

BTI 2008 | Latvia Country Report

Status Index	1-10	8.60	# 13 of 125	
Democracy	1-10	8.70	# 15 of 125	➔
Market Economy	1-10	8.50	# 12 of 125	➔
Management Index	1-10	6.92	# 10 of 125	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

The BTI is a joint project of the Bertelsmann Stiftung and the Center for Applied Policy Research (C•A•P) at Munich University.

More on the BTI at <http://www.bertelsmann-transformation-index.de/>

Please cite as follows: Bertelsmann Stiftung, *BTI 2008 – Latvia Country Report*. Gütersloh: Bertelsmann Stiftung, 2007.

Key Indicators

Population	mn.	2.3	HDI	0.85	GDP p.c.	\$	12,141
Pop. growth ¹	% p.a.	-0.5	HDI rank of 177	45	Gini Index		37.7
Life expectancy	years	71	UN Education Index	0.96	Poverty ³	%	4.7
Urban population	%	67.8	Gender equality ²	0.62	Aid per capita	\$	-

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

From the beginning of 2005 to the end of 2006, two important events influenced Latvia's political and economic transformation: the fifth parliamentary elections since the restoration of independence in 1991 and the organization of the NATO summit in November 2006. During this period two different governments, both under Prime Minister Aigars Kalvitis, shaped the policies of Latvia; the second government came into office in November 2006 after the last general elections. The government's re-election was a first for Latvia and only the fourth example thereof in post-socialist European history. None of the newly found parties managed to even run candidates for election. During the two years under review, Latvia has made headway in terms of strengthening its polity in certain areas and has advanced some reforms – particularly in the economic sphere – with significant gains mainly in retail trade. However, this success, as measured by economic indicators, is based mostly on domestic consumption resulting from the politically driven abundance of cheap credit from commercial banks. This results in a high and still rising commercial balance sheet deficit. The high number of non-citizens underscores another persistent shortcoming in Latvia's governance. Yet the most serious problem is perhaps the lack of engagement in public life on the part of the population, which is a legacy of Soviet rule. The result is a political culture of top-down policy-making, which promotes corruption. There is widespread discontent among the population with regard to Latvia's poorly performing market economy. As the reasons for this performance are poorly understood among the population, the political system is often blamed and, as surveys show, the population is dissatisfied with democratic rule. Latvia's entry into the European Union has meant that its domestic labor force is being depleted as individuals increasingly exercise their right to work abroad.

History and Characteristics of Transformation

State- and nation-building in Latvia has been shaped for centuries by the experience of foreign rule. After a bloody war for freedom in the aftermath of World War I, three Latvian-speaking territories were unified in one state for the first time in history. In 1934, authoritarian rule overtook Latvia's liberal democracy, which was then illegally incorporated into the Soviet Union in 1940. In the years after 1940, many Russians were forced to settle in Latvia, while many Latvians fled to the West, were deported to Siberia or simply not allowed to return home. In the period of time leading up to 1989, many people from other Soviet republics moved to Latvia, since its living conditions were comparatively better than those within the Soviet Union.

In 1988, after Mikhail Gorbachev implemented his reform policy, two movements were founded: the Latvian Popular Front (LPF), which was made up primarily of reform communists supporting Gorbachev, and the more radical Latvian Movement of National Independence. The LPF won a majority in the 1989 elections for the USSR Congress of People's Deputies and again in the 1990 elections to the Latvian Supreme Soviet, while the Independence Movement boycotted the elections. 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 pre-war 1922 constitution, which later was complemented by provisions guaranteeing human and civil rights. The 2004 education law defined Latvian as the main language of instruction, even in minority schools. The lessons taught in the minority pupils' native language were gradually reduced to 40% by 2006. Latvia received the blessing of OSCE High Commissioner on National Minorities Rolf Ekeus for his school reform, which converted Russian-language school classes into bilingual classes.

System transformation precipitated a deep change in Latvia's economy and society. Some of Latvia's large industrial enterprises, such as the electronics producer VEF and the van factory RAF, went bankrupt, while other property was privatized or returned to former owners. The two currency reforms (instituting first the Latvian ruble and then the Latvian lat) liquidated people's savings. Through this process of privatizing properties built during the Soviet era, most people became homeowners for the first time. However, the introduction of a market economy also meant that many services became much more expensive. In addition to the transformation of political institutions, Latvia's transition from a centrally planned 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

Russia, but was oriented instead toward entering the European Union. 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 2.5% (2001), but did not prevent Latvia from suffering a severe bank crisis in 1995. The national currency has been tied to a number of foreign currencies, and the exchange rates with European currencies during the 1990s did not promote export to the most important trade partner countries. During the young republic's early years, the government flanked a stability-oriented monetary policy with a largely successful budgetary policy (Latvia had its first budget surplus in 1997), but with a growing commercial balance sheet deficit of -12.4% of GDP. The privatization of small- and medium-size enterprises was largely completed by 1998. One of the large enterprises, a shipping company, was finally privatized in 2002.

Transformation Status

I. Democracy

1 | Stateness

There is no competition with the state's monopoly on the use of force throughout the entire territory.

Monopoly on the use of force

All citizens have the same civic rights, as do immigrants (a term which in the Latvian case is not congruent with national minorities), at least after a transitional phase. Latvia regards itself as a continuation of the Latvian Republic founded in 1918 and not as a new state. In order to prevent a constitutional crisis, Latvia granted citizenship to all residents of the time before Soviet occupation and their descendants, but excluded migrants from the Soviet period, a majority of which did not favor an independent Latvia in 1991. This was not merely ethnic discrimination, because as a result of Latvia's multiethnic history, many non-Latvians were granted citizenship. At 18.2% in 2006, Latvia has a high number of non-citizens. Some of them, often due to the difficulty of procuring visas to their most frequent travel destination, such as Russia or other CIS countries, refuse to become Latvian citizens. At the beginning of 2006, Latvians numbered 59% of the population, Russians 28.5%, Belarusians 3.8%, Ukrainians 2.5%, and other ethnicities, including Poles, Lithuanians, Jews, Romanians, Germans and Estonians, account for 6.2% of total population. Compulsory military service for young men in the national army was abolished in 2006, a policy which formerly dissuaded non-citizens from applying for citizenship. Non-citizens are denied the right to participate in elections, but otherwise enjoy full rights and protection.

State identity

Since Latvia's accession to the European Union in 2004, the rate of naturalization has risen significantly. Contrary to frequent reports in international publications, the requested tests in history and language are not difficult, as they require only superficial knowledge. The possibility to travel throughout the European Union without a visa has undoubtedly proved to be a greater attraction than has the prospect of political participation in Latvia. In spite of the fact that one can find two societies in Latvia (i.e., Latvian and Russian), the rate of inter-ethnic marriages has always been high, and neither Latvian nor Russian attitudes cause

any serious or violent conflicts. While Russians are economically more active in general and tend to employ more Russians, there is also no serious discrimination in the labor market against people who do not speak Latvian. The slightly higher unemployment rate among non-Latvians results primarily from a lack of professional skills and education.

The state is defined as a secular state. Religious dogmas have no noteworthy influence on politics or the law.

No interference
of religious
dogmas

The state has a differentiated administrative structure throughout the country, making it possible to extract and allocate state resources on a broad basis.

Basic
administration

2 | Political Participation

There are no constraints on free and fair elections. After they won their independence, the people's active interest in politics faded during the liberalization period. Participation in elections decreased to 61.88% in 2006. Of course, non-citizens cannot participate at all.

Free and fair
elections

Elected rulers have the effective power to govern. There are no formal veto powers, but the interests of individual power groups have become rooted in political parties, thanks in large part to Latvian society's political passivity. Political parties are in effect lobbying organizations that can easily realize their interests.

Effective power
to govern

The freedom of association and assembly is unrestricted within the basic democratic order.

Association /
assembly rights

There are unrestricted freedoms of opinion and the press framed by the basic democratic order. A council comprised of representatives from different organizations supervises state television. The state-financed radio and television industries are sometimes suspected of bowing to political pressures in their programming. The privately owned print media are, like the political parties, linked to certain economic interests.

Freedom of
expression

3 | Rule of Law

There are no constraints on the basic functions implicit in the separation of powers, especially mutual checks and balances. The Constitutional Court effectively supervises the constitutionality of laws, government and administration. Parliament has been sufficiently independent from the executive. For example, the draft on state compensation to the Jewish community submitted by the government was not adopted by parliament immediately after the elections

Separation of
powers

in 2006, although the elections provided the governing parties with a parliamentary majority.

The judiciary is established as a distinct profession and operates relatively independently, but its functions are partially restricted by factors such as corruption and psychological pressure. If one is involved in any kind of trial and does not offer a bribe, it is not certain that one's case will be reviewed on time and according to the law. Trials can be delayed or penalties can be weakened for those who have the means to influence procedure, while ordinary people might be punished more severely. In politically difficult cases, judges may try to avoid involvement in the final judgment. The recent trial against the mayor of the port town of Ventspils, Aivars Lembergs, provides an example of such a case. When the witness, former economic minister Krišjānis Kariņš, was asked during the trial, neither the witness, nor the prosecutor nor the judge gave the answers, but the accused Lembergs himself interfered with examination, resulting in a noisy argument within the court room.

Independent
judiciary

As a rule, corrupt officeholders are prosecuted under established laws, but also slip through political, legal or procedural loopholes. The minister of transport had to resign in March 2006, because he was held responsible for electoral fraud committed during the 2005 local elections in Jurmala. During the transformation period, many privatization cases might have been illegitimate but not illegal due to the advantage of knowledge of former cadres, who became owners. The collapse of Banka Baltija in 1995, which involved the disappearance of 3 million LVL from energy monopoly Latvenergo, has not yet been investigated, and probably never will be. The recent case of the mayor of Ventspils gives rise to hopes that the situation is improving. In 2003, the KNAB (Bureau for the Prevention of Corruption) was established, as recommended by the European Union. As it remains under government supervision, its independence is questionable, but independent observers such as Transparency International have thus far described its outcomes as honorable.

Prosecution of
office abuse

There are no restrictions on civil rights. Individual cases of aggressive behavior were observed in state institutions, namely, the police. State institutions do not treat minorities and non-citizens any differently. Services in Russian are also readily available.

Civil rights

4 | Stability of Democratic Institutions

The ensemble of democratic institutions is mostly effective and efficient. As a rule, political decisions are prepared, made, implemented and reviewed in legitimate procedures by the appropriate authorities. During the transition period, there have been frequent changes in legislation, including the passage of laws that

Performance of
democratic
institutions

are unclear or contradict old laws that are still in effect. The executive has subsequently increased its influence within the legislative process, insofar as the share of government-sponsored bills submitted to the Saeima has grown. The Saeima did not reject any of the laws proposed by the Latvian government during the holidays, thereby conforming to the extraordinary legislative procedure stipulated by Article 81 of the constitution (403, between 1993 and 2007). Some civil servants have had difficulties adopting to these changes and remain influenced by their experience under the former authoritarian regime. Moreover, due to the low wages in state institutions, personnel turnover is high, which creates greater dependence on student employees. Second-year university students have even been known to fill leading positions. This impairs the professionalism of the state institutions.

All relevant political and social players accept democratic institutions as legitimate, although they are limited by corruption and often end up resolving disputes in an informal way.

Commitment to democratic institutions

5 | Political and Social Integration

Between 1993 and 2002, the Latvian party system was characterized by high electoral volatility; recently founded parties won every election. However, the number of truly new actors was small. 2006 was the first year in which no significant newcomers presented candidates and no new party managed to get a mandate. Polarization has always been low in the absence of anti-government parties. The party system is consolidating, but probably will remain fragile, since the main cleavage at present is ethnic in nature. Many citizens married to non-citizens, as well as ethnic non-Latvian citizens who live apart from the Latvian-speaking community, vote for so-called left-wing parties, which in fact represent minority interests. Parliamentary parties are, apart from the successor of the national independence movement, top-down parties founded by politicians who were already active before Latvian independence. These parties have continued to be organizations dominated by the political and economical elite, with a membership of less than 3,000. That means political parties are not rooted in society, but rather represent the economic interests of certain oligarchs. The effective number of parties is 6.0, indicating a highly fragmented party system.

Party system

The number of registered NGOs has been historically high at about 8,000. A new law requesting that NGOs register with the government again by 2006 experienced limited compliance, with less than 3,000 NGOs re-registering. But most interest groups have small memberships, and social and labor NGOs (e.g., trade unions) exercise a weak influence on policy-making due to the economic situation and to people's political passivity. Many small interest groups are actively dealing with problems that concern only a small number of people living

Interest groups

in specific places, and are not involved in nationwide movements.

During the Soviet era, jobs and housing were guaranteed. Many people unfamiliar with democracy and a market economy expected the same safeguards from the new system, but at a higher level of quality, that is, like the West. Now, since living standards have gone down, people are disappointed and blame the new system. An opinion survey conducted in 2005 found that 26.2% of the population favored strong leadership over democracy, 28% rather agreed and 8% had no opinion, leaving only 37.7% satisfied with democracy. Members of different generations responded almost identically; differences in education and income, as well as ethnic background, also showed little effect on the results. However, democracy is accepted, even if this acceptance results from a lack of alternatives rather than conviction.

Consent to
democratic
norms

Self-organization in civil society encompasses all spheres, but especially cultural life, in which many engaged volunteers work. In the political and socioeconomic sphere, actions are often spontaneous and temporary and sometimes contradict democratic principles, such as equal rights for homosexuals. There is relatively low trust among the population.

Associational
activities

II. Market Economy

6 | Level of Socioeconomic Development

Social exclusion is quantitatively and qualitatively pronounced and to some degree structurally ingrained. Access to employment is defined by education and age, which means that the educated elderly in particular experience difficulty in finding jobs. Pensions are very low due to the exclusion of Soviet-era incomes in the current pension system's calculations, as well as the limited benefits for young mothers and for people at or under the age of 24. Given the growth in economic sectors other than industrial production, there is no wonder that people with higher education, especially in foreign languages, have an advantage in the labor market. Interestingly, women account for a large percentage of this skilled population.

Socioeconomic
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	9,315	11,186	13,737	15,826
Growth of GDP	%	6.5	7.2	8.6	10.2
Inflation (CPI)	%	1.9	2.9	6.2	6.8
Unemployment	%	12.0	10.6	10.4	-
Foreign direct investment	% of GDP	2.7	2.7	4.6	4.6
Export growth	%	5.4	5.2	9.4	20.7
Import growth	%	4.7	13.1	16.6	13.5
Current account balance	\$ mn.	-624.6	-920.8	-1773.5	-2001.5
Public debt	\$ mn.	1,123.6	1,238.1	1,580.2	1,318.2
External debt	\$ mn.	6,808.5	8,802.9	12,654.2	14,283.4
External debt service	% of GNI	6.9	8.4	10.2	19.8
Cash surplus or deficit	% of GDP	-1.8	-1.3	-0.9	-0.9
Tax Revenue	% of GDP	13.7	14.1	13.6	15.3
Government consumption	% of GDP	21.0	21.5	19.6	17.7
Public expnd. on edu.	% of GDP	5.8	5.3	-	-
Public expnd. on health	% of GDP	3.2	3.2	4.0	-
R&D expenditure	% of GDP	0.4	0.4	0.4	-
Military expenditure	% of GDP	1.6	1.7	1.7	1.7

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

An institutional framework exists, but is sometimes ignored. The informal sector generally plays a minor role, but there is widespread unofficial work and unofficial income paid by the employer beyond the minimum wage. In a country of only 2.3 million inhabitants, where the people are interconnected through their native villages, schools or universities, contact networks are of central importance, a characteristic that in some ways is a holdover from the Soviet era.

Market-based
competition

Since 1998, the Competition Council has controlled the formation of monopolies and oligopolies, yet privatization in the communications, energy, and transportation sectors is unsatisfactory. The Competition Council adopted 68 resolutions in 2005; 17 merger requests were granted, with two of them subject to special conditions; 15 of 23 investigations of anti-competitive practices were completed and closed; seven cases of collusion resulted in one conviction, and 16 cases of advertising violations resulted in one conviction. Telecommunication, railway and energy networks have not been fully liberalized.

Anti-monopoly
policy

Foreign trade is mostly liberalized, with uniform low tariffs and no fundamental state intervention in free trade. Trade disputes with neighboring Estonia and Lithuania concerning the export and import of foodstuffs were resolved expeditiously. In October 2006, Russia stopped the import of allegedly contaminated Latvian sprats, probably for reasons that politicians and journalists assume have little to do with the actual quality of these imports.

Liberalization of
foreign trade

The banking system was vulnerable to severe fluctuations due to extreme dependence on outside factors and a de facto lack of supervision until a bank crisis in 1995 and the subsequent accession to the European Union. Since then, the institutional foundations are laid for a solid banking system upholding international standards, with functional banking supervision, minimum capital requirements and market discipline. Capital markets are open to domestic and foreign capital, and they demonstrate sufficient resilience to cope with speculative investment. Banks are very dependent on outside money, with debts twice as high as assets on average, and in some cases three or four times higher. The difference is bigger in foreign banks than in domestic banks. This is a clear sign that foreign banks supply money from outside resources, usually foreign banks with Latvian subsidiaries or the IMF.

Banking system

8 | Currency and Price Stability

Inflation and foreign exchange policies are brought into alignment with other goals of economic policy and are institutionalized in a largely independent central bank. While minimizing inflation is an official goal of the government, for the moment neither the government nor the national bank are trying to limit the credit lines of the commercial banks in order to stop foreign money from streaming into the country, which influences inflation by boosting domestic consumption. Another necessary reform involves wage increases for civil servants and clerks in state departments in order to minimize staff turnover. In Latvia, the existence of an independent central bank does not guarantee good performance regarding inflation and foreign exchange, since it has limited possibilities to implement its own inflation and monetary policy. The influx of money facilitates inflation and aggravates trade imbalances (Latvia's imports twice as much as it exports), and

Anti-inflation /
forex policy

most of this activity takes place in the private banking sector, which is not under the direct control of the government and the central bank.

There is a consistent stability policy and the budget deficit has remained close to zero since the 1990s. The problem is that these policies were implemented administratively rather than economically. They were not supported by an economic microsystem (business activities), and therefore did not have a strong economic background. This has caused severe problems in the current economic system. The share of manufacturing in the GDP is just about 12%, and more than 45% of GDP relates to sectors that develop on the basis of money allocation: real estate, trade, banking and construction.

Macrostability

9 | Private Property

The Latvian constitution protects the right to private property. Property rights and the regulation of the acquisition of property are well defined in terms of acquisition, benefits, use and sale; they are limited solely by basic liberal rights, and in special cases problems may occur with jurisdiction.

Property rights

The role of private enterprises as the institutional backbone of the national economy is not questioned, but there are still state companies and strong market concentrations in the form of oligopolies. Concentration of market power is tolerated by the state. For example, the state owns 51% of the communications enterprise Lattelekom, while 49% belongs to the Finnish Sonera. By a law adopted in 2000, the energy market monopoly Latvenergo cannot be separated into different enterprises and/or privatized. At that time, the government of Andris Berzins tried to avoid a referendum initiated by the social democrats against this privatization. The government has tolerated the dominant position of some companies, as it is very difficult to develop economies of scale in a small country without attaining a monopoly or oligopoly position. Private companies are discriminated against in some fields, for instance in education and research.

Private
enterprise

10 | Welfare Regime

Latvia has a state-organized social security system to compensate for social risks, but both protection and financing fall short. Social networks are well developed in part, but do not cover all risks for all strata of the population. Considerable portions of the population are still at risk for poverty. Although the health care system is organized to provide universal coverage, benefits remain minimal. This especially concerns pensioners, who, during the Soviet era, had no opportunity to save money for the funding of their own future. Now the state cannot pay pensions high enough to survive on. By January 2007, 470,902 pensioners had an

Social safety nets

average income of 103.83 LVL (approximately €47). Therefore, the elderly rely on their children for help, while the youth often need the help of the elder generation as well in taking care of grandchildren and working in vegetable and fruit gardens (to save money on groceries). Support for the unemployed does not suffice for survival. Child benefits and family allowances are very modest.

There are institutions to compensate for gross social differences, which cannot be prevented due to the economic situation. But women and/or members of ethnic or religious groups have equal access to higher education and public office. Non-citizens are excluded from the civil service. Discrimination on any grounds is strictly forbidden by law (such as the labor law, legislation on education and others). Access to training and retraining institutions, as well as employment services (consultations, career development services, job seeking services, etc.) are free of charge for all. Many of these services are quite advanced, even by EU standards. In January 2006, amendments to the Law on the National Human Rights Office were adopted, specifically designating the National Human Rights Office as the body responsible for the implementation of the principle of equal treatment. For the moment, thanks to an economy based less on production than on services, women's educations better enable them to get a job. In the public as well as in the private sectors, most clerks are female. The main factor limiting access to education is money, namely, the fees required to attend private schools in Latvia. Moreover, the majority of students in state education institutions also have to pay to attend classes and to graduate. The state and commercial banks extend credit for this purpose. Lastly, there may be physical constraints to participation in society (for instance, poor transportation services), or other financial concerns, such as communication costs.

Equal opportunity

11 | Economic Performance

Growth of per-capita GDP is high, as are employment levels. The budget is more or less balanced, but the lack of price stability will probably prevent Latvia from joining the euro zone until 2012. There are several macroeconomic problems – negative population growth rates, growing negative foreign trade balance, growing negative current account balance (compensated by loans and not so much by FDI), an unhealthy economic structure (about 47% of the economy is based on money flows and related processes – real estate, trade and construction). It is doubtful whether this contradictory situation will lead to economic problems or not, because the Latvian economy is deeply integrated within the EU economic system (if unofficially). EU countries are major trade partners and major sources of FDI, and the majority of foreign banks with branches in Latvia are based in EU countries.

Output strength

12 | Sustainability

Although environmental concerns are not a top priority in Latvia, a considerable amount of legislation has been aligned with the high standards of EU legislation since closing the accession negotiations. Several transitional agreements have been agreed upon and will be in force until 2010. Environmental protection agencies are in place, but their efforts could be better coordinated. The Latvian government continues to actively support international environmental accords, such as the Kyoto Protocol and the Agenda 2005 for the Baltic Sea Region. In the 2005 Environmental Sustainability Index, Latvia is ranked 15 out of 146 countries, showing the best performance of the ten new EU member states. Latvia even sells its domestic unused quota of pollution. Environmental concerns are mostly subordinate to growth efforts, but institutional frameworks do exist, including NGOs, although these have limited influence. Regardless, the economy's concentration on services over production, low population density, and largely non-chemical, subsistence-based agriculture make polluting the country a less important political concern.

Environmental
policy

Environmental protection is less a result of implemented programs than of the economic and societal realities. Environmental protection was one of the key motivations for starting the protest movements at the end of Soviet rule. NGOs nowadays fight against environment-unfriendly projects, such as port and oil transportation facilities, a wood-pulp factory near the river Daugava (a source of drinking water in Riga), and recently the Ignalina nuclear power plant. However, most people think less about these questions; for instance, they take no measures to decrease their output of household garbage.

Both state and private institutions for education, training and research and development are strong and in some cases quite advanced. Revenues for the educational sector have been about 6.5% of the GDP in recent years. Vocational education lags behind, and there are fewer jobs for graduates in the labor market; the younger generation has to study at an institute of higher learning. The number of students is rather high and increasing – 131,000 students in 2005/2006, or 57 students per 1000 citizens. Students in both private and public education institutions must pay for their studies. In 2005/2006, 77.2% of students in higher education institutions (public and private) paid fees. The proportion was even higher in Latvian University (the main state-funded university), where 77.7% of studies required a fee.

Education policy
/ R&D

Higher education institutions are more oriented toward earning money by offering education than toward R&D and the attraction of international funding. In 2005, R&D spending was 0.6% of GDP, of which 34.3% was total enterprise funding for R&D, 46% state funding, and 18.3% funding from foreign countries. The

financing of the education and R&D system increased in 2006. Schools offer vocational education in programs that do not always fit the needs of the local labor market. Some private institutions offer rather questionable education.

Transformation Management

I. Level of Difficulty

The structural constraints on governance are low. First of all, the economic situation after 50 years of Soviet rule is tough; state revenues are low, and therefore the state budget cannot ensure welfare – including social benefits as well as the health care system – on the level people expect. The country also cannot finance the system of higher education, including R&D, especially in technical subjects, up to recommended levels. For the same reason, several necessary reforms cannot be carried out. This affects vocational education, which is not oriented toward the market. Therefore, graduates in technical professions, which would be necessary to develop industrial construction and production, are underrepresented on all levels. The elderly often only have skills from the Soviet-era education system, which no longer have a place in the current labor market. Although there has been some improvement, another problem during the transition period is the unclear division of the state department's competencies due to the necessity of building a new institutional system in order to transform the existing civil service inherited from the Soviet Union. The Soviet legacy has also left behind a widespread fear of dismissal for making mistakes, which is pervasive amongst civil servants and state department clerks. In order to avoid such foibles, they often delay with excuses or simply refuse to make decisions at all.

Structural
constraints

The traditions of civil society are weak. Latvia's development as a nation and as a state was interrupted by foreign rule. Latvia underwent a series of rulers until independence in 1918. Even up to the end of the nineteenth century, higher education was available only in foreign languages, which also prevented the development of a national literature. After the war of independence in 1920, Latvia became an independent liberal-democratic republic, but only for 15 years, when the system was overthrown by authoritarianism. This period was so economically successful for Latvia that people remember it even to the present day. The half-century of Soviet rule was a time of social security. Society is still deeply influenced by communal ideas from the authoritarian era, such as social equality, which was a reality during Soviet rule when passivity was used as protest and safeguard. However, in overthrowing this regime, people showed

Civil society
traditions

civic courage when they dared to participate in forbidden demonstrations. Now, partly due to social questions and partly as a result of mistaken understandings of democracy and a market economy, many people have returned to public passivity now that the new regime has disappointed them. This reaction empowers oligarchs and makes it more difficult to fight corruption, creating a situation that must be described as a self-fulfilling prophecy. People expect the democratic government to fulfill the promises of the socialist rulers. According to the latest Eurobarometer, satisfaction with the current economic and social life situation is particularly low in comparison to European counterparts. Currently, many people are involved in helping their own families, but even those who volunteer in different NGOs largely limit their involvement to the cultural sphere.

Without any doubt, Latvia encompasses two societies, one Latvian and one Russian-speaking, which contain ethnic Russians, Ukrainians, Belarusians and the Polish minority, who all were Russified during the Soviet era. Within these 50 years, multilingual non-Latvians, who were already Latvian residents before the incorporation of Latvia into the Soviet Union, were also alienated from Latvian society. This societal reality is reflected also in the party system, which is less socioeconomic than ethnically oriented. Society and the political elite are modestly polarized along ethnic lines. But there are no really radical political actors, and success in mobilizing ethnic groups has decreased, a trend no doubt due to the growing rate of naturalization. Thus, ethnic cleavages pose no risk of worsening, while the suffering of those in particular social categories – that is, the uneducated and the elderly – will continue to hamper political representation.

Conflict intensity

II. Management Performance

14 | Steering Capability

The political leadership is committed to constitutional democracy and a socially responsible market economy. All governments since 1991 have tried to solve the country's problems, but the authorities have been bound by restrictions on available resources, which are currently insufficient to satisfy the people's expectations, based as they are on the social guarantees of the Soviet era. At the same time, politics during the years since independence have not always been consistent due to the oligarchic structure of the party system and the political elites. The government's policies give long-term goals priority over short-term

Prioritization

expediency. In spite of the rapid succession of governments since 1993, all of them followed the two main goals of joining NATO and the European Union. These policies were successful despite vocal (especially domestic) critics, which regarded both goals as unrealistic.

The government is able to implement many of its reforms effectively. Step by step, all reforms of the transition period towards a market economy and democracy were realized, up to the current necessity of implementing European law (although probably a bit more slowly than in neighboring Estonia). The privatization policies of the biggest enterprises have prevented some branches of the Latvian government from meeting the EU standard. Moreover, the government is carrying out the reforms for the regional territorial reorganization, although at a very slow rate. The present legislation, adopted in the 1990s, asks municipalities to form larger regional units by bringing together several municipalities. Up to now, this is only voluntary.

Implementation

The political leadership has not faced any major failures; however, there have been no opportunities for the leadership to demonstrate its ability for complex learning. The Latvian law on citizenship, adopted in the early 1990s, was criticized internationally, although privatization initiatives have also drawn the criticism of both the population as well as international organizations. In both cases, however, the government acted flexibly and replaced failed policies with innovative ones (i.e., a new legislation on citizenship was established). Changes to energy monopoly Latvenergo are still difficult due to the legislation passed by the government of Andris Berzinsš, which, under public pressure, passed a new energy law in 2000 that allowed the enterprise to remain state-owned by excluding Latvenergo from privatization measures. Also, in the privatization of the telecommunications monopoly Lattelekom, the first government after independence made the mistake of guaranteeing investors that Lattelekom would remain a monopoly, a decision that proved problematic during the negotiations with the European Union. Changing the agreement to open the telecommunication market solved it. The delayed privatization of the Latvian shipping company Latvijas Kugnieciba was successfully completed in 2002, but the ongoing proceedings with Latvenergo may cause problems in the future.

Policy learning

15 | Resource Efficiency

The government uses most available resources efficiently. Recently, the wages of civil servants and clerks in state departments were raised in order to minimize staff turnover, but political frictions also create a great deal of turnover as well. People are accused of corruption, dismissed and returned to office; the director of the Riga city council's department for development, Vilnis Strams, was such a case. Ministers asked to resign as a result of scandals are often re-elected, such as the minister for transport, Ainars Slesers, who was re-elected last autumn and

Efficient use of assets

returned to the same position. There are examples of recruiting procedures based on political influence, such as the four new judges recently nominated for the Constitutional Court. First, in February 2007, the parliamentary commission of law rejected government candidates Viktors Skudra and Kaspars Balodis, as well as the candidate for the highest court, Uldis Kinis. Politicians and lawyers harbor the suspicion that the government is trying to install less critical judges, or at least to slow down the recruiting process. State debt is low and the auditing system functions, but a lack of financing exists on the local level. However, the administrative reforms recommended by the European Union over the last decade have yet to be carried out effectively. Younger people abandon the countryside and small towns due to the lack of jobs. With a few exceptions, both the administration and private business suffer from a lack of qualified personnel; such staffers are critical for EU financing regulations.

Aside from major political goals, politics is often oriented towards short-term results, and specific interests are most strongly represented. Political parties are not rooted in society, but rather identified with their politicians and leaders. All governments since 1993 have been coalitions, most of them with at least three partners. However, conflicts between coalition parties are more about personality clashes than differences in proposed policies. One recent example is the conflict between two big factions in the eighth Saeima. After the breakdown of the minority government of Prime Minister Indulis Emsis in Autumn 2004, which was supported also by the Tautas Party (People's Party), President Vaira Vike-Freiberga said, "it can't be true, that in a parliament composed of more than two-thirds of right-wing party deputies, it is not possible to form a government pressing the two mentioned parties to cooperate." The new coalition continued only until spring 2006, when the New Era named certain frictions as reason to leave the government. For years, one party was called a representative of the transit business and another representing food branches, indicating the degree to which parties and their leaders are perceived as representing special sectoral interests. Moreover, opposition to certain politicians has led entire parties to be excluded from government coalitions for the sole reason that their leading personalities are disliked.

Policy coordination

Corruption is an elusive term in Latvia, since people describe special interest representation and lobbying as corruption. It is a question of definition. Most integrity mechanisms are functioning, albeit with limited effectiveness; the political parties largely represent certain business interests. The establishment of the anti-corruption office KNAB is a real attempt to fight corruption. The office recently criticized the ruling coalition parties for violating party financing laws during their electoral campaigns. Small corruption exists in other sectors, such as the health care system. Due to the low wages of doctors, patients give presents or pay extra money without being asked to do so.

Anti-corruption policy

16 | Consensus-Building

All major political actors agree on building a market-based democracy. Many are disappointed by political performance under the democracy and market economy, especially the elderly. The political passivity of the people is an ideal environment for business interests masquerading as political interests, while opinion surveys document a high percentage of people who believe that a return to authoritarian governance is necessary. Since independence, each general election has been accompanied by the formation of new parties by popular individuals who are regarded by the population as possible saviors of Latvia. This has resulted in a fragile and unpredictable party system.

Consensus on goals

Potential veto actors, such as the military, large landowners, powerful opposition groups and capital oligarchies either do not exist or are oriented in favor of democracy and a market economy. The political and economic elite has no interest in changing the system into an authoritarian government. They are within the democratic consensus and integrated into Latvia's politico-economic system.

Anti-democratic veto actors

The party system is still dominated by the ethnic cleavage between Latvian and Russian-speaking people, although this will certainly decrease with the higher quota of naturalization, and especially the younger generation's identification with Latvia rather than with their ancestors' home country, where they have never lived or perhaps even visited. Ethnic Latvians continue to vote for nationalist parties with more or less economically liberal programs, regardless of possible "social democratic" cultural orientations. So far, poorer people with less education are underrepresented. The social cleavage between the winners and losers of transformation, which has become increasingly apparent in the growing income gap, will not decrease with the GDP growth; however, this may develop into a new societal conflict, which will probably lead to the foundation of a party representing the lower classes or cause an existing party to change its program. But the conflict may simply result in growing political abstention. The parties representing the non-Latvian electorate, which are usually called "leftist" because they are more oriented towards social democratic ideas, have been excluded from coalitions since Latvia gained independence. These parties have also split in recent years into a more radical wing, "For Human Rights in an Integrated Latvia," and a more moderate party, "Harmony Center." One part of this coalition is the Socialist Party of Alfreds Rubiks, who tried to overthrow the Latvian government during the putsch in Moscow in 1991, but other parties do not wish to cooperate with him. Recent announcements of the smaller coalition partner "Latvia First Party" can't be taken seriously, at least for the moment, because it does not have a basis to form a government, and ideological differences are deep.

Cleavage / conflict management

There are procedures established to take civil society actors into account, but civil society's weakness facilitates the government's tendency to ignore it. Mechanisms of societal involvement and consensus-building concern trade unions and business people first and foremost. Some ministries and state institutions have consultants' councils, made up of representatives from society. Social dialogue is institutionalized in Latvia in the National Tripartite Cooperation Council. There is also a requirement to consult society (social partners) in any large development project (local development plans, big construction projects, etc.). Environmental NGOs are active and involved in such projects. However, broad public discussions about major policy decisions are rare. For example, issues such as the necessity of a professional army or how to deal with former members of the secret services do not receive broad public attention. Latvia has remained a very traditional society, and the question of whether to allow the homosexual pride parade has been discussed intensively and from a negative perspective, as catalogued on the website, www.noprider.lv. Other topics of protest that attract wider participation concern social questions, such as the demonstration "we against poverty" (mes prēt nabadzību) in October 2005. Paternalist notions of politics and public disaffection are widespread. As a result, politics is dominated by particularist interests.

Civil society
participation

There is no manifest conflict. Most problems came from abroad, as the Soviet dictatorship was understood as a foreign power and an occupier. Of course there were collaborators and convinced communists from the beginning, including ethnic Latvians, who were installed in the 1940s from Moscow. Some of them, who cooperated, were punished, like the putsch leader Alfreds Rubiks, who spent four years in prison. Everybody who, after a deadline in 1991 was still a member of the communist party was no longer allowed to run for public office, with a lone exception due to EU requests for the European Parliament, where the national law does not apply. This made it possible for Tatjana Zdanoka (Татьяна Жданок) to become a member of parliament in Brussels. The same restriction applies to everyone who worked for the KGB, such as Juris Bojars, the long-time party leader of the social democrats. Currently there is a discussion over whether to publish a list of spies or not. President Vaira Vīķe-Freiberga announced that she is against the publication of a list of spies. She argues that it is difficult to trust the files of the former secret service KGB, since the voluntary character of the cooperation is questionable, and the names of the cadres working in leading positions of the secret service and who hold responsibility for its actions would not be included on this list.

Reconciliation

17 | International Cooperation

As a part of the coalition agreement of November 2006, a new portfolio for special affairs concerning the management of EU finances was established. The ministry of special affairs concerning the European Union stated in February that by the end of 2006, Latvia had applied for 96% of all possible financial resources from the EU structural and cohesion funds for the period 2004. 46 projects valued at a total of €710.7 million were realized, one third of which, €21 million, had to be paid by the Latvian initiators. Latvia's most effective application for resources was in farming, for which it succeeded in committing 99% of the available EU funds. Of the EU regional development funds provided to Latvia, 95% were used in project contracts. Within the pre-accession program for agriculture (SAPARD), Latvia had only been able to use 61% of the available resources for projects. Funds received from public and private foundations, such as EU organizations and the Soros Foundation, are often invested in the education system to provide scholarships to students and financing for R&D.

Effective use of support

The government is considered credible and reliable by the international community. As a member of different international organizations, Latvia adheres to all required norms. Latvia showed its ability to organize an international meeting with the NATO summit in November 2006. Taking advantage of a small nation's possibilities, Latvia began to take part in international NATO missions as soon as it joined, and is currently militarily engaged in four countries. The first international operation to which Latvian soldiers were deployed was the peacekeeping mission to Bosnia and Herzegovina. Latvia has participated in this operation since 1996. Also, from 2000 through June 2006 Latvia had ten soldiers in the NATO operation in Kosovo (Kosovo Forces - KFOR) performing the duties of the Military Police and staff officers. Since 2003 and still as of November 2006 Latvia has 36 soldiers in the NATO operation in Afghanistan (International Security Assistance Forces - ISAF) who neutralize unexploded mines, and perform the functions of field officers and guard units. In the same year, Latvia started to join the operation in Iraq (Operation Iraqi Freedom - OIF), and as of June 2006, 120 Latvian soldiers continue to perform functions of infantry unit and field officers. After joining NATO, Latvia's contribution to international operations increased considerably. By November 2006, 168 Latvian soldiers were participating in different international operations, compared to 97 on average in 2003. Some 7.74 million LVL (about €1.05 million) from the defense budget in 2006 are allocated to this purpose, compared to 2.56 million LVL (about €3.66 million) in 2003. Since July 2006, Latvia has participated with its NAF Unexploded Ordnance Neutralization Team in the NATO Rapid Reaction Force, and starting in January

Credibility

2008, Latvia also will delegate its Military Police Team. In addition, a countermine naval ship will be prepared for participation in the NATO Response Force. Latvia also participated in other international actions, such as the observation of the Organization for Security and Co-operation (OSCE, since 2000) in Europe and in Georgia, where Latvian soldiers operated as international military observers.

Latvia cooperates with neighboring Estonia and Lithuania more for the sake of contact than for the implementation of cooperative policies. The Baltic Assembly had become a solid organization by the end of the 1980s, but after 1989, Latvia's main goal was integration into NATO and the European Union. After 50 years of incorporation into the Soviet Union, shared interests among the Baltic neighbors had never been so high as when all pursued the common goal of independence. As regards the border with Russia, after more than ten years Russia has yet to ratify the treaty, in spite of the fact that Latvia agreed not to request its reunification with the Abrene region, which once belonged to the independent republic of Latvia before it became a part of the Russian republic within the Soviet Union after World War Two. Currently, the lineup of trucks at the border, which is a result of Russia's inefficient dispatching, is a point of local discord. The problem is compounded by the large number of trucks entering Latvia from Lithuania to avoid transit through Belarus. Relations with Belarus began to deteriorate after foreign minister Artis Pabriks began pushing for democratic reforms.

Regional cooperation

Strategic Outlook

Though the state of democratization was either satisfactory or good throughout 2006, there are clear shortcomings in political transformation that need to be given top priority by the Latvian government. These include the citizenry's low level of political participation and the widespread corruption that plagues political life, obstructs the rule of law and hampers the economy. The situation will improve only with rising income levels and the development of a robust democratic political culture.

Macroeconomic data show clear, solid development in recent years. However, this trend cannot sustain itself, since it is based on domestic consumption financed by foreign capital through the credit policies of commercial banks. The Latvian government must therefore promote production, which is a safer foundation for economic growth. Emphasizing the importance of vocational education would facilitate this shift. In general, Latvia should maintain its market-oriented policy and continue with the reform process. As its integration into the European market continues, Latvia should focus on its announced aim of becoming member of the European Monetary Union and concentrate on the reduction of its inflation rate and foreign trade deficit. Commercial banks should support these attempts by changing their politics of cheap credit. Joining the euro zone has already been postponed to 2012. The aforementioned rapid development has benefited only parts of the Latvian population. While socioeconomic indicators suggest improvement, the current government should ensure just and sustainable funding to restructure large sectors of social security, particularly the health care system.

For the moment, the emigration of workers is a growing problem for the local economy as it has decimated the domestic labor force. The level of emigration will probably not rise as people with higher education increasingly eschew work in low-skill jobs abroad. Despite the relatively small number of emigrants with the required knowledge and language skills to work in state institutions, deficiencies still may occur in state institutions due to the continued labor turnover, which in turn results in persistent bureaucratic inefficiency and a lack of coordination among various agencies. Politically, Latvia differs from its neighboring Baltic countries by having a party system with an ethnic rather than a socioeconomic orientation. Nevertheless, the Latvian party system's stability improved in 2006. Changes in legislation and a growing interest in naturalization will lead eventually to a decrease in the number of non-citizens and the decline in relevance of the ethnic question.

Finally, transformation success in Latvia will depend on how well the government can ensure the necessary welfare for the people in order to maintain legitimacy for democratic rule. Education and experience can help to correct misconceptions about how a market-based democracy functions and thus, by association, help counteract discontent with the new system. If left unchecked, however, this dissatisfaction could be mobilized in support of authoritarianism. Since the elites are not interested in overthrowing the current regime, however, such a political alternative does not yet exist.