

# The Political Economy of the Latvian State Since 1991: Some Reflections on the Role of External Anchors

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*This brief discusses the role of external anchors or goals such as WTO accession, NATO and EU accession in Latvia's development strategy since 1991. On the one hand the external goals 'depoliticised' many potentially contentious areas of Latvian life. On the other hand, some developments would not have happened or would not have happened as fast without the constraints imposed by the external goals. For example liberalisation of the citizenship laws was prompted by NATO accession and the balance was tipped when the rejection of Latvia from fast-track EU accession talks in December 1997 led Latvia to abandon its quota or 'windows' naturalisation system. Most recently, Eurozone accession was an externally defined exit strategy from the austerity episode induced by the economic and financial crisis. Today there are no big external goals left to guide policy making. Home grown problems such as inequality require home grown solutions. But even now an external dependency persists. For example a long needed reform of the financing model of higher education has had to wait for a World Bank report published in September 2014 for action to be taken.*

On January 1<sup>st</sup>, 2015 Latvia assumed the Presidency of the European Union. This milestone represents a certain level of maturity of the Latvian state and offers an opportunity for reflection on some aspects of how politics and political economy have evolved in Latvia between 1991 and today.

After Latvia regained independence in 1991, it faced (at least) two political economy challenges: one was to disentangle the economy from the Soviet system in which it had been deeply integrated, and the second, perhaps more difficult challenge, was to create an independent nation state. At a formal level, the solution to the latter challenge appeared straightforward – assume continuity of the Latvian state. Effectively this meant

reinstating the pre-war constitution, which was indeed done for the most part. Symbolically this continuity was signalled by, for example, calling the first post-Soviet parliamentary elections held in June 1993 the elections for the 5<sup>th</sup> Saeima (parliament). The elections for the 4<sup>th</sup> Saeima had taken place more than 60 years earlier in October 1931.

At a practical level the challenges were more complex – Latvia had had no practical experience of statehood for nearly fifty years and mistakes were made. For example, Latvia initially diplomatically recognised Taiwan rather than the Peoples Republic of China.

There was a presumption that newly independent Latvia should become a market economy but little consensus on how this

should be achieved. This is in contrast to Estonia where a group of ‘young market economy Turks’ were able to implement a kind of zero option i.e. zero tariffs, fast privatisation, etc. In Latvia there were strong protectionist sentiments and the initial privatisation was a muddled process.

Advice and advisers were abundant in post-independence Latvia. In the early 1990s, Latvia was awash with international advisers: the IMF and the World Bank were both present, the Germans were advising on a constitution for the Bank of Latvia, the British were active in public administration reform, the Danish advised on research and higher education and so on. Advice was often conflicting with different advisers promoting their own visions of structures as models that Latvia should adopt e.g. on legal and education systems. Today, we see something akin to this in the Eastern Partnership countries such as Moldova and Ukraine.

There was a general sense of the desirability of a ‘return to Europe’ but no plan or strategy. Nevertheless, even without a conscious plan a strategy emerged – namely a strategy of external anchors.

The external goals or anchors that emerged included the following:

- World Trade Organisation, 1998
- NATO, 29 March 2004
- European Union, 1 May 2004
- Eurozone, 1 January 2014

The most important effect of the external anchors was that they ‘depoliticised’ many potentially contentious areas of Latvian life. This has been particularly important given the fragmentation that has historically dominated Latvian politics. Thus, in the interwar period, no less than 32 different political parties were represented in the Saeima. In the early post-Soviet parliaments, similar tendencies were observed with newly created parties being the winners in terms of the number of seats in the first four elections. The election of 2006 was

the first in which the previously largest party returned as the largest party. Between the first post-Soviet election in 1993 and the 2014 election, there have been no less than 17 governments which mostly have been uneasy coalitions of 3 or 4 partners with divergent views and interests. In this context the benefit of external anchors is self-evident.

The external anchors each contributed in different ways: WTO accession contributed to modify the protectionist sentiments that were rife in the early years of independence. Rather curiously, Estonia, which adopted a radical free trade policy right from the first days of independence, had more difficulties in achieving their WTO membership than ‘protectionist’ Latvia. Estonia was obliged to implement additional economic regulations in order to conform to the rules of the WTO and the EU (to which it was committed to join as its WTO application proceeded), and as a consequence, Estonian WTO accession was delayed to 1999. The WTO accession process also gave Latvia’s fledgling Foreign Ministry invaluable experience of multi-lateral negotiation.

Apart from the obvious security benefit, NATO membership was conditional on the creation of the Latvian anti-corruption Bureau (KNAB) and on the liberalisation of citizenship legislation, the latter because NATO was concerned about the prospect of a member state with a large number of non-citizen residents.

EU accession represents the biggest and most significant anchor. The requirement of candidate countries to accept the EU *acquis communautaire* took huge swathes of economic and social legislation out of the political arena. While the economic criteria for accession presented few difficulties of principle for Latvia – most people were in favour of a market economy – the requirement of respect for and protection of minorities presented problems for many Latvian politicians and liberalisation of the citizenship

law was resisted until after 1997 when the rejection of Latvia from fast-track EU accession talks in December 1997 prompted a rethinking of Latvia's intransigent position on the quota or 'windows system'.

It is hard to over-estimate the impact of EU accession on Latvia. What would Latvia be like today if it were not a member state of the EU? There are sufficient tendencies even now in Latvia to suggest we would observe something like a tax-haven, off-shore economy, probably with weak democratic institutions. EU accession has saved the Latvian people from something like such a fate.

Even later in Latvia's largely self-inflicted financial and economic crisis of 2008-10 it was the 'Holy Grail' of accession to the Eurozone that politically anchored Latvia's famous austerity programme.

What of today? The 'big' external anchors are used up, and Latvia today:

- Is the fourth poorest country in the EU with GDP per capita in 2013 at 67% of the EU average (only Croatia, Romania and Bulgaria are poorer);
- Is a particularly unequal society – Latvia has some of the worst poverty and inequality indicators in the EU;
- Has a shadow economy at 23.8% of GDP (data on 2013; Putniņš and Sauka (2014)); and
- Has an internationally uncompetitive higher education system.

These and other problematic aspects of Latvian life and society are home grown and it is hard to imagine external anchors that can improve poverty or inequality, that can reduce the size of the shadow economy, or which can improve the quality of the Latvian higher education system.

Nevertheless, Latvian policy makers seem to be addicted to the external anchor concept and often find difficult to progress without it. The

recent experience of reform of the financing of higher education illustrates. Latvia has historically had a funding mechanism for universities and other higher education institutions based entirely on student numbers. The lack of a link between funding and quality has resulted in a Latvian higher education system that is strong on enrolment but low on quality e.g. as measured by peer-reviewed publications. At some level this has been understood and there has been much talk of reform. Although various reports and evaluations have been published, there has been little progress on concrete reform until the Ministry of Education commissioned the World Bank in December 2013 to produce a report on funding models for Latvia. The final report was delivered in September 2014 and action has now been taken to adopt the World Bank recommended three-pillar model where the funding criteria will now include performance and innovation.

Of course, the new model will not solve all the problems of Latvian higher education – far from it – but it illustrates the pervasive nature of policy makers seeming dependency on external anchors.

## References

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