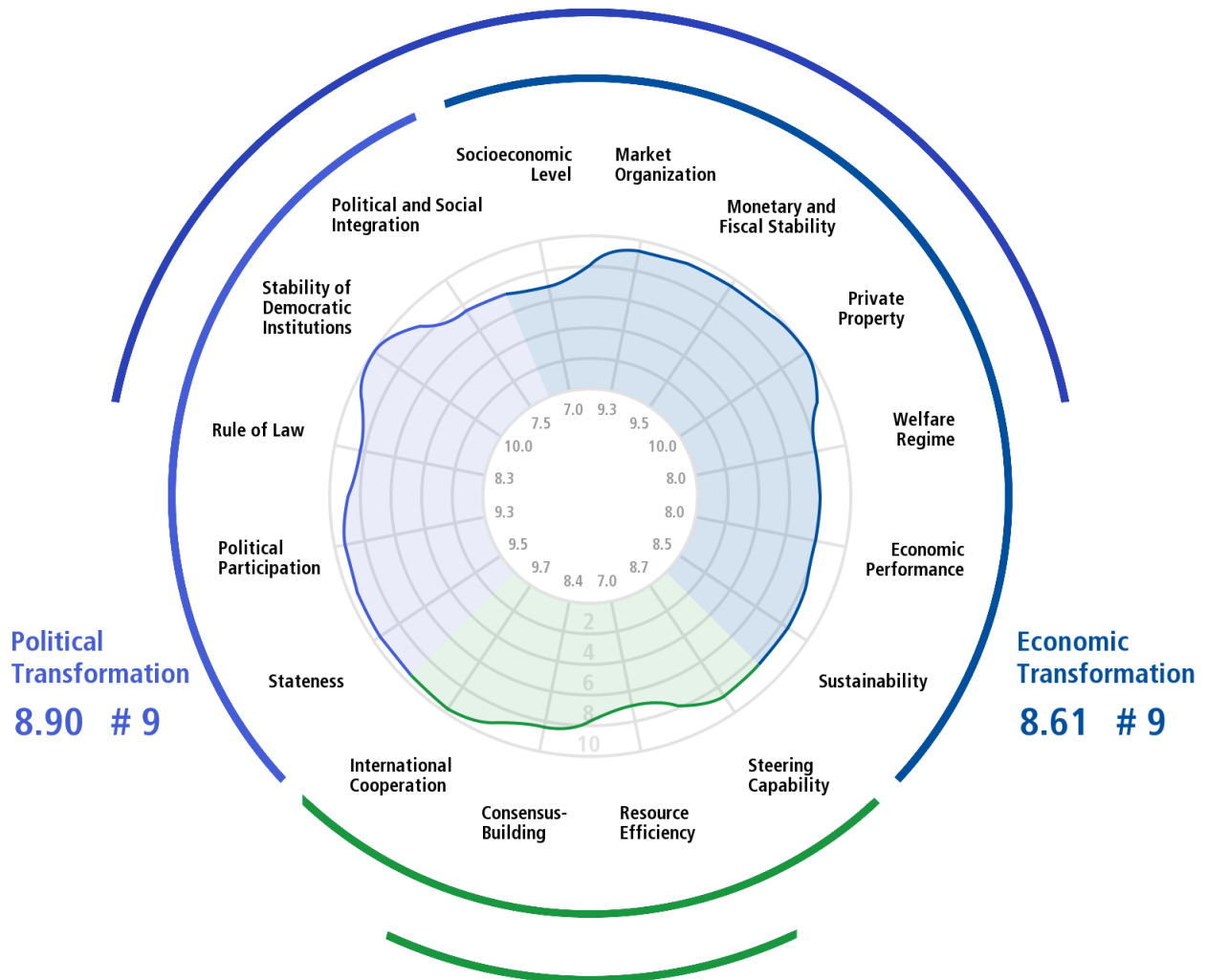


Latvia

Status Index

8.75 # 8

on 1-10 scale out of 137



Political Transformation
8.90 # 9

Economic Transformation
8.61 # 9

Governance Index

7.00 # 8

on 1-10 scale out of 137

This report is part of the **Bertelsmann Stiftung's Transformation Index (BTI) 2020**. It covers the period from February 1, 2017 to January 31, 2019. The BTI assesses the transformation toward democracy and a market economy as well as the quality of governance in 137 countries. More on the BTI at <https://www.bti-project.org>.

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Key Indicators

Population	M	1.9	HDI	0.854	GDP p.c., PPP \$	30692
Pop. growth ¹	% p.a.	-0.8	HDI rank of 189	39	Gini Index	34.2
Life expectancy	years	74.7	UN Education Index	0.871	Poverty ³	% 1.5
Urban population	%	68.1	Gender inequality ²	0.169	Aid per capita \$	-

Sources (as of December 2019): The World Bank, World Development Indicators 2019 | UNDP, Human Development Report 2019. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

Executive Summary

Latvia experienced both political stability and economic growth between 2017 and 2019. However, harsher critics might characterize recent years as stagnant rather than stable.

Prime Minister Maris Kucinskis (from the Green/Farmers' Union) held office from February 2016 to January 2019. Initially seen as a steady hand, his government oversaw a major tax code reform (introducing a progressive tax rate and a 0% tax rate on reinvested corporate profits, designed to increase productivity through higher rates of investment). The economy grew at a comparatively brisk rate, largely fueled by capital investment projects financed by EU cohesion and structural adjustment funds. The Rail Baltica project slowly inched along. It is a €5 billion ten-plus-year regional infrastructure project, largely financed by the European Union, to construct the infrastructure for an 870 km electric passenger and freight railway that will connect the Baltic states to Western Europe. The Baltic states have bickered about its management (causing the Latvian CEO of the project to resign in September 2018), construction and routes. This has delayed the project but preliminary engineering work has finally begun.

The Latvian government has failed to address the low rates of spending on research, development and innovation, and also to undertake reforms that would make the higher education sector more competitive. Corruption remains a problem, with the "Oligarch Tapes" (leaked conversations, recorded in a hotel, of leading political figures in Latvia discussing politics and their own economic interests) failing to lead to any arrests. The government tackled the critical challenge of demographic decline half-heartedly in the period under review, with a policy focus on raising benefits for families with three or more children and attempting to build contact with Latvia's near 400,000-person diaspora in order to hasten their return. Migration from third countries (primarily Ukraine and other post-Soviet states) continued to gradually increase, but was rarely spoken about. An increasing number of international students chose to study in Riga, bringing in desperately needed funds to the higher education sector, but also new challenges to societal cohesion.

These recent trends have contributed to conflicts related to identity politics, which have expanded from their traditional focus on ethnic Latvians versus Russian speakers to a broader debate on liberal versus national-conservative values. National conservatives successfully opposed both the ratification of the Istanbul Convention (the Council of Europe Convention on preventing and combating violence against women and domestic violence) in 2017 and the United Nations Migration Pact in 2018, arguing that they represented unacceptable Western liberal values that conflicted with wholesome core Latvian values oriented around the traditional family unit and, in the case of the UN Migration Pact, control over who lives in your country. This divide is now represented in parliament after the explicitly socially liberal Development/For! party alliance won 13 out of 100 parliamentary seats in the October 2018 election and now sits in an uncomfortable government coalition with the national conservatives of the National Alliance and the New Conservative Party. Indeed, the sense of stagnation and the public's perception that political change is needed contributed to a particularly high turnover of parliamentarians after the 2018 election – 60 of the 100 parliamentary deputies were new to the post. With seven evenly-sized parties elected, parliament was polarized, and it took more than three months and two failed attempts to negotiate a new governing coalition, which took office in late January 2019.

History and Characteristics of Transformation

Over the last 800 years, 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 East and Central Europe. The new Latvian state adopted a parliamentary constitution in 1922, although this failed to provide solidity – 13 government coalitions were formed by 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, 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 again in the 1990 elections to the Latvian Supreme Soviet, which then voted to restore independence in May 1990, leading 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 multiparty 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 multipartyism has meant that government stability has been hard to come by, with governments lasting, on average, little over a year. The other major political challenges have been an agreement on the withdrawal of Russian forces from Latvian territory (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).

Reforms to the economy have been 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 lats) 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. The early-2000s saw Latvia experience rapid economic growth, albeit primarily as a result of a construction and consumer-spending boom funded by cheap credit, especially after accession to the European Union and NATO in 2004. However, the Latvian economy fell back to earth in late 2008 as Latvia's largest domestically owned bank, Parex, collapsed 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 growth followed stabilization of the economy in 2010 and, in October of that year, the Latvian electorate surprisingly returned the Valdis Dombrovskis government – which had introduced sharp spending cuts in 2009 and 2010 – to power. Dombrovskis was again elected after the snap election of September 2011, called after the then 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 the vote for two of

the three oligarchs collapse, while the party of the third oligarch (the Green/Farmers' Union) was pushed into parliamentary opposition with a reduced number of parliamentary deputies.

However, the 2014 parliamentary election saw the Green/Farmers' Union increase their share of the vote. Green/Farmers' Union politician Raimonds Vejonis was elected state president the following summer. Then, in February 2016, after the government of the Unity party's Laimdota Straujuma fell, the Green/Farmers' Union seized the opportunity to take the prime minister's office for its own candidate, Maris Kucinskis.

The 2018 parliamentary election returned a fragmented seven-party parliament that spent a record three months negotiating a new coalition government, which was finally hobbled together at the third attempt by Unity's Krisjanis Karins, an experienced member of the European Parliament and former Latvian minister of economics.

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

The Latvian state has a complete monopoly on the use of force and there are no serious domestic challenges to the contemporary democratic system.

Question
Score

Monopoly on the
use of force

10



The Latvian territories have long been home to many different ethnic groups. However, there were a large number of Latvian fatalities during the Second World War, when many people also fled to western Europe. In the post-war years, the Soviet Union deported many Latvians, sending them to the east, alongside introducing “Russification” policies which saw some 700,000 Russian speakers (approximately one-third of the Latvian population) settle in Latvia. This fundamentally changed Latvia’s demographics. The 1989 Soviet census of the Latvian Soviet Socialist Republic revealed that Latvians made up just 52% of the population.

State identity

8



Partly in reaction to this, Latvia’s 1994 Citizenship Law granted citizenship to individuals and their direct descendants who were citizens before the Soviet occupation of July 17, 1940. This effectively denied automatic citizenship to those 700,000 Russian speakers who had moved to Latvia during the Soviet era.

External pressure from the European Union, NATO, the Council of Europe and other Western international organizations led to Latvia loosening the Citizenship Law and, by the late 1990s, anyone meeting the country’s residency and language proficiency criteria could become a naturalized citizen. There was a sharp increase in naturalization after accession to the European Union, but the numbers fell from 2012 onward. At the end of 2018, Latvia still had 229,000 resident non-citizens in a population of around 2 million people. In recent years, the fact that children born to

resident non-citizens inherit their non-citizen status has attracted some controversy. In 2017, President Raimonds Vejonis submitted a draft law to parliament that would have automatically granted Latvian citizenship to these new-born children. Although the parliament rejected the law, the president has announced his intention to resubmit the draft law to the new parliament elected in October 2018.

Non-citizens cannot vote in national, local or European elections, and they are 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 platforms. Political parties are also aligned along this ethnic cleavage.

The ethnic division has become increasingly politicized, culminating in a February 2012 referendum on whether Russian should be recognized as Latvia's second official language. Voters rejected the proposal, and the referendum further polarized Latvians and Russian speakers along ethnic lines.

Three major Christian denominations, Lutheran, Catholic and Orthodox, are practiced in Latvia, although regular church attendance is among the lowest in Europe. Leaders of all three churches are active in the public debate, typically criticizing the encroachment of "Western liberal" ideas – primarily the growing social and legislative acceptance of same-sex relationships as well as rights for women – and speaking out against economic inequality. However, the 2018 parliamentary election did not see political parties with explicit links to the church elected to the legislature.

The state delivers all basic services. Recent governments have committed to increasing the amount of government spending as a percentage of GDP in order to better fund healthcare in particular, but also education and various welfare benefits, particularly those related to families with young children. However, dramatic demographic decline in Latvia's rural regions has meant recent governments have closed down small rural schools, medical facilities and other social service providers. While the quality of services has risen as a result of this consolidation, it has made school journeys longer and it is now more difficult for some people in rural areas to access core services. The new government, formed in January 2019, has put administrative territorial reform among its priorities. In doing so, it aims to ensure better access to public services in all parts of the country and equal access between regions, despite the demographic decline.

European Union structural and cohesion funds have ensured that Latvia's communication services, transport system and basic infrastructure have been upgraded across the country, even in more rural regions.

No interference of religious dogmas

10



1

Basic administration

10



1

2 | Political Participation

European, national and local elections in Latvia are both free and fair. The most recent parliamentary election was held in October 2018. This was the ninth election since Latvia gained renewed independence in 1991. Sixteen parties participated in the election (up from thirteen in the previous parliamentary elections) with seven passing the 5% threshold needed to win seats in parliament. In contrast to the 2014 election (when courts found several candidates guilty of buying votes in exchange for small cash payments), there were no irregularities in the process.

Latvia's elections feature parties that represent both Russian speakers and ethnic Latvians, but ideological differences between parties can be harder to discern. Parties tend to campaign on personalities rather than programs or policies. The pro-Russian-speaker Harmony Social Democracy won the largest percentage of votes again in 2018, although its share of the vote has been in decline since 2011. As with previous elections, the party was excluded from subsequent coalition negotiations as it is accused of being too close to the Kremlin.

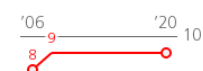
A new party, KPV LV (an acronym of the Latvian for "Who Owns the State?") finished second. It was formed by a Latvian actor who was first elected to the parliament on the Latvian Regional Alliance (LRA) ticket in 2014, but he broke from LRA within a year of first being elected. KPV LV has no ideological affiliation, merely positioning itself with the "the people" and in opposition to "the elite," and promising to cleanse the Latvian political system.

The Central Election Commission, which organizes and oversees elections in Latvia, is an independent organization with an experienced management team and sufficient resources to fulfill its core functions.

However, media access remains a concern. The ownership of the majority of both the Russian-speaking and Latvian printed press, as well as internet news portals, is not transparent. This leads to concerns of biased reporting and "hidden political advertising" as well as occasional accusations of "fake news." Latvia's business daily newspaper, "Dienas Bizness," was particularly active in the 2018 election campaign, advocating and supporting the interests of the populist Who Owns the State? (KPV LV) party. Both KPV LV and Harmony Social Democracy actively utilized social media, including Facebook and YouTube, in their campaigning and received the highest number of votes in the election. Other parties utilized traditional television, radio and billboard advertising and were less active on social media.

Free and fair elections

9



1

Long-standing concerns that three powerful “oligarchs” have an undue influence over the Latvian political system seemed to be confirmed in 2017. A series of leaked recordings made by Latvia’s anti-corruption agency, the Corruption Prevention and Combating Bureau (KNAB), showed them meeting in a hotel room with politicians from different political parties. They had already been in the spotlight in 2011 when the then president of Latvia, Valdis Zatlers, called a referendum on the recall of parliament because of concerns the oligarchs had gained a dangerously disproportionate influence over political parties and the government. The resulting September 2011 election saw support for two of the oligarchs’ political parties collapse (and the two parties subsequently folded). Although the third party (the Green/Farmers’ Union, a political vehicle for Aivars Lembergs, the mayor of Ventspils) was re-elected, it was initially excluded from the government coalition and went into opposition. However, this was short-lived – the party returned to government a few years later and held the prime minister’s post from 2016 to early 2019.

While Lembergs continues to play a role in politics, the other two oligarchs – Skele and Slesers – have been pushed out of the political system (although rumors swirled that Slesers was supporting the KPV LV party in the 2018 election and using newspapers such as Dienas Bizness, where he is alleged to have influence over the editors, to promote the party).

Reforms to both party financing (which reduced limits on political parties’ income from private sources and their expenditure, while also introducing public party financing from 2012) and election advertising have further limited the political influence of wealthy benefactors, although private money continues to play a crucial role in party financing. In January 2019, the government proposed amendments to legislation increasing state budget for political parties, which would result in decreased dependence on sponsors.

There are no formal restrictions on association or assembly. However, Latvia sees few political demonstrations or trade union protests. Even the radical government austerity measures of 2008 to 2011, which featured large cuts to benefits and public sector salaries, prompted only minor, largely peaceful protests. The Riga local authority has regularly attempted to ban gay pride and far-right nationalist parades, but the courts have consistently overturned these bans and the marches have gone ahead.

Latvia has a large number of NGOs, although they tend to have few members and an even smaller number of donors. For example, the Latvian branch of Amnesty International – Delna – has long been an important and influential voice in fighting corruption and pushing for good governance in Latvia, yet it constantly struggles to pay the bills and has a fee-paying membership in the low double digits.

Effective power to govern

10



1

Association / assembly rights

10



1

Latvia's constitution guarantees freedom of expression, and the Latvian court system, particularly the Constitutional Court, has actively defended this right.

However, oversight of the media has long been deeply politicized. The National Electronic Mass Media Council (NEPLP), which supervises radio, TV, the printed press and online media, is elected by parliament and composed of political party representatives. The council works in a highly politicized climate, and parliamentarians and the media regularly criticize its members. In December 2018, the council was criticized by the Latvian Journalists' Association after it dismissed the head of Latvian public TV as well as the board member responsible for program development.

The public media remains under-financed and, whenever elections approach, its management finds itself under political pressure from both the government and the opposition. Nevertheless, journalists in the public media, especially public radio, are still among the finest in Latvia, producing independent coverage of the political system, investigating corruption and incompetence, and acting as a check on political power.

Ownership of much of the private media is not transparent, an issue that came up during the 2018 parliamentary election campaign as Latvia's business daily, "Dienas Bizness," ferociously attacked some political parties while consistently supporting the populist Who Owns the State? (KPV LV) party.

3 | Rule of Law

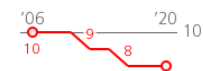
Democratic power in Latvia is balanced between the parliament (Saeima), the head of state (the state president), the executive (the prime minister and cabinet of ministers) and the court system.

The parliament is elected every four years and is Latvia's central legislative actor. However, it suffers from a deficit of policy planning and evaluation capacity, with a parliamentary research service only being set up in 2017 and with only a small number of junior researchers. Parliamentarians also only have a small budget for assistants.

The 100-deputy Latvian parliament elects the state president. Despite the key role that political parties have in selecting, nominating and voting for the head of state, all of Latvia's post-Soviet era presidents have acted independently. They have occasionally returned laws to parliament or otherwise challenged, within the framework of Latvia's laws, the parliament. The next president, due to be elected in June 2019, will be the first elected in an open parliamentary ballot.

Freedom of expression

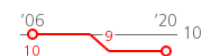
8



1

Separation of powers

9



1

In late 2018, parliament adopted amendments to the constitution that mean the president will be elected in an open ballot in future, thus reducing room for manipulation.

The political executive (the cabinet of ministers) has continued to strengthen as political parties have created more effective party organizations and tightened internal discipline, leading to more harmonious cooperation between ministers from the same parties. However, the prime minister is a much weaker figure than in other European democracies, effectively controlling only his own party's ministerial portfolios, while other coalition parties maintain effective control of their own ministerial fiefdoms. The Coalition Council's Monday meetings, where the major political figures of the coalition parties gather every week, ensure some level of coordination.

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

Latvia's judiciary is both formally and substantively 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 and frequent investigations, arrests and dismissals of judges.

A 2017 investigation by the weekly news magazine "Ir" found that between 2008 and 2014 a small number of judges were repeatedly allocated key insolvency cases despite them supposedly being apportioned randomly. In the same year, a poll showed that 55% of the population believed that legal processes in Latvia were unfair.

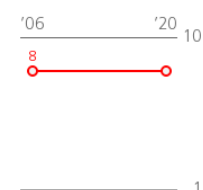
Channels of appeal work efficiently, with initial court decisions regularly being changed. But the functional operability of the court system is compromised by the slow pace of court processes, with some cases lasting more than 10 years.

Corruption and the fact that public officeholders are rarely prosecuted remains one of the major issues in Latvian politics. Indeed, the two new parties that finished second and third in the October 2018 parliamentary election (Who Owns the State? and the New Conservative Party) made these issues central to their election campaigns.

These issues have been in the public eye as, in January 2019, the Latvian prosecutor general charged a former anti-corruption agency employee, Juris Jurass, for disclosing state secrets. Just a few months earlier, he had been elected to the Latvian parliament on the New Conservative Party ticket and he is chair of the Defense, Interior and Corruption Prevention Parliamentary Committee. Jurass describes himself as a whistle-blower, with the charges pertaining to him publicly releasing information that he had been offered a €1 million bribe while heading a division at the anti-corruption agency.

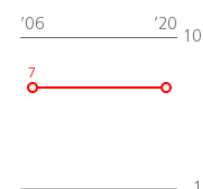
Independent judiciary

8



Prosecution of office abuse

7



Latvian legal and security authorities have long struggled to win major corruption cases. This continues to be best illustrated by the ongoing case of Aivars Lembergs, the long-standing mayor of the wealthy port and transport hub city of Ventspils. He is one of Latvia's wealthy three "oligarchs." Lembergs was indicted with large-scale money laundering and corruption in 2000. Later that year, he was briefly detained behind bars and then under house arrest amid allegations from the prosecution that he was interfering with the case and hindering further investigation. Since then, there have been a number of breaks in the court process due to illness (of the accused, his lawyers, the judges, etc.) and other technical issues. This has demonstrated the ease with which the Latvian judicial system can be delayed and manipulated. As of early 2019, there is still no sign of the case concluding. Some legal disputes involving international actors have been resolved in British and other jurisdictional courts, due to international actors' skepticism toward having their cases heard fairly in Latvia.

This has contributed to a widespread populist, anti-elite attitude in Latvia. Much of the public view politicians, civil servants and successful businessmen as corrupt. This has resulted in low levels of mutual trust and social capital, and open distrust of the judicial system. High-profile arrests of judges and low- to mid-level public servants (policemen, customs officials, bureaucrats) strengthen such opinions.

Latvia protects all core human rights, including the right to life and security, while also prohibiting torture and cruel or inhuman treatment or punishment. In 2006, it created a national Ombudsman's Office and, as an EU member state, Latvians also have recourse to the office of the European ombudsman.

The Latvian Ombudsman's Office has consistently challenged government institutions and defended the rights of both individuals and groups, such as Roma and low earners. In January 2016, the ombudsman even challenged the anti-corruption agency, claiming that it was failing to fulfill its anti-corruption mandate and that politicians should debate closing the institution. In October 2018, the ombudsman started a discussion on redefining the legal concept of a family in Latvia, arguing that definitions focusing on marriage were too narrow for the twenty-first century.

The Latvian Constitutional Court ensures that laws and administrative practices do not conflict with the constitution, and has overturned several major laws passed by parliament, for example, when it scuppered a law to cut pensions as part of the 2009 austerity program. Latvia has no formal restrictions on the civil rights of women, religious groups or ethnic groups. However, both refugees and the gay rights issue can mobilize radical movements, including far-right activists and even mainstream churches (both Catholic and Protestant). Much of the mobilization is online and the turnout at anti-gay or anti-migration public events tends to be very low, however, numbering in the double digits in recent years.

Civil rights

9



1

In 2005, the Latvian parliament passed a constitutional amendment banning gay marriage. This amendment has strong political support and is unlikely to be reversed in the immediate future.

4 | Stability of Democratic Institutions

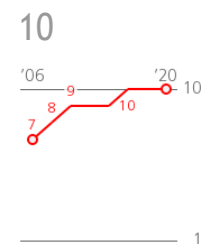
Latvia's democratic institutions came under extreme strain during the uncertain political, economic and social transition of the 1990s and then again when successive governments introduced severe austerity measures between 2008 and 2011. Nevertheless, the institutions proved strong and rigorous, as evidenced by Latvia's membership of every major western international institution, including the OECD and the eurozone.

The constitution and other laws give a mandate to parliament, the executive, national and municipal bureaucracies, and judicial institutions to take decisions and implement them. Checks and balances are in place, and the state president and the Constitutional Court return laws to parliament and the executive.

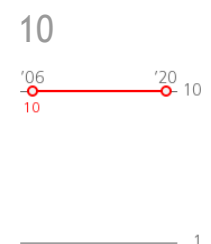
In recent years, the lack of research capacity to support policy formulation has been recognized as a major deficit in the working of Latvia's democratic institutions. In early 2017, the Latvian parliament created a new parliamentary research unit while the Economics Ministry established an institution, now based at the University of Latvia, that will study Latvia's competitiveness and productivity. Latvia's Fiscal Discipline Council similarly reviews budget procedures and offers both advice and criticism to the government. These developments will improve the functioning of government institutions.

Many different government institutions and NGOs participate in the political process in Latvia and recognize mutual legitimacy. There are no major actors that advocate authoritarian alternatives to democracy. The military and the clergy do not have veto powers.

Performance of democratic institutions



Commitment to democratic institutions



5 | Political and Social Integration

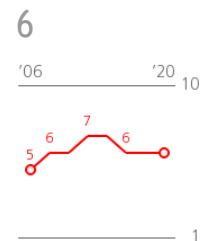
Latvia's political parties have the smallest memberships in the European Union, measured as the percentage of the voting population that are party members. With just 1.2% of the population engaged in political parties, there is little hope of the parties becoming socially-rooted or maintaining complicated organizational structures. While Latvia provides modest state funding for parties polling over 2% in national parliamentary elections (€0.71 per year for each vote received, amounting to a total of around €600,000 a year), for many parties it is not enough to fund their organizations. For example, between 2014 and 2018, From My Heart for Latvia received just €44,000 a year in state financing. As a result, parties also rely on individual donations to fund their activities, especially for election campaigning. While annual donations are limited to just €20,000 per individual, this still leaves open the opportunity for clientelism. However, in January 2019 the government proposed legislative amendments to increase state funding of political parties.

Latvia's parties are also small because of the low barrier to entry. The party registration requirement of just 200 individuals (raised to 500 in 2015 for those parties wishing to participate in parliamentary elections) means that internal conflicts often result in splinter groups emerging and new parties being formed. Of the 100 deputies elected to the parliament in 2018, 60 were new to the job, while three of the seven elected parties were new to parliament.

The main division in the party system is ethnic. Ethnic Latvian parties differentiate themselves via charismatic leaders rather than competing policy offers or ideologies. Indeed, the lack of ideas in politics (no party has its own think tank or, indeed, a tradition of turning to think tanks or research centers to generate ideas) remains a fundamental weakness of the Latvian system. While ethnic Latvian voters have low levels of identification to a specific party and float from supporting one party or coalition (from the constellation of ethnic Latvian parties) to another, Russian-speaking voters have rallied around Harmony Social Democracy (previously known as Harmony Center), which has had a virtual monopoly of the Russian-speaking vote since 2010. The party has attempted to reach out to the ethnic Latvian electorate in order to expand its share of the vote, but this has hitherto only worked in municipal rather than national elections.

In 2018, Latvia also saw the rise of the populist party KPV LV, which gained the second-highest number of votes in the October elections and entered the governing coalition.

Party system



Latvia's economics and business groups are by far the most significant interest groups in the country; other groups are too small and informal to play any serious role. Latvia's National Tripartite Council brings together groups representing employers (the Latvian Employers Association) and employees (the Latvian Free Trade Association) with the Latvian government. In the past, there have been complaints from both that governments ignore their comments and suggestions. However, in recent years the council has played an important role in debating tax reform (undertaken in 2016 and 2017) and government reform initiatives. Politicians increasingly reach out to other economic groups. For example, in January 2019 the new government coalition spent several days debating its putative economic policies, as laid out in the coalition's draft policy plan, with the Latvian Chamber of Commerce and other economic actors.

At the same time, the role of informal economic and business interests have weakened as the "oligarchs" have been politically marginalized and changes to the party campaigning and financing regime have weakened, if not eradicated, the influence of informal interests.

The 2008 to 2010 economic downturn severely affected support for democracy in Latvia. A 2011 report by the European Bank for Reconstruction and Development (EBRD) found that Latvia was the only EU member state where less than 40% of the population favored democracy. However, a 2018 Eurobarometer report found that a majority (59%) of Latvians were satisfied with the performance of democracy in the country.

Trust in national political institutions has rebounded slightly, hand-in-hand with the economic upswing, and the spring 2018 Eurobarometer data revealed that trust in the government was below the EU average with 28% tending to trust it (the EU-28 average was 34%). Trust in parliament had grown from 17% in 2016 to 19% (although that is well below the EU average of 34%). Nevertheless, this indicates an increase in trust compared to spring 2010, when trust was, respectively, just 13% and 6%.

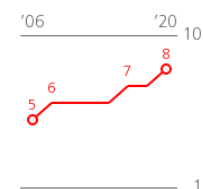
The deep cleavage between ethnic Latvians and Russian speakers, reflected in the ethnically divided politics, media and education system, is a major barrier to building social capital in Latvia. In 2017, 44.7% of survey respondents agreed that "most people can be trusted" but 51.7% disagreed.

Latvia has a strong tradition of public participation in various different cultural associations such as choirs, folk-dance groups and sports clubs. However, there are far fewer politically-oriented interest groups, largely because there is no established tradition of donating finances or time to good causes.

A positive development was the establishment of an online platform for entrepreneurial social initiatives that gives people the opportunity to formulate and

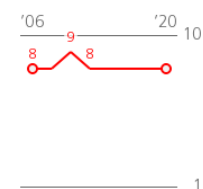
Interest groups

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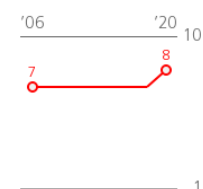
Approval of democracy

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Social capital

8



then circulate online citizens' initiatives (www.manabalss.lv). A number of internal checks and balances ensure that the initiatives are well-formulated and meaningful. If an initiative collects 10,000 authenticated electronic signatures, it is submitted for parliamentary deliberation. A majority of the initiatives submitted by the platform have been passed into law (26 of 38).

Another recently-created initiative is the "Democracy Festival," based on the Scandinavian model. The "Lampa" festival, as it is known in Latvian, was first held in 2015 and now gathers tens of thousands of participants in the small town of Cesis, to listen and participate in hundreds of discussions about multiple topics over two days.

II. Economic Transformation

6 | Level of Socioeconomic Development

Latvia's rapid economic development in the early 2000s was derailed by the global economic downturn that began in 2008 and hit Latvia particularly hard. The politics of austerity characterized the following years and led to a rapid rise in inequality and poverty. Latvia slipped from 44th in the UNDP Human Development Index in 2010 to 48th in 2012, although by 2017 it had risen to 41st, equal with Portugal. In 2017, inequality was the highest in the European Union, ahead of Bulgaria and Lithuania. The 2017 tax reform partially tackled these issues, with a new progressive income tax (rates of 20%, 23% and 31.4%) and capital gains tax rising to 20%.

Those at greatest risk of poverty in Latvia include rural communities (especially those in the eastern region of Latgale, which borders Russia and Belarus), pensioners and the low-skilled, who were most likely to be thrown into unemployment after the 2008 downturn. It also includes families with a high number of children, although in recent years a focus on "demographic" issues has led to targeted benefits increases and tax deductions for families with three or more children. Poor employment prospects and relatively low benefits have led to many Latvians migrating to Western Europe, particularly Ireland and the UK. While estimates vary, the Foreign Ministry claims that approximately 370,000 Latvian citizens and non-citizen residents live outside Latvia.

Economic indicators		2015	2016	2017	2018
GDP	\$ M	26972.9	27695.5	30463.3	34849.1
GDP growth	%	3.0	2.1	4.6	4.8
Inflation (CPI)	%	0.2	0.1	2.9	2.5
Unemployment	%	9.9	9.6	8.7	7.9
Foreign direct investment	% of GDP	3.1	0.9	3.7	1.2
Export growth	%	3.1	4.4	6.2	1.8
Import growth	%	2.1	4.4	8.9	5.1
Current account balance	\$ M	-130.3	377.0	-245.7	-296.0

Question
Score

Socioeconomic
barriers

7

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Economic indicators		2015	2016	2017	2018
Public debt	% of GDP	36.8	40.3	40.0	35.9
External debt	\$ M	-	-	-	-
Total debt service	\$ M	-	-	-	-
Net lending/borrowing	% of GDP	-2.4	-0.2	-0.6	-
Tax revenue	% of GDP	22.6	23.8	23.4	-
Government consumption	% of GDP	17.9	18.0	18.0	17.7
Public education spending	% of GDP	5.3	4.7	-	-
Public health spending	% of GDP	3.3	3.4	-	-
R&D expenditure	% of GDP	0.6	0.4	0.5	-
Military expenditure	% of GDP	1.0	1.5	1.7	2.0

Sources (as of December 2019): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

7 | Organization of the Market and Competition

As a member of the European Union, the World Trade Organization and the OECD, Latvia complies with international norms that regulate and enforce market competition. Nevertheless, corruption and allegations of judicial bribery distort competition in areas such as state procurement, enforcement of contracts and bankruptcy administration. The shadow economy (which is estimated to be between 20% and 40% of GDP, although on a downward trend) and widespread use of “cash-in-hand” salaries (i.e., non-taxed wages in cash) also create an unequal playing field between enterprises. Successive governments have identified these challenges but done little to address them.

Starting a business in Latvia is relatively easy, with no significant entry or exit barriers. The registration of a company takes as little as 5.5 days, four procedures and 1.6% of the average income per capita, according to the World Bank’s 2019 Doing Business report, which ranks Latvia 24 out of 190 countries in its sub-index “Starting a Business.”

Market organization

8



Latvia complies with European anti-monopoly legislation and also has national-level laws and authorities. The Latvian Competition Council issued 21 resolutions in 2017 and received over €10 million in fines. In the last few years, some considerable improvements to the institutional framework for competition policy were made. Alongside working to implement competition policy and to apply the law governing competition, the Competition Council focused its strategy on challenges such as high staff turnover, new development, elaborating amendments to legislation and strengthening deterrence to dissuade people from breaking the law.

As an EU member state, Latvia's foreign trade relationships are regulated and overseen by the European Commission. As a small, open, liberal state, Latvia's governments have traditionally been strongly pro-trade, strongly supporting, for example, ratification of the Transatlantic Trade and Investment Partnership (TTIP), which has been halted by Donald Trump's administration in the United States.

Latvia's banking industry has long been seen as both a blessing and a curse. The country has the biggest banking sector of the Baltic states, with some supporters arguing that Riga could become a major international financial center.

However, critics point to a string of spectacular banking failures. The first collapse came in 1995 when Banka Baltija, Latvia's largest commercial bank, folded, owing some \$400 million to more than 200,000 creditors. A further fifteen banks collapsed by the end of that year. Banking regulations and supervision of the sector were tightened, and a financial regulator was created to oversee banking in 2000. The sector was further consolidated as the largest Latvian banks were taken over by a succession of mostly Nordic banks. The great Latvian recession of 2008 to 2010 was triggered by the collapse and subsequent government bailout of Parex, Latvia's oldest commercial bank. The Russian-owned Latvijas Krajbanka was declared bankrupt in December 2011. Most recently, in February 2018, the US Treasury's Financial Crimes Enforcement Network (FinCEN) issued a notice accusing ABLV, Latvia's largest domestically owned bank, of money laundering. A few weeks later, the bank went into liquidation. Under US pressure, Latvian authorities passed laws banning banks from servicing shell companies. Non-resident holdings fell from \$12 billion to \$3 million in a little over six months. A critical report by the Council of Europe's Moneyval (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism) on the Latvian finance industry will lead to a further reorganization of Latvia's banking regulators in 2019.

Since 2015, the Latvian government has focused on increasing regulation of the large non-resident banking sector. The Financial and Capital Market Commission – the industry regulator – has enacted new anti-money laundering laws and increased oversight of the sector. Several banks, including the Latvian branch of Swedbank,

Competition policy

10



Liberalization of foreign trade

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Banking system

9



received fines for insufficient internal anti-money laundering control systems. Nevertheless, these controls have significantly strengthened the Latvian banking system.

Despite its issues, the overall indicators for the banking sector remain strong. Latvia has a relatively low proportion of non-performing loans (3.5% of the total number of loans in 2017), largely because banks have been very careful about handing out loans since the 2009 recession. This is also reflected in the modest average bank capital-to-assets ratio (11.13% in 2017), according to the World Bank.

The Riga Stock Exchange (RSE) is part of the NASDAQ OMX chain of stock markets. The volume of trading is very low, and very few Latvian enterprises are publicly listed.

8 | Monetary and fiscal stability

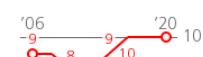
Latvia joined the eurozone on January 1, 2014, enabled by focused policies on currency stability and inflation. This was particularly challenging during the economic downturn of 2008 to 2010, when many politicians and a minority of economists called for a devaluation of the lats (the currency at the time) in order to allow the Latvian economy to regain competitiveness. However, Prime Minister Valdis Dombrovskis (now vice-president of the European Commission) and successive finance ministers, supported by Ilmars Rimsevics, the governor of the Bank of Latvia, ensured that this was a key part of the IMF-led financial rescue package in late 2008.

Since 2012, annual inflation in Latvia has been less than 2%, but it crossed that threshold and reached 2.5% in 2018 due to an increase in energy prices.

As a member of the eurozone, monetary stability is now governed through the European Central Bank (ECB). There are, however, concerns that Latvia is not adequately represented in the ECB, because the governor of the Bank of Latvia, Ilmars Rimsevics, was charged with corruption and influence peddling by Latvia's anti-corruption authorities in February 2018. He has refused to resign from the post, but the conditions of his bail prevent him from traveling to ECB meetings in Frankfurt. A new governor of the Bank of Latvia is scheduled to be elected in December 2019, when Rimsevics' term ends.

Monetary stability

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As a member of the eurozone, Latvia's budgetary policies are tightly constrained by the structure of the European Semester. In 2017, Latvia had a budget deficit of 0.5% of GDP, and in 2018, it was under 1%. The new government that came to power in January 2019 plans to run a government budget with a fiscal surplus. A Fiscal Discipline Council of local and international experts was created in January 2014 and helps to oversee government budget discipline.

Latvia's public debt burden grew rapidly after the IMF-led international bailout in late 2008. Latvia had previously had low levels of public debt, largely because it had emerged from the Soviet Union with no public debt. However, the bailout amounted to a total €7.5 billion, which raised Latvia's public debt from 7% of GDP in 2007 to 40% in 2010, slightly decreasing after that but returning to 40% by 2018. The more recent increase is mainly due to the costs of servicing the debt and the need to borrow funds on the international market to repay the loans received from the European Commission and the World Bank during the financial crisis.

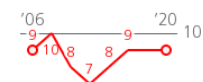
9 | Private Property

Private property rights are well-regulated and protected. However, the Foreign Investors Council in Latvia (FICIL) has repeatedly criticized insolvency procedures in the country, complaining that recovery rates are significantly below international benchmarks. That is largely as a result of abuse of the insolvency procedures, high fees and costs claimed by the administrators, and administrators' failure to meet the required reporting standards. FICIL claims that research carried out by Deloitte shows that weakly regulated insolvency procedures cost the Latvian economy around €665 million between 2008 and 2014. Along with media pressure, this led to an increased focus on insolvency issues in 2017 and 2018, whereby many of the more prominent insolvency administrators were arrested and there was legislative reform of the sector.

Latvia's economic structure has fundamentally changed and been reformed during the last quarter of a century. The breakup of the Soviet Union in 1991 resulted in Latvia kicking off a controversial program to privatize state-owned assets. The most profitable state-owned companies (those involved in the transit business and monopolies such as gas) endured a complicated, politicized and controversial privatization process. The state maintains a significant stake in some large enterprises, for example, 51% of the profitable telecommunications company Latt telecom (efforts to privatize it in the mid-2000s were thwarted by political interests), as well as similar stakes in the largest mobile telecommunications company, LMT, and the electricity monopoly Latvenergo, which has a 90% share of the domestic market. The Swedish telecommunications giant Telia Sonera holds a minority stake in both LMT and Latt telecom and has attempted to buy the government's stake in both companies and then unify the two Latvian companies

Fiscal stability

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Property rights

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Private enterprise

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several times. However, this has been resisted by government, most recently in 2017, largely because of fears that it would have a negative impact on competition and innovation in the Latvian telecommunications industry. Nevertheless, the Latvian economy is now dominated by private companies owned by both Latvian and international investors.

10 | Welfare Regime

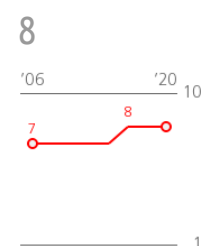
Latvia has a comprehensive welfare system. The state provides pensions as well as benefits for children, maternity leave and illness, among others. Some, such as maternity and invalidity benefits, were reduced during the austerity era; others, such as pensions, were left largely untouched after government efforts to reduce them were successfully challenged in the Constitutional Court. In recent years, the biggest increases in welfare payments has been for families with three or more children, with the aim of reducing Latvia's demographic decline.

Latvia has a mixed three-pillar pension system. Pensioners who worked during the Soviet era receive small pensions based on receipts from current workers (the first pillar), while a 1990s pension reform introduced a capital-funded pension scheme for current employees (the second pillar). There are also third-pillar voluntary private pension funds that are complementary to the mandatory schemes. The second pillar has proved the most controversial, with claims that banks are charging excessive fees for managing the funds. Parliamentarians have drafted legislation that aims to limit bank commissions and fees.

A mixture of state and private financing funds the healthcare system. Patients must co-finance certain visits to family doctors and specialists as well as some procedures. This co-financing occasionally takes the form of informal cash payments – the former president Valdis Zatlers (2007-2011) admitted to accepting cash payments while he worked as an orthopedic surgeon. In 2016, the government began planning an overhaul of the medical system and it adopted a new model in 2017, which was due to be rolled out in 2019. The law plans to provide two different levels of healthcare service – a comprehensive package for patients who pay insurance contributions and a minimum package for those who do not. However, implementation has been delayed because of issues with the IT system as well as the new government (as of January 2019) proposing changes to this reform.

Primary and secondary education are free, although there is a national shortage of nursery school places. Tertiary education is a mixture of both public and private institutions, with state-funded university places being allocated according to grades rather than being needs-tested.

Social safety nets



All citizens and permanent residents, regardless of their gender or ethnic origin, have equal access to the education system, public services and employment. Latvia was ranked 17th in the 2018 Global Gender Gap Index and has typically hovered between 10th and 20th place.

However, Russian speakers do appear to be at a disadvantage in the education system. Russian-speaking schools score lower average grades than Latvian schools (largely because of the challenge of finding fluent Latvian-speaking teachers willing to teach in minority schools). Approximately two thirds of students in higher education are privately funded. Many of these are Russian speakers who choose to study in their native language because free public higher education is only available in the Latvian language. Students have access to cheap student loans to fund their education. The higher education system also allows students to hold down part-time and, in some cases, even full-time employment, while enrolled in tertiary programs.

Latvia's non-citizens are barred from working in the civil service or occupying posts directly related to national security. A long list of professions requires Latvian language skills, including in the private sector, which may influence the employment of Russian-speaking people. At the same time, employers cannot ask employees for information on knowledge of certain foreign languages. The regulations, which were introduced in 2018, followed complaints about the barriers to employment faced by young people lacking the knowledge of Russian.

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, disabled people and sexual minorities in the labor market.

11 | Economic Performance

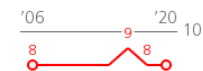
Latvia has been among the fastest growing economies in the European Union over the last half-decade. As a member of the eurozone, the country's budget is balanced, with only a small deficit, low inflation and steadily falling unemployment. Latvia's biggest challenge in 2018 appeared to be a shortage of qualified labor, particularly outside the capital city, Riga, and in the information, communication and telecommunications (ICT) sector.

This has been a significant turnaround following the shock of the severe economic recession between 2008 and 2010, when Latvia saw a 23.9% contraction of GDP, a historic high for an industrialized state, second only to the USA's Great Depression in the early 1930s. However, while in the US the Great Depression lasted for four years, Latvia's contraction took place over just seven financial quarters.

GDP growth also saw dramatic changes during the 2008-2010 financial crisis, with a 13% drop in 2009 and 8% growth in 2011, followed by an average of 3% growth

Equal opportunity

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Output strength

8



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between 2013 and 2016. Similar tendencies were visible in FDI and unemployment levels. There was a decrease in FDI of 0.1% of GDP in 2009, but it returned to an average of 3% in 2012-2015. The unemployment rate peaked in 2010, reaching 19.5%, but has steadily fallen since, sinking to 8.7% in 2017, with the economy recovering and many Latvians also having emigrated to other EU countries.

Nevertheless, the Latvian economy still lags significantly behind its Baltic neighbors. In 2017, the country's per capita GDP (PPS) was just 67% of the EU average, while Lithuania was at 78% and Estonia at 79% (Eurostat).

12 | Sustainability

Latvians generally see themselves as a green and an environmentally-friendly country. In 2004, Indulis Emsis became Europe's first Green Party prime minister and Raimonds Vejonis, president from 2015, is also a Green Party politician who had previously served as Latvia's minister for the environment and local government. Another prime minister from the Green/Farmers' Union, Maris Kucinskis, served from February 2016 to January 2019.

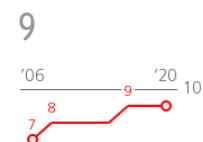
However, the environmental movement in Latvia remains rather weak despite political success and public support for green values. The Green Party has long been the submissive partner in a party alliance with the Farmers' Union (indeed, the union has been heavily financed by the Latvian oil and transit lobby) and green issues have little salience in Latvian politics. Latvia's solid performance on different environmental indicators (such as ranking 37th in Yale University's 2018 Environmental Performance Index, EPI) can largely be attributed to a low and declining population, dense forest cover and the de-industrialization of the quarter of a century following the collapse of the Soviet Union. Consumption remains lower than the EU average.

Nevertheless, efforts to improve the quality of the environment continue. Latvia has introduced taxes and regulation to limit the use of plastic bags. There are also plans for a large-scale electrification of the Latvian rail network and new car taxes with higher-polluting cars paying more. The Riga municipality is in advanced talks to introduce a road congestion charge for those driving into the center of the city.

Latvia's higher education, vocational training and research system still awaits major reform and investment to raise productivity, effectiveness and quality.

Spending on education is typically between 5% and 6% of GDP while just 0.5-0.6% of GDP goes toward research and development. This has resulted in a sub-par performance (especially when compared to neighboring Estonia) in various international education indexes, such as the OECD's PISA report and international rankings of universities, where no Latvian institution makes it into the global top 500

Environmental
policy



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Education policy /
R&D



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of any major ranking. Education and research spending was particularly hard hit by the austerity policy a decade ago, and tight government budget constraints since then have kept spending at a low level. Recent reforms have focused on closing down and merging rural schools with low student numbers, merging under-performing universities (the Riga Pedagogical University was forced to merge with the University of Latvia in 2017) and utilizing EU funds to invest in rebuilding neglected vocational institutions. A school curriculum reform will also be implemented in 2019. In addition, in 2018 parliament approved transitioning to solely Latvian language instruction in public schools as of the 2021/22 academic year, citing the building of a cohesive society with Latvian language as the main language of communication as the reason for the legislative amendments.

An interesting recent development is Latvia's emergence as a major exporter of higher education, with some 8,000 full-time international students seeking a degree in Latvia (primarily in Riga) in the 2018/19 academic year.

Governance

I. Level of Difficulty

There are few structural constraints to governing Latvia. While the country is among the poorest in the European Union (as of 2018, only Bulgaria, Romania and Croatia were poorer), it is also a Baltic Sea state with growing economic and political links with the wealthy Nordic countries. Its border with Russia and Belarus, established transit infrastructure (including the biggest airport in the Baltic region and the largest national airline) and widespread knowledge of the Russian language and culture, give Latvia unique trade and economic opportunities. However, low investment in education and healthcare means that the Latvian labor force remains unhealthier, less educated and less productive than its Western counterparts, and the country has also lost competitiveness to its Baltic neighbors.

Latvian civil society has long been small, weak and fragmented. It suffers from severe financial constraints caused by a lack of contemporary tradition of either association membership or charitable donations. As a result, civic associations have few members and face constant financial struggles. For example, Delna, the Latvian branch of Transparency International, heavily relies on just a few generous donors and has a membership that has never been above the low double digits.

This situation was exacerbated by accession to the European Union, which led to a number of the key financial supporters of civil society – the Soros Foundation and the Nordic governments, for example – retreating from Latvia and moving to the next countries in line for EU accession, in the Balkans and post-Soviet territories. However, EU financing (through the structural, cohesion, social and other funds) was not an adequate replacement, as it offered only project-based funding, not the long-term “operation financing” that these other actors had provided.

At the same time, civil society lacks popular legitimacy. The forced voluntarism of the Soviet era has left the older generation skeptical of charitable and non-governmental activities. Moreover, all three major Latvian language daily newspapers (Diena, The Independent Morning Newspaper and Latvia’s Newspaper) have adopted a language and tone that is skeptical of civil society and particularly any organization or individual associated in some way with the Soros Foundation (the major supporter of civil society since the early 1990s).

Structural
constraints

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Civil society
traditions

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Social capital is low as a result. Latvians have the highest levels of distrust in their own political institutions (particularly political parties and parliament) in the European Union, and they also have low levels of mutual trust. Even the severe austerity measures of recent years failed to rouse society from its slumber. Only a few, largely low-key, sectoral demonstrations took place. Indeed, there was little solidarity shown between, for example, medical workers and education professions.

Finally, there are few institutionalized links between civil society and government. Political parties remain rather isolated from these organizations, although several candidates from civil society organizations have been elected to parliament from political party lists in recent years. Another positive recent development is the increased representation of professionals representing various civil society organizations in parliamentary committees and ministerial working groups. However, groups representing economic interests, which have greater financial resources, retain more influence than civic groups.

There is little risk of civil war or violence in Latvia. However, the country has both a deep ethnic cleavage that polarizes society and an emerging divide between conservative nationalists and liberal pro-Europeans.

While Latvians and a large part of the Russian-speaking community united in opposing the Soviet regime in the late 1980s, this fragile coalition fell apart after Latvia gained independence. Automatic citizenship was denied to former citizens of the Soviet Union and the 1990s and 2000s were marked by the battle over citizenship rights, naturalization and language rights, with no small involvement from the international community. This 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 Latvia's citizens).

Ethnic tensions were raised again by Russia's occupation of Crimea in 2014, with ethnic Latvians opposing it while many Russian speakers adopted a more pro-Russian and favorable view. Surveys indicate that these differing views are becoming more entrenched.

More recent tensions have centered around a battle to prevent liberal (sometimes also identified as "European") values creeping into Latvia. Society was divided by the refugee relocation quotas agreed by the European Council in 2015. More recently, there has been a battle over ratification of the Istanbul Convention (2017) and the UN Migration pact (2018), both of which were ultimately rejected by parliament.

Conflict intensity

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II. Governance Performance

14 | Steering Capability

Latvian governments have proven they are capable of executing international strategic priorities (conditionality). Integration with the West has been a priority for all major political parties in Latvia, thus “conditionality” issues were largely out of the realm of party competition. The prioritization of integration with the West allowed Latvia to join the European Union and NATO in 2004, the eurozone in 2014 and the OECD in 2016.

However, the short political life of most governments (which have had an average of one year of effective government before being chopped or changed) means that settling on domestic priorities has proven to be far more difficult. For example, the Latvian government was guilty of both economic and political backsliding after EU accession in 2004. The unexpectedly swift economic growth that followed was not accompanied by balanced budgets or prudent macroeconomic policy but by an uncontrolled government and private sector spending binge that ended with the crash and recession of 2008 to 2010. The reintroduction of international conditionality following the IMF-led international bailout allowed Latvia to return to a balanced budget and economic growth while adopting the euro and becoming an OECD member.

The strategic capacity of the government to prioritize and organize its policy measures was increased with the establishment of the Cross-Sectoral Coordination Center in the State Chancellery in 2011. The center was, for example, systematically checking whether the sectoral policy planning documents were in line with the Latvia 2020 and Latvia 2030 agendas. However, the institution has been weakened by operational capacity and a lack of impact on ministries that continue to work as single entities, which consequently makes it difficult to cooperate and work cohesively on policy priorities.

Procedures that govern how work on any policy document or legislative proposal should be conducted formally ensure that the government is able to gain expertise. The procedures include the need to consult with stakeholders. The National Tripartite Council involves representatives of trade unions and employers, as well as the government, and is another channel for gaining expertise. However, evidence-based policy-making, regular impact assessments and strategic planning remain challenges, since the political culture still tolerates the introduction of last-minute ideas in the final reading of the legislation. This has been criticized by the Latvian president, Raimonds Vejonis, who has asked the parliament to stop adding new ideas in the final reading of legislation.

Question
Score

Prioritization

9



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In addition to the Latvia 2020 medium-term and Latvia 2030 long-term planning documents, governments formulate their short-term aims in a coalition contract, overseen by a Coalition Council, which details the problems, issues and ambitions that each ministry will tackle.

Governments have the capacity to implement difficult and controversial policies. In 2009, Prime Minister Valdis Dombrovskis oversaw a fiscal adjustment of 9.5% of GDP. While taxes were increased and public sector salaries (and other expenditures) were decreased, public protest was muted. It should, however, be emphasized that these were policies that the international donors that had bailed out the economy insisted upon. Reforms that need domestic agreement – such as cuts to the school network or a reform of the healthcare system – tend to flounder at the policy formulation stage.

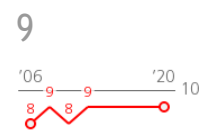
Cuts in the number of schools are needed as the number of pupils has decreased due to the dramatic demographic decline. As a result, many schools – especially in rural areas – have far too few pupils to be able to provide quality education. Latvia is also the EU country that spends the most on schools – 16% of state and municipality budgets, while the average in the European Union is 10%, according to Eurostat. But municipalities, who are responsible for their schools, have until now been reluctant to make the needed changes and the government has not been able to facilitate it. At the same time, in March 2018, parliament approved the plan to introduce solely Latvian language instruction in schools as of the 2020/21 academic year, showing that it is able to effectively introduce some reforms.

In healthcare, the main challenge is access. Due to insufficient funding, there are limited spaces to specialists provided by the state budget and not everyone is able to pay market prices to get the support they need promptly. In 2018, the government introduced a plan to divide the population into two groups, depending on their tax payments, with those not paying sufficient taxes being able to access only publicly-funded emergency services. However, the new government intends to abolish the reform, increasing funding for the healthcare system by increasing input from taxes.

Both of these reforms also touch on the need to reform Latvia's administrative territories, as people have unequal opportunities to access public services under the current system of 119 municipalities. The new government (formed in January 2019) has put administrative territorial reform among its top priorities, aiming to have the new system in place for the next municipal elections in 2021.

Between 2016 and 2018, the government also negotiated, formulated, passed and implemented a wide-ranging reform of the tax system. Among the most significant changes is the differentiated personal income tax – from 20% to 34.1%, depending on an individual's income levels. Until 2018, the income tax for everyone was the same (23%). A 0% tax on reinvested profit was also introduced.

Implementation



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Policy learning and innovation has primarily originated from external sources. In the 1990s, it was in the form of advice from the World Bank and the IMF, and in the 2000s, it came from the European Union. In recent years, the government has become more open to advisors from the OECD in addition to these other institutions.

There are several reasons for this. First, Latvian political parties are not ideologically rooted and therefore lack a basic political compass or instinct. Second, political parties and the government have no autonomous research capacity or even established links with think tanks. Rather, politicians rely on civil servants for policy ideas. Third, effective monitoring and evaluation has been undermined by the harsh dislocations and funding cuts the public sector has experienced from late 2008 onwards.

However, recent events indicate that the government is aware of these challenges and is seeking to improve these skills. A new Parliamentary Research Unit was set up in 2017 and the Economics Ministry created a Productivity and Competitiveness Council (although this is a recommendation from the European Council and could be classified as external conditionality). There is also a broader discussion on the importance of research in policy formulation, although governments continue to instinctively turn to international rather than domestic institutions for policy advice.

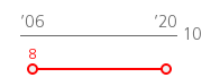
15 | Resource Efficiency

Latvia has no centralized recruiting procedure for hiring bureaucrats. This indicates a fragmented approach to personnel policy in the public sector. Ministries and agencies manage these procedures individually, leading to highly non-transparent and dubious recruiting practices. Moreover, ministers have often hired and fired the most senior civil servants in a ministry. The highest position is state secretary and in many cases, state secretaries have not hidden their political allegiances. High-profile bureaucrats often leave the civil service in order to enter national politics. However, all monthly salaries in ministries and public agencies are now published on the internet, and public officials have to submit annual financial declarations that are also available to the public. The state sector does not really function as a cohesive whole due to the nature of the Latvian government – ministries are divided between parties, which then become fierce protectors of their own sectors and substantial reforms are turned into a zero-sum game.

In an attempt to create a more cohesive public sector planning system, a planning and coordination institution located in the Cabinet of Ministers was created in December 2011. This “Cross-Sectoral Coordination Center” employs around 20 civil servants and is charged with ensuring that the work of Latvia’s different ministry is cohesive and “joined-up.” Its key tasks have been to: (1) develop a long-term strategic approach to public policy-making; (2) monitor decision-making to ensure that public policies are effective; (3) oversee ministries’ progress toward meeting goals agreed on in the government declaration; and (4) coordinate the management of state-owned enterprises.

Policy learning

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Efficient use of assets

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The Cross-Sectoral Coordination Center has drafted a plan to reform the public sector by reducing the number of civil servants while simultaneously using these savings to raise salaries for what it hopes will be a leaner but more productive bureaucracy.

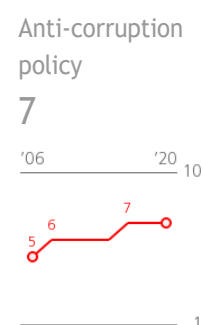
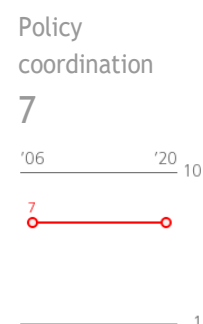
In 2019, the government plans to undertake a territorial administrative reform that aims to cut the number of local municipalities in Latvia from the current 119. This is largely driven by efficiency concerns raised by Latvia's rapid rural depopulation.

Coordination between ministries and other state institutions remains problematic due to the decentralized, party-based distribution of ministers. Moreover, the political parties that make up government coalitions often feud and compete, feeding over into the effective management and coordination of government. The prime minister often has little control over ministries that are governed by other coalition parties. This was clearly seen in the multiple budget-cutting exercises of 2008 to 2010, which were mechanical (e.g., each ministry cut expenses by 20% across the board) rather than being based on a functional audit of government and a future vision of the government's role. In the same way, a return to growth has broadly resulted in increased budgets for all ministries rather than some sort of prioritization (e.g., investing in education or research and development). An exception is the recent focus on raising spending in the health sector, largely as a pre-electoral response to citizens' concerns about the quality of healthcare. Another exception was the increase in defense spending, which has reached the 2% GDP level agreed by NATO members and is supported by the majority of the Latvian public due to Russian aggression in Ukraine.

Therefore, while prime ministers may set priorities and form an agenda, the decentralized nature of the government ministries means that there can be problems achieving these aims. The Cross-Sectoral Coordination Center was created to deal with some of these problems, and it has certainly improved the flow of information from the prime minister's office to line ministries and vice versa. At the political level, the weekly Coordination Council of governing party representatives aims to resolve conflicts and build coalitions.

Latvia has long been criticized for corruption by its international partners, including the European Union, which requested reforms in the area to enable EU accession and further investments of EU funds. This shortcoming was addressed by the creation of the Corruption Prevention and Combating Bureau (KNAB) in 2002, which was envisaged as an independent institution with the power to combat and prevent corruption at all levels of the state system.

KNAB has indeed emerged as a powerful anti-corruption player, although its work has been hampered by constant political interference and an instability at the leadership level (not least because the director is elected by parliament, thus making the position part of the political horse-trading process). Indeed, in late 2016, a committee called to evaluate applications for the director's post decided that none of



the applicants (including Jaroslavs Strelcenoks, who held the post at that time and had reapplied for another term!) were qualified for the post. A new chief, Jekabs Straume, who has a background in military intelligence, was only appointed in June 2017. Straume was then instantly flung into a controversy, as a weekly news magazine published leaked conversations from a KNAB investigation into the political influence of Latvia's three "oligarchs," who were recorded profanely discussing politics, the government and their own influence. However, no charges have been made against any of the three or other politicians appearing in the conversations.

This is indicative of a general trend. KNAB has proved quite effective at fighting low-level corruption (bribes to police officers, regulating party financing and low-level bureaucrats) but has found it far more challenging to fight political corruption, particularly when the "oligarchs" or other influential figures under investigation turn the power of their print and electronic media against the bureau. For example, while the mayor of Ventspils, Aivars Lembergs, was first charged with corruption and money laundering in 2006, his case had still not come to a conclusion at the time of writing in early 2019.

At the same time, there was progress in 2018 as KNAB detained the president of the Latvian central bank for alleged corruption, and several people were detained for alleged corruption in the public procurements of the capital city's public transport company, Rigas satiksme.

Latvia has a powerful state auditor's office, which frequently publishes critical reports of state and local government institutions. Civil servants and politicians have their salaries published online and must submit annual financial declarations.

16 | Consensus-Building

All major political actors agree on democracy as the core element of the political system. There are no significant political parties advocating authoritarian rule or seeking to undermine the democratic apparatus of the state. However, populist discourse in the 2018 election did chip away at some of the core elements of a liberal democracy, with threats to the freedom of the press and the impartiality of civil servants, as well as a lack of civility to political rivals.

All major political parties agree that Latvia should be an open, liberal, pro-trade market economy. The opposition pro-Russian-speaker Harmony Social Democracy tends to emphasize a more redistributive agenda, but does not oppose the core elements of the market economy.

Consensus on goals

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The Latvian military (which is composed of 5,000 professionals and 8,000 members of the national guard) is firmly under civilian control and has refrained from entering the political fray. A 2018 annual report by Latvia's security police states that there are no significant organized groups threatening Latvian democracy, although there are a number of extremist and radical associations (both Latvian nationalist and pro-Russia) active on the fringes of politics. They have few members, find it difficult to rally significant numbers of demonstrators and are largely confined to the internet.

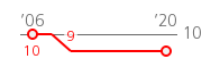
Latvia has one primary well-established cleavage – the ethnic Latvian versus Russian speaker divide – and an emerging liberals versus national conservatives cleavage.

Russia's occupation and annexation of Crimea in 2014 exacerbated the Latvian-Russian speaker cleavage. This was largely caused by the differing news sources and reporting consumed by the two groups and resulted in different attitudes toward the annexation. A few years earlier, a February 2012 referendum campaign on adopting Russian as an official state language was the setting for emotional speeches by politicians from both sides (Russian speakers wanted “respect” and “recognition” while Latvians believed their culture was under threat). Although this did not transmit into societal violence, it led to the two communities drifting further apart. The referendum was motivated by the major Russian-speaking party, Harmony Center (now renamed Harmony Social Democracy) being excluded from participating in a government coalition, despite it winning the greatest share of seats in the September 2011 early parliamentary election. Harmony claimed that this was discrimination against Russian speakers while the Latvian parties claimed ideological incompatibility (Harmony has a much more left-wing program and rhetoric than the Latvian parties). This divide continues. Harmony won the greatest share of seats in both the 2014 and 2018 parliamentary elections but has continued to be excluded from government coalitions, with Latvian parties drawing a “red line” and describing Harmony as pro-Kremlin rather than just pro-Russian speaker (something Harmony denies).

An emerging cleavage exists between liberals and national conservatives. Liberals advocate support for refugees and the LGBT community, and they are explicitly pro-European. However, national conservatives (who come from the nationalist extremes of both the Latvian and Russian-speaking communities) are sharply anti-refugee and advocate for “traditional” family policies. This divide is now also reflected in the Latvian parliament, with the Development/For! party alliance and the New Unity party forming a liberal block in parliament (with 21 out of 100 seats) following the October 2018 election.

Anti-democratic actors

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Cleavage / conflict management

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NGOs representing a wide variety of interests regularly participate in parliamentary committees, ministerial working groups and other forums. Political parties have also started recruiting NGO activists as candidates for local, national and European elections. However, ongoing internal institutional weaknesses, as well as the greater influence of business associations and interests, mean that their involvement is often of a symbolic rather than substantive nature.

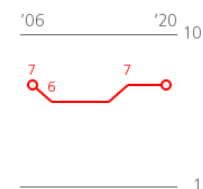
Governments have proved responsive to the rare large protests that have been seen over the last two decades. Public anger, as expressed in the November 2007 “Umbrella Revolution” in Riga’s Dome Square led to the resignation of Prime Minister Aigars Kalvitis, while the relatively small, violent anti-government protests of January 13, 2009 led to the collapse of the government led by Ivars Godmanis. Public dissatisfaction at the secretive way in which the last two state presidents were chosen and elected by parliament has led to parliament changing the election procedure so that in 2019 the parliamentary vote to elect the president will not be made in secret.

There is little political appetite to bring about a reconciliation of the ethnic Latvian and Russian-speaking communities. In recent years, several political leaders have attempted to reach across the ethnic divide. Ainars Slesers, one of Latvia’s three then-influential “oligarchs,” attempted to recruit both Latvians and Russians to his unusual Christian pro-technocrat party (named Latvia’s First Party). Valdis Zatlers, the leader of the Zatlers Reform Party, which came third in the 2011 snap election, attempted to form a national government coalition with Harmony Center after the vote. However, other Latvian parties refused to countenance a coalition with Harmony Center, and Zatlers also faced opposition from within his own party. A political reconciliation between the two communities has subsequently been seen as the “third rail” of Latvian politics, and no major Latvian political actors propose politically bridging the gap between the two communities.

Although the passing of time has reduced the salience of the communist versus anti-communist divide, the issue came to the surface again in December 2018 when the Latvian National Archive finally published the KGB archives – the dossiers of 4,300 out of about 25,000 KGB agents active in the period from 1953 to 1991. This led to a public backlash against those named in the files. At the same time, some of the individuals provided detailed explanations of how they had been recruited, providing a greater explanation of the era and the basis for greater social understanding.

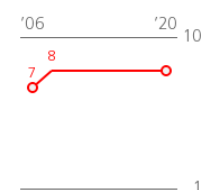
Civil society participation

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Reconciliation

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17 | International Cooperation

Latvia has two key planning documents, the medium-term National Development Plan for 2014 to 2020 (NAP 2020) and the Sustainable Development Strategy (Latvia 2030). The latter elaborates seven long-term development priorities: development of cultural space, investment in human capital, change of the paradigm in education, an innovative and environmentally efficient economy, nature as future capital, perspectives of spatial development, innovative government and civil society participation.

The NAP 2020 has three priorities: growth of the national economy, “human securitability” (a form of resilience) and growth for regions. It aims to coordinate the use of EU cohesion and structural funds for the 2014 to 2020 EU multi-annual budget. This recognizes the fact that Latvia’s membership of the European Union, with accompanying access to structural funds as well as support for the agricultural sector, is key to future development. Indeed, Latvia’s ambition to converge economically and politically with the European average drives policy-making in the absence of ideologically rooted political parties. The EU funding is key to maintaining and developing the agricultural sector and is an important source of finance for higher education, innovation and research, as well as developing transport networks and constructing facilities in small towns and rural areas. Latvia received over €4.5 billion in structural and cohesion funds in the 2007 to 2013 financial perspective period, with another €4.2 billion in the 2014 to 2020 period.

A criticism is that rather than focusing funds on the most competitive areas – such as education and innovation or developing transport infrastructure – the funds have been used in a more decentralized, scattershot way, with a more or less even distribution across regions. This has resulted in newly refurbished libraries and cultural centers, three large, new regional concert halls, bicycle paths and other upgrades to living infrastructure, but at the cost of investing in infrastructure that could upgrade skills or bring new investment.

Latvia has taken its international commitments seriously for more than a quarter of a century. Militarily, Latvia has provided troops for NATO missions in Afghanistan and the Balkan region and participated in the “coalition of the willing” in the US-led war in Iraq. As the military threat from Russia has grown in recent years, Latvia has started hosting a greater number of military troops on its territory. Canadian troops lead the one thousand-plus NATO troops in Latvia, which in 2018 also included personnel from Spain, Italy, Poland, Slovenia and Albania.

Latvia has also proved itself to be a reliable partner with international financial institutions. In 2012, the country successfully “graduated” from the IMF-led international lender program it began in 2008. A conference in Riga that same year saw IMF President Christine Lagarde laud Latvia for its “collective determination and resilience,” and she cited the country as an inspiration for other European countries.

Effective use of support

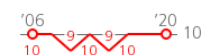
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Credibility

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Indeed, Latvia has proved to be one of the more reliable EU member states and is consistently among the members that have most quickly transposed EU law into national law. Latvia joined the eurozone in 2014 and the OECD in 2016.

Nevertheless, in recent years Latvia has been a rather less compliant partner. The government coalition was split on accepting a refugee quota as part of the EU's relocation program, although the government did eventually agree to the plan. But in 2017, Latvia failed to ratify the Council of Europe's Istanbul Convention (on preventing and combating violence against women and domestic violence) and in 2018 it similarly rejected the United Nations Migration Pact after pressure from the radical right National Alliance, which has been in government coalitions since 2011. However, the government, including the National Alliance, remains committed to membership of the European Union and the other major Western international organizations.

Latvia is an active participant in a number of regional organizations centered around the Baltic Sea, such as the Council of Baltic Sea States and the informal Nordic-Baltic 6 (NB6) group in the EU, as well as a number of regional initiatives including the creation of the Baltic macro-region. The Baltic Sea Strategy (BSS) aims to further governmental and regional cooperation among the EU states that border the Baltic Sea. Latvia has long benefited from regional cooperation with the wealthier states bordering the Baltic Sea (Germany, Sweden, Finland and Denmark, as well as the Nordic countries of Norway and Iceland).

However, despite a common past and closer geographic links, cooperation with Lithuania and Estonia has been far weaker. Institutions of cooperation do exist (such as the Baltic Council of Ministers and the Baltic Assembly, which brings together parliamentarians), but they have little substantive output. The closest links between the three Baltic states are in the sphere of defense, where there is a joint Baltic Defense Academy in Tartu, Estonia, a Baltic battalion and multiple other regional initiatives that have assumed a much greater importance following Russia's annexation of Crimea in 2014 and rising security threats in the region.

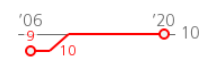
Latvia has also used the EU's Eastern Neighborhood Policy to promote democratization and marketization in other post-Soviet states, particularly Georgia, Moldova and Ukraine – countries that the Latvian government feels could benefit from the experience of Latvia's transition to a market democracy. Cooperation with these states remains a foreign and development policy priority.

However, relations with Latvia's eastern neighbor, Russia, continue to be difficult at the political level and the economic sanctions levered on Russia in 2014 have led to a further weakening of bilateral economic relations.

Broadly speaking, Latvia is constantly building closer ties to the West while simultaneously loosening political and social (but ideally not economic) links to Russia.

Regional
cooperation

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Strategic Outlook

Latvia's key medium- to long-term challenges have remained unchanged for several years: (1) mitigating a drastic demographic crunch; (2) managing political and economic relations with Russia; and (3) raising productivity through developing the higher education and research sectors. Additional challenges include fighting corruption (where the trend has largely been positive in recent years) and a developing values cleavage between liberals and national conservatives.

The 2011 census found that Latvia's population had declined by 309,000 people (a fall of 13%) over the previous decade. This trend has continued in subsequent years as a result of both a negative birth rate and emigration to Western Europe, primarily the UK and Ireland. This is coupled with accelerating urbanization, with the capital city Riga and its surrounding suburbs being the only part of the country to experience positive demographic trends. An increase in life expectancy combined with low birth rates means that Latvia's old-age dependency ratio has been creeping up. This brings challenges to service provision in both the private and public sectors as well as the labor market. These issues can be dealt with through the consolidation of Latvia's 119 local authorities and municipalities, which would cut costs and lead to better services. EU structural and cohesion funds in the 2021 to 2027 period should be focused on creating the infrastructure that will bring jobs and investment to Latvia's regions. In the short run, businesses complain of a shortage of labor in manufacturing as well as the IT sector. Latvian politicians must begin a necessary debate on immigration in order to build a consensus on accepting (or rejecting) the need for importing skilled labor to boost growth.

The government will also have the challenge of continuing to manage relations with Russia in an era of heightened military tension. Ongoing sanctions mean that trade with Russia has sharply declined since 2014. Russia is also gradually redirecting the lucrative rail cargo transit business to its own ports. Russian state-funded media and NGOs continue to agitate against Latvia, promoting dissatisfaction in the Russian-speaking communities. The government will have to continue investing in Russian-language public media as well as the crucial long-term aim of integrating Russian-speaking public schools with their Latvian counterparts.

The Latvian economy can only hope for long-term productivity gains if investment is increased in the higher education, innovation and research sectors. The increased openness, transparency and comparative competition that membership of the European Union brought about has revealed these sectors to be largely internationally noncompetitive. No Latvian university makes the top 500 in any global index of universities. The most talented Latvian students continue to flock to foreign European universities. Latvian research centers fare comparatively badly in EU-funded research framework competitions and Latvia spends far less on innovation (perhaps because there are few places to spend the funds). Higher education reforms that introduce stricter evaluations, performance-based financing and a restructuring and reorganization of higher education institutions (Latvia has well over fifty) and research institutions, as well as infrastructural investments from EU funds, are needed if Latvia is to continue to grow economically and eventually converge with the Baltic Sea states and the European Union.