

# BTI 2016 | Latvia Country Report

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	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2016. It covers the period from 1 February 2013 to 31 January 2015. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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## Key Indicators

Population	M	2.0	HDI	0.810	GDP p.c., PPP \$	23337.4
Pop. growth <sup>1</sup>	% p.a.	-1.1	HDI rank of 187	48	Gini Index	35.5
Life expectancy	years	74.0	UN Education Index	0.813	Poverty <sup>3</sup>	% 0.0
Urban population	%	67.4	Gender inequality <sup>2</sup>	0.222	Aid per capita	\$ -

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | UNDP, Human Development Report 2014. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.10 a day at 2011 international prices.

## Executive Summary

While the rate of economic growth remained negligible in much of the European Union, Latvia's economy expanded rapidly after 2013. However, the rate of economic growth gradually declined after tit-for-tat economic sanctions between the West and Russia began to take effect. By 2014, the economy was close to stagnating. These tit-for-tat economic sanctions began after the West imposed a series of economic sanctions on Russia following Russia's annexation of Crimea in 2014. Social and economic consolidation has characterized recent domestic politics, following the introduction of severe austerity policies between 2008 and 2011. However, the salience of Latvia's integration into the European Union, among other international organizations, increased following Russia's actions in Crimea and eastern Ukraine. The West is increasingly perceived within Latvia as an important security and military protection. In 2015, Latvia's involvement in European policy-making increased when it took on the presidency of the Council of the European Union for the first time.

The severity of the austerity program introduced between 2008 and 2010 increased tax revenues and dramatically cut public expenditure. This enabled the government to achieve a respectable budget deficit of around 1% of GDP. It also had the secondary effect of increasing exports and attracting more FDI. Another sign of increased confidence in the economy was the adoption of the euro on 1 January 2014. The real estate market also returned to growth and a number of long-term construction projects resumed. However, rising real estate prices, driven by temporary visa residents purchasing real estate, has led to fears of a property bubble.

Prime Minister Valdis Dombrovskis resigned in late 2013, after a supermarket roof in Riga collapsed killing 54 people. In January 2014, the former Minister of Agriculture, Laimdota Straujuma, was elected Dombrovskis' successor. Following the October 2014 parliamentary elections, Straujuma was returned to the government. Dombrovskis was appointed a Vice-President of the European Commission in the autumn of 2014.

Despite high hopes, following the 2011 parliamentary election, there have been few substantial changes to domestic politics. The 2011 election promised a new era of democracy in Latvia. The parliamentary election had been called following a referendum that recalled parliament. The referendum had been initiated by the former president, Valdis Zatlers, to purge Latvian politics of the three oligarchs who, he claimed, endangered the fundamentals of democracy. In the referendum, the electorate voted to recall of parliament. Then, in the September 2011 parliamentary elections, two of the three political parties controlled by the oligarchs failed to gain any seats in parliament, while the third party (Union of Greens and Farmers) was relegated to the opposition. Despite the electorate's rejection of the oligarchs in 2011, the Union of Greens and Farmers returned to power in January 2014. The Union of Greens and Farmers then further expanded its share of the vote in the October 2014. The eponymously named Zatlers Reform Party also failed to reform the political party system. Indeed, it simply highlighted the fundamental challenges that plague Latvia's political parties, namely a lack of any coherent policy agenda and an inability to unify disparate interests. The Zatlers Reform Party quickly imploded, with six of the party's 22 elected deputies defecting to other parties even before the first parliamentary sitting. Then, after an attempt to coalesce with the Russophone Harmony Center, public support for the party collapsed. Despite a renaming of party, now the Reform Party, it has effectively folded. In the 2014 parliamentary election, the party entered into an electoral pact with its governing coalition partner, Unity. Overall, the 2014 parliamentary election represented a return to the norm, as two newly created parties won seats in parliament on the back of the electoral appeal of their charismatic leaders. In terms of policy, no major structural reforms or policy developments have been introduced during the period under review. The Cross-Sectoral Coordination Center has done little to coordinate cross-ministry policy-making.

Change is more likely to be driven by external threats than by domestic politics. The perceived military threat posed by Russia has led to a rapid increase in military expenditure and a restructuring of the armed forces. Economic sanctions imposed by Russia on western economies has pushed Latvian businesses to enter more stable European markets.

## History and Characteristics of Transformation

The Latvian territories have been a part of the Swedish, Polish, and Russian empires. However, throughout these different eras of empire the effective governors of Latvia remained the Baltic Germans, who had first conquered Latvian territory in crusades against the pagans of Northern Europe in the early thirteenth century.

The modern Latvian nation emerged in the mid-nineteenth century as a result of Tsarist peasant emancipation, urban industrialization and the subsequent emergence of an educated Latvian middle-class. Independent Latvia emerged in the aftermath of the First World War, as the Russian empire collapsed, and new countries formed all across eastern and central Europe. The new Latvian state adopted a parliamentary constitution in 1922. However, this failed to provide

stability, with 13 government coalitions holding power between 1922 and 1934. This political instability, accompanied by an economic downturn in the early 1930s, led to a peaceful coup in 1934, and the benign dictatorship of Karlis Ulmanis. He had been the dominant figure of inter-war Latvia, having served as Latvia's first prime minister and as the head of the committee that declared Latvia's independence in 1918. These years of dictatorship are remembered with great popular affection largely because of the brutality and violence of the following Soviet and German occupations during the Second World War, and Latvia's subsequent forced annexation into the Soviet Union.

Soviet occupation after 1945 saw the collectivization of agriculture, an increased pace of industrialization and sharp demographic change. The large German and Jewish minorities had virtually disappeared as a result of the holocaust and the dislocations of the Second World War, while many Latvians (largely the middle class elite) fled west or were deported to Siberia. The post-1945 era saw a large influx of Russian-speakers. The Soviet regime floundered in the 1980s as falling energy prices threatened economic stability, and the democratic reforms of Mikhail Gorbachev allowed the forces of Latvian nationalism to organize and compete in free elections. Three major factions emerged in the late 1980s: the radical nationalists of the Latvian National Independence Movement, the more moderate and inclusive Latvian Popular Front (LPF) and the anti-reform Interfront movement. The Interfront movement was an amalgamation of pro-Soviet forces primarily composed of ethnic Russian Latvian Communist Party members and Soviet officers who had settled in Latvia after their retirement. The contemporary Latvian party system still largely reflects this order, with radical Latvian nationalist, moderate centrist nationalist and left-leaning pro-Russian-speaker parties in the Latvian parliament. The LPF won a majority in the 1989 elections to the USSR Congress of People's Deputies and in the 1990 elections to the Latvian Supreme Soviet, which then voted to restore independence in May 1990. The May 1990 vote led to the establishment of parallel Latvian and Soviet government structures. De facto independence was achieved following the failed August 1991 anti-Gorbachev coup in Moscow.

At this point Latvia faced a radical political and economic transition. The political transition to a multi-party democracy began with the re-adoption of the 1922 constitution and the first post-Soviet parliamentary elections in 1993. Since then Latvia has had seven parliamentary elections, all of which have been judged as free and fair by international observers. However, Latvia's extreme multi-party system has meant that government stability has been hard to achieve. On average, governments have lasted one year in office. Other major political challenges have included negotiations over the withdrawal of Russian forces from Latvian territory (with an agreement reached in 1994), internationally acceptable rules on the naturalization of Russian-speaking Soviet-era immigrants and accession to the major Euro-Atlantic organizations (Latvia joined the European Union and NATO in 2004).

The implementation of economic reforms proved to be equally challenging. Many of Latvia's largest industrial enterprises, such as the electronics manufacturer VEF and the minibus producer RAF, went bankrupt, while others were privatized or returned to previous owners. Unemployment was high in the early 1990s, and the quality of public services fell as government receipts collapsed. Two currency reforms (first instituting the Latvian ruble, then the Latvian lat) and

rampant inflation in the early 1990s, as well as the collapse of several commercial banks in the mid-1990s, wiped out people's savings. However, the mid-2000s saw Latvia experience rapid economic growth, albeit primarily as a result of a construction and consumer-spending boom funded by cheap credit. The Latvian economy fell back to earth in late 2008, and the government turned to an IMF led international consortium for a financial bailout. A dramatic recession – the deepest in the world – followed, with Latvia experiencing a cumulative GDP decline of 23.9%. Modest economic growth resumed following the stabilization of the economy in 2010. In October 2010, the Latvian electorate surprisingly voted to return the Valdis Dombrovskis government – which had undertaken the sharp cuts in spending in 2009, 2010 and 2011 – to power. Dombrovskis returned to power after the early election of September 2011, called after the former president, Valdis Zatlers, complained that parliament was controlled by a number of oligarchs that threatened the very basis of democracy in Latvia. The subsequent election saw two of the three parties controlled by the oligarchs' collapse, while the third party was pushed into opposition.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

Question  
Score

The state has a monopoly on the use of force. There is no serious domestic challenge to the current democratic regime. However, Russia is increasingly perceived as an international threat, because of its annexation of Crimea in 2014, increasingly belligerent rhetoric and violation of Latvian territory for military maneuvers. In response, the Latvian government has increased military spending, placed the military under a higher state of readiness and also welcomed military forces from NATO member states, including the United States.

Monopoly on the  
use of force  
10

The territories that form Latvia, particularly the eastern Latgale region, have long had a multi-ethnic character. However, the dislocations of the Second World War and the russification policies of the Soviet Union fundamentally changed Latvia's demographic composition. These dislocations included the loss of hundreds of thousands of Latvian citizens under the Second World War, either through death, western migration or eastern deportation, as well as the inward migration of some 700,000 Russian-speakers, equivalent to a third of the Latvian population, during the Soviet era. The 1989 Soviet census of the Latvian SSR revealed that Latvians made up just 52% of the republic's population.

State identity  
8

In reaction, the 1994 citizenship law denied automatic citizenship to the 700,000 Russian speakers who had moved to Latvia during the Soviet era.

External pressure from the EU, NATO, Council of Europe and other western international organizations led to a loosening of the citizenship law. By the late 1990s, anyone meeting the residency and Latvian language knowledge criteria could be naturalized. There was a sharp increase in naturalization after accession to the EU. In 2004, 16,064 people were naturalized, with a further 19,169 people in 2005 and 16,439 people in 2006. However, the annual number of people being naturalized has since fallen with 1,732 people naturalized in 2013. In April 2014, Latvia still had 283,000 resident non-citizens in a population of 2 million people. Of these resident

non-citizens, 66% were ethnic Russians, 14% Belarusians and 10% Ukrainian. These non-citizens are ineligible to vote in national, local or European elections. They are also barred from holding certain public posts, but otherwise enjoy full economic and social rights and protections.

Little progress has been made in integrating Russian speakers. Latvians and Russian-speakers live in two distinct communities, with different newspapers, TV shows, radio channels and social media. As a reaction to the 2014 crisis in Ukraine, Latvian public television and radio increased the number of Russian-language current affairs broadcasts. There has been an extensive public discussion about the creation of a Russian-language radio channel for the Russophone eastern Latgale region of Latvia.

Political parties are also aligned along ethnic cleavages. In 2012, a public referendum rejected the possibility of adopting Russian as a second official language. This further polarized ethnic cleavages between Latvians and Russian speakers.

There are no political parties in parliament with explicit links to the church. In the mid-2000s, the First Party, which has subsequently disbanded, cultivated links with religious leaders and increased state support for churches. It also used in public discourse language adopted from prominent church leaders to criticize the encroachment of “liberal western” ideas, such as the increasing tendency among western European countries to legally recognize same-sex marriages. In response to this particular debate, parliament adopted a constitutional amendment, which explicitly defined marriage as being between a man and a woman. In late 2014, Latvia’s Foreign Minister Edgars Rinkevics publicly announced that he was gay and called for legislators to discuss the constitutional ban on same-sex marriage. He was roundly criticized by Lutheran, Catholic and Orthodox - the three leading denominations in Latvia - church leaders. Attempts to discuss introducing limited rights for people living in unregistered (whether same-sex or opposite-sex) relationships have been criticized for undermining the institution of marriage. The influence of religious dogma is also evident in the ongoing attempts of the pro-life movement to limit the right to abortion. In 2012, several NGOs publicly announced that they would no longer participate in a Parliamentary Committee on Demography working group, which was discussing policies that would decrease the number of abortions in Latvia. The NGOs protested against the disproportionate consideration given to pro-life arguments. Socially conservative parliamentarians from the National Alliance appear to have close contacts with religious pro-life groups. However, these relationships develop on an ad hoc basis. Overall, religious groups operate outside the political system and no longer have the same privileged access to power.

No interference of religious dogmas

10

The severe economic recession of 2008 to 2010 as well as continued demographic decline have resulted in reforms to the provision of education and healthcare as well as law enforcement. These reforms particularly targeted the provision of public services in isolated and sparsely populated rural regions. Nevertheless, the state continues to provide core services. Latvia's increased access to structural, cohesion and social funds, following its accession to the European Union in 2004, has ensured that the country's physical infrastructure has continued to be upgraded.

Basic  
administration  
10

## 2 | Political Participation

Latvia has had eight parliamentary elections since regaining independence in 1991. One of the eight was an early election - called in September 2011 - following a July referendum on the recall of parliament. The referendum had been initiated by the former president, Valdis Zatlers. Elections in Latvia are observed by international monitoring organizations and all recent elections have been adjudged free and fair in terms of their management and accessibility. The Latvian Central Election Commission is a non-partisan institution, which manages Latvian elections.

Free and fair  
elections  
9

The most recent parliamentary election was held in October 2014. Six of the competing 13 parties passed the 5% threshold and won seats in the parliament. As was the case with the 2011 election, the resulting government coalition comprised the three ethnic Latvian parties, which had held office before the election. However, the coalition excluded Harmony, Latvia's social democratic party, which had previously been the Harmony Centre alliance. Harmony won the most seats in the 100-seat legislature. It is the largest political party that claims to represent Russian speakers. Harmony was excluded from the coalition for reasons of ideology (the coalition is nominally center-right) and ethnic/foreign policy (Harmony is marginally more cooperative toward Russia and Russia's ruling United Russia party).

Media access remains a concern. Ownership of the majority of both the Russian-speaking and Latvian printed press is opaque, leading to concerns of biased reporting and "hidden advertising." Recent legislative changes, which limit party access to paid-for TV and radio advertising in the month before a parliamentary election, have increased the relevance of the printed media. Previously, the relevance of the printed media had been declining. However, there is no evidence that the media has had a key role in influencing electoral outcomes.

The 2014 parliamentary election result was challenged by Harmony following a vote-buying scandal, which emerged the day after the election. Dzintars Zakis, the Chief Whip of Unity, the largest coalition party, was accused of being involved in a scheme to buy votes for cash. Investigation is ongoing on alleged buying of votes linked to several candidates from several political parties. Latvia's Administrative High Court eventually ruled that there had indeed been irregularities in voting across several Latvian regions, but that these irregularities were not so significant that a new election was necessary.

The first two decades of Latvia's post-communist democracy were dogged by concerns that a group of wealthy "oligarchs" dominated Latvia's political system. Indeed, the 2011 referendum on the recall of parliament was called by the former president, Valdis Zatlers, in order to challenge the influence of the oligarchs. The resulting election saw two of the three political parties, which represented the interests of the oligarchs, collapse. However, the Union of Greens and Farmers was re-elected and returned to government in early 2014. The Union of Greens and Farmers is a political vehicle for the influential Mayor of Ventspils, Aivars Lembergs.

Effective power to govern

9

Since 1991, governments have always been composed of multi-party coalitions, which has restricted the influence of potential veto-players.

There are no formal restrictions on association or assembly. Generally, there are few political demonstrations or trade union protests. However, a few, large-scale, heavily policed public gatherings are held every spring. These include: the 16 March rally for Latvian Waffen-SS veterans and a counter demonstration by Russophone "anti-fascists;" the 9 May World War Two victory celebrations, which is the main annual public rally of Russophones in Latvia; and gay pride in late spring, which now rotates annually between Riga in Latvia, Tallinn in Estonia and Vilnius in Lithuania. The Riga local authority has previously attempted to ban the gay pride and Latvian Waffen-SS parades, but the courts have overturned these bans.

Association / assembly rights

10

Article 100 of the Latvian constitution guarantees freedom of expression. The Constitutional Court, Latvia's highest court, has actively enforced freedom of expression.

Freedom of expression

8

However, in 2014, the National Electronic Mass Media Council temporarily suspended Rossiya RTR broadcasts, a Russian public television station, following Russia's annexation of Crimea. Rossiya RTR was accused of "justifying military aggression against a sovereign state." An accusation that violated the Electronic Mass Media Law's ban on "incitement to war or the initiation of a military conflict."

The National Electronic Mass Media Council, which supervises electronic media, is a politicized organization. It is elected by parliament and made up of representatives from political parties.

Although private media ownership is largely opaque, a wider range of opinions are represented in the media. Popular news websites promote lively political commentary and culture of public debate. Although this can occasionally spill over into a vitriolic argument.

### 3 | Rule of Law

The Latvian political system has a clear separation of powers. The parliament, in a secret vote, elects the state president for a period of four years. The fragmented nature of the parliament limits its capacity to effectively scrutinize government policies and enabled the election of independent presidential candidates. Only Guntis Ulmanis, Latvia's first president after independence in 1991, was a member of a political party at the time of his election. Although Andris Berzins, elected in 2011, was a parliamentary deputy for the Union of Greens and Farmers at the time of his election, he was not a member of the party. Indeed, all presidents in the modern era have acted independently and have occasionally challenged or returned laws to parliament, within Latvia's framework of laws. The most significant use of executive presidential power was in May 2011 when the former president, Valdis Zatlers, triggered a referendum on the recall of parliament.

Separation of  
powers

9

The political executive is the Cabinet of Ministers. It has grown in power as political parties have created more effective party organizations and tightened internal discipline. However, Latvia has a fragmented system of cabinet government, which divides power between the coalition parties. The prime minister is a much weaker figure than in other European democracies, effectively controlling only their own party's ministerial portfolios. Other coalition parties are able to maintain effective control of their own ministerial fiefdoms. While the prime minister can dismiss a minister from the cabinet, this may trigger the collapse of the government. Since 1993, cabinets have held office on average for approximately 12 months.

The Constitutional Court remains an important check on both the executive and legislature, returning laws when it adjudges them to be unconstitutional.

The judiciary in Latvia is formally independent, and is certainly a distinct profession and differentiated organization. However, the de-facto independence of the judiciary is compromised by widespread perceptions of judicial corruption. For example, in November 2014, the Latvian Corruption Combating and Prevention Bureau raided the offices of two Riga District Court judges who were subsequently suspended from office. The frequency of such cases undermines public trust in the judiciary.

Independent  
judiciary

8

The election of Vineta Muizniece, a parliamentary deputy who had no previous experience as a judge or legal scholar, to the Constitutional Court by parliament raised concerns that the Constitutional Court was becoming politicized. Muizniece was subsequently suspended from the post after having been found guilty of forging parliamentary documents. In June 2014, having exhausted her right to appeal, she was forced to resign from the court. Her replacement by Ineta Ziemele, a respected Latvian judge at the European Court of Human Rights, is an attempt to depoliticize the Constitutional Court.

In 2002, Latvia created a specialized anti-corruption institution, the Corruption Prevention and Combating Bureau (KNAB). KNAB is responsible for tackling political and administrative corruption. It is under the direct supervision of the Cabinet of Ministers and its director is elected by parliament.

Prosecution of  
office abuse

7

In 2013, KNAB opened 33 cases, including bribery within local municipalities, and customs and tax authority offices as well as money laundering and the misuse of office by District and Regional Court justices. However, the number of public officials convicted of corruption is decreasing. In 2013, 20 public officials were convicted, the lowest number of convictions since 2004. Meanwhile the number of public officials prosecuted for corruption is also decreasing, which indicates a decline in the complexity of cases going to court.

KNAB has consistently been weakened by ongoing feuds between its political leadership. Jaroslavs Strelcenoks, director of KNAB since 2011, has fired his deputy, Juta Strike, three times. However, Strike has been re-appointed by a combination of courts and the Cabinet of Ministers. This lack of cohesion within the leadership of KNAB has hampered the organization's ability to investigate major cases. The political commitment to fighting and preventing corruption was in question also when politicians in the 2014 pre-election debates threw out ideas to divide KNAB into separate branches to operate within other existing institutions (e.g. controlling finances of political parties within the State Auditor's office).

Aivars Lembergs has been Mayor of Ventspils, a wealthy trading hub, since the late 1980s. He was first charged with bribery, money laundering and abuse of power in 2006. However, the case against Lembergs has been repeatedly delayed due to issues such as the poor health. As of early 2015, the case remains ongoing.

Overall, while anti-corruption authorities have been largely successful in tackling administrative corruption, they have been largely unsuccessful in tackling high-level political corruption.

Citizens have recourse to both a national Ombudsman and European Ombudsman. The national Ombudsman is elected by parliament for a five term. Since the creation of a national Ombudsman in 2007, the Ombudsman's Office has emerged as a powerful voice for group grievances in Latvia. It has regularly defended the rights of ethnic minorities, such as Roma, as well as socially disadvantaged groups, such as pensioners and the poor.

Civil rights

9

In addition, the Constitutional Court ensures that laws and administrative practices do not conflict with the constitution. It has also overturned several major laws passed by parliament. For example, following the government's 2009 austerity program, the Constitutional Court returned a law that would have cut pensions.

Latvia has no formal restrictions on the civil rights of women, religious groups or ethnic groups. However, gay rights issues continue to mobilize radical anti-gay movements, including radical right activists and mainstream churches. In 2005, parliament passed a constitutional amendment banning same-sex marriage. This amendment received strong political support and is unlikely to be reversed in the immediate future. Although the issue was again debated following the announcement by Foreign Minister Edgars Rinkevics that he was gay. Increased tensions with Russia, following the annexation of Crimea in 2014, have not led to any increase in ethnic discrimination or violence.

#### 4 | Stability of Democratic Institutions

Over the last quarter-century, Latvia's democratic institutions have withstood a number of severe tests, including an economic collapse in the early 1990s and the introduction of severe austerity measures between 2008 and 2010. Nevertheless, the parliament, executive, bureaucracy and judiciary continue to operate. The balance of powers between these institutions is evident in the regular review and rejection of laws by the Constitutional Court.

Moreover, accession to the European Union in 2004 has increased opportunities for social partners and interest groups to participate in the policy-making process. In January 2015, the Minister of Justice returned a draft law on the media to the working group stage, after complaints from the media that they had not been sufficiently consulted on the legislative changes.

Latvia's democratic institutions recognize the democratic legitimacy of other institutional actors. However, two weaknesses remain. First, while mechanisms for the formal participation of civil society organizations in the policy-making process exist, civil society organizations have small membership bases and relatively little financing (with the exception of business associations). Although there are signs that public participation in and the funding of civil society organizations is increasing. Second, political parties, which claim to represent the interests of Russian speakers, continue to be excluded from governing coalitions. Although Harmony, the largest party in parliament that claims to represent Russian speakers, has controlled the municipal government of capital city, Riga, since 2009. However, the exclusion of these parties from governing coalitions can be explained by the incompatibility of social and economic programs as much as by ethnic prejudice.

Very few extremist political actors have emerged out of the Russophone community. However, the Latvian Security Police (DP) has stated that there is a risk of the radicalization of Latvian Russophones, with some dozen Latvian nationals having fought in eastern Ukraine. The DP is tracking these individuals and there appears to be little evidence of a widespread radicalization among the Russophone community.

Performance of  
democratic  
institutions  
10

Commitment to  
democratic  
institutions  
10

## 5 | Political and Social Integration

Most political parties in Latvia have shallow social roots, though the 2000s has seen an institutionalization of political parties.

Party system  
6

Of the six parties elected to the parliament in October 2014, only the National Alliance and Harmony could claim to represent a particular constituency. In both cases, this is an ethnic demographic. The National Alliance has its roots in Latvian nationalism and emerged in the independence movement of the late-1980s. Harmony dominates Russophone politics. More recently, it has unsuccessfully attempted to expand its electoral appeal by adopting social democratic rhetoric. However, Harmony remains an ethnically, rather than ideologically, rooted party. In addition, Latvian parties are divided by differing attitudes to corruption. A group of “purifier” parties have based their public appeal on limiting the influence of oligarchs and tackling corruption. This group includes the older Unity party as well as newer parties, such as From My Heart for Latvia and the Regional Alliance. An opposing group, which includes the Union of Greens and Farmers, claim that allegations of corruption are overstated. They advocate that instead of focusing on allegations of corruption, the government should concentrate on promoting economic growth and technocratic management.

Membership of political parties is limited, with around 1% of eligible voters registered as party members. This is the lowest percentage in the European Union.

As a result, parties have weak social roots and voter volatility remains high. Two of the six parties represented in parliament since 2014 are new parties. Although these two parties together account for only 15 out of the 100 seats in parliament.

Government coalitions are defined along ethnic lines, with Russophone parties consistently being in opposition. The only Russophone party currently represented in parliament is Harmony. This polarization along ethnic lines has increased since the annexation of Crimea by Russia in 2014.

Interests in Latvia are represented through a combination of both corporate and pluralist institutions.

Interest groups  
7

Latvia has a National Tripartite Council. Although it is rarely convened and, when it has (e.g. during antagonistic discussions on introducing austerity measures in 2008 and 2009), its members complain that it is largely ignored by government. Organized interests are increasingly represented in ministerial and parliamentary working groups.

Interests groups can also legally influence the policy-making process through private donations to political parties. Business interests are far stronger than trade union

interests, because industrialized labor lacks a political party (e.g. a genuine social democratic or labor party) to represent its interests in parliament.

Public demonstrations are relatively rare with many Latvians having chosen “exit” the state, rather than “voice” their protests. This exit has largely taken the form of migration to, for example, the UK and Ireland, and increasingly to the Nordic states and Germany.

According to a Eurobarometer survey conducted in 2014, 47% of respondents declared their satisfaction with the way democracy worked in Latvia, three percentage points less than the EU average. Trust in national political institutions has steadily increased as Latvia has recovered since the economic recession of 2008 to 2010. Furthermore, 28% respondents indicated that they trust the government, compared to an EU average of 29%, which is an increase from 17% in 2012. Meanwhile, 22% of respondents indicated that they trust parliament, compared to an EU average of 30%, an increase from just 12% in 2012.

Approval of  
democracy  
8

The development of social capital is a work in progress. Deep divisions between ethnic Latvians and Russophones will likely continue for the foreseeable future due to an ethnically divided education and political systems as well as media. Russia’s annexation of Crimea in 2014 has only deepened this division.

Social capital  
7

Latvia has a tradition of public participation in cultural associations, such as choirs, folk dance groups and sporting clubs. However, there are few politically oriented interest groups, because there is no tradition of donating financial or time resources to good causes. Trust in non-governmental organizations among respondents to public opinion polls increased from 20% in 2011 to 34% in 2014. Meanwhile, 32% respondents in 2014 indicated they trust trade unions. Public participation in national events is increasing, such as the annual cleanup day (“liela talka”). These events may prove to be the catalyst for greater civil society activity.

At the same time, however, these public opinion polls indicate that participation in autonomous, self-organized groups has declined over the last decade. In 2004, 8.3% of respondents participated in some artistic activity (e.g. choir, folk dancing, art group). However, this had fallen to 4.3% of respondents by 2013. Similarly, membership in youth groups fell from 4.6% in 2004 to 1.5% in 2013. Participation in NGOs that assist disadvantaged people fell from 2.5% in 2004 to 0.6% in 2013. Indeed, the percentage of respondents who claim that they do not participate in anything increased from 61.9% in 2004 to 71.7% in 2013.

Many media outlets rely on the expertise of civil society organizations. However, the Independent Morning Newspaper, a Latvian language daily newspaper, is increasingly skeptical of civil society and any organization or individual associated with the Soros Foundation Latvia. Almost every major NGO in Latvia has received financing from Soros.

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Question  
Score

Socioeconomic  
barriers  
7

The economic crisis of 2008 to 2010 and the accompanying austerity program have significantly increased economic inequality and poverty. According to the HDI, Latvia ranked 39 in 2008, but ranked 48 out of 187 countries in 2013. Moreover, while economic growth returned after 2010, successive governments have done little to tackle economic inequality. According to Eurostat, Gini coefficient for Latvia was 35.5% in 2014. This indicates that Latvia has the highest level of income inequality within the EU. Indeed, both the International Monetary Fund (IMF) and the European Commission criticized the excessive austerity measures proposed in the government's 2013 budget. These measures included cuts to social security benefits, including the guaranteed minimum income.

Those at greatest risk of poverty include rural communities (especially in the eastern Latgale region, which borders Russia and Belarus), pensioners (particularly pensioners who retired during the Soviet era), families with more than two children and low-skilled workers (i.e. the proportion of the workforce most likely to be made unemployed following the 2008 economic downturn). Rapid rural depopulation has reduced employment opportunities in rural areas, because fewer new enterprises will be attracted to rural regions as the available labor force reduces.

Poor employment opportunities and a weak social security system led to an increase in migration to Western Europe, particularly after the 2008 economic recession. The most reliable estimates indicate that between 150,000 and 200,000 people (i.e. 10% of the total population) have emigrated over the last decade.

The Foreign Ministry has created a "diaspora program" to maintain links with the growing Latvian émigré community. Meanwhile, the Ministry of Economy in 2013 created an action plan to encourage émigrés to return. However, estimates indicate that only 20% of émigrés plan to return in the short to medium term.

Economic indicators		2005	2010	2013	2014
GDP	\$ M	17091.4	23868.6	30908.8	<b>31920.8</b>
GDP growth	%	10.2	-2.9	4.2	<b>2.4</b>
Inflation (CPI)	%	6.7	-1.1	0.0	<b>0.6</b>
Unemployment	%	8.9	18.7	11.1	-
Foreign direct investment	% of GDP	4.7	1.8	3.2	<b>2.4</b>
Export growth	%	23.5	13.4	1.4	<b>2.2</b>
Import growth	%	16.9	12.4	-0.2	<b>1.6</b>
Current account balance	\$ M	-1987.5	563.4	-717.6	<b>-1004.4</b>
Public debt	% of GDP	11.2	39.8	35.2	<b>37.8</b>
External debt	\$ M	-	-	-	-
Total debt service	\$ M	-	-	-	-
Cash surplus or deficit	% of GDP	-0.6	-4.8	-	-
Tax revenue	% of GDP	9.9	9.0	-	-
Government consumption	% of GDP	19.1	19.2	18.3	<b>18.3</b>
Public expnd. on education	% of GDP	-	5.0	-	-
Public expnd. on health	% of GDP	3.6	3.9	3.5	-
R&D expenditure	% of GDP	0.56	0.60	-	-
Military expenditure	% of GDP	1.6	1.1	0.9	<b>0.9</b>

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | International Monetary Fund (IMF), World Economic Outlook, October 2015 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2015.

## 7 | Organization of the Market and Competition

Latvia has been a member of the European Union since 2004 and the World Trade Organization since 1998. In 2014, Latvia began negotiations to join the OECD. Membership of these organizations underpins the regulation and enforcement of market competition. Prices are fully liberalized, and Latvia adopted the euro in January 2014. Latvia fully complies with international rules defining the equal treatment of companies. On average, establishing a business takes of 12.5 days, four procedures and 3.6% of Latvia's per capita income (Doing Business Report 2015). The shadow economy and widespread use of "envelope" salaries (i.e. cash, non-taxed salaries) undermines fair competition between enterprises. The Stockholm School of Economics in Riga estimated that the shadow economy equated to 23.8% of GDP in 2013.

Market-based  
competition  
8

As an EU member state, Latvia is regulated by EU competition authorities as well as national authorities. In 2013, the Latvian Competition Council resolved 40 cases and issued over €5 million in fines. In January 2015, the Council fined a cartel of Volkswagen dealers €7.6 million for coordinating their public and private procurement bidding strategies over the last five years. While the electricity market has been fully liberalized, the distribution of natural gas continues to be controlled by one supplier, Latvijas Gaze. According to a 2015 European Commission report, "the capacities of the Competition Council are not sufficiently strong."

Anti-monopoly  
policy  
10

Latvia is a member of the WTO and the EU, and its foreign trade is now regulated by the European Commission. Latvia has a small, open economy, which is dependent on foreign investment and exports for continued economic growth.

Liberalization of  
foreign trade  
10

As of 2015, Latvia has 17 domestically owned banks and nine foreign-owned banks. In terms of assets, the two largest banks in Latvia are the Swedish-owned Swedbank and SEB. The share of nonperforming loans as a percentage of total loans decreased from 15.9% in 2010 to 5.3% in 2014. Meanwhile, the ratio of bank capital to assets rose from 7.7% in 2009 to 11.4% in 2013 (World Bank data). According to a 2014 IMF report, nonresident deposits accounted for almost half of the banking sector's total deposits at the end of 2013. This represents a major financial vulnerability. Following accession to the euro zone, the European Central Bank has begun to directly supervise Latvia's three largest commercial banks.

Banking system  
8

Latvia's post-1991 history has been marked by a number of spectacular banking failures. The collapse and subsequent government bailout of Parex, Latvia's oldest commercial bank, led into the deep economic recession of 2008 to 2010. In 2014, the government sold its remaining stake in Citadele, the performing part of Parex. The Russian-owned bank, Latvijas Krajbanka, was declared bankrupt in December 2011. These failures led to the resignation of the head of the Financial and Capital Market Commission, and a reorganization of the institution.

## 8 | Currency and Price Stability

Latvia joined the euro zone on 1 January 2014 at a rate of LVL 0.70 to €1. Accession to the euro had entailed meeting criteria for long-term currency stability and low inflation. Inflation remained below 1% throughout 2014.

Anti-inflation /  
forex policy  
10

The Latvian Central Bank is now a member of the European System of Central Banks, whose central goal is to maintain price stability.

The previously low public debt burden grew rapidly after Latvia received an IMF-led international bailout in late 2008. Latvia had enjoyed low levels of public debt after independence from the Soviet Union, because it had not inherited any share of the Soviet Union's outstanding international debt. However, between independence and the economic recession of 2008, governments routinely demonstrated a lack of fiscal discipline, running budget deficits even during periods of unprecedented double-digit GDP growth.

Macrostability  
9

Nevertheless, overall public debt remained low. The IMF-led bailout raised Latvia's public debt from 9% of GDP in 2007 to 19.7% of GDP in 2008 to 36.7% in 2009. By 2014, the ratio of public debt to GDP was 37.4%.

As a member of the euro zone, Latvia has signed up to the European Fiscal Compact, which introduced a budget deficits target of less than 3% of GDP. Recently, Latvia has run a budget deficit of 1% or less of GDP.

In addition, Latvia has adopted a Fiscal Discipline Law and a Fiscal Discipline Council. The Fiscal Discipline Law is an attempted to ensure that future budgets are balanced, with the Fiscal Discipline Council designed to monitor compliance. The six-member Fiscal Discipline Council includes one Danish and one Estonian national in addition to four Latvian nationals.

## 9 | Private Property

Membership of most major European and Western international organizations ensures that the private property rights are well regulated and protected. According to the 2015 Doing Business Report, enforcing a contract takes 469 days, involves 27 procedures and costs 23.1% of the cost of the claim on average.

Property rights  
10

The Latvian Privatization Agency was created in 1994 to oversee the process of selling-off state-owned enterprises inherited from the Soviet Union. This was a lengthy process, because of the large size of manufacturing enterprises in Latvia compared, for example, to neighboring Estonia and Lithuania. This process was largely completed by 2000, though the state continues to hold shares in some of Latvia's largest enterprises. For example, the state owns a 51% of shares in the profitable telecommunications company, Lattelecom. Efforts in the mid-2000s to sell-off state shares in Lattelcom were blocked by political interests. Similarly, the state owns shares in electricity company Latvenergo which dominates 90% of the electricity market. Nevertheless, the private sector now employs 75% of the workforce and dominates the national economy. In 2014, the Latvian Privatization Agency sold the commercial part of Mortgage and Land Bank. After Latvia's biggest steel company, Liepajas Metalurgs, was declared insolvent in 2013, the government undertook preparations to sell its assets.

Private enterprise  
9

Latvia adopted a new law on the governance of state-owned enterprises following advice from the OECD, which Latvia aspires to join in 2016 or 2017. The new law will affect the 127 wholly or partially state-owned enterprises as well as over 500 enterprises wholly or partially owned by local municipalities. The law aims to depoliticize these enterprises by introducing universal guidelines for the management of these enterprises, including decision-making, remuneration, and the appointment of board and council members.

## 10 | Welfare Regime

After independence in 1991, Latvia created a broad social security system, which included unemployment, income and child support payments as well as maternity and paternity allowances. The latter parental allowances were generously expanded in the 2000s as political fears of demographic decline increased. However, the level of the social security payments are generally small, reflecting the low overall levels of public expenditure on social protection in Latvia and the Baltic states in general. In 2009, welfare expenditure in the EU-27 was, on average, 29.5% of GDP. However, in Latvia it was just 18.8%. In 2014, 32.7% of Latvia's population were defined as being at risk of poverty, a decrease from 40.1% of the population in 2011. However, this remains the highest proportion within the EU, including Greece, according to Eurostat.

Social safety nets  
8

Latvia adopted a three-pillar pension system. The first pillar is a pay-as-you-go scheme. It provides a basic state pension. The second pillar is a mandatory scheme, which is managed by the state. The third pillar is an optional supplementary scheme, which is funded through individual contributions and privately managed. Final pensions are calculated by both the number of years worked and the amount of social security contributions paid.

Unemployment, sickness and maternity benefits are tied to salary and length of previous employment. They are provided for a maximum of one year. In 2013 and 2014, the government increased pension levels and the minimum wage. According to a 2015 European Commission report, “access to health care is hampered by low public health care financing in high out-of-pocket payments, leaving a large proportion of the population with unmet health care needs.”

All citizens have equal access to the primary, secondary and tertiary education system as well as public services and employment. Latvia was ranked 15 out of 142 countries in the 2014 Global Gender Gap Index. This was an improvement on 2010 when it ranked 18, but a fall from 2008 when it ranked 10. Indeed, women make up a greater share of those in higher education than men.

Equal opportunity

8

More than two-thirds of students in higher education are privately funded, and a great many of these are Russophones who choose to study in their native language because free public higher education is only available in the Latvian language. Students do have access to cheap student loans in order to finance their education, and the higher education system also allows students to hold down part-time and, in some cases, even full-time employment, while enrolled in tertiary education. However, student scholarships are based on grades rather than economic need, which inhibits opportunities for individuals from poorer families. The perceived lack of individual opportunities is reflected in high emigration rates.

Individuals have recourse to the Ombudsman’s office in the event of discrimination. Over the past few years, the office has made rulings on the discrimination of Roma and sexual minorities in the labor market. However, these have been individual rather than systematic incidents.

## 11 | Economic Performance

Between 2000 and 2008, Latvia’s economy grew rapidly, which contributed to an increase of 33% between 2000 and 2005 in the real income of those in employment. In 2005 alone, the real income of those in employment grew by almost 10%. GDP increased by 12.2% in 2006 and 10% in 2007, which was the highest rate of growth in the European Union at the time. However, these increases were reversed when the economy entered a sharp recession in late 2008. GDP declined by 23.9% over seven quarters between 2008 and 2010. At the same time, the government adopted a stringent austerity program, which combined tax increases with cuts in public expenditure. These cuts targeted spending on social security, investment and public sector employment. The government also attempted to restructure the public sector, which led to modest school, hospital and public agency mergers. However, fundamental restructuring of the health and education sectors remains a key challenge for future governments.

Output strength

8

Economic growth returned in 2010. GDP increased by 5% in 2012 and 4.1% in 2013. However, there was an economic slowdown in 2014 and 2015. This was due to tit-for-tat economic sanctions between the West and Russia, which severely affected Latvia's food processing and transit sectors. Nevertheless, the fundamentals of the economy remain strong with small budget deficits, low inflation and declining unemployment. In 2014, unemployment fell below 10% from a high of 23% in 2010.

## 12 | Sustainability

Latvia is one of the most environmentally responsible countries in Europe. It has relatively few polluting industries and its forests cover almost 50% of national territory. Latvia is second only to Sweden in terms of renewable energy use. More than one-third of energy consumed in Latvia is generated from renewable sources. Latvia has introduced all the environmental protection regulations required by the EU and enforces EU standards of environmental protection. The natural environment is central to Latvian national identity and Soviet-era pollution was a major mobilizer of political opposition in the mid- to late-1980s. Prime Minister Indulis Emsis remains the only head of an EU member state to have been a representative of an environmental party. Paradoxically, however, the environmental movement is quite weak. The Latvian Green Party has long been the junior partner in a curious electoral alliance, the Union of Greens and Farmers, with the Latvian Farmers' Union. Green issues are of little salience in Latvian politics.

Environmental  
policy  
9

Successive governments have neglected both the education system and R&D. In 2012, government expenditure on education has been the equivalent of 5% to 6% of GDP, while government expenditure on R&D has equated to less than 1% of GDP. Indeed, government expenditure on R&D declined between 2011 and 2012. Various international measures of educational performance (e.g., the OECD's PISA survey as well as international rankings of universities and research centers) indicate that Latvia's education system is below par. R&D and education were particularly hard hit by austerity measures, with government expenditure on R&D having not yet recovered to pre-2008 levels.

Education policy /  
R&D  
8

The experience of Roberts Kilis, Education Minister between 2011 and 2013, illustrates the key challenges to sectoral reform. Kilis has a doctorate in anthropology from the University of Cambridge and was long employed as an Associate Professor at the Stockholm School of Economics in Riga. As a result, he was seen as an outsider by established interests in the education and R&D sectors. Kilis swiftly set about reforming the education system. In particular, he proposed restructuring of the academic calendar of secondary schools (Latvian students have a three-month summer break, well above the European Union average) as well as sweeping changes to higher education financing and accreditation. However, Kilis overwhelmed the education sector with his proposals, provoking a severe backlash from teachers,

students and researchers. Teacher trade unions, consortiums of universities and other powerful interests simply refused to cooperate with the Ministry of Education, which led to paralysis. Kilis resigned in 2013 having achieved very few of his ambitious reforms.

Latvia's tertiary education system is particularly weak. Sharp demographic decline and an increasing number of high school graduates electing to study in other EU member states has led to a decline in enrolled students and associated income. Only medicine and some engineering programs have succeeded in attracting non-EU students to study in Latvia. The number of people from non-EU member states granted residence permits for purposes of studying increased from 303 people in 2004 to 902 in 2013. Wage stagnation makes it even more difficult to attract people to study in Latvia. A lack of exposure and openness to international competition (e.g. evaluation of teaching staff based on publications in international journals) is another significant obstacle to the tertiary education system.

# Transformation Management

## I. Level of Difficulty

Poor physical infrastructure is the largest constraint to regional economic development, particularly the eastern Latgale region that borders Russia. An aging rail network, narrow and pot-holed roads, and persistent poverty make Latvia's peripheral regions unattractive to private investment. Underinvestment in education and healthcare means that Latvia's labor force is less skilled and in poorer health than in many Western economies. Rapid depopulation since 2004 further limits economic development.

Structural  
constraints

2

At the same time, however, Latvia is a Baltic state with growing economic and political links with the wealthy Nordic region. Meanwhile, its borders with Russia and Belarus, combined with a widespread knowledge of the Russian language, means that Latvia has a unique trade advantage and economic opportunities. Although the unpredictability of the Russian government can have a negative impact. For example, the economic sanctions imposed on and by Russia, following the annexation of Crimea, particularly hurt the Latvian economy. Accession to the European Union in 2004 has resulted in increased investment in physical infrastructure, including better roads, telecommunications and sanitation networks. However, it will take many more years of high invest to fully modernize Latvia's peripheral regions.

Latvian civil society draws on the environmental protection movement that emerged under the Soviet Union. This mass protest movement was the key political actor achieving national independence in 1991. However, civil society has lacked the legitimacy of broad popular support. In particular, older generations remain skeptical of charitable and non-governmental activities due to their experience of forced voluntarism during the Soviet era.

Civil society  
traditions

3

While Latvian civil society remains smaller, weaker and poorer than in its Nordic neighbors, there are signs that the sector is strengthens. The biggest challenge is financial. Latvia has no tradition of associational membership or charitable donations. As a result, civil society associations have few members and lack regular sources of income. This situation was exacerbated by accession to the European Union, which saw a number of the key financial supporters of civil society – for example, the Soros Foundation and other the Nordic governments – withdraw

funding. Meanwhile, EU financing through, for example, structural, cohesion or social funds offers only project-based sources of income. As such, civil society organizations have lost the long-term operational financing that other actors had provided, with a state-funding program only now being drafted.

Social capital is relatively low. Public opinion polls indicate that Latvia has the highest levels of distrust in its own political institutions among EU member states, with political parties and parliament polling particularly poorly. This is further exacerbated by low levels of mutual trust. Even the severity of austerity measures introduced between 2008 and 10 failed to mobilize society. Only a few, largely low-key demonstrations took place.

The most serious ethnic division within Latvia is between Latvians and Russophones. The Russophone group includes ethnic Russians and eastern Slavs. Concerns over this schism increased through 2014 with fears that Russia was increasingly using a compatriot media narrative and policy approach to manipulate the Russophone community.

Conflict intensity

4

In the late 1980s, Latvians and a significant part of the Russophone community united in opposition of the Soviet regime. However, this fragile coalition fell apart after Latvia gained independence in 1991 and political forces began organizing in advance of the first post-Soviet parliamentary elections in 1993. Many ethnic Latvians resented the russification of Latvia after 1945. While it rapidly became clear that any attempt to forcibly deport Russian-speaking individuals would be unacceptable to the international community, mainstream nationalist politicians advocated for the denial of automatic citizenship to anyone who had settled in Latvia during the Soviet era. Thus, the 1990s were marked by the battle over citizenship rights, which also involved the international community. Meanwhile, the 2000s were marked by a battle over historical narratives and language rights.

The battle over historical narratives centers on the Second World War. Latvians consider the entry of Soviet forces into Latvia as an armed invasion followed by an occupation. In contrast, Russophones portray it as an essential piece of the battle against fascism. This conflict reaches a boiling point every spring when Latvian nationalists march to the Freedom Monument on 16 March. The march is in honor of Latvian Waffen-SS war veterans who are perceived as freedom fighters by Latvian nationalists and fascists to Russian speakers. On 9 May each year, Russian speakers celebrate the end of the Second World War, which is perceived as a moment of victory by Russian speakers and the beginning of an illegal occupation by Latvian nationalists.

The language war culminated in a referendum in February 2012, when Latvia's citizens voted on the introduction of Russian as a second language in Latvia. This was defeated by a margin of 75 to 25 (which roughly reflects the ethnic distribution

of Latvian citizens). In response, the coalition government increased the minimum number of signatures a petition needed to force a referendum from 10,000 citizens to at least 10% of the population (approximately 155,000 citizens). In 2014, the parliament also adopted a preamble to the constitution. This preamble references historic moments and values of the Latvian nation, and makes reference to Latvian as the only official language.

These events have reinforced ethnic polarization. However, this division has rarely, if ever, threatened to descend into violence. Russia's support for insurgents (the "little green men") in Crimea and eastern Ukraine in 2014 led to fears that a similar insurgency could appear in Latvia. As a result, the Latvian government increased public financing for Russian-language media and also re-invigorated the debate on how successfully Russophones have been integrated. However, integration policy only becomes a priority for government in exceptional situations, such as the situation that followed Russia's annexation of Crimea. Integration policy has not benefited from a systematic investment of public funds. For example, public expenditure accounted for only one-third of a total of €4 million invested in integration efforts between 2012 and 2013. The majority of expenditure on integration efforts comes from the European Union and European Economic Area.

## II. Management Performance

### 14 | Steering Capability

Latvian governments have proven to be extremely capable in following international strategic priorities (conditionality), but much weaker in developing domestic priorities.

Consensus among Latvia's elites over foreign policy facilitated Latvia's accession to the European Union and NATO in 2004, and the euro zone on 1 January 2014. However, in the period between 2004 and the economic bailout in late 2008, the government proved incapable of strategic planning and prioritization. The government made frequent changes to the annual budget in order to increase public expenditure, but failed to tackle serious structural problems in the provision of healthcare and education.

In 2011, largely in reaction to these perceived failures, the government created the Cross-Sectoral Coordination Center. The Center is responsible for coordinating and monitoring national development planning. It was responsible for drafting the 2020 National Development Plan, which integrates the EU Multiannual Financial Framework for 2014-20. It was also responsible for drafting the Latvia 2030

Question  
Score

Prioritization  
9

Sustainable Development Strategy. While it is too early to assess the success or failure of the Center, it has received criticism for being understaffed and frequently disregarded by ministries. In January 2015, the Center had just 17 employees.

Governments are generally able to deliver on externally negotiated policies (international conditionality) and also on more modest domestic initiatives. For example, international observers were skeptical of the government's ability to implement a program of austerity, which had been accepted as a condition of the 2009/2009 financial bailout deal. This program included internal devaluation and fiscal consolidation. However, the government largely delivered on its promises. Furthermore, the government has also met the conditions required to join the euro zone in 2014.

Implementation  
9

However, reforms have been more difficult to deliver in areas with established and powerful political interests, such as healthcare, education and the judiciary.

Successive Latvian governments have proven to be flexible, though not particularly innovative. Most recently, after taking office in March 2009 in the midst of a severe economic crisis, Prime Minister Valdis Dombrovskis quickly adapted government policy to the situation. Between 2008 and 2011, Latvia's cumulative fiscal adjustment was estimated at 17% of GDP. Of this fiscal adjustment, 6.8% came from increased government and 10.2% from reduced government expenditure. This reduction in government expenditure included making one-third (a total of 23,000) government employees redundant, cutting public sector salaries, and closing 50% of public agencies. Initially, public sector pensions were also cut, but this was later reversed after the Constitutional Court declared it unconstitutional.

Policy learning  
8

However, the Latvian government has little ability to innovate when acting alone. There are several reasons for this. First, Latvian political parties are not ideologically rooted, and thus lack a basic political compass or instinct. This lack of ideology is further compounded by a sector factor, an absence of autonomous research capacity. Indeed, parties have no established links with think tanks or other research centers. Rather, politicians rely on civil servants for policy ideas. However, much of the civil service is young, inexperienced and underpaid. Third, although a potential source of innovation, the parliament lacks an independent research center. The Latvian parliament, the Saeima, is the only parliament in the Baltic Sea Region that does not employ any researchers. As a result, there are few sources for government innovation. The relatively high turnover of governments (approximately one a year since 1993) also means that many governments are out of office before they have found their feet.

## 15 | Resource Efficiency

Between 2008 and 2010, one-third of all ministry staff were made redundant. In January 2015, Prime Minister Laimdota Straujuma discussed the possibility of making further redundancies so that salaries could be raised for those employees who remained. The goal was ensure that the public sector could retain its best personnel. The weakness of public sector unions means that there is little organized opposition to this policy, which means it could well be enacted.

Efficient use of  
assets

7

The public sector is increasingly transparent. Fiscal discipline is strictly enforced and public debt levels are low. In 2014, gross public debt was equal to 37.4% of GDP. All monthly salaries in ministries and public agencies are now published on the internet, and all public officials have to submit annual financial declarations that are also available to the public. Political appointments are also more infrequent than in the 1990s and early 2000s. However, Latvia still lacks a centralized recruitment procedure for the public sector. Furthermore, in-work training and skills upgrading for civil servants is underfinanced and neglected.

Coordination between ministries and other state institutions remains problematic due to the party-based distribution of ministries. A council of the coalition government parties meets weekly for informal consultations. However, the political parties that make up government coalitions are often in dispute, and this feeds over into the effective management and coordination of government. The prime minister has only nominal control over ministries that are governed by other coalition parties. This was most evident in the multiple budget cutting exercises between 2008 and 2010, which were mechanical (e.g. each ministry cutting expenses by 20% across the board) rather than based on a functional audit of government and a future vision of the role of the state. In the same way, a return to growth has resulted in increased budgets for all ministries, rather than some sort of prioritization (e.g. investing in education or R&D).

Policy  
coordination

7

The Cross-Sectoral Coordination Centre (PKC), under the office of the prime minister, was created in 2011 to address these problems. PKC's mandate is to nurture strategic thinking by producing long-term planning documents and monitoring routine decision-making to ensure compliance. PKC also monitors ministries' progress toward meeting the government's stated goals, as outlined in the Government Declaration. However, its little resources mean that it has been unable to extend its role beyond information gathering.

The Latvian Corruption Prevention and Combating Bureau (KNAB) was created in 2002 to tackle administrative and political corruption. It is an independent agency that has investigative and law enforcement powers. In addition, it has the right of legislative initiative (i.e. the power to propose a new law), legislative review, and oversees funding for political parties. KNAB has seen a gradual increase in its workload. In 2003, KNAB investigated 18 allegations of corruption, but in 2013 KNAB, investigated 33 allegations.

Anti-corruption  
policy

7

KNAB has proved effective at fighting administrative corruption (i.e. bribes to public servants, such as police officers, judges and bureaucrats), but has found cases of high-level political corruption far more difficult to investigate. For example, the Mayor of Ventspils, Aivars Lembergs, was first charged with corruption and money laundering in 2006, but at the time of writing, his case remains open.

However, there are also other institutions that tackle corruption. The State Auditor's Office has emerged as a powerful political player, producing annual reports on waste and corruption at national and local levels of government. Working in collaboration with national competition authorities, the State Auditor's Office has also identified irregularities in public procurement procedures.

Latvia's media has also proven to be able to identify and report on corruption cases. This is largely because of the increased transparency in government practices. The IR (a weekly magazine), the Re:Baltica (an investigative journalism center) and TV News (particularly its Sunday evening editions, which focuses on longer investigations) have demonstrated themselves to be particularly adept at putting corruption on the political agenda.

## 16 | Consensus-Building

All the major political actors agree that democracy is the only legitimate form of government. Latvia's membership of the European Union and regional integration with the Nordic states is further strengthening this consensus.

Consensus on goals

10

The only concern is with the major Russophone political party, Harmony. Harmony has a formal cooperation agreement with United Russia, Russian President Vladimir Putin's ruling party. However, Harmony insists that this relationship is based on economic concerns, such as supporting access to Russian markets for Latvian exporters, rather than ideological affiliation.

All major parties are supportive of a market economy. Of the six parties in parliament, only Harmony claims to be economically left of center. However, this is more an electoral tactic to appeal beyond its Russophone constituency rather than a real reflection of the party's economic policy.

Latvia has no major anti-democratic actors. There are a number of small anti-democratic groups, but they are fragmented and unable to attract more than a dozen people to their protests. Moreover, these groups are closely supervised by the Security Police and Latvia's clandestine Constitutional Defense Bureau. The military has just under 6,000 servicemen and is firmly under civilian control and has refrained from entering the political fray.

Anti-democratic  
actors

9

Latvia's only major cleavage is between ethnic Latvians and Russophones. The last half-decade has been marked by increased social polarization. This has been caused primarily by an increase in the activism of the Russophone minority and Russia's increased use of soft policy tools to influence this community.

Cleavage /  
conflict  
management

8

The February 2012 referendum on introducing Russian as a second official language generated a highly emotional political discourse. Politicians representing Russian speakers demanded "respect" and "recognition," while politicians representing Latvian speakers argued that Latvian culture was under threat. However, the emotional intensity of this discourse did not translate into violence. The 2012 referendum was a response to a 2010 referendum initiative proposed by For Fatherland and Freedom/LNNK (TB/LNNK). TB/LNNK is part of the electoral coalition, the National Alliance. In 2010, TB/LNNK proposed to introduce a constitutional amendment that would require all state-funded schools to teach only in Latvian. At the time, many state-schools taught in both Latvian and Russian. The 120,433 signatories to the TB/LNNK's proposed amendment fell short of the required number to force a referendum. However, the proposal itself revived fears among the Russian-speaking population that education reforms, similar to those proposed in 2004, were going to marginalize Russophones. A second driver behind the 2012 referendum was the exclusion from government of Harmony Center, now reformed as Harmony. Despite winning the largest share of seats in the September 2011 parliamentary elections, Harmony Center never managed to enter into a coalition with other political parties. This was perceived by Harmony Center as discrimination against Russian speakers. Although the other political parties argue that this is due to ideological incompatibility. Harmony Centre is the only major party to have adopted a left-wing platform. In October 2014, the reformed Harmony party again won the largest share of votes, but was again excluded from the governing coalition.

Russia's annexation of Crimea has prompted the Latvian government to readdress the issue of integrating Latvia's Russophones. The government has increased funding for Russian language radio and television programming as well as civil society actions. However, the inclusion of Harmony into government remains a taboo issue.

Parliamentary committees, ministry working groups and other government institutions routinely involve civil society organizations in the policy-making process. Public donations to specific causes (e.g. raising money for someone's medical treatment or gifting someone a charitable donation as a present) are increasing. However, institutional weaknesses, primarily inadequate human and financial resources, among civil society organizations limit their involvement. Moreover, cooperation between civil society organizations and government institutions is based on informal networks rather than institutionalized relationships. Political parties remain isolated from civil society organizations. Nevertheless, the role of civil society within the policy-making process is becoming increasingly established. In January 2015, the Justice Minister returned a draft law on the media to the working group stage, following criticism that media stakeholders had been inadequately consulted.

Civil society participation  
7

Reconciliation between ethnic Latvians and the Russophone communities has only partially been achieved. Latvians, in particular, recall the Soviet era as one of occupation and russification. Hundreds of thousands of Latvians emigrated to the West in order to escape Soviet occupation, while tens of thousands of Latvians who had remained were deported to the Soviet Union's gulags.

Reconciliation  
8

Political leaders have occasionally attempted to bridge the ethnic divide. For example, Ainars Slesers, one of Latvia's three influential oligarchs, attempted to recruit both Latvians and Russians to his Latvia's First Party (LPP). LPP was an unusual Christian democratic, technocratic party. In the 2009 Riga municipal election, the LPP adopted a "zipper" system in the ordinal ballot (Russian-Latvian-Russian-Latvian, etc.). The LPP then formed a municipal governing coalition with the Russian-speaking Harmony Center. However, LPP has since folded and Slesers is no longer active in mainstream politics.

More significantly, Valdis Zatlers attempted to form a national government coalition with Harmony Center after the 2011 parliamentary election. Zatlers led the Zatlers Reform Party (ZRP), which came third in the 2011 election. However, Zatlers failed to build a parliamentary majority as the other parties and politicians within ZRP refused to cooperate with Harmony Center.

Relations with Russia also remain a significant hurdle. Russian President Putin has made reference to the glory of the Soviet Union and even appears ready to rehabilitate the memory of Stalin, who ordered the Latvian deportations. These tendencies represent significant obstacles to developing a common understanding of historical events.

## 17 | International Cooperation

Latvia's membership of the European Union remains key to the country's future economic development. Economic and political convergence drives policy-making in the absence of ideologically distinct political parties. Between 2005 and 2012, no infringement procedure was initiated by the European Commission against Latvia. In 2012, Latvia achieved a transposition deficit of 0.4%. The transposition deficit is the gap between the number of Single Market directives adopted at the EU level and those transposed into domestic law. The average transposition deficit among the EU-27 was 0.6%, meaning that Latvia transposed an above average number of directives into domestic law (Eurostat data). Moreover, European Union funds are crucial for developing Latvia's agricultural sector, higher education system and fostering domestic R&D. These funds include structural and cohesion funds, and the common agricultural policy. Between 2007 and 2013, Latvia received over €4.5 billion from the EU's structural and cohesion funds. This amount will increase for 2014 to 2020. Without access to European Union funding, Latvia would struggle to attract the capital necessary to undertake large physical infrastructure projects, such as Rail Baltica (a high-speed rail line from Finland through Latvia to Poland).

Effective use of  
support  
9

However, international advice has been more difficult to implement in political areas due to resistance from established political interests, particularly in the areas of healthcare, education and the judicial system.

Latvia has been an active participant in all the major international organizations that it has joined. For example, Latvia has provided troops for NATO missions in Afghanistan and the Balkans, and participated in the "coalition of the willing" in the US-led war in Iraq.

Credibility  
10

In 2012, Latvia successfully "graduated" from the IMF-led international lender program it had begun in 2008. A 2012 conference in Riga saw IMF President Christine Lagarde applaud Latvia for its "collective determination and resilience" and cited it as an inspiration for other European countries.

For the first six months of 2015, Latvia holds the Presidency of the European Union's Council of Ministers, chairing meetings and setting the agenda. Prime Minister Dombrovskis is now a Vice-President of the European Commission, holding the portfolio for the Euro and Social Dialogue.

Latvia is an active state in the Baltic region. Alongside several organizational arrangements between the Baltic States, Latvia is also a member of the Council of the Baltic Sea States, and the Nordic-Baltic Six and Nordic-Baltic Eight formats.

Regional  
cooperation  
10

During the 1990s, several organizations were established to coordinate activities between the three Baltic States, Estonia, Latvia and Lithuania. For example, the Baltic Council was established in 1990, as a platform for Baltic politicians and senior officials to meet on a regular basis. Similarly, the Baltic Assembly was created in 1991, it is formed of 20 representatives from each of the three Baltic States parliaments. In 1993, a Baltic Free Trade Agreement was signed. In June 1994, a Baltic Council of Ministers was formalized. The Baltic Council of Ministers is a forum for the heads of the Baltic States, it meets every six months. However, these institutions are largely symbolic and lack substantive powers. The deepest integration among the Baltic States is in the area of military cooperation. NATO has driven cooperation in the setting up of the Baltic Defense College (BALTDEFCOL) and the Baltic Battalion (BALTBAT). Furthermore, the Baltic ministries of defense have moved towards common military procurement policies.

Latvia has also increasingly integrated into the Baltic Sea Region. Since 2004, the three Baltic States have cooperated in the Nordic-Baltic Six (NB6) format with the Denmark, Finland and Sweden. The NB6 have pushed for common European Union initiatives, such as the creation of the Baltic Sea Region as the EU's first "macro region," and ministers have increasingly coordinated their positions in advance of Council of Ministers meetings.

Latvia has also used the EU's eastern neighborhood policy to promote democratization and marketization in Georgia as well as support for Moldova and Ukraine, which the Latvian government feels could benefit from Latvia's experience of transitioning to a market democracy. Cooperation with these states remains a foreign policy priority.

However, relations with Latvia's eastern neighbor, Russia, continue to be politically difficult. Although economic relations were thriving before the tit-for-tat imposition of economic sanctions between the West and Russia in 2014. Latvia's support for the West's policy of imposing harsh economic sanctions on Russia has complicated this relationship.

## Strategic Outlook

The political discourse in Latvia is dominated by medium-term security threats. The effect of this has been to focus political attention on the military (which had been neglected since Latvia's accession to NATO in 2004), strengthen trade with wealthier and more stable European markets and increase energy security (away from its reliance on natural gas from Russia). At the same time, however, three substantial medium- to long-term challenges remain, namely increasing economic inequality, population decline, and an inadequate higher education and research sector.

The deep economic recession has effected the poorest socioeconomic groups the hardest. The country has made some progress in recent years. For example, according to Eurostat data, the proportion of the population defined as "materially deprived" fell from 33% in 2011 to 24% in 2013. However, despite this progress, Latvia has the highest level of economic inequality in the European Union, as defined in the Gini coefficient. Latvia's comparatively high level of economic inequality is due to its low tax revenue, low welfare expenditure regime. In 2009, average welfare expenditure among the EU-27 was equivalent to 29.5% of GDP. However, in Latvia it was equivalent to just 18.8% of GDP. This is further exacerbated by the lack of targeted benefits, which means that many benefit payments fail to advantage the poorest. More means-tested benefits targeted at those who most need assistance as well as changes to the tax system – such as the introduction of a more progressive tax system, which taxes consumption or real estate – could target the wealthy and help to reduce the tensions created by extreme economic inequality.

Responses to the 2011 census indicate that the Latvian population declined by 200,000 (approximately 10% of the total population) over the preceding eleven years. This is the result of a negative birth rate combined with mass emigration. The rate of emigration increased dramatically after accession to the European Union in 2004 and increased again during the economic recession of 2008 to 2010. Demographic challenges include an aging population, an increase in people drawing public pensions, a declining ratio of workers to pensioners and an increasing demand for healthcare services. Over the last decade, multiple governments have attempted to promote population growth through improved family and maternity benefit payments. However, these have had little success. As Latvian migrants to other EU member states find stable employment, invest in foreign real estate and send their children to local schools, it will be increasingly unlikely that they will be attracted back to Latvia. Nevertheless, Latvia needs a skilled and healthy workforce to maintain economic growth and development. This economic demand requires a public debate on immigration, as other policy options have failed to halt these demographic trends. However, given the tensions that persist from the last half century of russification, this debate will be painfully. Moreover, many rural areas are rapidly depopulating and aging. Future governments will have to balance the social benefits against the economic costs of maintaining education, healthcare, transport and telecommunications services in these regions.

Finally, the higher education and R&D sectors have been neglected for over twenty years. The highly uncompetitive nature of these sectors was revealed due to the increased openness, transparency and competition that membership of the European Union brought. Latvian students increasingly move to other EU states to study, while students moving to Latvia to study (primarily medicine and engineering) almost entirely come from outside the EU. Latvian research centers fare comparatively poorly in EU-funded research framework competitions, while few Latvian academics publish in international peer-reviewed journals. Higher education reforms proposed in 2012 were largely scrapped following ferocious opposition within the higher education sector. Yet, substantial education reforms are required to maintain economic growth, and achieve convergence with the Baltic Sea States and the European Union. These reforms include stricter international evaluations of institutions and programs, performance-based financing, and a restructuring of higher education and R&D institutions. Before these reforms, Latvia still had more than 50 autonomous higher education institutions.