

¹¹ KPMG (2012): EU Funds in Central and Eastern Europe. Progress Report 2007-2012, <http://www.kpmg.com/CEE/en/IssuesAndInsights/ArticlesPublications/Documents/eu-funds-in-central-and-eastern-europe-2012.pdf> [10 April 2014].

¹² European Commission (2013): Staff Working Document assessing Poland's 2013 National Reform Programme and Convergence Programme, SWD(2013) 371 final, Brussels, 29.5.2013, http://ec.europa.eu/europe2020/pdf/nd/swd2013_poland_en.pdf, p. 37 [10 April 2014].

¹³ European Commission (2013): Staff Working Document assessing Slovakia's 2013 National Reform Programme and Convergence Programme, SWD(2013) 375 final, Brussels, 29.5.2013. http://ec.europa.eu/europe2020/pdf/nd/swd2013_slovakia_en.pdf, p. 45 [10 April 2014].

¹⁴ European Commission (2014): Innovation Union Scoreboard, http://ec.europa.eu/enterprise/policies/innovation/files/ius/ius-2014_en.pdf [10 April 2014].

¹⁵ Excessive deficit procedure – status at mid-April 2014: http://ec.europa.eu/economy_finance/economic_governance/sgp/corrective_arm/index_en.htm

¹⁶ OECD (2014): Economic surveys, Poland, March 2014 Overview, http://www.oecd.org/eco/surveys/Overview_Poland_2014.pdf, p. 20 [14 April 2014].

¹⁷ Stability Programme of the Slovak Republic, 2013, http://ec.europa.eu/europe2020/pdf/nd/sp2013_slovakia_en.pdf, p. 45 [10 April 2014].

¹⁸ Economist Intelligence Unit (2014): Country Report, Czech Republic, April 2014, p. 6.

¹⁹ 2013 Stability/Convergence Programmes of the Visegrad countries can be retrieved here: http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/2013/index_en.htm [10 April 2014].

²⁰ Economist Intelligence Unit (2014): Country Report, Czech Republic, April 2014, p. 5.

²¹ <http://www.gdma.hu/>

²² In Hungary there has been an intensive promotion of government bonds and securities among the population. In fact, constantly lowering interest rates may discourage foreign investors from financing the Hungarian debt, while the historically low personal income tax may encourage residents to choose this form of savings.

■

TEN YEARS OF LATVIA IN THE EU – REFLECTIONS, IMPLICATIONS AND CHALLENGES

*Aldis Austers**

Latvia had high expectations from the membership of the European Union, yet the first ten years of this membership have brought both positive and negative results. Latvia has managed to get into the core of the EU by joining the border-free Schengen area and the eurozone. During the first half of 2015 Latvia will hold the rotating

presidency of the Council of Ministers of the EU – a remarkable event in Latvia's history. Moreover, a stable political system, pretty decent public administration, renovated roads and public buildings, and higher quality goods in shops attest to Latvia's regained fortune after a painful transition from a Soviet centralised state to a liberal market economy. However, a post-accession economic growth was followed by a deep slump. While benefiting politically from belonging to a club of rich countries, Latvia had to ask for international bail-out assistance in 2008. Today Latvia is back to economic growth, but new challenges have emerged stemming from extensive emigration of young people and demographic decline. Regional instability caused by Russia's aggression towards Ukraine is another major challenge to Latvia's future.

This article is intended to provide an assessment to what extent the expectations of the Latvians towards the EU membership have been met. First, a look at Latvia's pre- and post-accession strategy towards the EU will be presented. Further, an analysis of the Europeanisation in Latvia and Latvia's behaviour in the EU will be brought forward. Finally, political and economic development of Latvia during the last ten years will be examined. The most relevant areas of tension will be highlighted.

Latvia's pre- and post-accession strategy for Europe

After the restoration of independence in 1991, Latvia and other Baltic states were seeking quick reintegration with Western Europe. Memories of pre-war statehood and then existing well-being¹, in combination with the post-Soviet miserable economic conditions, provided a widespread support for democratisation and economic liberalisation, including full opening to capital and trade flows primarily with the West, but also with other countries from Central and Eastern Europe (CEE). Moreover, the Baltic states were desperately searching for ways on how to increase the stake of the Western powers in their existence, as a counterbalance to possible rebirth of Russian revanchist mood. In 1995, the Latvian government declared that Latvia saw the accession to the EU as indispensable for survival of the Latvian nation and preservation of the Latvian state².

Initially, Latvia had not been included into the group of the first six candidate countries invited to start the accession negotiations in 1998³. Being left behind was perceived in Latvia as a great shame. Therefore the government revised its preparation strategy, pursued the priorities identified in the Accession Partnership, and moved ahead at high speed. The Russian financial crisis of 1997, which cost Latvia a fortune, acted as another catalyst for market-oriented reforms. As a result, the progress in reforms was so significant that within two years, in 1999, the European Commission concluded that Latvia had generally fulfilled all membership criteria, and, provided that it continued with reforms, it would be

invited to start the accession negotiations in 2000⁴. Two years later, in 2002, Latvia received invitation to start accession negotiations on full membership of NATO.

On 1 May 2004, Latvia joined the European Union. Earlier, that is on 29 March, Latvia became a member state of NATO. Having successfully achieved its major strategic foreign policy goals Latvia had to look for new benchmarks to sustain the momentum of change. It was not an easy task. On the one hand, the accession to the EU and NATO had considerably diminished traditional military threats against Latvia and provided more opportunities and autonomy in developing and shaping its foreign policy. On the other hand, it was also clear that both memberships would not ensure sustainable improvement of living standard by default, and that Latvia would have to remodel its domestic and international arrangements before it achieved the Western level of prosperity and political stability⁵. Table 1 provides some figures regarding Latvia's economy demonstrating the scale of that challenge.

Table 1
Selected data on Latvia

	2004	2008	2013
GDP (current prices, million euros)	11 154	22 890	23 372
GDP per capita (PPS, EU15=100)	41	53	59 ^a
Monthly net average wage (euros)	214	498	516
Population (million)	2.32	2.27	2.02

Note: ^a 2012 data.

Source: Central Statistical Bureau of Latvia, Eurostat.

According to D.J. Galbreath, "Latvia's foreign policy development illustrated the evolving nature of cooperation and conflict on the threshold between East and West, a transition to post-existential politics and the nature of geo-politics in the Baltic region in general"⁶. So, what were the main elements of Latvia's post-accession European strategy and what has been Latvia's achievement regarding these elements?

First, after 2004, Latvia was seeking deeper integration with the EU. That required fulfilment of the accession commitments (e.g. equalisation of excise tax on tobacco, application of costly environmental standards, opening of agricultural land market to all EU citizens), attainment of membership in the Schengen area and the eurozone, construction of interconnections with other EU countries for diversified energy supplies (Latvia is fully dependant on Russian gas supplies, and its electricity production is expensive and does not meet internal demand), as well as improvement of transportation infrastructure to increase Latvia's capacity for cargo transit between East and West.

Latvia has fulfilled its accession commitments. The only remaining transitional arrangement will expire at

the end of 2015 and concerns drinking water quality in small villages with up to 10 thousand inhabitants. Border controls between Latvia and the other Schengen area countries were abolished in December 2007. Notwithstanding the initial difficulties in compliance with the entry criteria, Latvia managed to become a fully fledged member of the eurozone as of 1 January 2014. All in all, Latvia turned to be a pragmatic, disciplined and cooperative partner in the EU, following the rules of the club. In defence of its interests, Latvia has been acting in unison with other likeminded member states, and so far has not applied its veto right all alone. Moreover, Latvia has been very diligent in transposing the EU's legal acts into national law, and was among the very best performers in this respect in 2012⁷.

As to the constructions of infrastructure of interconnectedness, the progress in this area has been rather uneven. With the completion of "NordBalt" - electricity grid interconnection between Lithuania and Sweden, in 2015, the Baltic region will be fully integrated in the Scandinavian electricity network. Disagreement over the route and financing has been delaying the construction of the high-speed railway "Rail Baltica". This railway project, connecting Finland and Germany, has now been declared as a priority for the Trans-European Transport Network; however, the railway will not become operational until 2024. As far as diversification of gas supplies is concerned, the progress has been very meagre. While Estonia and Lithuania have already liberalised their internal gas markets, Latvia is delaying its liberalisation until the expiry of the existing exclusive supply agreement with Gazprom in 2017. Moreover, Lithuania has proceeded with a construction of a liquefied natural gas (LNG) terminal in Klaipeda on its own (to be completed in 2015), while the Working Group of the Baltic Energy Market Interconnection Plan⁸ has agreed in March 2013 on a regional LNG on the shore of Gulf of Finland⁹. It appears that Latvia is facing a difficult dilemma of defining a clear long-term sustainable energy strategy. Cost considerations, vested interests, and lack of transparency in decision-making have made diversification of energy supply a difficult task. Lately the supply security considerations have taken priority over cost considerations (the LNG delivery solution is more expensive than through pipelines)¹⁰.

Second, Latvia wanted to use its newly obtained policy freedom to strengthen its global position after 2004. This involved Latvia's integration in the broader international security architecture, through accepting certain niche capabilities within the North Atlantic structure (like expertise in mine-clearing and special task diving operations) and participating in military missions beyond Latvia's borders, like in the Balkans, Afghanistan and Iraq. Moreover, Latvia was looking for policy niches where its competence could be advanced at the EU level. It included engagement in matters concerning the other post-Soviet states in direct proximity of the EU, like Belarus, Ukraine, Moldova, or situated further to the East – like

Georgia, Azerbaijan and the countries of Central Asia. Latvia's historically good relations with these countries as well as superior knowledge of their political and economic systems have been an asset. During its Presidency of the EU Council in the first half of 2015, Latvia intends to focus, *inter alia*, on the Eastern Partnership and relations with Central Asia¹¹.

Third, after 2004, Latvia had to find ways to transform its newly gained political clout into economic benefits for the Latvians. Firstly, the agenda included measures aimed at minimising the negative side-effects of Latvia's EU membership, especially equalising the level of financial support for Latvian farmers with those for other EU member states¹², and mitigating the impact of policies restraining industrial development like environmental protection initiatives. Secondly, Latvia has been striving to maximise the economic benefits from joining the EU. Thus, it has been pushing for greater receipts from the EU structural funds needed to overcome the structural shortcomings of its national economy. The capacity of public investment in Latvia has become particularly acute in aftermath of the massive fiscal consolidation undertaken during the financial crisis of 2008-2011 (for more details see chapter on economic developments)¹³.

Impact of Europeanisation and public attitude towards the EU

The EU has had enormous impact on the socio-economic development of Latvia. Numerous EU directives and regulations, along with institutional requirements, have helped Latvia transform from a backward post-soviet territory into a modern European country. Like in the other CEE countries, Europeanisation¹⁴ in Latvia has enhanced the legitimacy of national authorities¹⁵. Better streamlining of public policies, accountability, as well as measurable performance criteria were a few of many new elements introduced in Latvia's public sector. The inflow of European funds and more frequent exchange of people and ideas have gained prominence as channels for societal change. For example, the finalisation of the delayed territorial administrative reform in Latvia was forced by initial problems with the absorption of the EU structural funds in regions¹⁶. Likewise, the exchange of people at all levels – be it public officials, business people, students, workers or simply tourists - has considerably intensified since 2004 (in fact, the number of travellers exceeded the total population of Latvia four times in 2011). Latvian people have gained more opportunities for realisation of their personal freedom. Moreover, during the last ten years Latvia has become a healthier and safer place to live. Although it is difficult to prove a direct casual link between the improvement in social situation and the accession to the EU, the figures speak for themselves (see Table 2).

Table 2

Stylised facts about societal and quality of life change in Latvia after EU accession

	2004	2012
Life expectancy, males (years)	65,6	68,9
Fatal road accidents	5081	3489 ^a
Cases of registered crime	62 173	47 561 ^a
Share of foreign students (% of total number of students)	1.8	5.25
Travellers, incoming and outgoing (thousands)	5489	8795 ^b
Persons at risk of poverty (% of total population)	46.3	36.2
Incidence of cancer illness (cases per one hundred thousand people)	443	564

Notes: ^a data from 2013; ^b data from 2011.

Source: Central Statistical Bureau of Latvia, Eurostat.

The ruling political and business elite of Latvia have been supportive of Latvia's participation in the EU; however, the pressure for transformation generated periodic backlashes from some parts of the power elite. Thus, the European pressure to strengthen the rule of law, the fight against corruption and money laundering met fierce resistance. The problem was that back in 1990s, Latvia, on contrary to Estonia, accepted many members of the former Soviet nomenclature in its elite, thus unwittingly creating a basis for clientelism, behind the scene transactions and corruption¹⁷. The extreme volatility in Latvia's economic growth can be largely attributed to infighting between the Europeanised civil society and intellectuals on the one side and the mentioned power groups on the other side (for more details see the section on political developments). Fortunately, these recoils were not strong enough to derail the integration process. Next, Europeanisation has induced a shift in power balance between executive and legislative authorities¹⁸. Latvia is a parliamentary democracy, yet, as the EU related legal acts are, as a rule, shaped by the national governments, with the national parliaments being relegated a task of "take-or-leave-it", the Government of Latvia has been able to usurp large part of responsibility over domestic affairs. Latvia, in fact, has been gradually transforming into a technocratic type of democracy with administrators presiding over political processes. The latest example includes the establishment of an EU induced fiscal council, consisting of experts, elected by the national parliament, responsible for setting ceilings of national annual public spending.

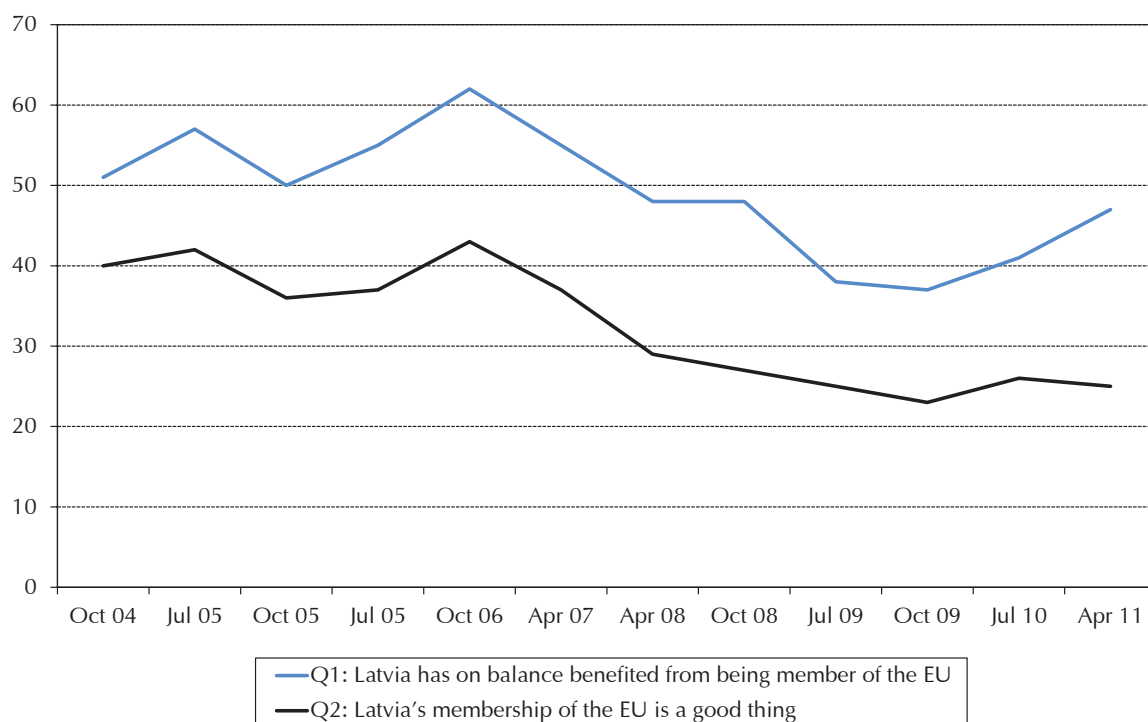
In general, Latvians are supportive of Latvia's EU membership, albeit the level of support was lower than in other new EU member states. In fact, in referendum on the EU accession on 20 September 2003, the level of support – 67.5% – was one of the lowest among the CEE acceding countries (e.g., in Estonia it was 66.8%; in Lithuania – 91%, and in Poland – 77.5%)¹⁹. Since then

the approval of the EU membership has diminished. As depicted in Figure 1, the number of people who consider the country's EU membership as a good thing has been constantly declining. This relatively low support for EU membership can be attributed to a very low level of public trust in authorities and growing social disparities. Many sceptically minded people have a feeling that a substantial part of the society has been excluded from the EU membership benefits, captured by a narrow and powerful group of "winners". Moreover, the results of

public opinion polls reflect existing ethnic divisions in Latvia, as Russian speaking part of population is less supportive for European integration of Latvia. Finally, Latvians' self-perception of their place in Europe, a division between "we-Latvians" and "they-Europeans" play an important role, too. For many Europe is still very distant, being developed practically without their influence²⁰. Yet, as of the end of 2009, with the return of economic growth more and more people see benefits from the EU again.

Figure 1

Public opinion on Latvia's EU membership



Source: Eurobarometer.

Curiously, the relatively reserved stance of the Latvians towards the EU has got a limited support among politicians. No significant political force has so far campaigned against Latvia's membership in the EU, and Euroscepticism has been confined to the activities of few marginal politicians. Indeed, most people perceive the EU as "the least evil", instinctively feeling that there is no viable alternative to, as they call it, the cosmopolitan establishment.

Russia – a "litmus test" to Latvian-European engagement?

Russia's engagement in Ukraine - occupation and annexation of the Crimean peninsula, under the pretext of protection of Russian people, and continuous destabi-

lisation of situation in Eastern provinces of Ukraine, has changed the security situation in Europe. Many Latvians, as well as citizens of other Baltic states and Poland²¹, believe that Europe's reaction to Russia's aggression will provide a "litmus test" for the European commitment to provide security in this region²². The so far lukewarm reaction by the European leaders has raised some doubts about their willingness to confront Russia; hence demands for greater presence of NATO military troops in the Baltic countries have followed.

For Latvia, relations with Russia – its direct neighbour, represent a complicated issue. Latvia's rapprochement and subsequent accession to the EU and NATO reduced somewhat public anxiety towards Russia²³, and Latvia increased economic exposure towards Russia. In 2013, Russia was the third Latvia's trading partner, after Lithuania and Estonia (accounting for 12% of Latvian

total external trade). Latvia depends on Russian oil and gas supplies, while the Russian market is an important market for Latvian food products. Moreover, Russia is one of the most important buyers of Latvia's transit and banking services, and an important source of foreign direct investment.

Alike Ukraine, Latvia hosts a sizeable ethnic Russian diaspora (27%). Division among the two parts of Latvia's population - the Latvian and Russian-speaking²⁴, has remained after Latvia's accession to the EU. Latvians accuse their Russian-speaking co-inhabitants of not being loyal to the Latvian state. They, in turn, accuse Latvians of forcing assimilation and imposing on them Latvian cultural traits. Latvian national populists, on the one side, and Moscow-controlled Russian TV channels, which are very popular among Russian-speakers, on the other side, amplify these differences. Ethnic divisions are also visible when it comes to the assessment of Russia's aggression towards Ukraine. According to recent public opinion polls, 43.1% of the Latvian inhabitants, whose mother tongue is Russian, believe that Russia's actions in Ukraine are justified. This sharply contrasts with the view of ethnic Latvians as only 7.8% of them support Russia's deeds²⁵.

Political developments since 2004

Since 2004, Latvia has had six governments, three parliamentary elections and several national referenda. The composition of political elite has considerably changed, yet all political successions followed strictly Latvia's constitution. Even the unprecedented economic crash of 2008-2009 and painful economic adjustment afterwards did not result in violent protests threatening constitutional order²⁶. This good news notwithstanding, Latvia has not been among the best performers of CEE countries in terms of democratic consolidation, the rule of law and minority protection, as it has admitted several deflections from the best practice. Thus, according to the assessment of the European Commission and IMF of 2013, the performance of the Latvian judiciary still requires some improvements²⁷. Fight against corruption was also insufficient (according to the Global Corruption Barometer, in 2013, 77% of respondents stated that corruption was a problem in Latvia's public sector and 67% - that government's actions in the fight against corruption were ineffective)²⁸. Moreover, Latvia has regressed in terms of protection of ethnic and sexual minority rights. However, the most blatant violation of democratic standards relates to the assault on the freedom of press. Thus, in 2006, some local business tycoons took control over the largest Latvia's printed media "Diena" and, despite protests, imposed editorial censorship. The same year several popular investigative journalists were forced to leave the public TV under the shady pretext of lack of financing and restructuring of programmes. The overall Latvia's performance in terms of different political indexes can be seen in Table 3.

Table 3

Latvia according to different indexes

	2005	2010	2012
Human Development Index (maximum best score - 1)	0.792	0.805	0.814
Bertelsmann Transformation Index (maximum best score - 10)	8.69 ^a	8.51	8.41
Corruption Perception Index (maximum best score - 10)	4.2	4.3	4.9
Press Freedom Index rank (1 is the best rank)	16	30	50

Note: ^a figure from 2003; blue – best Latvia's results.

Sources: United Nations Development Programme, Bertelsmann Foundation, Transparency International, Reporters without Borders.

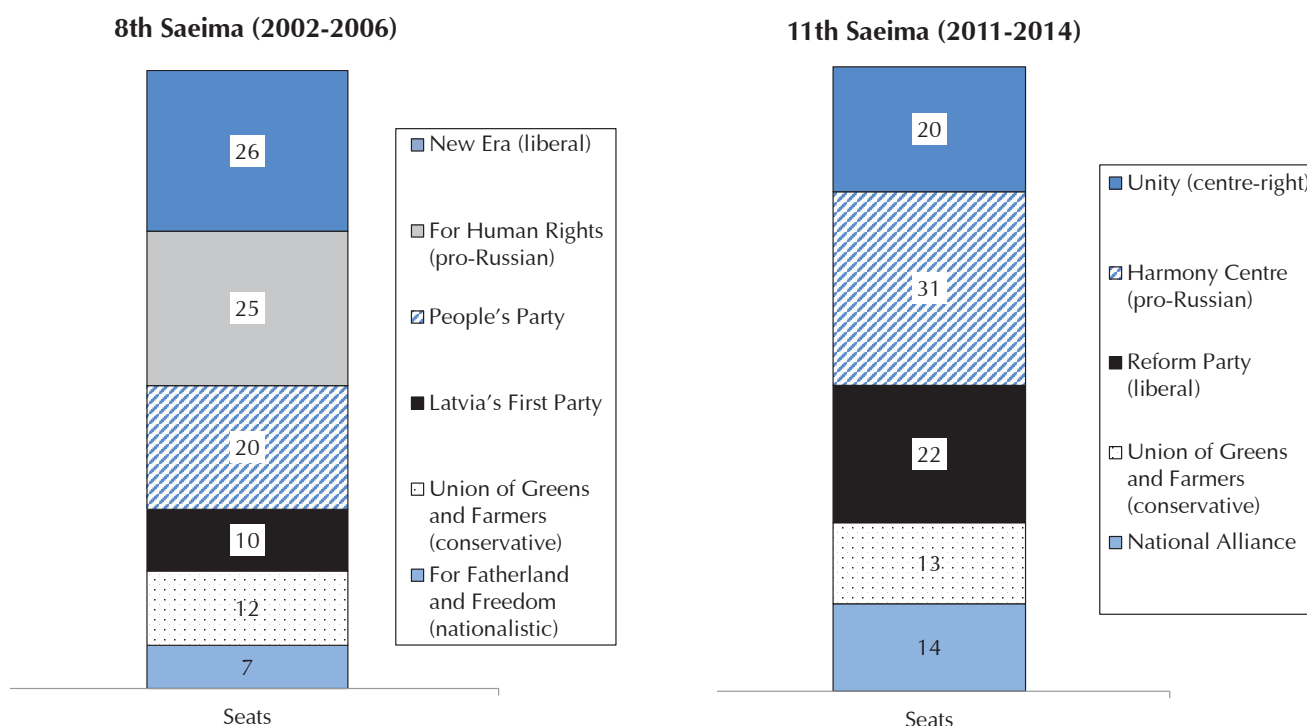
As already mentioned, a particular feature of Latvia's political system has been a permanent ethnic cleavage between ethnic Latvian and Russian-speaking inhabitants. Latvians consistently vote for the Latvian parties, which all have rightist political affiliation, as communist and social democratic ideals are unpopular in Latvia due to the Soviet traumatic experience. Russian-speaking citizens, however, chose the parties who pledge defence of ethnic minority rights and have leftist inclination (the former Latvian Communist Party, now called the Latvia's Socialist Party, is part of this political group). Latvia's accession to the EU has not changed this peculiarity, nor have the economic and financial crises of 2008-2011²⁹. Thus, while the politics in other CEE countries has been dominated by competition between centre-right and former Communist or social democratic parties since their emergence after the collapse of the Soviet Union, in Latvia, the struggle has been among the right wing parties (pro-business, conservative, nationalist and liberal ones)³⁰. This has had a negative impact on democratic consolidation of Latvia's political system.

All Latvian governments were formed through coalitions of ethnic Latvian parties with rightist inclination³¹. As a result, business interests were given priority. Taxation of capital and corporate earnings is low, but the level of income inequality and poverty – higher than in other EU member states. On the wave of economic growth, voters gave preference to populist business parties in elections of 2006, because these parties promised lower taxation and increase in wages and social spending. The then incoming government introduced lavish public spending policies and promoted incompetent people to senior public positions. Non-observance of freedom of press was also part of this story. Only fierce public resistance prevented the plans to subdue the Latvian security and anti-corruption services to vested interests.

As of 2002, the focus of political struggle had gradually shifted towards reduction of prevalence of business and other individual interests over national politics; however, only with the eruption of crisis in 2008 clean of

Figure 2

Distribution of seats in 8th and 11th Saeima by political forces



vested interests liberal reformers and pro-justice politicians got their chance. The climax of political tension fell on May 2011, when President dismissed the Parliament - for the first time in Latvia's history. This led to extraordinary parliamentary elections the same year and exclusion of a number of old business parties from the Parliament. Many new politicians entered the Latvia's political scene in 2011³². Yet further political transformation is expected in Latvia. The pro-reform parties, who bore the brunt of economic adjustment, are losing voters' support, and most likely will have to make room for more radical and conservative political forces at next elections, due already in October 2014.

Economic developments since 2004

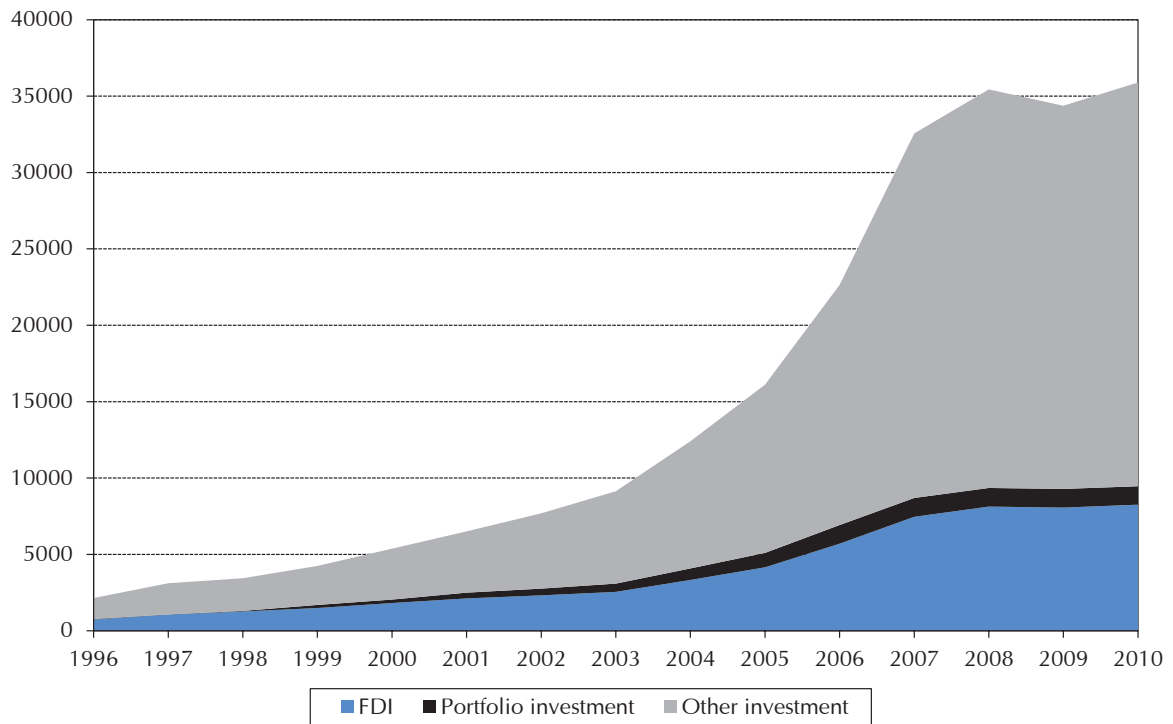
Despite its smallness³³, Latvia's economic development came to the spotlight of the EU decision makers on several occasions. At the beginning, Latvia's post-accession speed of economic growth (10% annually in 2005-2008 on average) was treated in the EU with some suspicion. It was a consequence of investment glut. The accession to the EU and solid determination to join the euro-zone as quickly as possible had motivated investors and local economic actors. In the years 2004 and 2010, the amount of financial assets from the EU countries, in particular from Scandinavia, rose four times exceeding by far investments from any other group of Latvia's partner countries (see Figures 3 and 4). Alas, the largest share of foreign capital fell to short-term credits (70%), and was invested in

the services sector - mostly in banking and retail. Foreign investment in manufacturing accounted for a marginal fraction, and, as a consequence, contribution of manufacturing to Latvia's GDP diminished. The government, though appreciating large investment inflow, was unprepared to cope with imbalances it caused. Instead of building-up reserves for "rainy days" (unfavourable time), government admitted small deficits during the boom. At the same time, the Bank of Latvia kept national currency strongly pegged to the euro, which fostered euroisation of the Latvian economy (by mid-2009, the share of loans issued in euro reached 90% of total loans). As a result, consumption boomed, so did the housing segment; inflation reached double-digit figure, current account deficit reached an extremely high level, and external debt was rapidly expanding (see Table 4)³⁴.

For the second time, Latvia came to the spotlight of the European institutions due to economic downfall in autumn 2008. Latvia's economic slump and default, which stemmed from the global financial crisis, could destabilise situation not only in neighbouring Lithuania and Estonia, but also in other CEE member states. If that had happened, the funding intended for member states under severe balance-of-payments distress would have been far too small, leading possibly to a regional economic catastrophe. In December 2008, Latvia was granted an international emergency loan in the amount of 7.5 billion euros, of which the EU provided 3.1 billion euros³⁵. The loan was conditioned: Latvia had to consolidate its public finances, unwind its structural imbalances and pursue institutional

Figure 3

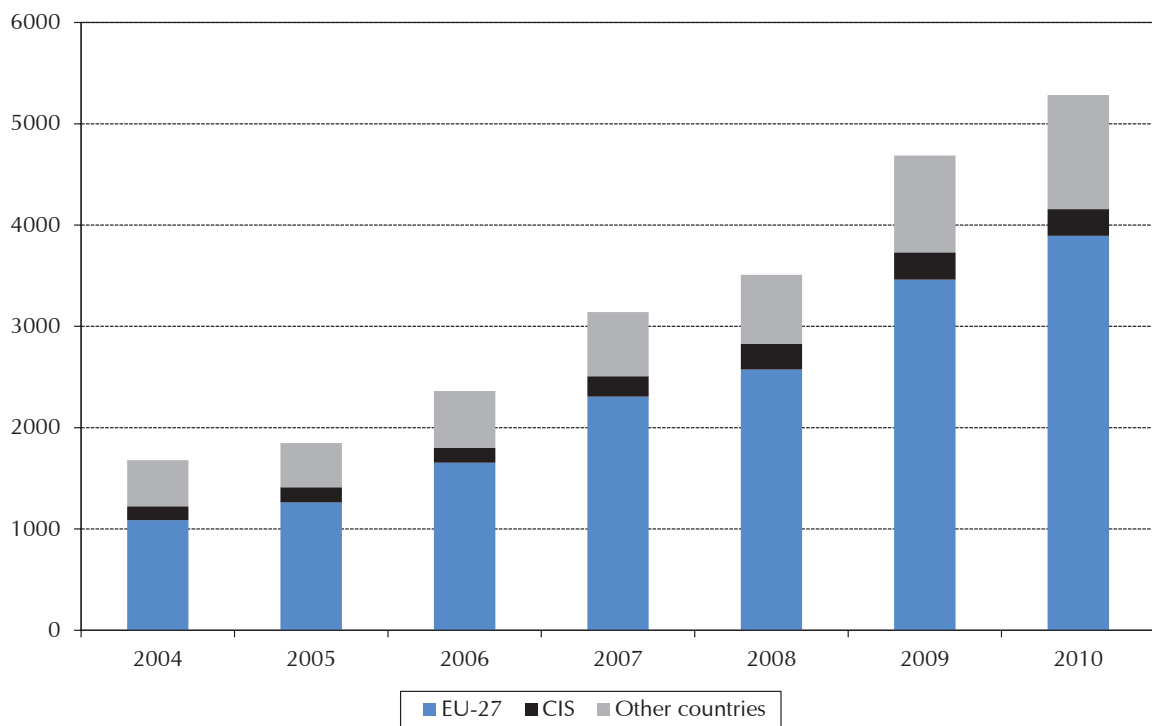
Accumulated investment in Latvia, 1996-2010 (million euros)



Source: Bank of Latvia.

Figure 4

Accumulated FDI in Latvia, 2004-2010 (million euros)



Source: Bank of Latvia.

reforms in a number of areas (e.g. in education, health and social security). The stabilisation programme was completed in January 2012, when return on Latvia's government bonds regained its pre-crisis level.

Table 4

Latvia's imbalanced growth and adjustment

	2004	2008	2013
GDP growth (% , y-o-y)	8.9	-3.3	4.1
Inflation (% , HICP)	6.2	15.3	0.0
Unemployment (% of employed)	11.2	8.0	11.6
Current account deficit (% of GDP)	12.9	13.2	1.6
International investment position (net, % of GDP)	-49	-79	-65
Government expenditure (% of GDP)	35.9	39.1	36.4
External debt (% of GDP)	62	91	95
Inequality (S80/S20 ratio)	6.7	7.4	6.3
Poverty (% of population)	46	34.2	35.1

Sources: Eurostat, Central Statistical Bureau of Latvia.

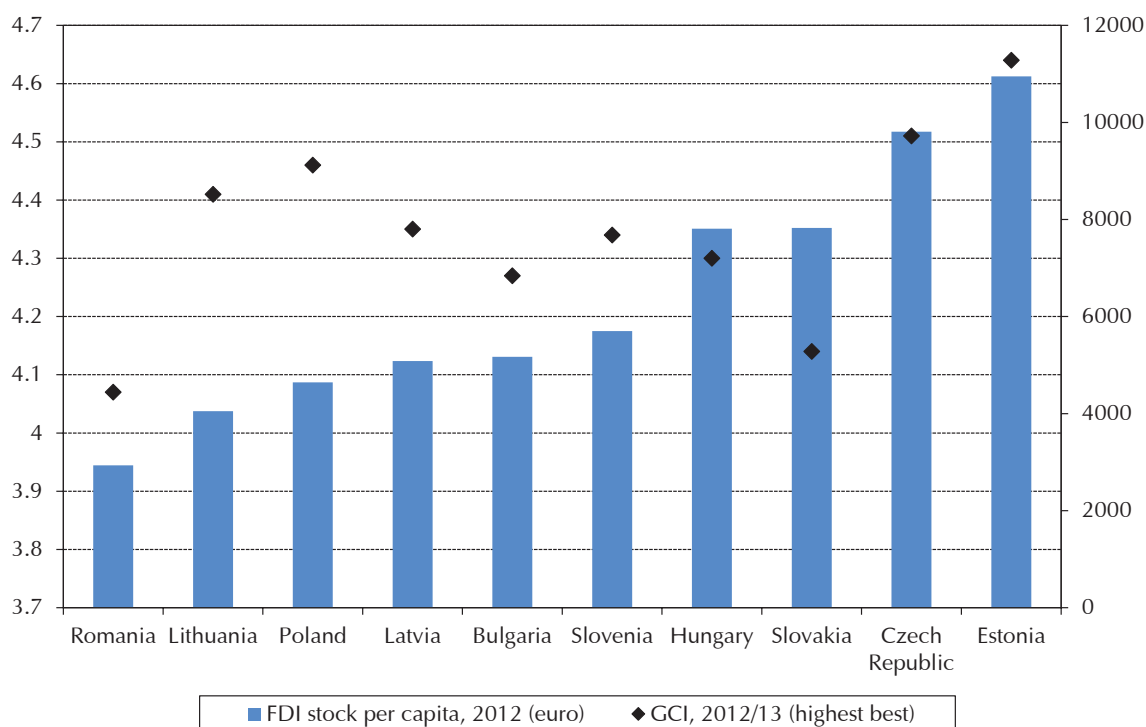
Latvia's astonishing recovery has been made a model for other debt ridden EU member states. Since the second

half of 2009 Latvia has enjoyed an interrupted economic growth with rates exceeding those of other EU member states (4-5% on average). As provided by the stabilisation programme, Latvia became the eurozone member on 1 January 2014. The key element of Latvia's success story was economic adjustment through the so-called internal devaluation. It involves a fall in prices and wages, induced by public austerity and liquidity squeeze, until country's international competitiveness is restored. Yet, such a policy is controversial because of high economic and social costs it imposes, and therefore only a few countries have succeeded in implementing such a policy. In fact, during the adjustment period Latvia lost a quarter of its economy. The high rate of long-term unemployment and low indicators of market activity (low price dynamics, contraction in banking credit, and negative market sentiments) suggest that Latvia's economy still remains suppressed despite economic growth.

After financial stabilisation, Latvia has been facing another set of challenges. Although in terms of national income, Latvia has achieved some convergence with the developed EU countries during the last ten years, huge income inequality between different strata of the Latvian society and regions have emerged. Moreover, despite its relatively high score in Global Competitiveness Index (GCI), Latvia had to compete for fixed foreign direct investment at par with other peer countries (see Figure 5).

Figure 5

Left axis: Global Competitiveness Index for 2012/13. Right axis: Foreign direct investment stock per capita (in euro)



Source: Bank of Latvia, World Economic Forum.

A comparatively low FDI inflow and domestic legal impediments place Latvia among the least innovative EU member states³⁶. Yet, without sustained efforts to improve its innovation performance Latvia risks falling in the middle income trap – a situation when a country has reached a certain level of well-being based on cheap labour and capital, but struggles to switch to the production of higher added value products due to lack of innovation and highly skilled labour. Poor vocational and university education, judicial and insolvency efficiency, control over state-owned enterprises as well as the lack of social justice are main Latvia's bottlenecks identified by the IMF³⁷.

However, the major Latvia's problem is demographic decline and mass emigration³⁸. In short run, emigration was beneficial both to mobile people because of greater choice of job opportunities and to Latvia as emigration reduced the burden on social system during the crisis. However, from the longer-term perspective, without remigration Latvia's society will be ageing very fast, and that will endanger the sustainability of Latvia's social system. Moreover, as a consequence of youth drain, Latvia has negative returns on public investment in education and health. Ageing and shrinking population will make Latvia also less attractive to foreign investment because of contraction in labour supply and consumption market. Thus, the eurozone membership may have increased Latvia's credentials in the eyes of investors; however, the stringent fiscal and monetary rules of the monetary union will be of little help to Latvia's future growth, if more funding – private and/or public (e.g. from EU funds) – is not available for Latvia's development objectives.

Conclusions

The results of the first ten years of Latvia's membership of the EU have been mixed. On the one hand, Latvia has benefited a lot geopolitically. It became a more important player on the world stage. It has enjoyed also more freedom of action on the international stage – participating in international military operations and has been building bridges between Europe and countries of the former U.S.S.R., in particular in Central Asia. Latvia's deep integration with European structures has so far provided some relief from the anxiety over Russia's potential temptations to destabilise the situation in the Baltic region. However, since 2004, Russia has become more aggressive, while the EU as a whole has been weakening, as a consequence of its internal economic problems. Therefore, Latvia's and other Baltic states' expectations in terms of security will not be fully met until the EU member states take a more concerted and tougher action to stop Russia's hostility towards Ukraine. Using the words of Mart Laar, the former prime minister of Estonia, by joining the EU, Latvia and other CEE countries have turned from "the object of history" into "the subject of

history"³⁹; however, Russia still continues to represent a major risk to Latvia's future.

Since 2004, Latvia's democracy has matured. Even though it continues to suffer from deep political division along ethnic lines, and certain delays in terms of democratic standards, most notably in respect to freedom of press, the constitutional order has functioned smoothly – despite low public trust in governmental institutions. The EU accession has facilitated the transformation of Latvia's society, and provided greater opportunities for exercise of personal freedom. Since 2004, the exchanges of people between Latvia and other European countries have intensified remarkably at all levels. People have brought new ideas, hence this channel of societal transformation has supplemented the earlier - formal or directive induced – Europeanisation.

Finally, the economic development of Latvia represents the most dramatic part of Latvia's "ten years in the EU" story. Latvia has not been very successful in transforming its newly gained political clout on the world stage into sustainable economic gains. The overall level of Latvia's convergence with the developed European countries has increased; however, a significant part of achieved fortune was wasted due to wrong political decisions, institutional inertia, and economic illiteracy. The Latvian economy is slowly recovering from the crisis; however, the prospects of its further convergence with the developed EU countries are rather bleak. Emigration and aging are major hitch to Latvia's future, along with threats coming from Russia. In order to prosper, Latvia needs to increase the number of decently paid jobs and inject more innovation into its economy.

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¹ In 1937, the Baltic states' GNI *per capita* exceeded the level of Spain and Portugal, and was on par with Austria's one. See M. Laar, *The power of freedom: Central and Eastern Europe after 1945*, Brussels, Centre for European Studies, 2010, p. 246.

² "Main directions of Latvia's foreign policy until 2005" adopted by Saeima (Latvian Parliament) on 7 April 1995. See *A security and defence evaluation of the State: Latvia entering the 21st century*, Riga: Latvian Institute of International Affairs, 1998, p. 32.

³ In 1997, only six candidate countries were invited to start the accession negotiations: the Czech Republic, Estonia, Hungary, Poland, Slovenia and Cyprus.

⁴ Along with Latvia, also Lithuania, Slovakia, Bulgaria, Romania and Malta were invited to the accession negotiations. In fact, it was not only the candidates' progress that mattered. The Kosovo crisis and the change of the European Commission in 1999 following the publication of a critical report alleging the Santer Commission of fraud, nepotism and mismanagement prompted a major rethinking of the EU's enlargement strategy.

⁵ "Latvia's foreign policy concept 2006-2010," available at <http://www.am.gov.lv/en/policy/guidelines/>.

⁶ D.J. Galbreath, *Latvian foreign policy after enlargement: Continuity and change*, "Cooperation and Conflict", no. 41, December 2006, pp. 443-462.

⁷ The latest monitoring report on the application of EU law puts Latvia among the very best performers in terms of transposition of directives. Latvia had the lowest number of infringement procedures launched against it (at the end of 2012 it was only 20 opened infringement cases, while Italy had 99). See: *30th Annual Report on monitoring the application of EU law*, Secretariat General of the European Commission, 2012.

⁸ The Baltic Energy Market Interconnection Plan is based on a memorandum of understanding, signed between eight EU member states of the Baltic Sea region and the European Commission on 17 June 2009.

⁹ Baltic Energy Market Interconnection Plan. 5th progress report. June 2012 – July 2013. Available at http://ec.europa.eu/energy/infrastructure/doc/20140225_5rd_bemip_progress_report.pdf

¹⁰ See A. Spruds, *Latvia's energy strategy: Between structural entrapments and policy choices*, in *Energy: Pooling the Baltic Sea region together or apart*, ed. A. Spruds and T. Rostoks, Riga: Zinatne, 2009, pp. 223-249.

¹¹ The Eastern Partnership is a policy initiative launched at the Prague Summit in May 2009. It aims at deepening and strengthening relations between the European Union and its six Eastern neighbours: Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. The Central Asia region includes Uzbekistan, Kazakhstan, Kyrgyzstan, Tajikistan and Turkmenistan. For more information see the website of the European Commission at <http://ec.europa.eu/europeaid/where/neighbourhood/regional-cooperation/enpi-east/>.

¹² In 2005, direct payments per hectare in Latvia totalled 14 euros, in Lithuania – 29 euros, and in Poland – 44 euros. See J.F.M. Swinnen and L. Vranken, *Land & EU accession*, Brussels, CEPS, 2009, p. 34.

¹³ Latvia is a net receiver of the EU funds. Since 2004 it has received 5 619 million euros (for comparison, in 2012, Latvia's budget expenditures accounted for 8 050 million euros). Over the next seven years (2014-2020), Latvia is entitled to another 5 593 million euros. However, this amount will represent considerably lower share of its GDP, as Latvia's economy has expanded.

¹⁴ The term "Europeanisation" has many meanings. In this article, I follow Claudio M. Radaelli's definition, according to which the Europeanisation as „a process involving, a) construction, b) diffusion and c) institutionalisation of formal and informal rules, procedures, policy paradigms, styles, 'ways of doing things' and shared beliefs and norms which are first defined and consolidated in the EU policy process and then incorporated in the logic of domestic (national and subnational) discourse, political structures and public choices." See C.M. Radaelli, *Europeanisation: Solution or problem?* "European Integration Online Papers" (EIoP), 2004, vol. 8, no. 16, available at <http://eiop.or.at/eiop/texte/2004-016a.htm>.

¹⁵ I. Rollis, „Eiropēizācijas konceptuālais ietvars un tā izmaiņas" (The Conceptual Framework of Europeanisation and its modifications), in *Latvija eiropēizācijas krustceļos*, ed. Ž. Ozoliņa and T. Tisenkopfs, 2005, Riga: UL Press, pp. 39-40.

¹⁶ The territorial administrative reform in Latvia lasted from 1999 to 2009. During the reform, the number of administrative units was reduced from more than 500 to 119. This number is still too large (bigger than in Estonia and Lithuania) and further reforms are needed sooner or later. See "Administratīvi teritoriālās reformas izvērtējums" (The assessment of administrative territorial reform), informative report from the Ministry of Environment and Regional Development of Latvia, 2013, pp. 21-29.

¹⁷ See M. Laar, *ibidem*, pp. 166-168, 230-231 and 250.

¹⁸ U. Sedelmeier, "Europeanisation in new member and candidate states", *Living Revues of European Governance*, No. 6, 2011, pp. 17-21.

¹⁹ European Election Database, http://www.nsd.uib.no/european_election_database/election_types/eu_related_referendums.html, accessed on 27 March 2014.

²⁰ Cf. I. Kažoka, "Esam Eiropieši vai neesam?! Latvijas iedzīvotāji un ES" (Are we Europeans or not?! Latvian people and the EU), blog entry of 25 March 2014 in www.politika.lv, accessed on 1 April 2014.

²¹ Reportedly, the CEE countries seem to be as divided on the Russian issue as are the Western member states of the EU. The most hawkish are the Baltic states and Poland, while the most dovish are Bulgaria and Hungary. See "The eastern blockage", *The Economist* (print edition), 17 May 2014.

²² Although the EU Treaties do not contain explicit guarantees for security and defence of any member state, there has been a general perception that the EU eastern enlargement is part of a more general effort to avoid the repetition of bloody conflicts close to core of Europe and to build a wide area of peace and well-being. See, c.f., P. Ludlow, *The making of the new Europe: the European Councils in Brussels and Copenhagen 2002*, EuroComent, 2004, pp. 9-40.

²³ According to former Latvian Prime Minister Aigars Kalvītis, the German Chancellor Angela Merkel played a decisive role in mediating the conclusion of the border agreement between Latvia and Russia in 2007. See N. Titova, "Robežlīgums ar Krieviju parakstīts, pateicoties Merkelei" (Border treaty signed thanks to Merkel), *Diena.lv*, 6 March 2008, <http://www.diena.lv/sabiedriba/politika/robezligums-ar-krieviju-parakstits-pateicoties-merkelei-36609>.

²⁴ The Russian-speaking population of Latvia consists not only of ethnic Russians, but also of people of many other nationalities, mostly from former Soviet countries (e.g. Byelorussians, Ukrainians, Lithuanians). According to the national census of 2011, 37.9% of Latvia's population had other than Latvian ethnic origin, 37.2% spoke Russian in family, and 17% did not have Latvia's citizenship.

²⁵ L. Grundule, "Aptauja: 35% Latvijas krievvalodīgo uzskata, ka Krievijas rīcībai Ukrainā nav attaisnojuma" (Survey: 35% of Latvian Russian-speakers believe that Russia's actions in Ukraine have no justification), *Diena.lv*, 9 April 2014, <http://www.diena.lv/latvija/zinas/aptauja-35-proc-latvijas-krievvalodigo-uzskata-ka-krievijas-ricibai-ukraina-nav-attaisnojuma-14051618>.

²⁶ The only episode of violent riots in Latvia took place on 13 January 2009, when a peaceful opposition meeting in Riga centre turned into violent one. A number of police cars and facades of state institutions were demolished. Several people were injured. It was reported that a gang of strange mobsters with alleged connections to Russia's services were involved in that riot. A fear of losing control over crowd restrained political leaders from organising further protests.

²⁷ *Republic of Latvia: Selected Issues*, IMF Country Report No. 13/29, January 2013, p. 22.

²⁸ Transparency International webpage, accessed on 16 April 2014, www.transparency.org/gcb2013/country?country=latvia

²⁹ During the financial crisis of 2008-2011, Latvia lost 25% of its economy. This resulted in numerous bankruptcies and massive unemployment. The stabilisation of public finances required fiscal consolidation in magnitude of 15% of national GDP. Under such severe economic conditions, one would expect re-orientation of people's attention from ethnic prejudices to inequality and redistribution issues.

³⁰ A. Aslund and V. Dombrovskis, *How Latvia Came Through the Financial Crisis*, Washington DC, Peterson Institute for International Economics, May 2011, pp. 13-14.

³¹ Despite failure to reach the status of a governing party, the Russian wing party "Harmony Center" has succeeded in capturing the majority in Riga City Council since 2009.

³² In 2014, only 20% of members of Latvia's Parliament were parliamentarians who served in 2002. Out of six parties active in Parliament in 2002, no more than three were still active in 2014. Moreover, only one of them - the conservative Union of Greens and Farmers - did not change its structure.

³³ With GDP of 23 billion euros (0.18% of EU-27 GDP) in 2013 Latvia came fourth after Malta, Estonia and Cyprus in terms of smallness of economy among the entrants of 2004.

³⁴ There are a number of theories which help to shed some light on the dynamics of Latvia's boom-and-bust experience; however, none of them can explain it completely. For sure, each country has its own particular, non-replicable political economy. Some scholars have applied the theory developed by Francisco Rivera-Batiz in 2001 called "emerging market disease". Basically, Rivera-Batiz argues that capital liberalisation leads to a surge in foreign investment and economic boom, which ends in crisis and capital flight due to accumulated debt burden and expectations of currency devaluation. Other researchers point out to a phenomenon called "convergence play", when a combination of real appreciation and declining long-term interest rates due to falling inflation and country risk premium leads to domestic consumption boom, severe overheating and repeated inflationary pressures.

³⁵ The Nordic countries supplied 1.8 billion euros, the IMF – 1.7 billion euros, the World Bank 400 million euros, the Czech Republic 200 million euros, and the European Bank for Reconstruction and Development, Estonia, and Poland 100 million euros each. See "IMF Press Release" No. 08/332, 19 December 2008, available at <https://www.imf.org/external/np/sec/pr/2008/pr08332.htm>.

³⁶ See *Innovation Union Scoreboard 2014*, DG Enterprise and Industry, European Commission, 2014.

³⁷ *Republic of Latvia: Selected issues*, IMF Country Report No. 13/29, January 2013.

³⁸ According to national census, between 2000 and 2011 the population of Latvia decreased by 13% (9% on account of emigration and 4% on account of demographic decline). Due to emigration Latvia has lost about 14% of its working-age population. About 3/4 of adult emigrants were younger than 35 at the moment of their departure. See M. Hazans, "Emigration from Latvia: Recent trends and economic impact" (in:) *Coping with emigration in Baltic and East European Countries*, OECD, 2013, pp. 65-108.

³⁹ M. Laar, *ibidem*, p. 248.

WSPÓLNA POLITYKA ROLNA

HUNGARIAN AGRICULTURE A DECADE AFTER EU ACCESSION: HOPES, FACTS AND LESSONS

*Miklós Somai**

Spring 2014 is fully packed with expert meetings and conferences that are aimed at taking stock of Hungary's experiences of its 10-year membership of the European Union (EU). The introduction of the Common Agricultural Policy (CAP) and the gradual application of its main support schemes for farmers are, beyond doubt, emerging as key issues of interest in the above-mentioned events. Apart from giving a short outline of pre-accession expectations and preparations, as well as putting the whole issue into historical context, our intention with this paper is to highlight the main lessons learned from Hungarian experience in the agricultural sector during its first 10 years as an EU member; to display, first and foremost, how production and trade flows have changed and to explore the reasons behind these changes. By doing so, also some attention needs inevitably to be paid to pre-transition developments, as well as to the role of the hidden economy.

Expectations and preparation

Based on Hungarian agriculture's undeniable key strength as natural endowments – i.e. the size and qual-

ity of the arable land (excellent soil and topographic conditions) the amount and distribution of rainfall and the number of hours of sunshine during the vegetation period – significant trade surplus with both developed and developing countries, high level of production/technology standards and agronomic knowledge in market-oriented farms, not only politicians but also professionals and even scientists had long expected serious results from the country's European integration¹. Expectations were high in two ways:

- ☞ first, that CAP support would result in faster technological progress, hence in improving competitiveness;
- ☞ second, that EU membership would bring about a stable regulatory framework for farmers whose level of subsidisation used to be very dependent on, hence fluctuating with the ever-changing economic conditions and political climate of the country.

As for the preparation process to membership, we only treat it in as much as it is a common belief that Hungarian agriculture was not sufficiently prepared for participation in the Single Market by the time of EU accession. Part of the process was done correctly: e.g. the transposition of EU law into the national one. And the implementation of "training and development of human resource program" in the ministry and other public bodies also progressed on schedule. Besides, already since 1995, courses on EU policies were available at agricultural high schools². But other parts of the preparation process were not so much of a success: the establishment