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International and supranational institutions as social policy actors: the case of Latvia

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Abstract. For small and open market economies the relative role of international and supranational institutions in domestic policy processes is quite significant, especially when interaction between the parties is influenced by loan conditionalities. From the very first stages of the regained independent Latvian state in 1990s, the social policy making process has been being influenced strongly by the actors from outside. Policy-makers of Latvia have been being very sensitive to external pressures and practically all substantial reforms in the fields of pensions, social assistance and social inclusion were introduced following the recommendations such organisations as the World Bank, IMF and European Commission. However state matters and liberal value orientation of ruling political elite in Latvia hinder implementation of measures towards decrease of inequality

Key words: Latvia, World Bank, IMF, pension reform, European semester, social assistance

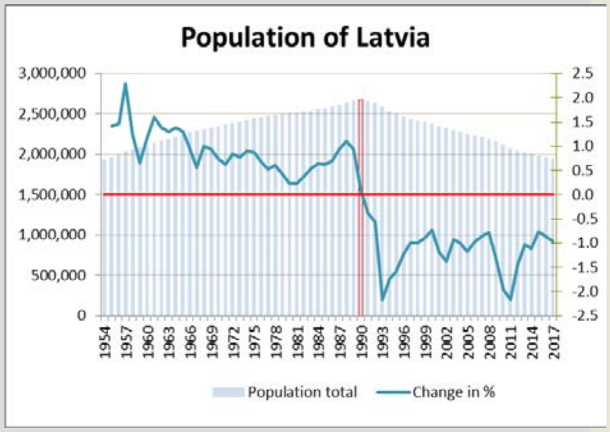
Introduction

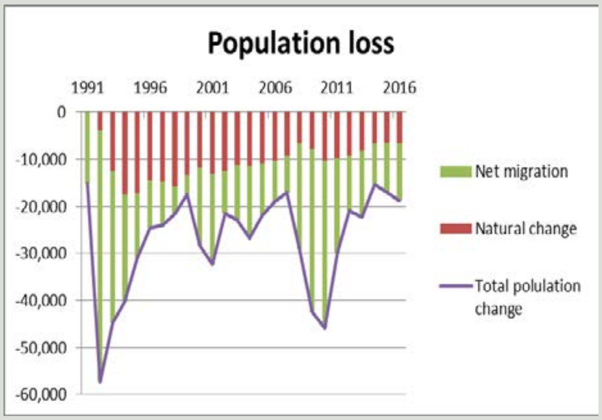
In 1991, when Latvia left the Soviet Union, the Soviet economy was collapsing in every sense: GDP was approaching free fall; prices were skyrocketing, but even so shortages prevailed as prices were still state controlled; and no foreign currency reserves were on hand, which disrupted most trade. The total official fall in Latvia's GDP from 1990 to 1993 was no less than 49 percent. Establishing a functioning economy was vital. International Monetary Fund arrived in Latvia in 1992 and imposed its stringent economic requirements in order to achieve macro-economic stability. Western experts elaborated a road map became known as "The Washington Consensus". The Washington Consensus to a considerable degree did set the stage for economic policies in Central and Eastern Europe (CEE) until the late 1990s. It consisted of four elements: stabilisation, liberalisation, privatisation and restructuring. The transformation to a market economy, price liberalization and curtailment of subsidies on basic goods and services required changes in the social security system. This system inherited from the socialist past was in need of reform to secure its financial sustainability and to meet the demographic challenges.

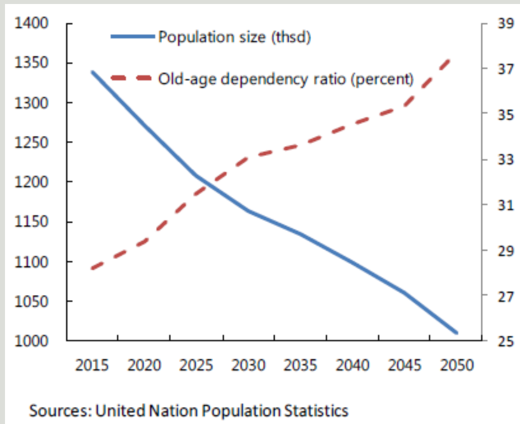
Politicians wanted to establish their own national currency for achieving monetary stability. The International Monetary Fund was the main international agency involved, but it considered the ruble zone a political issue and preferred to be neutral. Yet it assisted the Latvia with the launch of its own currency in 1992.The reforms carried out in the first half of the 1990s were mainly ad hoc emergency measures accompanying shock therapy approach. The IMF imposed a market discipline as the price of integration into the world economy. The government had frozen the minimal salary in accordance with its Memorandum to the IMF. Relative price stabilization was achieved by macroeconomic means: by curbing demand through a restrictive monetary, incomes and fiscal policy. It undertook an impressive stabilization, with an IMF program and large international financial support, but the heart of its stabilisation was strict monetary policy. (Aslund & Dombrovskis, 2011:8). The degree of commodification of the provision of basic welfare goods and services has increased rapidly. The parliament decided that the maximal sum of foreign debt for the 1994 budget year should not exceed 10% of GDP. Major creditors were the IMF and WB insisting on openness of Latvia's economy. Specialists of PHARE, WB, European Bank of Reconstruction and Development (EBRD) were the main consultants of Latvia's government in privatization process. Multiple international agreements reinforced trade liberalization. Most important was Latvia's cooperation with the European Union. Its Trade and Cooperation Agreement with the European Community came into force in February 1993. In June 1995 Latvia concluded the "Europe Agreement", an association agreement with the European Union. On October 13, 1995, Latvia formally applied for EU membership, and on October 13, 1999, the European Commission recommended that member states open

Box 1. Latvia - population

As on January 1, 2017, the population of Latvia was 1,950 thousand persons – last time such figure can be traced back in 1954. The peak figure – 2,668 thousand persons - was passed in 1990 and since that time the population is constantly decreasing by more than 1% per year.







Negative natural increase was accompanied with several waves of massive emigration: in the beginning of 1990s thousands of Russian-speaking persons (especially, military persons and members of their families) moved to Russia, Ukraine and other CIS-countries. Many Jews left for Israel, the USA and Germany. With accession to the EU and opening the labour markets in "old Europe" many Latvians emigrated to the UK, Ireland, Germany, Scandinavian countries, etc. Emigration enhanced in crisis years when it was seen as a remedy for unemployment and poverty. Even more than ten years after joining the EU, Latvia's GDP per capita in PPS remained at 65% of the EU-28 level in 2016; lower ratios were in Croatia, Romania (both 59%) and Bulgaria (48%).

negotiations with Latvia. As the EU accession process started, Latvia gradually adopted the whole common body of EU law, *acquis communautaire*. Especially during the years 1999-2003, Latvia implemented a far-reaching reform process, adjusting multiple laws, rules, standards and regulations to EU norms. This major transformation is often understated because it consisted of thousands of details rather than major legal codes. At 2004 Latvia had become a member of both the European Union and NATO.

From the very first stages of the regained independent Latvian state in 1990s the policy- making process has been being influenced strongly by the international actors. Civil society was weak and divided according ethnic origin. Political elite in such situation was quite autonomous from electorate in decision-making process. Policy-makers of Latvia have been being very sensitive to external pressures and practically all substantial reforms in the fields of pensions, employment, social assistance and social inclusion were introduced following the recommendations of or looking out for international or supranational organisations. It was not the Latvian case only.

The inheritance of former social model in post-socialist countries is very clear described with it strengths and weaknesses in the book "Labour market and social policy in central and eastern Europe: the transition and beyond" edited by Nicholas Barr and published by the World Bank in 1994. The system of social insurance which countries inherited at the start of the reform was well established. This was one of its great strengths. But the system was also wasteful and poorly adapted to the needs of a market economy. The old arrangements comprised a wide –ranging and mature system of social insurance, including sick pay, pensions and generous family allowances. The system covered the great majority of workers and their families. These benefits, combined with more or less guaranteed employment, gave workers and their families a considerable degree of security. "The major adverse political inheritance was the view that the state and the enterprise were jointly responsible for the well-being of individual. The adverse economic inheritances were lack of targeting and weak administration. The lack of targeting manifested itself particularly in the form of ineffective cost containment, holes in the social safety net, and adverse incentives" (Barr, 1994: 195). Major reform of social protection policies in the 1990th addressed the pressing fiscal challenges arising from the relatively generous social protection system in the context of a large income and employment losses that accompanied the transition to a market economy (OECD, p.196)

The World Bank

Latvia became the Member State of the World Bank structures in August 1992. In 2007, the status of Latvia has been changed from Group II (subscription country) to Group I (contribution country). Presently, Latvia is considered a developed country and the Bank is providing technical advice with a focus on social sectors rather than financial support.

1990s

The World Bank took a very active part in managing, monitoring and building up the administrative capacity of social reforms in Latvia, and especially in the field of pension reform. Just during the period 1992 -1998 the World Bank's commitments to the country totalled approximately US$ 265 million for 11 projects. Andrejs Požarnovs, then the Minister of Welfare, concluded his speech at the conference "Latvian Welfare Reform: Present and Future" organised in 2001 by the Ministry and the United Nations Development Program in the following way: "I would like to point out the fact that the social security system's reform implemented in Latvia would not be possible without the support of the World Bank. Within a common project of Latvia and the World Bank the best experts of Latvia and foreign countries have worked hand in hand and that is the reason why today we can together assess the positive and negative experiences and development of the implemented project". (Pozarnovs, 2002)

Pension system

Pension reform was the most important part of social reform and the World Bank was a very active player in pension policy-making in Latvia.

In the first half of 1990s, pension coverage in Latvia was very wide due to low statutory pensionable age (60 years for men and 55 years for women) and mandatory employment in Soviet time made it easy to qualify for necessary minimum length of employment (25 years for men and 20 years for women; years spent in vocational and tertiary education, military conscription and childcare leave up to 3 years were included into vesting period). In 1991, the social security system was made independent from the state budget and was financed by employee and employer contributions. The pension formula based benefit amounts on the number of working years, disregarding the individual earnings record. The benefit formula included a guaranteed minimum flat-rate pension of 30% of the national average wage, with an increase of 0.4% for each year of service. However, the existed system was considered as temporary and unstable. It did not create a link between individual earnings and pensions, not motivating people to pay taxes honestly, at the same time being unsustainable financially.

It was clear that the increase of pension age was inescapable, but only this measure would be insufficient for radical improvement of situation. Politicians of Latvia were looking for new comprehensive solutions. In those years, the World Bank was very active in formulating new approach to pension policy reviewing traditional PAYG model and investigating Chile experience. Chile switched to a pension system operated by the private sector based upon a defined contribution formula whereby an individual's pension would depend solely upon the worth of an individual's contributions invested in a private fund. The World Bank formulated its pension policy based on Chilean experience and began to make loans to Eastern Europe and elsewhere conditional upon the partial privatization of PAYG system. (Deacon, 2007: 35) The key role in multi-pillar pension policy was to be played by the second tier of a compulsory individualized private pension contribution. Under Robert Holzmann's intellectual leadership the Bank and its Associated Institute have invested considerable resources in convincing government civil servants of the wisdom of adopting the multi-pillar approach to pension reform. The World Bank's country operations became publicly accessible from 1994. From 1994 to 2004, 51 countries received assistance from the Bank in reforming their pension policy. 20 of them, located mainly in Latin America and Eastern Europe, have subsequently initiated reforms that included the establishment of a system of mandatory individual savings accounts.

As part of a large project to reform social protection system in Latvia, in 1993 the Latvian Government negotiated with the WB for a loan to set up a Welfare Reform Project. Pension Reform Concept document was prepared within the Ministry of Welfare with the assistance of Robert Holzmann and Louise Fox of the Bank team at the early stages of drafting. The Concept was formally agreed by the parliament in February 1995.However, by that time ideas had moved on. Although the Concept was never formally withdrawn by the Government, the legislation which followed took a rather different shape.

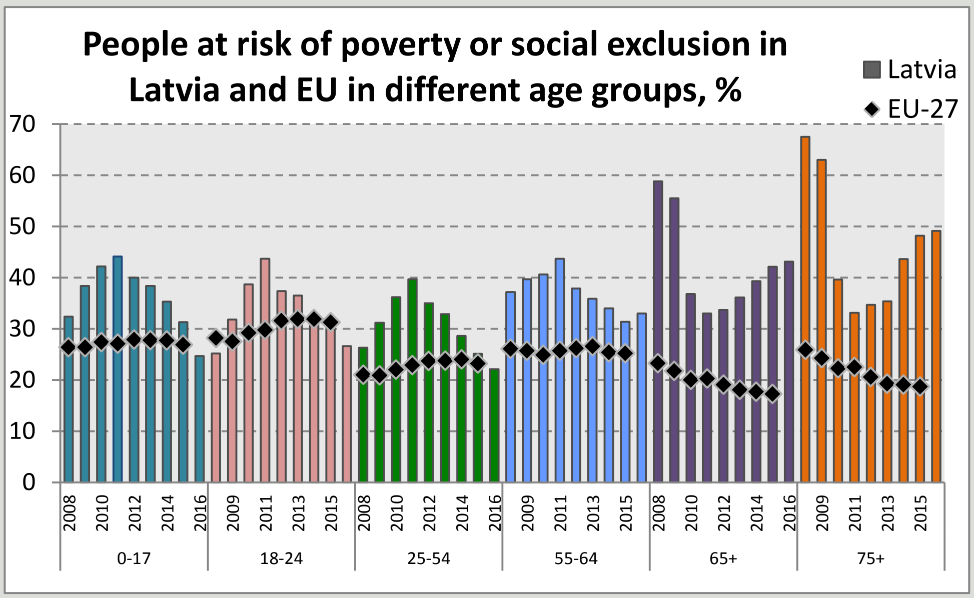
In the autumn of 1994, the WB contacted the Government of Sweden to ask for assistance in developing the new pension system for Latvia. The Swedish experts visited Riga in December 1994, in January 1995 Swedish and Latvian teams of experts met together in Stockholm and as a result, the Latvian delegates became fully convinced that the first-pillar scheme proposed in the Concept would not fulfil its stated goal of providing income security. Work continued at a 1-week joint meeting of the Latvian and Swedish teams in Stockholm in March 1995. At this point, a joint paper was given presenting a notional defined-contribution (NDC) alternative to the proposals in the Concept for the first tier, modelled on the new Swedish system. The

Government of Latvia decided that a new law would be prepared following the principles of NDC proposal.

In the context of banking crisis and national pre-election atmosphere, the government was

Box 2. Poverty in Latvia

Latvia has set the target to reduce the ratio of the risk of poverty and people living in households with very low work intensity by 21% (lifting 121 thousand people out of the risk of poverty and/or living in households with very low work intensity) by 2020. Although at risk of poverty or social exclusion rate has been gradually declining in Latvia – from 40.1% in 2011 to 28.5% in 2016, it still remains higher than the EU average in practically all age groups, except for the youngest ones.



The rate of poverty or social exclusion (AROPE) in Latvia reveals positive trends in the age groups 0-17 and 18-24. During the post crisis period AROPE for children (0-17) in Latvia declined more rapidly than for the whole population. If in 2008 it was 32.8%, reached its highest level - 44.1% - in 2011, and significantly decreased after 2012: in 2016 it equalled 24.7% (which is below the EU average in the previous year). The trend is positive: if during the preceding years children were at a greater risk of poverty or social exclusion than the rest of the population in Latvia, in 2016 this age group privileged compared to the whole population. The rapid progress is also observed in the working age population (25-54 years) mainly because the improvement in employment rates and rise of salaries. However, people in pre-retirement and (especially!) in retirement ages do not enjoy the improvement. The relative poverty of pensioners is increasing and is now more than twice higher than the average European figures. In the oldest age group (75+) practically each second pensioner in Latvia is exposed to the risk of poverty or social exclusion.

insisting on the soonest possible elaboration of new legislation, so the Law on State Pensions was submitted to the Parliament in July 1995, approved in November 1995, with implementation to begin in January 1996without any wider debates even among politicians in the parliament. Later in 2004 the Ministry of Welfare admitted that some activities had been implemented too quickly and that Latvia's weak institutional capacity had at times led to over-reliance on external experts and World Bank staff (Vanovska, 2006: 166).

Actually, Latvia implemented a pension system developed for Sweden. From the very beginning, the working group established for the preparation of the pension reform consisted only of two experts from the Ministry of Welfare and three Swedish experts. Despite that, all political parties in the parliament supported the principles of pension reform. The Swedish pensions experts had been working on reforms to their own system already for years. However, the implementation process in Sweden was planned to take place gradually over many years, making Latvia the "laboratory" for Swedish pension reform (Tavits, 2003: 646).

Thus, in 1996 Latvia became one of the first countries in the world to introduce the NDC scheme, and the only one that extended the NDC to all working population irrespective of their age. Three other European countries - Italy, Sweden and Poland - have also adopted the NDC in those years. In the same year of 1995, a pension reform introduced a NDC system in Italy. But in that country the NDC-scheme fully applies only to individuals entering the labour market from 1996 onwards, while people with at least 18 years of contributions in 1995 continued to be the subject to the previous system and people in between (with fewer than 18 years in employment by 1996) have pension calculated by a mix of the old and the new formula: pension rights obtained in the old system are not converted into the new one.

In Sweden, where the NDC concept was originally developed, the pension reform took place in 1999 and the reformed system applied in full to those born 1953 and later. Those born before 1938 were not included into the reformed scheme; those born between 1938 and 1952 received a mix of old defined-benefit and new NDC pension. NDC was “retroactively” applied to individual earnings histories from 1960 for everyone born 1938 and after to calculate their initial capital.

Poland launched NDC in 1999 as well and applied it to those born in 1949 and later, i.e. to those who were under 50 years at the time of implementation. Those aged 50+ continued to acquire their pension rights and have their pensions calculated according to the old defined-benefit formula. For people born after 31 December 1948, their initial capital was calculated according to the old rules reflecting their pension rights acquired before 1 January 1999.

Introduction of the funded pillars was a more complex task. Launch of the second pillar as a part of mandatory public scheme, originally planned for 1998, was postponed until 2001, while voluntary pension funds commenced their operation in 1998.

The reform aimed to strengthen work and reporting incentives by introducing strong links between earning histories and support entitlements removing the strongly redistributive elements that were a defining feature of social protection system „cradle-to-grave” during the Soviet era (OECD, 2016: 196).

Despite of the undoubtedly positive effect the reform had on ensuring fiscal sustainability of pension system and creating clear link between pension amount and individual contributions throughout the whole working career, the twenty years that have passed since the beginning of the reform had brought evidences of the system bottlenecks and shortcomings. Lack of redistributional mechanisms in either NDC or funded pillars combined with the high levels of income inequality in Latvia (see Box 3) has led to extreme at-risk-of-poverty levels among

Latvian pensioners (see Box 2), and it is very hard to find a feasible solution within the existing pension system framework without introduction new elements. OECD analytics in 2016 Review of Labour Market and Social Policies in Latvia noted that “a particularly worrying aspect of widening inequalities in old age is the growing poverty risk among pensioners… Even with the very low current minimum pensions, minimum pensioners already accounted for 13.6% of new pension claims in 2014” (OECD, 2016: 223, 225).

In April 2017, Latvia has commissioned the analysis of its pension system to OECD experts. The resulting report is expected in the 1st quarter of 2018.

The outcomes of Latvia’s pension reform have been studied by the Bank experts, who continue to monitor the evolution of pension system in this country. Generalising the experience of the reforms performed with the assistance of the World Bank in many countries, the multipillar concept underwent development since mid 1990s: the three-pillar model first delineated by the WB in 1994 (WB, 1994) has been later extended to include two additional pillars: a basic (zero) pillar to deal more explicitly with the poverty objective and a nonfinancial (fourth) pillar to include the broader context of social policy, such as family support, access to health care, and housing (Holzmann & Hinz, 2005: 3).

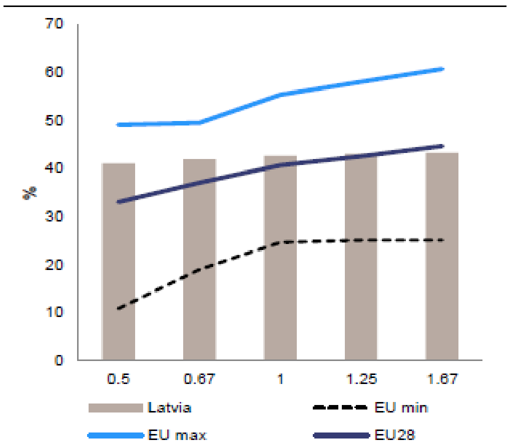
Experience with low-income countries has brought into focus the need for a basic or zero (or non-contributory) pillar that is distinguished from the first pillar in its primary focus on poverty alleviation in order to extend old-age security to all of the elderly. The experience in implementing pension reforms in numerous countries since the early 90-s has also motivated Bank staff to review and “soften” their position by appreciation of the diversity of effective approaches in response to particular circumstances or needs (the number of pillars in use, the appropriate balance among the various pillars, and the way in which each pillar is formulated).

The conceptual framework for assessing the existing pension systems and the degree of the

Box 3. Income inequality in Latvia

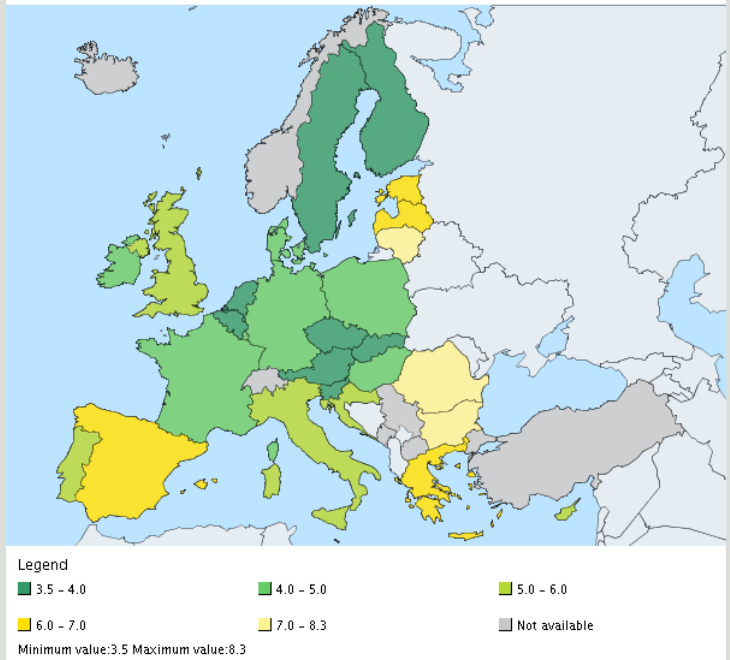
Latvia belongs to EU countries with the most expressed income inequality. While the average EU S80/S20 ratio during the last 8 years varied from 4.9 to 5.2 and Gini coefficient – from 30.4 to 31, Latvia's indicators were among the highest throughout the period.

Graph 3.1.2: Tax wedge of single earners, various income levels, 2015

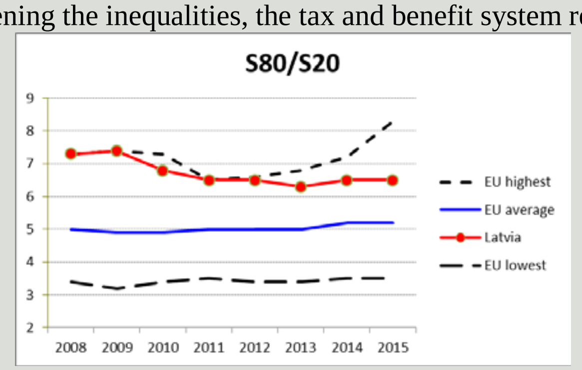


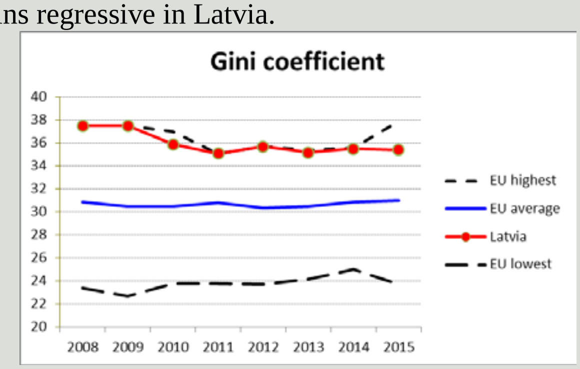
Source: European Commission, based on OECD Tax-benefit models.

Income quintile share ratio (S80/S20) by sex
2015
Total Total



Despite of numerous recommendations to introduce progressive taxation and take other steps aimed and evening the inequalities, the tax and benefit system remains regressive in Latvia.





necessity of a reform was also developing with time. In 2005 the World Bank experts have formulated four primary goals of any pension system: adequacy, affordability, sustainability and robustness (Holzmann & Hinz, 2005). In 2008 they expanded the primary goals to include two new parameters: equity and predictability. They point out that a successful pension systems is an equitable system “that provides the income redistribution from the lifetime rich to the lifetime poor, is consistent with the societal preferences in a way that does not tax the rest of society external to the system; and provides the same benefit for the same contribution” (Holzmann et al, 2008). Unfortunately, the design of Latvian pension system is far from addressing this goal effectively.

Health reform project

In November 1998, the World Bank signed a US$12 million equivalent Health Reform Project Loan to assist the Government of Latvia in the implementation of a long-term health services restructuring strategy. The loan was supposed to become the first in a series of smaller loans to support phased implementation of a long-term.

The loan has a maturity of 15 years including a 3-year grace period at the IBRD standard fixed interest rate in Deutsche Marks for single-currency loans. Total project cost, including contingencies, is approximately US$17.6 million. The project is supported by a US$2 million equivalent grant from the Swedish International Development Agency and US$3.6 million equivalent from the Government of Latvia. There were three main components: implementation of healthcare financing reforms; development and restructuring of health care services; and implementation of a health reform communication strategy. The project achieved its objectives and established a good basis for the continuation of health reforms.

The project was designed as Phase 1 - creating framework - of the total reform process. Although the triggers for Phase 2 - direct support of investments into health service restructuring - were met and the project implementation plan for Phase 2 has been prepared, no action had been taken by the government to request Bank support. While the sustainability of the project was rated as likely, there has been a loss of institutional memory and momentum, as well as losses in the institution building and skill developments that had been achieved in Phase I of the project.

In November 2014 the government of Latvia requested World Bank technical assistance to support ongoing efforts aimed at increasing overall efficiency of the health system. Specifically, the main objective of this reimbursable advisory services (RAS) program was to assist the National Health Service (NHS) of Latvia in the development of a comprehensive national health strategy to address priority disease areas and manage key health system challenges. The project is co-financed by the European Social Fund. During the years 2015-16 a number of technical and analytical products were developed by the World Bank and four cardinal reform areas were proposed: 1) phased investment in infrastructure, equipment, and human resources; 2) investment in critical quality assurance mechanisms; 3) health financing reforms; and 4) development of an integrated health management and information system. Detailed recommendations in these four areas have been prepared and presented by the World Bank in November 2016 (Holla, Rabie & Sales, 2016). It is anticipated that these recommendations would be incorporated into the national strategy which has to be elaborated by the end of 2018.

Crisis years

Within the International lenders aid scheme, Latvia received a loan from the World Bank totalling to 400 mln euros. The figure relatively low compared to the loans received from other lenders (IMF, EU) but the World Bank actively participated with technical assistance on policy elaboration, implementation and monitoring, including also social policy issues. Two major Bank programmes included social safety net and public works programmes.

Special Safety Net and Social Sector Reform Programme

Consisted of two Special Development Policy Loans (SDPL): in 2010 and in 2011, 100 mln euros each as a part of package of emergency assistance agreed between the Government, the IMF, the European Commission, Nordic and other European countries to limit the damage to the economy form the financial crisis and economic contraction. International support focused on the implementation of the Government's Emergency Social Safety Net Strategy that had been developed with inputs from the Bank. The objectives of the programme were to: (i) protect vulnerable groups with emergency safety net support during the economic contraction; (ii) mitigate the social costs of fiscal consolidation; and (iii) ensure that structural reforms lay a foundation for medium term improvements in the social sectors.

The SDPLs supported a large social sector reform program to mitigate the impact of economic contraction and fiscal adjustment on households. The SDPLs focused on the following policy areas:

In *education* to: (i) maintain pre-primary education and child development programs for 5 and 6 year old children; and (ii) cover the costs of transporting students from communities where schools have closed to their new places of instruction.

In *health* to: (i) exempt needy households from health service co -payments and subsidize their pharmaceutical costs; (ii) improve access to and use of alternatives to inpatient treatment for the entire population with subsidies to the poor for these services; and (iii) sustain and improve general practitioner (GP) and primary health care (PHC) services and access.

In *social protection* to: (i) increase the threshold for the guaranteed minimum income and thereby the coverage of beneficiaries, as well as the amount of the benefit; and provide state co-financing to municipalities to cover expenses for the guaranteed minimum income benefit and the housing benefit; and (ii) for unemployed who are not covered by unemployment insurance or other social support, expand and rapidly deploying labour-intensive emergency public-works programs.

The SDPL had a comprehensive results framework in each of the three sectors, which related inputs and outputs to outcomes that were likely to promote achievement of the three project objectives and, more broadly, also included indicators that were intended to monitor the overall situation in the social sector. In all three social sectors (i) subsidies were introduced or strengthened and public works started up that were likely to help mitigate the immediate effects of the economic crisis on vulnerable households; (ii) budgets were designed to reduce the effects of fiscal consolidation on emergency interventions and key ongoing programs (in health, out-patient services were strengthened, pre-school programs expanded and financing of the minimum income guarantee stabilized); and (iii) structural changes were initiated that would help raise efficiency over the medium-term in key areas of (emphasis on outpatient care; means to facilitate rationalization of schools).

However, the Bank admitted that the efficacy of foundation for the medium-term improvements was not convincing and was rated ‘modest’ (WB 2013c).

Public Work programme

Latvia’s public works program, partly financed with European Social Funds and conducted with technical assistance from the World Bank, was launched amid soaring unemployment in 2009, following the onset of the global financial crisis. In Latvia, the crisis worsened labour conditions and unemployment jumped from a pre-crisis low of 5 percent to more than20 percent in 2010. The goal of the public works program, called Workplaces with Stipends, was to assist families through the crisis by providing them with income-generating opportunities through a temporary job creation program. The program, which ran from the end of 2009through the end of 2011, created more than 110,000temporary jobs. All registered unemployed people who were not receiving unemployment benefits were eligible to participate in the program on a first-come, first-served basis for up to six months within a year, with two-week minimum participation requirement. No limit was set on the number of times a worker could benefit from the program. Job opportunities ranged from public infrastructure maintenance to environmental clean-up to social, municipal, and state services.

The World Bank has also supported an evaluation of the government-sponsored public works initiative. Data for the analysis was derived from a one-time, specialised household survey of a sample of registered unemployed people. Despite the low stipend (142 euros per month) and the labour-intensive work offered, the program proved very popular. The program was continually over-subscribed. The waiting list was always nearly twice the number of available positions in the program. The over-subscription reveals two important factors. First, people trying to gain employment faced immense difficulties because job opportunities were simply unavailable during the crisis. Second, given the scale of the crisis, the number of job opportunities created through public works was far smaller than needed. Beneficiaries did see their household incomes rise, showing that the program was an effective short-term safety net. (WB 2013a).

Other programmes

Research project "Latvia: Who is Unemployed, Inactive or Needy? Assessing Post-Crisis Policy Options"

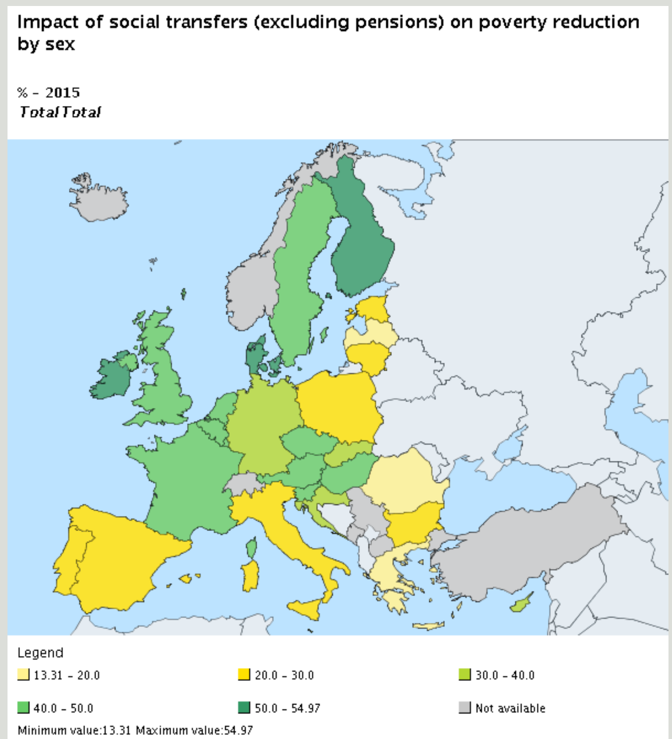
In 2012-2013 the World Bank has collaborated with the Government of Latvia on a study to examine policies to combat long-term unemployment and to draw people into the workforce. The research was funded from the European Social Fund. The aim of the study was profiling of people with no or limited labour-market attachment and of low income and elaboration of evidence-based policy recommendations.

The study has demonstrated that a large majority of households with vulnerable individuals is

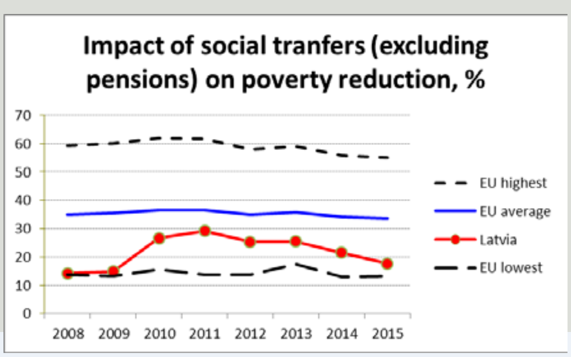
Box 4. Efficiency of social policy measures aimed at poverty reduction

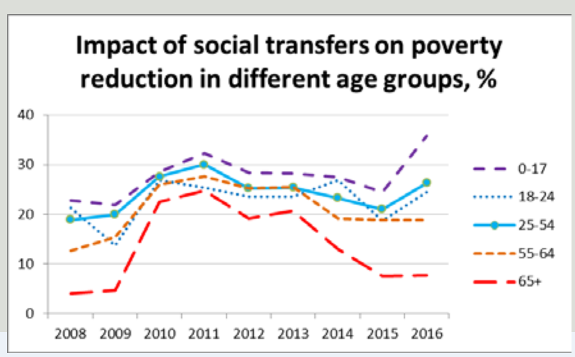
Latvia belongs to EU countries with the least effective poverty reduction mechanisms. While the average EU difference in at-risk-of-poverty rate before and after social transfers (other than pensions) during the last 10 years varied from 33.5% to 35.5%, Latvia lagged behind.

The maximum ratio was observed in 2011 – 29.1%. The emergency Social Safety Net programme that was introduced in crisis years (2010-2011) with the assistance of the World Bank brought immediate results in all age groups.



While a substantial progress is achieved in the recent years in preventing child poverty (increasing of family and childcare benefits, improved access to childcare institutions, etc.), the situation with elderly poverty remains hard.





receiving social transfers, meanwhile benefits have provided only a limited “top up” of family incomes, accounting for at most one third of family incomes (WB, 2013b : 17). It means that Latvia’s Guaranteed Minimum Income (GMI) system is very well-targeted to the poor, but at the same time is very small in terms of coverage and financing. WB research created a good basis for government decision. A significant step towards reducing income inequality and poverty was the approval of the Concept Paper on Defining the Minimum Income Level by the government in October 2014. The concept aimed to establish a methodologically justified minimum income level that would correspond to the social economic situation and that would serve as a reference point for improving support measures defined in areas of the social security system: labour taxation, social assistance benefits, unemployment benefits, and minimum pension amounts. It was also planned to develop a new complete minimum consumer basket of goods and services for different types of households by territorial breakdown.

However, the further implementation has been bogged down and only in March 2017, more than 2 years after approving of the Concept Paper, the Action Plan on Improvement Minimum Income Support for 2018-2020 has been submitted for inter-institutional consultation process. There is a high risk that financial resources allocated to support social policy and to reduce the high income inequality will be limited. As the planned changes require appropriate funding it is very important to ensure that these initiatives would not remain only at the level of good ideas.

Active Aging Strategy

In November 2014, the government of Latvia commissioned the World Bank for another RAS programme, funded from the EU, on development of an Active Aging Strategy. The WB report “The Active Aging Challenge for Longer Working Lives in Latvia” has been presented in October 2015. The Bank recommended raising public spending on preventive and primary health care; providing more eldercare and continuing the expansion of quality preschool childcare; ensuring that future retirees have a pension that protects them from poverty by introducing more redistributional elements to pension system. Although the report authors stressed that "given Latvia's considerable aging challenges, policy adjustments are urgent" (WB, 2015: 19), no actual progress in this policy area can be observed after 1.5 years.

The Bank regularly published working papers, policy briefs and other publications on various aspects, including also social policy issues. One of the latest Policy briefs dated in March 2016 is devoted to the regional aspect of poverty in Latvia (WB, 2016).

IMF

The IMF was active in Latvia in 1990s during transition to market economy, and in later periods did appear on the social policy stage only sporadically. It was, however a very important player during the crisis years in 2009-2011.

Crisis years

The surprise was the huge capital inflows the Baltic countries (included Latvia) attracted in 2002-2006. By most measures Latvia's extraordinary credit boom outsized most other credit booms with an annual credit expansion of 37 to 64 percent from 2000 2006, which picked in 2005-06 when the amount of credit in the economy more than doubled. No restrictions impeded lending, and real estate speculation was not taxed. Inflation rose from 2004 to between 6 and 8 percent a year until it peaked at 17.9% in May 2008. In 2008, Latvia, one of the most overheated economies in the world by then, was among the first countries to be stung by the crisis. IMF had warned Latvia about threats of overheating, but the governments in this period were not capable to react adequately. Parex Bank, the biggest domestically owned Latvian bank, could no longer finance itself on the European wholesale market, and it had syndicated loans falling due. Government took responsibility and converted private debts into public debts. But Latvia had no access to international or European liquidity. Like other new EU members Latvia had relatively small reserves compared with its short-term external debt. It had little choice but to go to the IMF.

In December 2008, the IMF, the European Commission and several European countries prepared and financed an international loan package for Latvia. The Stabilization program was concluded as traditional IMF Stand-By Arrangement on December 18, 2008. The IMF led the negotiations with staff from the European Commission, the European Central Bank, the World Bank, EBRD, the Swedish Ministry of Finance, the Riksbank and other Nordic governments' participation.

Given the scope and magnitude of the crisis, many countries turned to the IMF for financial or policy support. The design and purpose of their IMF-supported programs reflected countries' specific circumstances (Roaf et al. 2014).

The result of such development has been defined in Memorandum with IMF that Latvian government signed already in December 2008: "Years of unsustainably high growth and large current account deficit has coalesced into a financial and balance of payment crisis. (..) The Latvian authorities are launching a decisive economic reform program and are seeking substantial international financial assistance to quell this crisis**" (**IMF, 2009)**.**

The IMF approved a 27-month SDR 1.52 billion (about €1.68 billion, or US$2.35 billion) Stand-By Arrangement for Latvia to support the country's program to restore confidence and stabilize the economy. The Stand-By Arrangement entailed exceptional access to IMF resources, amounting to about 1,200 percent of Latvia's quota, and was approved under the Fund's fast-track Emergency Financing Mechanism procedures. The SBA was ended precautionary after

July 2010. The IMF collaborated with other multilateral institutions and bilateral donors in designing the financial packages. The program for Latvia was part of a coordinated international effort, in which the European Commission actively participated, along with representatives from the European Central Bank (ECB), the World Bank, and Nordic countries. The initial shares were agreed as follows: EU provides €3.1 billion, Nordic countries up to €1.8 billion, Czech Republic, Poland and Estonia €0.2 billion, €0.1 billion and €0.1 billion, respectively; World Bank and EBRD provide €0.4 and €0.1 billion. At later stages, these undertakings division were altered and not of the parties did participate.

The program was centred on maintaining Latvia's exchange rate peg while recognizing that this calls for exceptionally strong domestic policies and substantial international financial assistance.

For a long time key words for politicians and society of Latvia became: austerity, fiscal consolidation and structural adjustment measures.

Latvia made commitments to expand social safety nets and design a comprehensive social safety net strategy in collaboration with the World Bank; to safeguard appropriate financing of the guaranteed minimum income (GMI) and increase the levels of GMI; to cover patient co-payments for healthcare services and pharmaceuticals in full for the most vulnerable and partially for households earning less than half of the minimum wage; to increase funds for emergency housing support; to implement active labour market policies and temporary public employment programmes; to organise public work programmes for 50,000-100,000 people for up to 2 years (in this context, 20 mln lats to be reallocated from the European Social Fund).

The result of such efforts was summarized in IMF executive board calendar “When Latvia asked for financial support from the IMF and the European Union in December 2008 it was one of the first countries to suffer full consequences of the global economic crisis. Three years later Latvia has successfully completed its IMF and EU supported program" (IMF, 2012, February 07). Latvia's recovery sets an example for other European governments struggling to reduce national debt and get out of recession, but Latvia's successful recovery not easy to replicate (IMF, 2012, June 11). Prime Minister of Latvia (2009-2013) Valdis Dombrovskis together with Swedish economist Anders Ǻslund described this successful recovery in their book "How Latvia came through the financial crisis" and mentioned lessons learned after the financial crisis in Latvia. In 2013 Latvia had fulfilled all Maastricht criteria and joined euro zone in 2014. Latvia is among those EU countries that return loansquite successfully: 1 billion EUR was been returned to the European Commission in March 2014. Next repayment took place in 2015 – 1.2 billion EUR to the European Commission and 60.05 million EUR to the World Bank.

EU

Pre-accession

In 1995 all political parties elected to the 6th Saeima (Parliament) unanimously expressed their will to join the European Union and signed the Declaration supporting Latvia's joining EU, President and Prime Minister signed an official application for membership, and Latvia signed an association agreement with the EU. As the EU accession process started, Latvia gradually adopted the whole common body of EU law, *acquis communautaire*. Especially during the years 1999-2003, Latvia implemented a far-reaching reform process, adjusting multiple laws, rules, standards and regulations to EU norms. This major transformation is often understated because it consisted of thousands of details rather than major legal codes. Very important stage on this roadmap was preparing Joint Inclusion Memorandum signed in 2003 by the Minister of Welfare and Member of the European Commission. With this signature Latvia has declared their commitments in area of social policy. “In accordance with the provisions of the Accession Partnership, the Government of Latvia has prepared, with the European Commission, Directorate-General for Employment and Social Affairs, a Joint Inclusion Memorandum, with the purpose of preparing the country for full participation in the open method of coordination on social inclusion upon accession. The Memorandum outlines the principal challenges in relation to tackling poverty and social exclusion, presents the major policy measures taken by Latvia in the light of the agreement to start translating the EU's common objectives into national policies and identifies the key policy issues for future monitoring and policy review. Progress in implementing such policies will be assessed in the context of the EU social inclusion process, whose goal is to make a significant impact on the eradication of poverty in Europe by 2010”.

At 2004 Latvia had become a member of both the European Union and NATO.

The EU impact upon Latvia has been both direct and indirect. Actions that have a direct impact upon Latvia are: the Copenhagen criteria and procedures; the construction of a single market; the EMU; and “acquis”. Actions that have an indirect impact are: the dissemination of “soft” legislation, recommendations, White Books, the Open Method of Coordination (OMC) and National Action Plans. The Lisbon Summit, held in March 2000, coined the term “the Open Method of Coordination” and defined its key elements. These are establishment of guidelines for the European Union; translating the EU guidelines into national and regional policy by setting specific targets and adopting measures to meet them; establish quantitative and qualitative indicators and benchmarks as a means of comparing best practice; periodic monitoring, evaluation and peer review. Soft policy coordination has already made an impact upon employment policy (the European Employment Strategy).

The Lisbon Summit also decided to use the OMC to enhance social inclusion. Particular regulatory mechanisms include: joint language use; the building of a common knowledge base (including the collection and standardisation of statistics); the strategic use of comparisons and evaluations; the systemic editing and diffusion of knowledge, and they are combined with social pressures to conform to common standards and goals, and with time pressures in meeting specific deadlines. These measures taken together constitute a systemic system of governance with the potential to transform the practices of member states and to enhance the integration process, albeit by a somewhat different kind of dynamics than is generated by regulation and integration via hard law (Jacobsson, 2004: 356). OMC has been seen as a mechanism whereby national civil servants are encouraged to ratchet-up their policies against agreed benchmarks and through policy learning. With joining EU Latvia strengthened institutional capabilities, especially through the provision of structural funds and by the implementation of different programs using the open method of coordination. The increased mobility of qualified labour after Latvia joined the EU became a new challenge to compete with salaries and wages in the other EU countries.

Latvia is using ESF investments to up skill its workforce and offer new opportunities to all jobseekers, in particular the young. Social inclusion and education measures are also underway. Young people are benefiting from actions funded under the Youth Employment Initiative, offering training, work experience and apprenticeships as well as individual help to make the transition into working life. In addition, the ESF is supporting improvements to health and safety at work.

ESF measures are supporting social inclusion and anti-poverty actions. Among these is a strong focus on the de-institutionalisation of adults with mental disabilities and children in care. This is being achieved through new community-based care approaches. ESF projects are giving better access to health services for the socially excluded and people in remote rural locations. They are also supporting health promotion and disease prevention measures at community level.

European semester

Europe 2020 is the European Union’s ten-year jobs and growth strategy. It was launched in 2010 to create the conditions for smart, sustainable and inclusive growth. Five headline targets have been agreed for the EU to achieve by the end of 2020. These cover employment; research and development; climate/energy; education; social inclusion and poverty reduction.

Progress towards the Europe 2020 targets is encouraged and monitored throughout the European Semester, the EU's yearly cycle of economic and budgetary coordination.

The European Semester provides a framework for the coordination of economic policies across the European Union. It allows EU countries to discuss their economic and budget plans and monitor progress at specific times throughout the year. The European Semester is an integrated system, which “ensures that there are clearer rules, better follow-up and improved implementation by Member States of the commonly agreed policies throughout the year. It also allows for regular monitoring, and the possibility of swifter response ahead or in case of problems. This helps Member States deliver their reform and budgetary commitments, while making the Economic and Monetary Union more robust”(EC 2017a).

The Commission publishes the Country Specific Recommendations every spring, as part of the European Semester, the EU's annual cycle for economic policy coordination. The recommendations adapt priorities identified at EU level in the Annual Growth Survey and at the euro area level in the recommendation for the economic policy of the euro area to the national level. They give guidance on what can realistically be achieved in the next 12-18 months to make growth stronger, more sustainable and more inclusive, in line with the EU's long-term jobs and growth plan, the Europe 2020 strategy.

“The European Semester has been significantly streamlined over time to improve dialogue, ownership and delivery at all levels. In year 2017 edition, the Commission is putting increased emphasis on the multiannual dimension of the European Semester. A multiannual perspective on the implementation of past country-specific recommendations provides a clearer picture of the evolution of progress since each recommendation was first adopted. This is because implementing reforms takes time, often more than the one year that can be monitored in a single-year perspective” (EC 2017b).

Substantive progress is recorded for the large majority of reforms, but the pace and depth of reform implementation by Member States varies. Evaluation of efforts of Member States to implement reforms ranges degree of progress between 'limited' and 'some' for most policy areas identified in the 2016 country specific recommendations. Multiannual assessment of CSRs during six years (2011-2017) demonstrated such assessments of reforms’ progress: no progress - 5%; full implementation- 9%, substantial progress – 15%, limited progress – 28% and some progress -43%.

Latvia has been receiving CSRs since 2012 with their further annual assessment in country report. And in the areas related to social policies the single policy area where ‘substantial progress’ had been observed was reducing of child poverty. This recommendation appeared in CSRs only once – in 2013 and already in the next year it was verified that child-related benefits had been increased significantly and other measures implemented.

The Commission's assessments in respect of other CSRs relating to social policy areas are much less positive. One of the policy areas where year-to-year recommendations remain almost unchanged concerns labour tax rates.

There are recommendations that remain almost intact in each year CSR:

*Table 1***. *Country specific recommendations for Latvia in the field of labour taxes and assessment of their implementation in the subsequent year*** (excerpts from respective Country Reports)

CSRs for Latvia	**Assessment in the subsequent year**
2012*:* Implement measures to shift taxation away from labour to consumption, property, and use of natural and other resources	***2013****:* **Some progress**. Latvia has reduced taxes on labour and plans further steps in this regard in 2014-2015. However, focus on low-wage earners has been insufficient.
2013*:* reduce taxation of low-income earners by shifting taxation to areas such as excise duties, recurrent property taxes and/or environment taxes	***2014****:* **Some progress** in reducing taxation of low-income earners, as the tax wedge has been brought closer to the EU average. However, the focus on low-income earners has been only partial **Some progress** on shifting taxation to other tax bases and environmental taxes: a new excise tax on liquefied petroleum; euro vignette as of July 2014; a new tax on water use for hydroelectric power plants; an increase in environmental taxes for non-eco-friendly products (packaging); landfill tax increased as of January 2014
2014*:* Pursue efforts to further reduce the tax burden on low-income earners in the context of a shift towards more growth-friendly property and environmental taxes	***2015****:* **Some progress** in reducing labour taxation, but measures could be better targeted at low-income earners. **Limited progress** in shifting taxation to other tax bases and environmental taxes.
2015: Reduce the high tax wedge for low-income earners by shifting the tax burden to other sources less detrimental to growth	***2016****:* **Limited progress** has been made in reducing the high tax wedge for low-income earners by shifting the tax burden to other sources less detrimental to growth. The 2016 budget measures make labour taxation more progressive, but marginally reduce the high tax wage on low wages.
2016: Reduce the tax wedge for low-income earners by exploiting a growth-friendly tax shift towards	***2017****:* **Limited progress** has been made in shifting the tax burden away from low-wage earners. Adopted measures have a limited effect. The tax wedge on low-

environmental and property taxes	wage earners remains high, while there is a scope to shift taxation to consumption, property and capital.
2017*:* Reduce taxation for low-income earners by shifting it to other sources that are less detrimental to growth	*2018:*

As can be seen from the above table, the Commission's assessment of the progress in tax reform since 2012 is becoming more pessimistic transforming definition of some progress in 2013 and 2014 to limited progress in 2015 and subsequent years. The definition of "some progress" assumes that "the member state has announced or adopted measures to address the CSR. These measures are promising, but not all of them have been implemented yet and implementation is not certain in all cases". Meanwhile, "limited progress" means that "the member state has announced some measures to address the CSR, but these measures appear insufficient and/or their adoption/implementation is at risk". Taking into account that the tax reform plan is still under debates since the beginning of 2017 such assessment can be considered as a more precise one. At the same time, the repetition of the CSR creates more pressure on the ruling coalition because introduction of some elements of progressivity into tax policy is really a hard task for right-wing parties in Latvia.

The EC is not alone in recommending Latvian government to reduce taxation on low-income earners. The OECD in their evaluation of the resource base for social protection in Latvia have also pointed out that "social insurance contributions on wages accounted for 61% of all social protection financing" in 2012, which was the fifth highest share in the EU-27, and especially stressed high tax wedge for low-wage workers (OECD, 2016). The World Bank, who assessed Latvian tax system through the request of the Latvian government in 2016, has also recommended introducing progressive income tax rates: in their opinion, the existing flat rate should be reduced for low-income earners and increased for high-income earners. On the

Taxpayers' Forum – a special conference called by the Finance Ministry held in Latvia in December 2016, - the WB and OECD both presented fairly long to-do lists to policymakers, centring on the need to reform micro-enterprise tax and broaden the tax base so that low earners carry less of a tax burden. "You have very high taxes on labour income, very low taxes on capital income," [OECD Senior Tax Economist] Bert Brys said, before suggesting reforms to the so-called flat-tax system. „A flat tax doesn't work if social security contributions are very high, which is the case in your country... In fact you do not even have a pure flat tax system. Reform of the personal income tax is necessary," Brys said. „It's very important to address the very high social security burden on low incomes... the amount of taxes you levy on low income labour is too high." A similar tone was set by World Bank expert Emily Sinnot who said: "The flat tax option could be reconsidered... one thing you could do is strengthen tax progression. „Tax credits like those used in the US or UK could be used "to provide support for low-income families, to target in-work poverty." A big concern is that the underlying distribution of wages is very skewed with a lot of people working around a very low wage level, when the economy needs to move towards better-skilled and better-paid jobs, the World Bank added (LSM.lv, 14/12/2016).

Another policy area where the wordings of Commission's recommendations are repetitious and the reforms are stalled is the social assistance system.

Table 2. ***Country specific recommendations for Latvia in the field of social assistance and assessment of their implementation in the subsequent year*** (excerpts from respective Country Reports)

CSRs for Latvia	**Assessment in the subsequent year**
2012: Tackle high rates of poverty and social exclusion by reforming the social assistance system to make it more efficient, while better protecting the poor	*2013:* **No progress**. There has been little progress in addressing the problems of social assistance and some steps (abolishing central government financing for GMI; reduction of the GMI amount) go against the spirit of the CSR.
2013: Tackle high rates of poverty by	*2014:* **Limited progress** in reforming social

reforming social assistance for better coverage, by improving benefit adequacy and activation measures for benefit recipients.	assistance. Reform proposals based on sound evidence are being prepared; however, their implementation is uncertain.
2014*:* Reform social assistance and its financing further to ensure better coverage, adequacy of benefits, strengthened activation and targeted social services	*2015:* **Limited progress** in social assistance reform. Several studies and policy documents were prepared, but the implementation is uncertain.
2015*:* Take concrete steps to reform social assistance, ensuring adequacy of benefits	*2016:* **Limited progress** has been made in reforming social assistance and ensuring adequacy of benefits. The preparatory work is ongoing to reform social assistance by introducing the minimum income level from 2017, but its implementation is uncertain. The social assistance benefit adequacy has not improved since 2009.
2016*:* Improve the adequacy of social assistance benefits	*2017:* **Limited progress** has been made in improving adequacy of social assistance benefits. The key reform of the minimum income level was not implemented as planned in 2017 and future plans are uncertain. The family state benefit has been excluded from the means test to qualify for social assistance with a limited improvement in benefit adequacy.
2017: Improve the adequacy of the social safety net	*2018:*

The Commission's assessments are absolutely precise, because Latvia has announced some measures but did nothing for their implementation. Therefore in the year 2017 Country Report the EC draws the attention of the authorities in Latvia to the necessity of making actual steps: "Implementation of the recommendations has slowed down in the recent years. Over 2012-2014, Latvia made 'some' progress with the overall implementation of the country-specific recommendations, due to reforms initiated under the financial assistance programme, post-programme surveillance and the euro adoption process. More recently, as the economic situation has normalised and external pressure has decreased, the urgency of policy measures has abated, leading to a slowdown in the reform process to ‘limited’ in recent years.” (EC,2017c : 10)

Since 2011 there has been evidence of an improvement in the macroeconomic situation and a gradual recovery of national economy in Latvia in the wake of the 2008-2010 crises. The stabilisation of the economic situation has had a certain positive impact also on the indicators describing the living standard of the population as well as changes in the key social indicators. Yet at the same time some negative trends have emerged that reveal the depth of the impact the economic crisis has had on certain groups of the population at risk of poverty and social exclusion.

The reduction of the high risk of poverty or social exclusion as well as income inequality is one of the main challenges for social policy. Therefore in 2013, 2014, 2015, 2016 and 2017 the Country Specific Recommendations (CSR) that Latvia received concerning the necessity to implement social assistance reforms ensuring adequacy of benefits still remain relevant. Here we can find strong **coincidence** with the conclusions of WB research “Latvia: Who is Unemployed, Inactive or Needy? Assessing Post-Crisis Policy Options” (WB, 2013).

Healthcare topic has first appeared in CSR in 2014 and since that time is repeated each year, as only ‘limited progress’ is observed in its respect.

Jonathan Zeitlin argues that EU governance in many key policy domains continue to take the form of an experimentalist decision-making architecture, based on a recursive process of framework goal-setting and revision through comparative review of implementation experience in diverse local contexts. Broadly functional combination of an open-textured approach with experimentalist traits (in particular participative decision-making in which actors responsible for implementation at the local level have a central role, and a dynamic regulatory framework in which periodic review and adjustment in the light of ‘on the ground’ experience is embedded) with the disciplines and efficiencies of an administrative agency operating within an established EU framework” (Zeitlin, 2016: 9)

He positively evaluated this new governance model as “the substantive reorientation of the European Semester towards a more socially balanced policy stance from 2011 to 2014 was accompanied by organizational and procedural developments which have reinforced the role of social and employment policy actors in its governance, while at the same time expanding the scope for deliberation and mutual learning about how to adapt common European objectives to diverse national contexts”. Procedural framework was substantially revised beginning with the 2013 cycle. Through this process, Member State representatives were also able to push back against what they perceived as “over-prescriptive’, ‘one-size-fits-all’ recommendations from the Commission. …But no sanctions have yet been imposed on any Member State within the semester…and given the political and legal hurdles involved this seems likely to occur if at all only under very exceptional circumstances”. There are still wide differences between Member States in how seriously they take CSRs.

Evaluating the development of European Semester Jonathan Zeitlin concludes that EU experimentalist governance has proved remarkably resilient and that the Semester’s governance procedures are becoming less hierarchical and more interactive,. ..in the social and employment fields there are clear signs of a growing emphasis on joint exploration and mutual learning about how to address common European objectives and challenges in diverse national contexts (Zeitlin, 2016: 22).

Conclusions

Social policy making process has multi-sited, multi-layered, multi-actored nature. This is not to say that states do not matter. „They remain important as mediators of international influence and they in turn contribute to international policy dialogues. But state social policy choices in most countries are framed within those alternatives being canvassed by public and private international actors and are strongly influenced by loan conditionalities set by lending and donor agencies" (Deacon, p. 175).

We fully back this statement of Bob Deacon done 10 years ago, before the big world crisis. In this paper we did not touch on the contribution of UN Development Programs, the WHO, UNICEF, ILO and many other international actors in policy-making and society transformation processes. But the examination of IMF, WB and EU activities and analysis of experience of social policy-making in Latvia during the last 25 years substantiate the crucial importance of international actors to these processes. It is hardly possible to measure the degree of each actor's influence on the policy process. To our opinion, in the first decade after regaining the independence the influence of the IMF and, especially, the World Bank was stronger than that of the EU. Liberal values were very popular among representatives of Latvian political elite. Many of Latvian key politicians (Minister of Economy, Minister of Finance, Presidents of the Bank of Latvia) have studied in the USA in 1990th and were very much influenced by monetarist ideas. Many representatives of Latvian diaspora from abroad were elected to the parliament and nominated as ministers. The best example of Anglo-Saxon model influence is found in the Law on State Pensions.

Policy transfer and policy learning process through Open Method of Coordination contributed a lot to the social policy-making in Latvia. Politicians and civil servants were ready to learn and capable of adapting world experience sometimes without evaluation of its compatibility with the home situation. After Latvia has joined the EU in 2004, the role of this supranational institution has rapidly increased in all areas of Latvian public policy. Open European labour market has stimulated growth of outmigration and high mobility of population. The helpful involvement of European Commission during severe crisis years was crucial for successful overcoming the financial and economic crisis. Under pressure from outside the social policy in Latvia was better targeted during crisis. European Semester instruments: annual country assessment reports and CSRs have demonstrated their role of new tools of governance and communication. At the same time, the messages of these tools are addressed mainly to the political elite, while NGOs and civil society in general are still unaware of their importance and relevance to policy processes.

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