

And Then There Were Eighteen... Will Latvia Join the Euro Zone in 2014?

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Latvia's government is zealously preparing for accession to the Euro Zone. Prime Minister Valdis Dombrovskis is expected to request the European Central Bank (ECB) and European Commission (EC) prepare their respective convergence reports on Latvia's readiness to enter Economic and Monetary Union (EMU) within the next two months. The expectation is that Latvia will join on 1 January 2014. Indeed, the three-party coalition government has long been readying for the technical changeover to the euro. The Cabinet of Ministers adopted a detailed national euro changeover plan in September 2012 and appointed a high-level steering committee to manage the process. The government has launched a controversial multi-million euro advertising blitz aimed at winning over Latvia's skeptical public. Parliament passed the law on euro adoption in a 52-40 vote on 31 January 2013.

What could possibly go wrong? Although unlikely, a referendum or the collapse of the Dombrovskis coalition government could yet derail Latvia's euro ambitions.

Latvia and Europe

All Latvian governments have steered a steady pro-Western course in the two decades since the fall of the Soviet Union.¹ International recognition was followed by membership of the Council of Europe, World Bank and the other minor and major international organizations that make up the international community. However, the big attractions were the Western clubs – NATO and the European Union. Membership of both was achieved in the two ‘big bang’ enlargements of 2004. In all the giddy excitement of finally joining the Western world and seemingly slipping away from Russia's bear-hug, Latvia initially aimed to quickly join the Euro Zone, setting a target of 1 January 2008.

See the Latvia euro changeover site. Available at:
<http://www.eiro.lv>

However, the government proved half-hearted in its efforts, preferring to enjoy the low-hanging fruit of a cheap credit-driven booming economy rather than balance the budget. Both government and public entered a period of rabid consumption and spending that resembled nothing so much as sailors in a pub after a year at sea. Unsurprisingly, Latvia rapidly slipped far away from meeting the Maastricht criteria on inflation. Accession to the Euro Zone was quietly dropped from the political discourse.

However, euro adoption returned as a frontline government initiative after the dramatic economic collapse of 2008, and the advent to power of Valdis Dombrovskis, the Baltic Angela Merkel. Dombrovskis will soon have been in power for four years, a lifetime in Latvian politics where, prior to Dombrovskis, the average prime minister served for less than

a year.² He has overseen harsh austerity measures of tax hikes and spending cuts, but remains surprisingly popular (not least because his party was in opposition during the post-2004 economic bubble years). He has twice been re-elected to office, proving once again that Latvians favour monochrome technocrats over colourful populists.

Despite a return to growth (in 2012 Latvia recorded the highest GDP growth in the EU), the government has maintained tight control over spending. Indeed, it has even perhaps been over-zealous, with both the IMF and EU recently chipping in with criticism of the social spending cuts that Latvia has made to its 2013 budget.³ Nevertheless, Latvia is now applauded as a model of austerity and frequently used as a positive contrast to Greece.⁴

Moreover, Latvia is now on the cusp of meeting the Maastricht criteria for accession to the Euro Zone. A January 2013 IMF staff report argued that Latvia meets the public debt and budget deficit criteria, although inflation and interest rates may be a hurdle depending on the EU member states used for the reference value calculation (will Greece be treated as an outlier?).⁵ The informal political signals from both the EC and ECB are clearly positive. However, euro accession could still be derailed by either a referendum or a change of government.

² Pettai, Auers and Ramonaite (2011), 'Political Development' In Marju Lauristin (ed.), *Estonian Human Development Report 2010/2011: Baltic Way(s) of Human Development: Twenty Years On*. Tallinn: Eesti Koostöö Kogu. 144-163.

³ Aaron Eglitis (2013), '[EU joins IMF in criticizing Latvian cuts to tax, social spending](#)'. *Bloomberg news*.

⁴ Anders Aslund, an ardent cheerleader of Latvia's austerity programme, puts the country's success down to 'front loading' reforms, particularly fiscal adjustment. See Anders Aslund (2013) '[Why austerity works and stimulus doesn't](#)'.

⁵ [IMF Staff Report No. 13/28](#) (January 2013). Also see Swedbank Analysis (1 August 2012). 'Fulfilling the Maastricht Criteria – mission possible for Latvia and Lithuania?'

Let the People Decide?

The biggest potential hurdle remains the threat of a public referendum. The EC and ECB will not contemplate Latvia's accession to the euro zone with the Damocles Sword of a referendum hanging over the process. Moreover, public support for the euro remains low, with just 8% of the public wanting the euro introduced quickly and 41% being absolutely opposed to the currency.⁶ A vote would be a real throw of the dice.

A citizen's initiative aiming to delay euro adoption, by demanding a vote on the timing of accession, was submitted to Latvia's electoral authority (by the awkwardly named Latvia's Social Democratic Movement for an Independent Latvia, a fringe party that has never been elected to parliament) in late 2012. The Central Election Commission must make a final decision on whether to allow the initiative to go ahead by February 3. However, the legal opinions provided by scholars, the Latvian ombudsman's office and the Latvian parliament's legal advisors indicate that the initiative is likely to be rejected because:

- Latvians effectively voted to join the euro when voting on accession in 2003;
- The Council of Ministers is the only institution authorized to choose the date of accession to the euro zone, thus any initiative specifying a date (or conditions that need to be met) is not legal;
- The text of the initiative conflicts with the constitution.⁷

While the ruling could be challenged in Latvia's Constitutional Court or a reworded initiative submitted to the Central Election Commission, the weight of the legal opinions

⁶ Although another 42% had a positive attitude towards the euro, but did not want to see it hurriedly introduced. See DNB Banka (November 2012), '[Latvijas Barometrs: Eiro ieviešana Latvijā](#)'.

⁷ The [legal opinions](#) can be found on the Central Election Commission's homepage.

already delivered indicates that these efforts would be unlikely to succeed. At worst, the uncertainty could delay euro adoption past January 1, 2014 (and the Latvian legal system can certainly be ponderous at times). The same is true of any parliamentary attempt to initiate a referendum by having a one-third minority of deputies force the president to sit on the euro adoption law while citizens sign an initiative.⁸ Indeed, legal opinions cited by the President state that because euro introduction is a treaty obligation, a majority of parliamentarians (51 of 100) would need to sign any initiative attempting to call a referendum. The opposition will not be able to rustle up a majority of parliamentary deputies (although the legal haggling could delay the date of euro adoption).

Coalition Collapse?

The other risk is a collapse of the government coalition. While the Reform Party and the prime minister's Unity Alliance are firm supporters of euro adoption, the third coalition member – the radical right populist National Alliance is more torn. Its rank and file membership is largely against the euro, primarily for nationalist reasons (they see the Latvian Lat as a symbol of sovereignty and national identity). One NA parliamentarian even broke coalition ranks and voted against euro adoption. A motley conglomeration of far right radical groups and nationalist intellectuals has begun speaking out against the 'commercialization' and 'westernization' of Latvia, and sees the euro adoption battle as the opportunity to draw a final line in the sand. They are likely to put the National Alliance's ministers and parliamentary deputies under severe pressure.

Indeed, the National Alliance already played the 'euro card' in November 2012, successfully extracting budgetary concessions for pet projects from Prime Minister Dombrovskis. They may well play it again, as

they seek a greater number of ministerial portfolios. However, as Dombrovskis pointed out, opening up of the coalition agreement could well lead to the collapse of a government already creaking at the edges.

Conclusion: After Dombrovskis

There is strong political resolve to lever Latvia into the Euro Zone. Moreover, the unusual confidence emanating from both government officials and the Bank of Latvia indicates that certain reassurances have been made in Brussels and Frankfurt. Indeed, Latvia's glowing current reputation as the poster child of austerity gives it a once-in-a-decade political momentum. Latvia's entry into the euro on schedule on January 1, 2014 is more likely than not.

However, looking to the future, one pertinent question needs to be addressed. Which Latvia will we see in the Euro Zone? The grey, serious, disciplined almost Teutonic Latvia of Valdis Dombrovskis? Or the reckless drunken sailor, that has marked much of Latvia's post-communist era?

Naturally, Dombrovskis holds the key to this question. He is expected to leave domestic politics after the October 2014 parliamentary election, probably to cash in his international political capital with a well remunerated European post (the timing is right for a 2014-2019 European Commissioner portfolio). At best, if re-elected, he might be persuaded to stay on to oversee Latvia's presidency of the European Union in 2015. In any case, while Latvia has been reborn as a paragon of economic virtue under his watch, these assets have not been institutionalized. Dombrovskis will leave behind the same old fractured, frail and quarrelsome parties, politicians and oligarchs that he inherited. Recent international criticism of disequilibrium in government welfare and tax policies hints that political backsliding has already begun.

Latvia is at its strongest when its political, economic and administrative elite units in pursuit of some concrete target. Independence

⁸ See [Article 1, paragraph 3](#) in the law on referendums and initiatives.

from the Soviet Union, then NATO and EU accession, followed by harsh austerity measures and now even Euro Zone accession were achieved far quicker than many observers had believed possible. International conditionality has made up for the absence of ideology and ideas as moral and political compasses in Latvian politics. However, when left to their own devices, Latvian politicians have tended to run amok. After Latvia enters the Euro Zone it will be left without an all-encompassing political plan. Quite frankly, that is rather worrying.

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