe a process in which countries of a group become more similar to each other in terms of their economic structure. The Krugman index was used to evaluate the process of structural convergence. The index compared the share of particular sectors in the economy of Latvia to the share of the respective sectors in the EU. The absolute sum of difference is the meaning of the index. The lower the index value, the more similar the productive structures are. While catching-up in terms of nominal convergence, Latvia was diverging in terms of structural convergence. And vice versa, in later years when Latvia faced a sharp downturn in GDP growth, structural convergence was evident. Trade sector in combination with transportation as well as financial services sector contributed to the process of structural divergence during the boom years. In most years structural divergence in Latvia persisted in the presence of economic growth and vice versa. Nevertheless, Latvia has improved both indicators in the long-term: there has been some structural convergence (as measured by Krugman index) as well as some real convergence (at least if we judge by the GDP per capita figures).