

Book review

How Latvia Came through the Financial Crisis

Anders Åslund and Valdis Dombrovskis

Peterson Institute for International Economics, Washington DC

For a small country of just over two million people Latvia has received very much attention from the media and from economists and politicians in the past few years. First, as the fastest growing economy of the European Union 2004 – 2006 and as one of the ‘Baltic Tigers’, then for its massive recession of 2008 – 2009 where GDP dropped a cumulative 25%, the biggest such decline in the EU if not in the world, and now, 2010 – 2011 for a vigorous debate of whether or not it chose the right path out of recession via the so-called ‘internal devaluation’ strategy.

It is thus very timely and highly welcome to review a whole book that discusses these issues, even starting with Latvia’s transition to a market economy and the lessons to be drawn from that experience. For that, all kudos to Anders Åslund of the Peterson Institute in Washington DC and Valdis Dombrovskis, Prime Minister of Latvia since 2009, for providing the public with their collaborative effort ‘How Latvia Came through the Financial Crisis’.

The book is highly useful for seasoned observers of the Latvian economy as well as for those with only a peripheral knowledge of the rollercoaster experience the country went through. The former benefit from the book consistently mentioning exact sums of money, names of people and dates of important events; the latter will be informed by the book’s chronological structure and can e.g. use the ‘Chronology of events’ p.127 – 131 to track down exactly when certain events took place. In short, it is a book rich in information (it also provides very many notes for each chapter), in documentation, in argumentation (arguments are very well presented; almost in bullet points but it provides a very coherent and useful structure) but also a book that will be divisive. The authors are somewhat self-congratulatory and leave only figments of respect for those economists who argued against internal devaluation and in favour of external devaluation instead.

But this is perhaps understandable. There were (and are) several prominent and eminent economists, in particular Paul Krugman, who have argued forcefully against the Latvian internal devaluation but otherwise the ‘pro-devaluation lobby’, if one may be allowed such a description, has been marred by too many fringe economists who have discredited themselves by asserting that there was always stimulus available for the Latvian economy.

But the arguments are all there: Arguments in favour of devaluation are discussed and evaluated on pp. 54 – 58, the IMF view is presented on pp. 60 – 62 and lessons from Latvia for the world (as the authors, perhaps slightly pompously, put it), a long list of mostly relevant and useful conclusions on pp. 118 – 121.

Although the book is extremely well-structured and thus very easy to navigate, it is somewhat marred by obviously having been put together very hastily: the title of the book is rather unimaginative and most graphs and tables, though informative, are unappealing. A second version would benefit from graphs in colour and in general a more professional layout but this is a very minor piece of criticism – having the book so early after (or perhaps still within) the crisis is a major bonus.

I am sure many would have been delighted had the book gone into more (not least juicy...) detail concerning the nationalization of Parex Bank but this will hopefully be covered in a separate book (in English) by other authors some day. And one may have wanted more from the descriptions of policy-making among the high and mighty but they come across as rather dull which, given the crazy political-economic climate Latvia had in 2009 – 2010, seems both odd and disappointing.

But here, too, only minor pieces of criticism: Åslund and Dombrovskis deserve praise for the first book account of what took place in Latvia in the boom-bust times and for their very detailed and largely persuasive arguments.

From an economist's perspective this is by far the most important contribution in 2011 to the economic-political discussion in Latvia.

Morten Hansen

Head of the Economics Department at Stockholm School of Economics in Riga.

Book review

*Estonian Human Development Report 2010/2011, Baltic Way(s)
of Human Development: Twenty Years On, Marju Lauristin
(editor in chief), Eesti Koostöö Kogu (Estonian Cooperation Assembly),
Tallinn 2011 (ISSN 1406-5401).*

The point of departure for the *Estonian Human Development Report Baltic Way(s) of Human Development: Twenty Years On* is that twenty years have passed since the three Baltic States of Estonia, Latvia and Lithuania regained independence from the Soviet Union. With twenty years of regained independence characterized by social and economic transition, the Baltic States have reached a phase of development where they have begun to look for a social model that addresses the sustainability of covering social and education-related costs in addition to focusing mainly on economic capability as such.

To address these issues requires an understanding of where the three Baltic States currently stand with respect to human development. Furthermore, since there is a substantial amount of path dependency, it is also of relevance to know the route to the current position. With a focus on all three Baltic States, the question underlying the entire report is therefore whether there has been or whether there is a single Baltic development model employed in all three Baltic States. To answer this question the report looks not only at the three Baltic States but also at their neighbouring states around the Baltic Sea. The explicit aim of the discussion is to identify commonalities and differences in terms of the development models chosen by the three Baltic States.

The overall conclusion is that if looked upon from a Baltic Sea region perspective, and even more so from an overall EU perspective, the Baltic States seem to have chosen fairly similar approaches and development models. However, a closer look at the three Baltic States reveals important differences – differences that over time might generate quite different development paths for the three states.

To address these issues the report not only adapts a tri-country comparative analysis, it also adapts a tri-country approach when it comes to the contributing authors. In this context, the Estonian Cooperation Assembly (the initiator of the report) and the editors have been able to gather a team of leading Baltic social scientists joined by a number of non-Baltic scientists. The latter provide valuable views from a perspective outside the Baltic States.

The first chapter of the report addresses commonalities and divergences in the path of transition and human development of the Baltic States. This provides a basis for an overall comparison of the development of the Baltic States during the twenty years of regained independence. The chapter is rich in facts and indicators for the Baltic States as well as for a set of comparator countries (predominantly from the Baltic Sea region). The chapter ends with an

interesting comparative study on the transition from state-owned enterprises to innovation-based entrepreneurship. In terms of providing a general understanding of the overall similarities and differences between the three Baltic States and their regional neighbours as well as the between the three Baltic States as such the chapter serves its purpose well. Furthermore, it provides a lodestar for the remaining part of the report. It also provides a justification for the topics chosen in the following six chapters by more or less defining six important aspects of human development in the Baltic States:

- Demographics;
- Social policy;
- Education;
- Language space and human capital;
- Political development;
- Integration of the Baltic States.

Each of these fields is presented in individual and separately edited chapters involving contributions from a pan-Baltic team of leading social scientists. As for the choice of topics addressed, it could be challenged, as in any report of this kind. In the case of the current report one might ask why, for example, aspects such as environment and gender have not been explicitly addressed. On the other hand, the topics chosen are all highly relevant and represent areas where the Baltic States are facing and will face substantial challenges.

The second chapter being devoted to various demographical aspects is the first of four chapters discussing various aspect of human capital. It starts with an analysis of the demographic costs of the last twenty years of social and economic transition. In addition to 'traditional' demographic indicators the analysis highlights an interesting and often neglected aspect of the demographics of the Baltic transition: the effects and consequences of changes in ethnic composition following regained Baltic independence. Following this discussion is a comprehensive and well-written analysis of life expectancy and mortality allowing for national as well as regional comparisons. This discussion leads to an analysis of health care policies pursued in the Baltic States 1990-2010. The analysis includes aspects such as financing, affordability and availability of health care. The conclusion is that in most aspects analysed the Baltic States perform worse than most of their neighbours around the Baltic Sea. Furthermore, the performance of the Baltic States relative to each other has changed during the period studied with Estonia in many cases overtaking the role as the best performer in terms of key indicators.

The third chapter continues along the human capital theme by focusing on social policy, the labour market and the subjective well-being of the population – each of these closely linked to each other. The first part of the chapter discusses the Baltic welfare state(s), in particular various social security programmes and their generosity. This is followed by a discussion of employment and the labour market which starts with the observation that the labour force in all three states in general is highly educated and that there is a high female participation rate in the labour market. The analysis to a large extent focuses on the impact of the economic

crisis that hit the Baltic States in 2008. In this context the authors conclude that the labour markets of the Baltic States responded quickly to the economic crisis and that the explanation is to be found in the high degree of labour market flexibility combined with a high degree of labour force migration (in particular in Lithuania and Latvia) to other EU states. Closely linked to social policy and employment is subjective well-being where the analysis undertaken shows that differences in satisfaction have increased considerably between younger and older people and so have income-based differences. The final section of the chapter extends the analysis to the Nordic neighbours: Finland and Sweden.

Education, constituting an important part of human development as well as economic development in general, is addressed in the fourth chapter of the report. Following a discussion providing a historical perspective, the chapter continues with an analysis of the current situation supported by a rich set of indicators painting a maybe overly bright picture of the current state of education in the three Baltic States. With historical developments and the current situation being analyzed the report then addresses the issue of how the future of education should be shaped. To a large extent this discussion is based on a critical assessment of various policies and policy documents – a discussion that does not avoid addressing issues where, in particular in the Latvian case, additional reform is needed. The chapter ends with a discussion of the international framework of educational reforms. Although interesting as such, the last section would have benefited had the discussion of educational reforms been more closely related to Baltic developments and future prospects.

The highlight of the Estonian Human Development Report is the chapter on “Language space and human capital in the Baltic States”. This chapter provides an overall thought-provoking analysis of various aspects of the language issue characterized by a large minority having Russian as their native language. As such, the analysis takes the reader much further than the ‘standard’ (and in many cases highly politicised) analysis of the language issue in the Baltic States. Following an introductory discussion on the role of language skills for human development, the chapter links linguistic integration to structural factors in the Baltic States, where structural factors refer to: civic integration; educational arrangements, language management, inter-ethnic contacts, geographical distribution, and labour market differentiation – overall Lithuania seems to do slightly better than Estonia and Latvia in terms of integration. With linguistic integration at the heart of the integration policies pursued in all three Baltic States, the chapter also provides a country based critical assessment of linguistic integration policies including minority education. This is supplemented by a discussion of various aspects of attitudes to the respective state languages and linkages to identity formation and social differentiation. In this context, a small but nevertheless interesting observation is the different language adaption strategies of Lithuanian Poles and Lithuanian Russians, respectively. However, the language issue is not limited to use of the three state languages. In a European context knowledge of other EU languages is more or less of vital importance. Accordingly, the chapter also discusses knowledge of languages other than the state language. One of the observations worth mentioning is that in terms of “market value” (measured as usefulness of language) of foreign languages English has the highest market value in Estonia and Lithuania, whereas in Latvia the first position is shared with Russian. This is also re-

flected in the observation that Russian is the lingua franca in inter-ethnic communication in Latvia and to a lesser extent in Estonia and Lithuania. The chapter ends with two “views from outside” by non-Baltic researchers providing a discussion of language constellations across the Baltic area.

The sixth chapter of the report focuses on general democratic development (including civil and political rights) and development of the political landscape and culture during the last twenty years. The analysis employs a wide range of political development indicators in order to get an understanding of the similarities as well as the differences that have emerged between the three Baltic States during the last twenty years. Political development is probably the dimension where the difference between Estonia on the one hand and its two Baltic sisters, Latvia and Lithuania, on the other, is the biggest. Estonia shows the highest levels of government stability, party system consolidation, and trust in institutions. It is also worth mentioning that the authors of the chapter recognize the important link to civil society and social capital – areas where post-communist states in general perform badly. The Baltic States are no exception, although Estonia seems to do slightly better than the other two Baltic nations.

The last aspect of human development discussed in the report is the integration of the Baltic States and the role of smaller states in Europe – issues discussed in the last two chapters of the report. Following a discussion of the experience and an explanation of the development of the last two decades, the analysis adopts a forward looking approach by discussing three possible scenarios in terms of Baltic integration and cooperation:

- Three-level integration: a coherent Baltic Sea region in a cooperative Europe;
- The counter-project of Nordic states: Nordic-Baltic integration in response to the EU crisis;
- The counter-project of three small nations: Baltic unity in an uncertain world.

Being very much forward looking this is the most thought-provoking chapter of the report. It is worth underlining that the three scenarios are not merely wishful thinking, since discussion of each of these is preceded by an introductory section outlining the prerequisites of the respective scenario. Furthermore, what adds to the quality of discussion in the chapter is that analysis of the scenarios explicitly addresses the impact on key areas such as infrastructure, energy and markets.

Irrespective of which (if any) of the three scenarios will be the policy aim, the Estonian Human Development Report provides a solid basis for policy thinking and policy making in all three Baltic States by telling where the states stand today, how they reached their respective current position and where they might end up in the future. Hence, and needless to say, the report should be recommended reading to anyone with an interest in the economic and social development of the Baltic States. Among its virtues are its solid academic approach (although easily accessible to the non-specialist reader); the compilation of data and findings from a large number of policy documents and academic studies; the way it presents its material and

rich findings in various tables; and the rich list of references to the academic literature following each chapter. Given the number of contributors the chapter editors and the editor in chief have done an excellent job in creating a ‘unified’ text.

It is no exaggeration to claim that the report fills an important gap in policy oriented literature on the Baltic States – in particular by taking a pan-Baltic approach to human development showing the similarities and dismantling what might be seen as similarities before looking deeper into the findings, while at the same time not being afraid of asking unpleasant questions and highlighting current shortcomings and future challenges.

To some extent referring back to the discussion on Baltic integration, this is sadly one of the few examples of highly successful academic cooperation across the Baltic borders. As pointed out by the editor in chief, Marju Lauristin, “The Estonian Human Development Report is not a result of official cooperation between the Baltic States and has not been carried out as an internationally financed research project”. Maybe the answer to the success of the report can be found here – there is no political agenda, there is no national prestige, there is ‘just’ a team comprising several of the best social scientists in the Baltic States doing a great job. Hopefully, it will continue like this and then there will be many more high-quality pan-Baltic Human Development Reports to come...

Finally, as an ‘extra’ the report ends with the winning entries of the competition for the cover photo of the report on the theme “This is a beautiful place to live”. One could just hope that the report gets the attention it deserves, not only in Estonia, but also in Latvia and Lithuania, then the three Baltic States will be an even more beautiful place to live.

Anders Paalzow

Stockholm School of Economics in Riga