

SGI Sustainable
Governance
Indicators

2014 Latvia Report

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Executive Summary

Latvia has performed exceptionally well in achieving its overriding policy goal of economic recovery. Under the government of Valdis Dombrovskis, though within different coalitions, Latvia managed to overcome the effects of the global financial and economic crisis. Furthermore, the Latvian government fulfilled the necessary preconditions for joining the euro in 2014, achieving a condition of fiscal sustainability. However, the single-minded focus behind this achievement has proven to be a liability in some cases, leading to a failure to address social inequalities or to engage in structural reforms in areas such as innovation or higher education that are required for sustainable long-term growth and future competitiveness. Health and education outcomes lag significantly in comparison to other EU member states. High rates of income disparity persist despite optimistic signs of economic recovery.

With the establishment of the Cross-Sectoral Coordination Unit (PKC) in 2010, the government significantly improved its strategic capacities. In less than three years, the PKC has secured a central and influential role in policy planning. The system has become increasingly open to evidence-based policy planning and to outside advice. While still underfunded and underappreciated, the participation of academic experts and NGOs in policy development processes is becoming the norm.

The Saeima (parliament) faces serious challenges in exercising its executive oversight function. Severe underfunding hampers the Saeima's ability to rely on its own policy expertise or to commission independent expertise. A mismatch of task areas between parliamentary committees and ministries undermines the legislative body's oversight capacity.

Although Latvia has a stable democratic framework that affords respect to civil rights, political liberties and institutions of democracy, Latvia's citizens do not trust the government and are reluctant to participate politically. Only 15% feel that they can influence decision-making, and a negligible percentage actually engages in party politics. The government faces challenges in building trust, which hampers long-term stability and the performance of the democratic system. A number of reforms are necessary to improve governance: delays in

the justice system created by excessive court backlogs should be eliminated; the independence of the public broadcasting system should be guaranteed, and its quality improved; and anti-corruption institutions should be strengthened and their performance improved, with a focus on delivering results in high-profile political corruption cases. Innovative public engagement tools, such as petitions aimed at influencing the parliamentary agenda or websites enabling direct communication with parliamentarians and officials, represent promising developments that may overcome the public's reluctance to participate.

Key Challenges

The government has proven that it is capable of focused and driven policy achievements. With the consolidation of the economic recovery, this focus needs to shift so as to address long-term drivers of competition and growth such as education reform and innovation policy and issues of social inequality. Continued inattention to social inequality could cripple attempts to rebuild trust in the political system, and undermine the government's efforts to reduce out-migration.

The government should build on success of the Cross-Sectoral Coordination Unit (PKC), further consolidating its role in the policy-planning process. Additional allocations of human resources would enable the PKC to be responsive to ministries seeking to engage with the PKC in the early stages of policy planning. Allocation of funds to the PKC to pay for consultation with external experts on an ad hoc basis would ensure flexibility and keep the overall need for human resources in check. The PKC is well placed to support initial moves to a longer-term planning perspective, such as the new medium-term budget framework. The PKC should be given the mandate to actively assess all initiatives with reference to Latvia's long-term planning document, called Latvia 2030. This is currently the only planning document which places sustainability at the center of policy planning, and assigning the PKC an active oversight function would create an instrument by which concepts of sustainability could be introduced into day-to-day policymaking. Government decision-making processes are well managed, transparent and allow for stakeholder input. However, the practice of fast-tracking issues undermines this process. Government should take steps to significantly reduce the use of fast-tracking from its current level encompassing over one-third of proposals.

Parliamentary capacity for executive oversight is severely constrained. This institutional imbalance should be addressed by drawing up and implementing a capacity-building plan for the Saeima that would include creating significant in-house policy-analysis capacity, strengthening the substantive capacities of parliamentary committee staff, and improving analytical capacities and services available in the parliamentary library. Even though political parties forming the governing coalition may be uncomfortable with the idea of an improved oversight mechanism monitoring their own executive performance, the governing parties need to take the lead if these goals are to be achieved.

The government needs to take decisive, symbolic actions in order to rebuild societal trust and motivate the population to engage politically. It should work to dispel perceptions that the Corruption Prevention Bureau is subject to political interference and is largely ineffective. Eliminating court backlogs by improving the efficiency of the court system and adding personnel as needed would improve the likelihood of the successful resolution of corruption cases. Adopting legislation allowing local-government referendums would help to empower citizens. The government should embrace civic-engagement proposals generated by citizens themselves, such as the new petition system by which items can be added to the parliamentary agenda, or the social networking site enabling direct communication with parliamentarians.

Latvia should continue to pay more attention to education as financial difficulties recede. A reform of the higher-education system is necessary, but will be difficult to realize in the face of entrenched institutional resistance.

Policy Performance

I. Economic Policies

Economy

Economic Policy
Score: 8

After securing an emergency assistance package from the IMF, the European Union and others, and following a difficult adjustment program, Latvia has rebounded from economic crisis, returned to the international markets, and set itself again on a path of growth. Its economy grew by 6.9% in 2012, one of the highest such rates in Europe.

Economic policy has been governed by parameters laid out in the assistance programs. The difficult adjustment program provided Latvia with a framework for creating sustainable fiscal discipline. The Latvian government has been successful in implementing the policies outlined in these programs, and is on track for accession to the euro in 2014. The convergence report and the EU decision on Latvia's entry into the euro zone was expected in mid-2013. Latvia repaid all outstanding loans to the IMF in 2012, three years ahead of schedule.

Unemployment rates have been falling, from 16.2% in 2011 to 14.9% in 2012, and showing a continuing downward trend in 2013 (as indicated by the Central Statistical Bureau). However, structural unemployment remains a challenge.

The government has focused strongly on meeting euro accession criteria. Nevertheless, structural reforms are also ongoing in the areas of education and science, the energy market, and the judicial system, among others. The government's commitment to and ability to implement these reforms appears weaker than in the case of the euro-related policies. Significant parliamentary and stakeholder resistance has emerged, stalling higher-education reform, and delaying the opening of the energy market to competition, for example.

Citation:

1. European Commission, Unemployment Statistics, Available at: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php?title=File:Unemployment_rate,_2001-2012_%28%25%29.png&filetimestamp=20130417141135, Last Assessed: 20.05.2013.
2. Central Statistical Bureau (2012), Growth Rate Indicators, Available at: <http://www.csb.gov.lv/en/real-gdp-growth-rate>, Last assessed: 20.05.2013.
3. Central Statistical Bureau (2013), "Employment is still growing", Update, Available at: <http://www.csb.gov.lv/en/notikumi/employment-still-growing-36470.html>, Last assessed: 20.05.2013.
4. IMF (2012), Article IV Consultation and Second Post-Program Monitoring Discussions Report, Available at: <http://www.imf.org/external/pubs/ft/scr/2013/cr1328.pdf>, Last Assessed: 20.05.2013
5. European Commission (2013), EU BOP Assistance to Latvia - Second Review Under Post - Programme Surveillance, http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/pdf/lv_efc_note_2nd_pps_mission_en.pdf, Last assessed: 21.05.2013.

Labor Markets

Labor Market Policy
Score: 8

Unemployment rates have fallen consistently from 20% in 2010 to 16.2% in 2011, and again to 14.9% in 2012. The 2013 trend was similarly encouraging. Achieving further reductions will be increasingly difficult, as approximately 50% of the remainder is constituted by long-term unemployment. The government is actively adjusting its unemployment policies to focus structural unemployment. In 2012, the government made revisions to vocational training programs, extended the use of short-term vocational training programs, and introduced mobility allowances.

As of the time of writing, the Latvian government was awaiting the results of a World Bank study to introduce an evidence-based redesign of support measures. The new policy is expected to be more nuanced and tailored to the needs of particular groups of job-seekers.

Citation:

1. European Commission, Unemployment Statistics, Available at: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php?title=File:Unemployment_rate,_2001-2012_%28%25%29.png&filetimestamp=20130417141135, Last Assessed: 20.05.2013.
2. IMF (2012), Article IV Consultation and Second Post-Program Monitoring Discussions Report, Available at: <http://www.imf.org/external/pubs/ft/scr/2013/cr1328.pdf>, Last Assessed: 20.05.2013
3. European Commission (2013), EU BOP Assistance to Latvia – Second Review Under Post – Programme Surveillance, Available at: http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/pdf/lv_efc_note_2nd_pps_mission_en.pdf, Last assessed: 21.05.2013.

Taxes

Tax Policy
Score: 7

The overall tax burden in Latvia is among the EU's lowest. However, Latvia has one of the EU's highest tax burdens on wage earners, as a result of its flat rate. Overall taxation hits lower income groups disproportionately. With the aim of minimizing the tax burden for low incomes, the micro-enterprise was introduced during the economic and financial crises. Some government tax policies have sought to increase the burden on the wealthy, for example through the introduction of a tax on dividends or by raising property taxes. The government amended the personal-income tax law in 2012 to reduce personal-income tax, with rates dropping by 1% in 2013 to 24%; this will be followed by further decreases to 22% in 2014 and 20% in 2015. Tax allowances for dependents were also slated to increase in 2013.

In 2011, the Law on Declaration of Property and Undeclared Income of Private Persons was passed, requiring all individuals to file asset declarations in 2012. This policy measure was designed to combat the non-payment of taxes, reduce the risk that a shadow economy might develop, and improve anti-corruption measures.

Latvia's corporate income tax of 15% is one of the lowest in the European Union, and as such contributes to Latvia's ability to attract investment.

The country's economic recovery combined with structural reforms, improvements in tax collection and attempts to reduce the share of the undeclared economy have ensured the generation of sufficient public revenues. Budget deficits in 2011 and 2012 stood at 3.6% and 1.2%, respectively. The deficit target for 2013 is 1.4%.

Citation:

1. IMF (2012), Article IV Consultation and Second Post-Program Monitoring Discussions Report, Available at: <http://www.imf.org/external/pubs/ft/scr/2013/cr1328.pdf>, Last Assessed: 20.05.2013

2. European Commission (2013), EU BOP Assistance to Latvia – Second Review Under Post - Programme Surveillance, Available at: http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/pdf/lv_efc_note_2nd_pps_mission_en.pdf, Last assessed: 21.05.2013.

Budgets

Budgetary Policy
Score: 9

Both the European Commission and the IMF have deemed Latvia's budgetary policy to be fiscally sustainable, although challenges will remain in meeting future obligations such as previously legislated tax cuts, or returning the second-pillar pension contributions to pre-crisis rates.

In 2012, the Saeima passed its first medium-term budget framework for 2013 – 2015, which will allow for longer-range planning and stability. In 2013, the Saeima approved a Law on Fiscal Discipline, capping government debt at 60% of GDP and providing for automatic corrections to restore budgetary balance.

Citation:

1. IMF (2012), Article IV Consultation and Second Post-Program Monitoring Discussions Report, Available at: <http://www.imf.org/external/pubs/ft/scr/2013/cr1328.pdf>, Last Assessed: 20.05.2013

2. European Commission (2013), EU BOP Assistance to Latvia – Second Review Under Post - Programme Surveillance, Available at: http://ec.europa.eu/economy_finance/eu_borrower/balance_of_payments/pdf/lv_efc_note_2nd_pps_mission_en.pdf, Last assessed: 21.05.2013.

Research and Innovation

R&I Policy
Score: 3

Expenditure for scientific research in the business sector in 2010 was 0.22% of GDP, placing Latvia significantly below the average EU-27 rate of 1.23% of GDP. The amount of public funding provided for R&D was the lowest of any EU member states. The lack of public funding is identified by the Ministry of Education as a major factor slowing down scientific progress in the country.

Annual fluctuations in funding for research institutions produce uncertainty

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