

## Latvia

<b>Status Index</b> (Democracy: 4.4 / Market Economy: 4.3)		<b>8.7</b>	<b>Management Index</b>		<b>6.3</b>
<b>System of government</b>	Parliamentary		<b>Population</b>	2.4 Mio.	
	Democracy		<b>GDP p. c. (\$, PPP)</b>	7,730	
<b>Voter turnout</b>	72.0 % (2002)		<b>Unemployment rate</b>	14.2 %	
<b>Women in Parliament</b>	21 % (2002)		<b>HDI</b>	0.811	
<b>Population growth</b>	-0.2 %		<b>UN-Education Index</b>	0.95	
<b>Largest ethnic minority</b>	29.4 %		<b>Gini-Index</b>	34.0 (2000)	
<p>Figures for 2001 – if not indicated otherwise. <sup>a)</sup> Annual growth between 1975 and 2001. Sources: UNDP: Human Development Report 2003. European Commission (2002): Regular Report on Latvia's Progress toward Accession. Republic of Latvia - Ministry of Economics (2002): Economic Development of Latvia. Home page of the Latvian parliament (<a href="http://www.saeima.lv">www.saeima.lv</a>).</p>					

### 1. Introduction

After more than 50 years as part of the Soviet Union, Latvia regained independence in 1991. As a sovereign state, Latvia set out on the road to independent democracy and a market economy. The first free elections for the national parliament, the *Saeima*, took place in 1993. With only minor reservations, international observers evaluated these and all subsequent elections to date as free and fair.

This report on the status of Latvia's transformation to democracy and a market economy assesses a period corresponding to the most recent legislative term, from October 1998 to October 2002—a period shaped by the policies of three different governments under prime ministers Vilis Krištopans, Andris Šķēle and Andris Bērziņš. In the past five years, and particularly in the context of the accession negotiations with the European Union, Latvia has achieved successes in a number of the areas examined in this report. In October 2002, the EU set 2004 as the target date for Latvia's accession.

However, major shortcomings remain in the integration of the Russian minority and in the fight against corruption—areas where Latvia's transformation management to date has brought only limited success. The new government under Einars Repše, which took office after the October 2002 elections, has promised to continue its predecessors' reform policies.

## **2. History and characteristics of transformation**

Latvia's transformation process bears the hallmarks of contemporaneous political and socioeconomic transitions and of the processes of nation building and state formation. At the end of the 1980s, a strong movement for Latvian independence took shape against the backdrop of Mikhail Gorbachev's reform policy (*perestroika*) and the cautious liberalization this brought in the USSR. In October 1988, various reform movements joined forces to establish the Latvian Popular Front (LPF). In the 1989 elections for the USSR Congress of People's Deputies, and again in the 1990 elections to the Supreme Soviet, the LPF won enough seats to force the communists from power in Latvia.

In May 1990, the Latvian parliament voted to restore Latvia's national independence. The subsequent transition phase, which featured parallel Latvian and Soviet governance structures, ended in 1991 in the aftermath of the Soviet military's failed attempt to overthrow Gorbachev. The independent Republic of Latvia won international recognition on 21 August 1991. In 1993, Latvia set up its own state institutions by fully restoring the prewar 1922 Constitution, which since has been modernized via numerous amendments.

In addition to this transformation of political institutions, Latvia's transition from a centrally planned system to a market economy required a complete overhaul of its key economic institutions. The primary goal of the new economic policy was to establish a market economy that was no longer dependent on the Russian economy but was instead oriented to the EU. The establishment of an independent central bank and the currency reform of 1992 introduced a monetary and fiscal policy that succeeded in reducing the rate of inflation from 951 % (1992) to 8 % (1997).

During the first years of the young republic, the government flanked this stability-oriented monetary policy with a largely successful budgetary policy; in 1997, Latvia even achieved a budget surplus for the first time. "Small" privatization proceeded at a brisk pace and was largely completed by 1998. However, the privatization of some key large enterprises in the transportation, energy and communication sectors lagged behind. Apart from a few institutional shortcomings, the fundamental framework for free competition was already in place before 1998. After a drop in economic performance in the first half of the 1990s, the tide turned. Latvia's GDP rose by 3.3 % in 1996 and by 8.6 % the following year.

### 3. Examination of criteria for democracy and a market economy

#### 3.1 Democracy

In transforming its political order, Latvia made progress in some areas evaluated during the period under study. Definite shortcomings remain in the areas of state identity (citizenship for the Russian minority) and the rule of law (political corruption and judicial inefficiency). Latvia has not attained full institutional and democratic stability, not least because the party system is not very well established. However, there is no evidence of threats to the stability of the system.

##### 3.1.1 Political regime

(1) *Stateness*: Since regaining independence, Latvia has faced issues of state identity concerning its territorial borders and citizenship requirements. It has managed to resolve the dispute over territorial integrity: Russia, which had already withdrawn most of its military troops from Latvia in 1994, vacated its last remaining outpost (the radar station at Skrunda) at the end of 1999.

The most significant issue in Latvia is the question of which people qualify as citizens of the state. Because the Republic of Latvia considers itself a continuation of the first (interwar) republic, in 1992 citizenship was granted automatically only to people who had lived within Latvia's borders before 1940 and to their descendants. This excluded approximately 40 % of Latvia's population, primarily ethnic Russians, who were treated as foreigners. Not until 1995 were naturalization procedures established by law. Even then, these procedures could not be described as democratically fair; consequently, they drew criticism from the Council of Europe, the European Court of Human Rights, the EU and the Organization for Security and Cooperation in Europe (OSCE).

A 1998 referendum amended the right to citizenship, liberalizing the naturalization process in two ways. First, the "naturalization window"—which each year had allowed only individuals born in specific years to acquire citizenship by naturalization—was eliminated. Second, children born in Latvia were granted automatic citizenship; this right (*ius soli*) was extended retroactively to children born to non-Latvian parents after independence was restored in 1991. As a result, the annual number of naturalizations rose from 4,439 (1998) to 9,844 (2002)—still only a modest improvement, considering that more than 500,000 persons (mostly ethnic Russians) remain without citizenship.

Latvia's administrative systems leave much to be desired, though they have improved as legislation was brought into line with EU jurisprudence in preparation for accession. Shortcomings remain particularly in implementing

reforms of and by the administration, mainly because of underfinancing and the lack of professional development for civil service personnel.

**Table 2: Naturalization data (1998–2002)**

	1998	1999	2000	2001	2002
Number of applications for naturalization	5,608	15,183	10,692	8,672	8,370
Number of naturalizations approved	4,439	12,427	14,900	10,637	9,844

Source: Home page of the Republic of Latvia Naturalization Board: <http://www.np.gov.lv/fakti/statistika.htm>.

(2) *Political participation*: All Latvian citizens have the right to vote and the right to stand for election. According to international organizations (and aside from the restrictions on citizenship), all elections to date have met the general standards of fair elections. In May 2002, the Latvian parliament removed from the election law a clause that had required candidates for public office to demonstrate proficiency in Latvian at the highest level of a six-tiered rating system. In the past, this language requirement had limited the political participation of naturalized ethnic Russians—an infringement that the European Court of Human Rights had noted with disapproval in April 2002. Observers of the autumn 2002 parliamentary elections gave Latvia good marks not only for its removing the language clause, but also for the citizenry's high level of confidence in the process of administering elections and for greater transparency with regard to the financing of political parties and the media.

They criticized the occasional inspection of identity papers at polling places by the police rather than by the election commissions, as well as the inadequate assurance of privacy in some voting booths and the broadcasting of campaign advertisements on the radio and television even on election day. From the standpoint of democracy and an integrative policy toward minorities, the high proportion of non-citizen residents, and their consequent exclusion from elections, remains particularly problematic. In the 2002 elections, this effectively disenfranchised approximately 22 % of Latvia's population.

The elected government obeys the principles of an open, competitive election process. No veto powers pose a risk to the political process. Free media provide for open and pluralistic political reporting, but are somewhat restricted. A language quota for commercial television and radio requires most programming (at least 75 %) to be broadcast in Latvian. The adoption of a bill of rights in 1998 gave constitutional status to the right of association, which is also accorded *de*

*facto* respect. Ethnic Latvian and ethnic Russian citizens alike have extremely low confidence in Latvia's political parties.

(3) *Rule of law*: The separation of executive, legislative and judicial powers is anchored in the Latvian constitution. For the most part, the executive respects the independence of the other two branches. There are no apparent efforts to undermine the authority of the constitutional court. Indeed, when a political conflict in 1999 brought demands that the constitutional court be disbanded, that body emerged stronger than before. It arrives at its decisions independently; between 1998 and 2002, it certainly issued rulings that did not reflect the government's views. In isolated instances, however, there are signs of attempts by the executive branch (especially the Justice Ministry) to exert influence on the courts, which *de jure* are independent. Institutionally, Latvia still needs to establish clear criteria for judicial appointments, to improve the efficiency of the legal system and to invest in the judiciary's infrastructure and in the training and continuing education of judges. The population has little confidence in the judiciary or the legal system.

According to several surveys, the population perceives corruption as an urgent problem. Not least for that reason, confidence in the authorities is low. On Transparency International's latest Corruption Perception Index (CPI), Latvia shares 52nd place with the Czech Republic and Slovakia—the lowest ranking of all the candidates for EU accession in 2004. Although laws providing for the criminal prosecution of corruption are on the books, few such offenses are punished. After protracted delays, an anti-corruption authority finally took up its duties in May 2002. Members of parliament have immunity against criminal prosecution. Although this conforms to democratic norms, so far there are no clearly defined criteria for suspending that immunity. The basic rights guaranteed in the constitution are not systematically violated either by the state or by private parties. Nevertheless, the *de facto* consolidation of the rule of law is still inadequate. Latvia has yet to institute a new code of criminal procedure, amend the law regarding independence of the judiciary and enact measures governing the actions of law enforcement officers. Formally, access to the courts is open to all. However, the population considers the courts extremely corrupt. There is no evidence of discrimination against the Russian minority in the court system.

### **3.1.2 Political patterns of behavior and attitudes**

(1) *Institutional stability*: Latvia's democratic institutions are limited in their ability to perform effectively and efficiently. As a rule, political decisions are prepared, made, implemented and reviewed in legitimate procedures by the appropriate authorities. However, Latvia's political institutions cannot be considered stable, because of organizational problems that hinder implementing the rule of law and because of the frequent turnovers of government.

During the period from 1998 to 2002, the government changed hands three times during a single legislative term. The minority government under Vilis Krištopans (1998–1999) succumbed to dissension surrounding the presidential election. The next prime minister, Andris Šķēle (1999–2000), resigned in anticipation of defeat in a vote of no confidence following a privatization scandal. The third government, under Andris Bērziņš (2000–2002), was voted out of office in the regular parliamentary elections in November 2002. Despite these frequent changes of government, however, the relevant political actors accept the democratic institutions in the political process as legitimate.

(2) *Political and social integration*: Latvia's political system is burdened by problems of political representation. Extensive fragmentation has kept the party system unstable. The number of parties officially registered with the Justice Ministry rose again during the period under study, from 41 (1998) to 43 (2002). The eighth Saeima, like the seventh, included representatives from six parties. Of these six, however, only the People's Party and the TB/LNNK (TB, For Fatherland and Freedom, merged with the Latvian National Conservative Party, LNNK) were returning to that body; the other four were either new parties or alliances of smaller parties. Noteworthy is that the LC party, Latvia's Way—until then the only party to win seats in every Saeima—fell just short of the necessary five-percent threshold in the 2002 elections. By contrast, the fledgling New Era party immediately became the strongest parliamentary group and the governing party.

A positive feature of the party system is its moderate polarization. No party that opposes the system is represented in parliament. Overall, the parties are only weakly anchored in society. Only 3 % of the population belong to a party, and only 7 % have confidence in the political parties. Although non-citizens can join political parties, they are not allowed to found a new party; this limits many ethnic Russians' options for participation.

Like the parties, interest groups have yet to set firm roots in Latvian society. The Free Trade Union Federation of Latvia (LBAS), an alliance of 32 individual unions, has established itself as the most important organization representing workers. The Latvian Employers Confederation (LDDK), an umbrella association for employers, has had little political influence to date because of internal differences. However, there are signs that a social partnership is beginning to develop: Representatives of the unions, the employers and the government are working together in tripartite councils to improve working conditions. In addition to these organizations, the association of retired persons and the farmers' association have considerable ability to mobilize.

Latvia has a solid network of non-governmental organizations. The number of organizations registered with the Ministry of the Interior rose from around 2,700

in 1998 to around 4,500 in 2002. For the year 2002, the UNDP recorded a total of 774 active NGOs. According to surveys, however, only a few people are actively involved with NGOs, and only one-fourth of the population has confidence in them. Approval for democracy has strengthened but remains considerably below the level seen in Western Europe. According to the most recent (2001) edition of the New Europe Barometer, 38 % of respondents would prefer a dictatorship, 7 % communist rule and 4 % a military regime.

## **3.2 Market economy**

Latvia has made progress on the road to a functioning market economy. The gross domestic product has grown considerably in the last five years. Trade is very extensively liberalized; Latvia has belonged to the WTO since 1999. As in almost all post-communist states, however, the privatization of large enterprises poses insurmountable problems. The alternatives are to shut down the enterprises, causing considerable upheaval in the job market, or to continue subsidizing obsolete production structures and products. Like most post-communist countries, Latvia has chosen the latter course. Its investments in human resources are inadequate. There is no strategy for sustainability.

### **3.2.1 Level of socioeconomic development**

According to UN indicators, social exclusion in Latvia is quantitatively and qualitatively fairly minor. In international comparison in 2000, Latvia ranked 53rd, just barely in the top third of the Human Development Index (HDI). Socioeconomic inequality is moderate; Latvia's Gini index for 2000 was 0.34. This is the typical legacy of the communist period and bodes well for democratic consolidation and the social cohesion needed to sustain democracy. The Gender Development Index (GDI) does not indicate gender-specific exclusion in Latvia. Although there are no signs that ethnic Russians are generally excluded in the economic arena, studies suggest a correlation between their higher unemployment rate and their lesser competence in the Latvian language.

### **3.2.2 Market structures and competition**

Latvia has laid the foundation of a competitive market economy. Therefore, the Latvian government now generally limits its role to guaranteeing compliance with the rules of the game. There are no significant restrictions on access to the market. Administrative barriers have been further dismantled. Apart from controls applied by public service regulators, prices are deregulated. The proportion of regulated prices in the consumer price index dropped slightly between 1998 (22 %) and 2002 (20 %). A Competition Act passed in January 2002 further improved the

operational framework for the Competition Council, which was established in 1993. Except for restrictions on agricultural products, foreign trade is also very extensively liberalized. The banking system has stabilized since the banking crisis of the mid-1990s. Oriented to international standards and with functional banking supervision, it complies in almost all respects with the Basel Accords.

### 3.2.3 Stability of currency and prices

Latvia pursues a consistent inflation policy and foreign-exchange policy. With prudent action, the independent central bank managed to further reduce the rate of inflation from 4.3 % (1998) to 2.6 % (2001). Latvia's currency reserves doubled during the period under study. In its foreign-exchange policy, Latvia has *de facto* pegged its currency, the lat, to the SDR currency basket<sup>1</sup>—a decision that so far has proved appropriate. The Latvian government pursues a stability-oriented fiscal policy. Although both domestic and foreign debt rose slightly, new indebtedness—except for the economically difficult year 1999 (the Russian crisis)—remained less than 3 % of the GDP every year. In 2001, Latvia's total national debt was only 15 % of its GDP. Its close cooperation with the IMF also indicates a stability-oriented budgetary policy.

### 3.2.4 Private property

The right to private property is protected by the constitution. Private enterprises are viewed as the institutional backbone of the national economy. The percentage of GDP produced in the private sector rose further, from 62 % (1998) to 69 % (2001). While the privatization of agricultural land was largely completed by 2001, the privatization of residential property is still in progress. By 2002, however, 74 % of all housing in Latvia was in private hands. Even the privatization of large enterprises gained ground. For example, the privatization of the Latvian gas company, *Latvijas Gaze*, was completed in 2002, and—after several attempts—the state sold approximately 80 % of its shares in *Lasco*, the Latvian shipping company. In the energy, communications and transportation sectors, privatization is still pending. Major portions of the telecommunications company *Latt Telekom* (51 %) and the oil company *Ventspils Nafta* (32 %) are still in state hands. Because of restructuring measures, the energy company *Latvenergo* and the railway company *Latvijas Dzelzceļi* are currently not slated for privatization.

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<sup>1</sup> Special drawing rights: An international reserve asset created by the IMF and used by it for accounting. The SDR currency basket consists of the (weighted) US dollar, the euro, the British pound and the Japanese yen.

### **3.2.5 Welfare regime**

Latvia has a state-organized network to compensate for social risks, but both protection and financing fall short. Although the health care system is organized to provide universal coverage, the benefits are minimal; as one indication of this, public expenditures for health care decreased from 4.1 % of GDP (1999) to 3.4 % of GDP (2001). The state welfare system rests on a weak institutional foundation and offers little support. Social welfare offices are lacking at the local level. State welfare expenditures saw further cutbacks between 1999 (16.1 % of GDP) and 2001 (13.0 % of GDP). An initiative to combat mounting poverty, announced in 2000, is still on the drawing board. By contrast, the reform of the pension system has started to post successes. In 2001, the state pension system added its second pillar and a new law restructured the minimum pension.

Equal opportunity for Latvian citizens is provided by law. There is no evidence of discrimination in access to public services for ethnic Latvians. However, the practice of certain professions requires citizenship, which the majority of ethnic Russians still does not have. Furthermore, state regulations limit the use of the Russian language. As a result, Russians who are not sufficiently proficient in Latvian are at a disadvantage. The same applies to the universities. Special mechanisms to eliminate gender-specific inequality are still emerging. Granted, discrimination against women in Latvia—as in all post-communist societies—is less pronounced than in most other third-wave democracies. Nevertheless, an affirmative action plan was passed in March 2002.

### **3.2.6 Strength of the economy**

The Latvian economy grew steadily between 1998 and 2002. Most of the macroeconomic data show a positive trend. As noted above, prices remained largely stable. Latvia has managed to hold its rate of inflation below 3 % since 1999. Foreign direct investments flow into Latvia at only a moderate rate; furthermore, they dropped by 50 % from 2000 to 2001. Economic growth did not suffice to increase employment; the rate of unemployment has hovered at a high level, averaging 13.9 % during the period under study.

### **3.2.7 Sustainability**

Ecological concerns definitely take a back seat to considerations of growth in important segments of Latvian economic life. Therefore, the reduction of environmental pollution can be attributed primarily to the distinct drop in industrial production since independence. A Ministry of Environmental Protection and Regional Development was established in 1993. Furthermore, in 1995 the National Environmental Policy Plan set forth a comprehensive strategy for

environmental protection that is still in force. Laws passed in the last five years have further improved environmental regulations. Existing environmental protection agencies were expanded, although their efforts could be coordinated better. The Latvian government actively supports international environmental accords such as the Kyoto Protocol and the Agenda 2000 for the Baltic Sea Region. In 2000, the Environmental Sustainability Index (ESI) ranked Latvia in 10th place of 142 countries, the best showing among the central European transition states.

Latvia has an extensive network of primary and secondary schools as well as state and private universities. Its educational facilities have a solid infrastructure. At the end of 2001, more than 50 % of the population had finished secondary school and 14 % had earned a post-secondary degree. State expenditures for education, already relatively high in international comparison, rose even further, from 6.5 % of GDP (1999) to 6.9 % (2001). However, investments in research and development are very low. In the medium term, this will create problems. The total number of scientists is declining, particularly because the rising generation of scientists emigrates in significant numbers.

#### **4. Trend**

*(1) Democracy:* Before 1998, most of the indicators for evaluating the democratic system showed satisfactory conditions. The state monopoly on the use of force and public safety and order were fully established. However, shortcomings were evident in two areas: Corruption limited the effectiveness of the civil service, and the high proportion of ethnic Russians without citizenship caused particular problems in political participation. Since that time, institutional changes—establishment of an anti-corruption agency, amendment of the naturalization process—have brought noticeable progress.

In political participation, Latvia already satisfied the criteria for the indicators of elections, actual power to govern effectively, and freedom of opinion. Its institutions also adequately supported the formation of civil society groups. The elimination of the language clause in the electoral laws represents a small (though by no means adequate) step forward.

Aside from discrimination against the Russian minority, the greatest shortcomings were related to the rule of law. Here, the only criteria adequately met were the independence of the branches of government and citizens' rights of redress for infringements of civil liberties. In the areas where Latvia falls short, namely an independent judiciary and prosecution for abuse of office, certain institutional improvements have yielded modest progress.

However, the institutional stability of democracy was not threatened. The political institutions were and are supported by the relevant actors. Both the administration and the judiciary improved their ability to perform effectively. Nevertheless, corruption continues to plague political life, obstruct the rule of law, and hamper Latvia's economy.

The shortcomings in political and social integration saw only partial remediation. The party system has not yet stabilized. Indeed, in this respect the results of the 2002 parliamentary elections must be viewed as a step backward. There is no sign of much-needed improvement in functional representation by interest groups or in the accumulation of social capital. Nevertheless, just over 50 % of the population approves of the current democratic regime.

(2) *Market economy*: Socioeconomic indicators suggest a slight improvement. Latvia improved its standing by ten places on the HDI and by five places on the GDI, thus consolidating its position in the top third of the countries rated. One striking observation is the definite increase in per capita GDP. As might be expected, however, this development does not uniformly affect the entire population. According to the Gini index, social inequality in Latvian society has increased slightly, but in international comparison it remains low.

**Table 3: Development of socioeconomic indicators of modernization**

	HDI	GDI	GDP Index	Gini index	UN Education Index	Percentage of women in parliament	GDP p. c. (\$, PPP)
1998	0.771 (63)	0.770 (51)	0.68	32	0.91	1998: 17 %	5,728
2000	0.800 (53)	0.798 (46)	0.71	34	0.93	2002: 21 %	7,045

Sources: UNDP (2000): *Human Development Report 2000*, UNDP (2002): *Human Development Report 2002*; Republic of Latvia - Ministry of Economics (2002): *Economic Development of Latvia*; Home page of Latvian parliament: <http://www.saeima.lv>.

The institutional setting for a market economy has improved. However, shortcomings remain in many areas because of bureaucratic inefficiency and a lack of coordination among various agencies. Macroeconomic development definitely gained momentum compared with the first half of the 1990s. Although the 1999 Russian crisis caused problems for the Latvian economy, it recovered during the following year. The ongoing process of economic integration into the European market had a stabilizing effect. In this and other respects, economic developments in Latvia have benefited from its association with the EU. But unemployment remains a crucial problem, with no improvement in sight. Both long-term unemployment and youth unemployment remain as high as ever—and

this assessment does not even take into account hidden unemployment, such as people working in large state enterprises.

**Table 4: Development of macroeconomic fundamentals (1998–2002)**

	1998	1999	2000	2001	2002 <sup>a</sup>
Growth of GDP (in %)	4.8	2.8	6.8	7.7	5.0
Export growth (in %)	9.4	-0.4	25.5	10.8	-
Import growth (in %)	18.7	-3.8	25.5	13.1	-
Rate of inflation (in %)	4.3	2.1	2.6	2.5	2.5
Unemployment (in %)	14.5	13.7	14.2	13.1	13.0
Unemployment among persons under 25	27.1	23.4	21.4	22.9	-
Budget deficit as % of GDP	-0.7	-5.3	2.7	-1.6	-1.8
Current account balance (\$, millions)	-650	-654	-493	-553	-

<sup>a</sup> All figures for 2002 as forecast from: Republic of Latvia - Ministry of Economics (2002): *Economic Development of Latvia*. Source: European Commission (2002): *Regular Report on Latvia's Progress Toward Accession*. EBRD (2001): *Transition Report. Economic Transition in Central and Eastern Europe, the Baltic States and the CIS*.

## 5. Transformation management

### 5.1 Level of difficulty

The level of development at the start of the period afforded good conditions for the successful continuation of Latvia's transformation. Favorable factors were the basic market-economy structures, the high level of education, low polarization of the conflict over income distribution, and the state's effective monopoly on the use of force. Even before 1998, the political elite shared a fundamental consensus on the goal of democracy and a market economy. The greatest structural problem for the transformation process was and is the existence of two parallel societies. The extensive segregation of the Latvian and the Russian communities hampers social integration. Apart from the ethnic situation, the level of difficulty of transformation in Latvia is rather low. As Latvia continued its transformation, the Russian crisis and global economic developments made economic conditions more difficult. On the other hand, once accession negotiations had begun, increased support from the European Union facilitated Latvia's path to reform.

## 5.2 Reliable pursuit of goals

The successive Latvian governments identified themselves with the transformation process and pursued it resolutely. Although medium- and long-term goals were kept in sight, they were sometimes set aside in favor of short-term political considerations. Good examples of this were pension increases (1998) and a short-term increase in agricultural tariffs (1998). The reform strategy aimed to implement democracy and a market economy; it was based on a realistic assessment of scarce financial and human resources and proceeded without excessive fluctuations in public expenditures. Since 1998, the fundamental goals of democracy, rule of law and an effective market economy have not changed; indeed, they have been pursued with even greater resolve. However, corruption and frequent political scandals still cloud the confidence of investors and citizens.

## 5.3 Effective use of resources

The Latvian governments did not use all available resources efficiently. However, both new indebtedness and total debt remained low. Major deviations from expenditures planned in the state budget were the exception rather than the rule. Formally, Latvia's public administration is clearly organized, but in reality, there are problems with coordination. The accession negotiations with the EU, which emphasized administrative reforms, have brought some progress. So far, however, the Latvian governments have had only partial success in implementing announced reforms. They could not always comply with their own plans. In the economic sphere, property rights and a largely functional market are guaranteed, but the health care and education infrastructure is neglected. Widespread corruption continues to hamper the effective use of resources.

*De jure*, state expenditures are subject to parliamentary review. *De facto*, the absence of transparent oversight of expenditures by subordinate agencies hindered this review. However, new budget rules introduced in 2001 significantly improved the situation. Likewise, new regulations in the run-up to the 2002 parliamentary elections improved the transparency of party finances. As in the past, however, the parties receive no state financing; they remain dependent on private donors and hence are particularly susceptible to corruption. The lack of proper equipment in the courts, which generally leads to long delays, is the main reason for corruption in the legal system. Members of parliament enjoy immunity from criminal prosecution. In conformity with international standards, parliament can suspend this immunity, although clear procedural guidelines are still lacking.

The media are independent and play an important role in exposing political scandals. Institutional ties to traditions and constitutional institutions of the interwar period proved to be well-used resources in the consolidation of important political institutions. The comparatively high level of education from the

communist era contributed to the development of democracy and a market economy. However, Latvia is now starting to dissipate this resource as well by underfunding research, development and education—though this phenomenon is not specifically Latvian, but shared by post-communist societies in general.

#### **5.4 Governance capability**

While the leading political actors responded to mistakes and failed policies with changes, they often lacked the necessary strength to implement them. In general, the government has enough political authority to bring about reforms. However, the instability of the three governments between 1998 and 2003 and the population's resulting loss of respect for political parties had a negative effect on the ability to implement reforms. Nevertheless, the Latvian governments did manage to improve the conditions for a more effective allocation of production factors in the markets for capital, goods and labor.

#### **5.5 Consensus-building**

All major political actors agree on the reform goal of building a market-based democracy. A political pact between the old and new elite does not exist—nor was it necessary, in that many of the old elite, who had cooperated with the USSR, had been discredited after the restoration of independence and replaced by new elite.

Potential veto actors such as the military, large landowners, powerful opposition groups or capital oligarchies either do not exist or are oriented in favor of democracy and a market economy. They are located within the democratic consensus and integrated into Latvia's political-economic system. The question of ethnicity as linked to citizenship remains the crucial line of conflict. Even if the issue seems unlikely to escalate at present, there can be no talk of a political community until all Russians living in Latvia are integrated as citizens. Latvia's response to its recent history must also be viewed in this context. Certainly, the Russians are mainly blamed for the installation of the communist regime in Latvia. Even though there may be historical grounds for this behavior on the part of the elite, they are incompatible with the democratic principles of minority-sensitive citizenship rights. Attempts to come to terms with historical events are still too clearly aimed at settling accounts from the autocratic past than at shaping the democratic future.

## 5.6 International cooperation

Membership in NATO and the European Union took top priority for all the relevant actors. During the accession negotiations, Latvia generally followed the recommendations given in the EU progress reports. In 1993, an OSCE observer mission was invited to Latvia to review the rights of the Russian minority. Their recommendations on amending the laws governing citizenship were implemented in full, though after some resistance and delays. At the end of 2001, the OSCE officially ended its mission to Latvia. However, the language clause was removed from the election law only after the European Court of Human Rights issued a ruling against Latvia. This demonstrates that as the parliament and government of the Latvian titular nation moved toward gradual reforms in the integration of Russians as citizens, they were motivated more often by international pressure than their own views.

In the international arena, the Latvian government is regarded as a reliable partner. Latvia's active pursuit of integration into international organizations bore fruit in 2002, when both the EU and NATO issued membership invitations with a target date of 2004.

## 6. Overall evaluation

(1) *Originating conditions:* The starting conditions in 1998 were favorable. The institutions for democracy and a market economy were for the most part established and functional. However, the problem of integrating the Russian minority after the restoration of Latvia's independence has not yet been resolved. The deliberate decision to affirm historical continuity with the first republic had the effect of denying citizenship to a good third of Latvia's population. Because so little time has passed since the country cast off communist rule, the rule of law has not yet taken firm root in the national consciousness. Factors promoting Latvia's transformation included its social orientation to the West and the transfer of know-how as emigrants returned home. The anticipated entry into NATO and the EU as well as those organizations' de facto support for the transformation process were a crucial catalyst for many reforms.

(2) *Current status and evolution:* The democratic transformation has gained further ground. The core problems relating to the rule of law, political representation and integration of the Russian minority were tackled and in part alleviated but not satisfactorily resolved. The anti-corruption measures taken up in the last two years (2000–2002) have yet to yield measurable results. The unstable party system and the weak institutional underpinning of interest groups continue to stunt political representation. In the central shortcoming of Latvia's democracy, the exclusion of the Russian minority, changes in the electoral law and eased

naturalization requirements brought minor advances. Nevertheless, a majority of the country's Russians still lack Latvian citizenship.

In the transformation to a market economy, crucial institutions were consolidated and further developed. The reforms have boosted the economic upturn with high growth rates. At the same time, however, social inequality is steadily growing. Therefore, greater efforts are needed to strengthen the social state and promote sustainability.

*(3) Transformation management:* The verdict on transformation management is only partly positive. The invitations to join the EU and NATO attest to success in foreign policy, but in domestic policy reforms, the performance of the Latvian government is definitely weaker. The failure to establish a stable party system and the lagging privatization of certain large enterprises suggest shortcomings in transformation management on the part of key decision-makers. Latvia's widespread corruption was tackled too late and so far with too little success. Likewise, the Latvian government bears much of the responsibility for the inadequate integration of the Russian minority.

## **7. Outlook**

Latvia's transformation to an efficient market economy and consolidated democracy is far advanced. However, despite all its successes, the following tasks demand greater efforts: (1) integrating the Russian minority, (2) combating corruption, (3) stabilizing democratic patterns of representation and attitudes, (4) reforming social security systems and (5) reducing unemployment.

The first of these deserves particular attention in the context of Latvia's democratic transformation. The key strategic task over the medium term must be to fully establish Latvia's identity as a democratic state by integrating all its ethnic Russians as citizens. For most of these people, migration to Russia is not an option; they have roots in Latvia, and economic conditions in Russia are uninviting. Migration cannot be legitimized; it would merely constitute expulsion in disguise. The only democratic option is for the Latvian titular nation to accept the ethnic Russians as citizens with equal rights. For their part, the Russians must take greater advantage of the opportunity to become naturalized citizens.