

## Latvia – 20 years of independence: a trade-off between economic and political sovereignty?

### Abstract

*This article seeks to examine the standing of Latvia in the new European constellation. The following lines objectively question, partially using the results of a small-scale, but representative, survey of 130 people in Latvia, how the well-being of this east European nation has changed in the twenty years since the collapse of the Soviet Union and in the course of the country's integration into the EU. The author also turns her attention to whether a small country like Latvia can actually preserve both its political and economic sovereignty. The findings suggest that well-being in the Latvian SSR was better than it is today, but the author concludes that Latvia has been compelled to sacrifice economic sovereignty in order to preserve its political independence. Ultimately, and given the cut-throat trends sparked off by international competition and unrestricted monetary flows, is any other choice conceivable for a small and resource-challenged country like Latvia in the era of globalisation, either now or in the future?*

**Keywords:** European Union, Soviet Union, political sovereignty, economic sovereignty, well-being, human development

### Introduction

The Republic of Latvia is a small country situated on the Baltic coast of eastern Europe. The estimated population in 2012 slightly exceeded 2 million, 60% of whom is ethnic Latvian while a significant part, i.e. 27.3%, is Russian, demonstrating the legacy of the past (Eurostat, 2012).

Just slightly over twenty years ago, Latvia was under Soviet Communist rule and the government of Latvia was not recognised by the international community. The nation itself experienced the Soviet economic and political system, while the Soviet Union introduced the Russian language into all aspects of everyday life. The intelligentsia was deported and a series of five-year economic plans led only to empty store shelves and starving people. Even though the productivity of the agricultural sector was high, a majority of the harvest was transported to other Soviet territories. Nevertheless, industrial capacity was significantly improved, employment was high, education was free and most of the basic needs of the nation, such as housing, were satisfied.

Latvia's *de facto* sovereignty was recognised in 1991 and the first years of independence were spent developing a functioning state. The most difficult tasks facing the government were the creation of administrative bodies, reforms in the health and education sector and also the much-needed shift from the planned economy to a market economy system. When political stability was reached and reforms initiated, the nation

became increasingly concerned about the preservation of its statehood so, in 1995, the Latvian authorities adopted a statement defining foreign policy goals. They argued that sovereignty could be strengthened through early integration into the European and worldwide security and political and economic structures. Latvia became a member state of the UN in 1991 and joined the EU and NATO in 2004 (Jundzis, 2010).

### Developments in well-being

However, clear existence goals for the country were absent for the first decade of independence. Political sovereignty was at the top of the agenda, but a majority of society believed that a continuing increase in average human well-being, and the long-term conservation of cultural heritage and the Latvian language, should be the goals. Even though the initiated reforms strived at improvements in the standard of living, similar to those of many western countries, and increased individual freedom and protected rights, many question whether these reforms and integration into the EU have supported the achievement of one of those main goals – improved human well-being in Latvia (Pabriks and Purs, 2001).

The Human Development Index, published by the UN Development Programme, assesses the long-term progress in human development regarding a long and healthy life, access to knowledge and a decent standard of living. Overall trends in human development in Latvia has been positive, as the HDI value has risen from 0.693 (in 1990) to 0.805 (in 2011). Hence, the statistics rank Latvia among other countries with high levels of human development (UNDP, 2011).

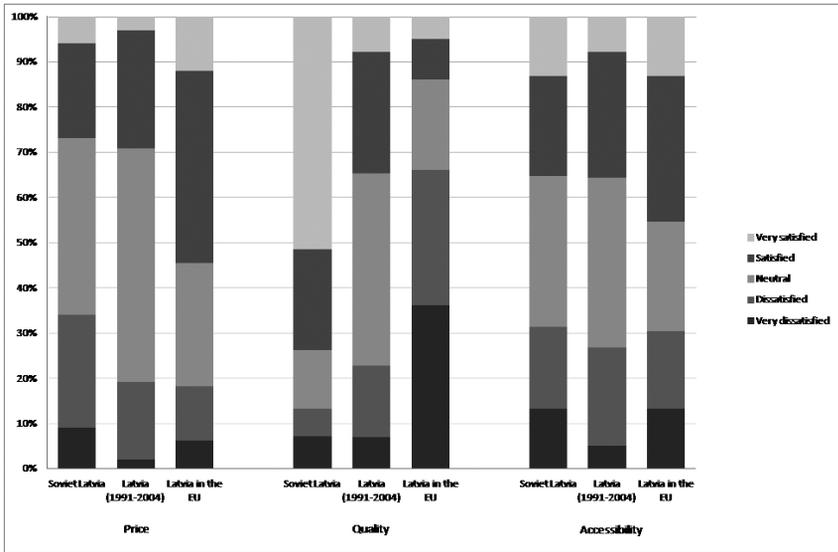
The majority of indicators, comparing 1990 to 2010, have followed a positive trend. Very often, development was slow during the first years of independence when the reforms were being launched. Years later, in the 21<sup>st</sup> century, especially after Latvia's accession to the EU, human well-being improved more rapidly until the crisis in 2008 which resulted in its decrease. Nevertheless, improved absolute numbers should not be overestimated.

### Healthcare

The previously centralised health sector has experienced notable reforms in the last twenty years; thus, the general condition of health of the inhabitants of Latvia has improved. The system has been decentralised; hence, it laid the foundation for the establishments of private healthcare institutions; thereby, healthcare has become more accessible and more qualitative, as portrayed from the results of our survey of 130 people in Latvia, contained in Figure 1. Furthermore, healthcare expenditure from the state budget has increased and financing from European sources has also been received, and so new technologies have been implemented.

At the same time, it is clear that more and more people are unable to afford healthcare services due to rising prices.

Figure 1 – Satisfaction of the surveyed population of the healthcare system in Latvia (in terms of quality, price, accessibility) during three different time periods



One can say that, in Soviet Latvia, general care was easily accessible but, when it came to very specialised treatment, it was challenging to find a proper physician. On the plus side, there are nowadays various physicians specialised in their fields; however, sick people might have to pay for treatment out of their own pockets in order to receive care without waiting. Consequently, many people are dissatisfied with the price of medical care in Latvia. Nevertheless, the quality of care provided has definitely improved over the past twenty years.

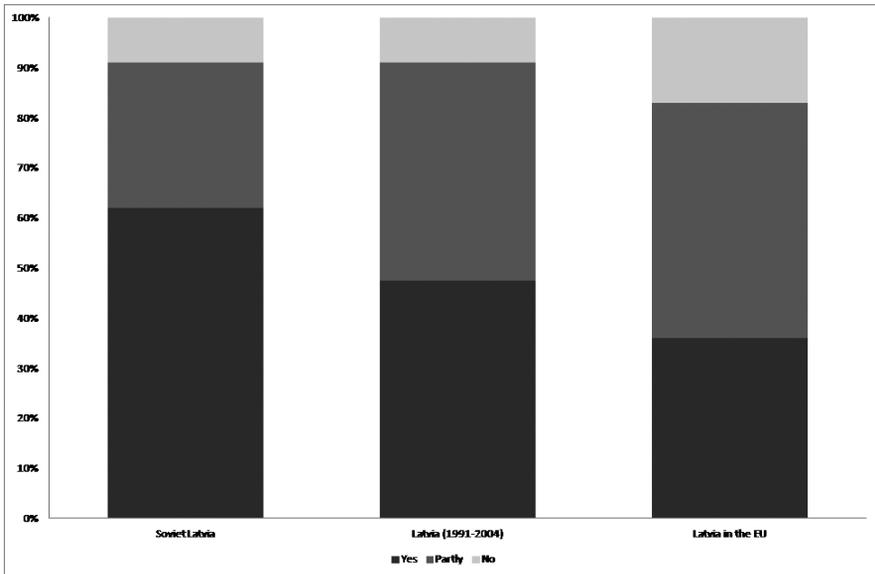
### Standard of living

Despite advancements and reforms in the healthcare system, the demographic trends are in recession, which is a serious threat to the country's succession. A natural decrease in the population due to lower fertility rates and a considerable migration outflow (especially within the first years of the collapse of the USSR and after Latvia's accession to the EU) has contributed to a decrease in the population from 2.67m in 1990 to 2.24m in 2010. The consequence of a smaller number of newborns and a rising life expectancy is that the population is ageing, which imposes an increasing burden on the economically active part of the population in terms of the financing of those who are retired.

Unfortunately, not only is financing the number of retired people a serious issue, but the burden becomes more complete in the context of increases in the costs of primary goods. Thus, paying for one's own needs is becoming harder. The results of our survey suggest that, in the Latvian SSR, more than sixty per cent of the representative sample had funds to pay for all basic needs, such as food, housing, healthcare and education.

Currently, less than forty per cent of respondents have the means to pay for all these needs. The proportion of people who can finance their needs only in part has risen from 29 to 47 per cent.

**Figure 2 – Ability to finance basic needs (food, education, healthcare, housing, etc.)**



Even though income has increased in absolute terms, the number of people earning less than the subsistence minimum is rising, especially in rural areas. It has to be mentioned here that the content of Latvia's subsistence basket has not been revised since the first year of renewed statehood; thus, in reality, it does not contain all the goods and services required for a decent living.

Furthermore, prices have risen rapidly since accession to the EU. For instance, total housing costs have increased significantly – in the USSR, rent and public utilities were highly subsidised by the government whereas, in 2005, average housing costs amounted to \$80 and, by 2009, to \$170 dollars (Central Statistical Bureau of Latvia, 2011). These costs are borne by the private sector and the burden is becoming heavier due to income being lower in comparison to the costs themselves. The situation is even worse considering that the proportion of overcrowded households is one of the highest within the EU. If people lived in and paid for apartments such that they were not characterised as overcrowded, housing costs would be even higher as a proportion of income. Many people agree that they enjoyed much better housing conditions when they were a part of a communist country.

*Education and development*

Similarly, respondents in our survey mentioned that the Soviet times guaranteed a certain security regarding employment. The majority of the economically active population was employed in the Latvian SSR, compared to a level of unemployment which stood at 16 per cent in 2009 (Central Statistical Bureau of Latvia, 2011). Even though the absolute level of remuneration was considerably lower in Soviet times, it had greater purchasing power. On the other hand, the labour market is becoming more knowledge-intensive while workers are becoming better educated and more specialised in their professions. Working conditions have also improved significantly, partly because of the regulations of the International Labour Organisation.

The transformation to a knowledge-based economy has been supported by the development of the education system, which is appraised highly in international surveys. High literacy and enrolment ratios are requirements of the nation as a means of educating people so that they may efficiently participate in such a naturally resource-scarce economy. Smart people are one of Latvia's major assets. Nevertheless, the state has to advance its education system still further, as the mark of the Soviet system is still present (in terms of books, teaching concepts, teaching staff, etc.). Furthermore, the government has to understand the role of expenditure on education. Ongoing budget cuts in the education sector lowers quality as teachers and professors lose motivation and their pupils and students become more motivated to enrol in universities abroad.

*Summary*

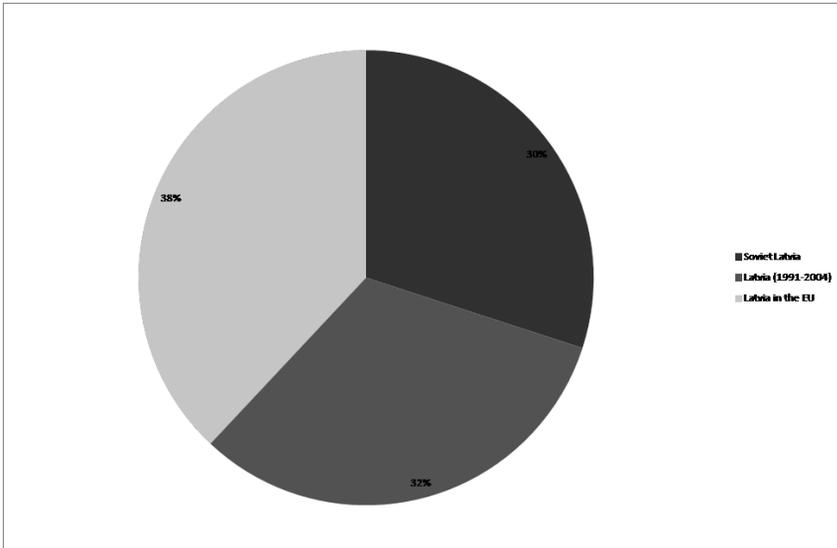
The EU has provided significant advantages to the Latvian population, especially young people who are now eligible to study permanently or temporarily in foreign universities, and on the basis of the same terms and conditions. Additionally, there has also been an advantage to people who are entrepreneurial and open-minded, and who have a certain understanding of how to take advantage of new business opportunities. The EU has contributed to the modernisation of hospitals, schools and the infrastructure and, furthermore, the EU has set standards for as well as acts as an observer of developments in human well-being; therefore, Latvia is motivated and under pressure to demonstrate continuous progress. The result is that the nation believes its health and education systems to have been improved and to provide greater quality and accessibility.

Nevertheless, given people's income level, they are discontented with the prices of tertiary education and specialised healthcare services. The Soviet government paid for housing, education and healthcare; thus more resources were available for food items, leisure time and clothing, while the employment ratio in the Latvian SSR was also close to 100 per cent. Therefore, there are people who believe that the time of communism ensured better well-being. In addition, equality within the population was much higher. However, as respondents mentioned very frequently: everybody was equally poor; nowadays, it is income polarisation that has become the significant issue.

To complete the picture of human development trends in Latvia, which have followed different directions, it is worth referring to the final question of our survey. This asked respondents when, in their opinion, well-being was highest: in Soviet Latvia; in

Latvia before joining the EU; or in Latvia as a member state of the EU. Figure 3 illustrates that opinions vary – approximately every one-third of the respondent pool shares a different view. This simply further proves the finding that there are indicators which have improved along with movement towards Europe, while there are also aspects which, so far, sovereign Latvia has not been able to offer its people as was done in the time of the USSR.

**Figure 3 – The period of highest human well-being, in the opinion of survey respondents**



### Sovereignty and the price of change

In order to succeed and attain the well-being benchmark set by the Union, it is clear that, above all, sustainable economic growth is needed, resulting in increased means being available for shifting into the social system. Additionally, the political powers have to co-operate with society – finding common ground and establishing the goals that are seen as important and beneficial to the state itself and to its population. It is of utmost importance to ensure that the population lives decently, meaning that their basic needs, such as food, housing and healthcare, are satisfied. This should be the main goal of the government, thereby increasing the satisfaction and loyalty of the population to the state. Hence, society should be willing to contribute to the development process, also by properly paying their taxes.

Furthermore, the lessons of the past need to be learned. One of the main arguments for Latvia entering the EU was the potential for economic advancement. The abolition of tariff and non-tariff barriers would imply the further increase in trade between the EU and Latvia, especially as regards exports originating from Latvia. Productivity would be increased when people started working in more productive sectors. Further-

more, fixed and human capital investments were expected to be attracted via low labour costs and subsequent to the adoption of EU legislation and additional privatisations. Investment was envisaged as initiating an upwards growth spiral. Nonetheless, sceptics argued that not every person residing in Latvia would benefit. Citizens who benefited the most would be young people, as they would enter better-paid jobs, whereas the pensions of retired people would not increase as rapidly as the prices of goods and services. Latvian farms would face serious hardship due to surpluses in the market resulting from foreign competitors being subsidised by their own governments (Merlino, 2000).

The sceptics were right. Membership of the EU has suppressed the Latvian economy as a result of the closure of industrial plants, uncontrolled FDI inflows which have enabled cheap credit, significant inflation and price increases, and foreign companies creating levels of competition which small Latvian companies and farmers cannot overcome. The smaller economy has led to an increasing budget deficit, external borrowing and, finally, budget cuts demanded by the IMF and the EU. These have harmed the population since adjusted income is not as high as living costs. One can say that Latvia has traded a part of its economic sovereignty in order to ensure its political independence, and the population is paying the price.

However, people living in Latvia have been willing to pay this price for the sake of Latvia's sovereignty. A survey carried out by the national news portal, TVNET, asked about the major threats to Latvia's sovereignty. 53 per cent of the 5 311 respondents indicated Russia and the uncontrolled influx of money as the biggest dangers. In contrast, just seven per cent perceived integration into the EU and NATO as carrying imminent danger to Latvia's independence (LETA, 2004). On the one hand, if Latvia had not joined the EU, the threat imposed by the inflows of money would have been limited, but political independence would have been significantly less ensured, suggesting that the preservation of both economic and political sovereignty is impossible for a small country like Latvia. In the words of Anis Bajrektarevic:

*The difference between dialectic and cyclical history is the distance between success and failure. (Bajrektarevic, 2012)*

If Latvia had not joined the EU in 2004, it could have taken its time to develop industries which corresponded to society's interests, not to EU regulations. In addition, the migration outflow would have been smaller; therefore, the people who are desperately needed in Latvia to help grow the economy would have been available. Hence, the influx of money into an economically-stronger country would not have resulted in such a crisis. In this case, Latvia would have experienced slow, but stable, growth in its economic and social welfare.

However, at some point in time, say ten years after the original accession date, Latvia would have joined the EU as it is too small to be acting alone on the global stage. Latvia does not have significant raw materials or highly-developed industries; thus, it lacks international power. Its needs and ideas are heard and pushed forward only in those cases where stronger partners share the same interests. The EU is a platform where

Latvia can find like-minded countries; therefore, it can find ‘allies’ and, together with them, strive both for development and economic and political stability.

Concerning Latvia’s perspective on the EU then Latvia is expected to join the Eurozone in 2014 if it fulfils the requirements. At the time of writing, it is believed that Latvia will succeed and be allowed to join, but opinions vary on whether the country needs to adopt the Euro. Public opinion on the adoption of the Euro was, as recently as September 2012, at a record low with only 13% of Latvians supporting the idea. Being a member of the Eurozone would further disable Latvia from controlling its own monetary policy and in the context of prices not corresponding to the income earned by a less productive workforce working in less-productive industries compared to those in other EU states. Therefore, many experts believe that Latvia should postpone its adoption of the Euro until the future of the Eurozone is clearer and until after Latvia has recovered from economic recession and has advanced its levels of production regarding productivity and value added.

Once Latvia substitutes its Latvian Lat with the Euro, it will be economically even more dependent on the EU and its regulations, but this would also present new trade opportunities for Latvian companies and, therefore, cultivate the economy and increase human well-being. The state would also become more creditworthy to foreign investors. Nevertheless, one should not forget how FDI affected the economy in the run-up to the crisis. The Swedish banks which had acquired Latvian banks issued loans excessively and irresponsibly during the pre-crisis period; thus fuelling unsustainable and unimaginable levels of private consumption and property prices in the country. Sweden’s subsequent position, demanding severe budget cuts that affected education and the healthcare sector, was indicative of its fear of losses in the case that the loans issued decreased in value as a result of devaluation. Latvia has to be much better prepared before welcoming the Euro as a replacement for its Lat – which was only reintroduced in 1993.

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