

Global economic crisis in Latvia: social policy and individuals' responses

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The global economic crisis has resulted in some devastating socio-economic and socio-political consequences in almost all countries of EU, and because of external and internal reasons Latvia is one of the hardest hit countries of the region.

The paper discusses the manifestation of crisis, the government's response to it, and individuals' coping strategies on the basis of statistical analysis and in-depth interviews.

Economic recession is characterized by GDP reduction, unemployment growth, increase in rates of poverty (needy persons), and household debt.

In response to the crisis, Latvia has been forced to borrow a significant amount of money from international lenders. The government has taken severe steps towards the budget consolidation – drastic cuts of income, reduction of social insurance benefits, and increase of taxes. These measures had impact on different categories of people, but the most vulnerable groups of population were hit hardest. As a result, the need for social assistance increased. Several new activities to strengthen social security net for the poorest were introduced.

Among others, one of the results of government's austerity measures is a rising distrust of the population in the system of social security, especially social insurance. In such situation inhabitants choose different individual survival strategies.

Key words: global economic crisis, social policy, individual coping strategies

INTRODUCTION

The current economic crisis opens a new chapter in the socio-economic development of Eastern Europe, signalling new forms of deep economic, political and social shocks, as well as dependency and vulnerability in the region (Lendvai 2010). The crisis is affecting all spheres of life and different categories of population, especially those in the risk of poverty and social exclusion. The problems people face have become more complex – decline or loss of income, unemployment, inability to pay for housing, health care, education, loans, etc. Latvia has taken several steps to mitigate the impact of the financial crisis on its economic system. All the measures taken significantly affect not only the current situation, but also have a long-term effect. The main approach of the Latvian government for addressing problems caused by the crisis has been the reduction of the national budgetary deficit. It must be pointed out that no alternative strategies are proposed, recognising that Latvia has no other option than to honour obligations it has assumed (which are often presented as requirements imposed by international lenders) for the receipt of the international loan.

The aim of the paper is to discuss manifestation of the crisis, the government's response to it, and individual coping strategies on the basis of statistical analysis and in-depth interviews.

Qualitative 64 in-depth face-to face interviews with residents of Latvia were carried out from 2009 to 2010 by the authors and students from the study programs *Sociology, Organizational and Management Sociology, International Relations – European Studies and Politics and Public Administration* of Riga Stradins University. Information was collected about people's views on the manifestation of the crisis in their families, their survival strategies and assessment of government's policies during the crisis and impact of these measures on their families.

CHARACTERISTICS OF CRISIS

Latvia regained its independence in 1991, and since then it has experienced both periods of recession and growth. The period since the year 2000 marks extremely high growth (Table 1) fuelled by easy credits. The situation can be characterized as overheating of economy, fast growing domestic demand and current account imbalances, fast growing social inequalities, and deterioration of the demographic situation (Lendvai 2010), which finally resulted in dramatic downfall, starting from 2008.

Table 1. GDP growth (%)

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
6.9	8	6.5	7.2	8.7	10.6	12.2	10	-4.2	-18	-0.3	3.3

Source: Latvia Country Report. <http://www.gfmag.com/gdp-data-country-reports/236-latvia-gdp-country-report.html#axzz1MzwAxuM1>

The global economic and financial crisis has resulted in some devastating socio-economic and socio-political consequences in almost all countries of EU, and Latvia due to a number of external and internal reasons is one of the hardest hit countries of the region. The dramatic situation was deteriorated by the collapse of Parex Bank, which was taken over by the state; this process has demanded significant allocation of resources.

Economic recession in Latvia is characterized by significant reduction of GDP, which reached its lowest point -18% in 2009 (EU-27 -4.2%). According to IMF estimates, it will take a decade before Latvia returns to its pre-crisis level of 2007 (Matos 2010: 28). The crisis was followed by the growth of unemployment¹ (registered unemployment rate increased from 5.3% in September 2008 to 13.9% in April 2011, reaching its peak in March 2010 with 17.3%). The crisis has affected also the long term unemployment rate. The unemployment rates in Latvia are among the highest in EU, and significantly exceed the average (Table 2).

Table 2. Harmonized unemployment rate

	2009 September	2009 December	2010 March	2010 December	2011 March
EU-27	9.3	9.4	9.6	9.6	9.4
Latvia	18.5	19.8	20.0	17.2	16.2

Source: Harmonised Unemployment Rate. <http://epp.eurostat.ec.europa.eu/>

¹ There are two approaches to the calculation of the rate of unemployment – registered (used in national statistics) and harmonized (used in EU).

Although the poverty rates were also high in the pre-crisis period, and the threshold of poverty risk at 60% of equivalent income is low, recession has also brought deterioration in this sphere. At-risk-of-poverty rate was 26% in Latvia (17% in EU-27) in 2008. However, this figure has no practical application, as only individuals with a status of a needy person (income does not exceed LVL² 90) are eligible to social assistance. Since this is a very low level of income, the number of needy persons was small during the pre-crisis period, but it has increased during the crisis and has grown from 5.3% in 2008 to 8.6% in March 2011.

Another indicator characteristic of the recent crisis is household debt due to a number of various reasons – decrease of income, loss of job, burden of loans, etc. People were not prepared for such significant changes. Most of the population lived for the day expecting improvement, not deterioration of their private economic situation, and therefore had no savings. According to research data by SKDS in 2009, only 19% of households had savings equal or more than their monthly income; 21% already had spent their savings due to the crisis; and 55% had no savings at all.

Economic and financial crisis had effect not only on the micro level, but also affected the macro level – the state budget deficit had reached LVL 672.4 million in 2008, making 4.1% of GDP (Par valsts budžeta deficīta un parāda 2009. gada oktobra notifikācijas rezultātiem).

GOVERNMENT'S RESPONSE

Borrowing abroad was limited during the period of crisis. Nevertheless, Latvia had to solve the problem of the current budget deficit. In response to the crisis, Latvia was forced to borrow a significant amount of money (about 7.5 billion euros or 1/3 of its 2008 GDP) from the international lenders – IMF, European Community and World Bank. The loans came together with “conditionalities, stressing fiscal consolidation, structural reform and support for the financial system” (Darvas 2009, cited from Lendvai 2010). This process involved substantial fiscal restraints.

Deep recessions produce increased demands for more spending within the social sphere, but fiscal constraints reduce the ability of the government to expand or even maintain the previous level. Conditionalities put the highest priority on stabilization, balance of payments adjustment, and structural adjustment measures, not on wellbeing of population.

The government has taken severe steps towards the budget consolidation, which Lendvai (2010) characterises as “most severe austerity packages of the past twenty years”. The stabilization without currency devaluation carried social costs, particularly employment contraction and wage reductions. Employment was reduced by 22% in budget institutions and by 11% in public firms in 2010 compared to 2008 (Matos 2010). This did not exclude drastic cuts of wages in public sector by 25%, cuts of pensions by 10% for non-working and by 70% for working pensioners. This activity was abolished by The Constitutional Court, and government had to discharge the withheld part and to pay pensions in full, thus increasing fiscal constraints.

To improve the state budget, the government decided to rise existing taxes and impose new ones. “In principle, taxes could be raised for this purpose, but such efforts face well-known structural as well as political limits” (Haggard, Kaufman 2006: 12). Nevertheless, personal income tax was increased from 23% to 26% in 2010 (25% in 2011), non-taxable minimum was reduced from LVL 90 to LVL 35 (LVL 45 in 2011), employee's share in social insurance payment was increased from 9% to 11%, VAT was increased from 18% to 22%, housing tax was introduced, etc.

²EUR 1 = LVL 0.7028.

These activities of the government resulted in increased necessity for social support – social insurance and social assistance benefits, especially increase in claims for the guaranteed minimum income (GMI) benefit, housing benefit, etc. However, the solutions proposed by the government regarding budget consolidation involved significant cuts of social spending: reduction of the pensions (discussed above); changes in the 2nd level of the pension scheme (reduction from 10% to 2% for private administration); reduction of the child care benefit (by 50% from July 2009 to May 2010, and after that it was not paid to working parents); the ceilings for child care benefits; reduction of the family benefit; imposing time limit of the sickness benefit (from 52 to 26 weeks a year, not exceeding 52 weeks within 3-years period); from 2010 unemployment, sickness, maternity and paternity benefits were divided into two brackets: if calculated benefits are below LVL 11.51 per day, they are paid in full amount, otherwise daily benefits are LVL 11.51 plus 50% of the sum over LVL 11.51. Unemployment benefit, which is paid for nine months, was restructured and converted into a flat-rate (LVL 45) if the insurance period is 1–9 years – for last five months, and if it is 10–19 years – for last three months.

These measures had impact on different categories of people, but mostly hit those with low or medium income, the most vulnerable groups of population. As the result, the need for social assistance increased. Therefore several new activities to strengthen social security net for the poorest were introduced.

One of them refers to GMI benefit which was increased from LVL 37 to LVL 40 for adults and LVL 45 for children. Even after the increase the benefit is extremely low and comprises approximately $\frac{1}{4}$ of the calculated subsistence minimum. As there was a rise of long-term unemployment and the number of people without any means of subsistence increased, time limit for GMI benefit was abolished (before it was paid for nine months). Also housing benefit was introduced as a mandatory benefit. Provision of both benefits is a responsibility of the local municipalities. As the number of beneficiaries increased significantly (GMI benefit was received by 28.8 thousand in January 2010 and 69 thousand in December 2010), and the financial resources of the municipalities were limited, the state co-financing of these benefits was introduced – 50% for GMI and 20% for housing benefit.

To improve the situation of the unemployed, a new activity – work practice in local municipalities (Table 3) with grant of LVL 100 – was introduced with the support of EU Structural Funds (ESF). The program is offered to those who are registered as the unemployed and do not receive unemployment benefit (the benefit is received by only 20% of the registered unemployed persons).

Table 3. Work practice in local municipalities

	2009	2010
New work practice places	16 080	34 679
Participants	19 300	52 941
On the waiting list	30 000	50 352

Source: Information received from the Ministry of Welfare of Latvia.

Several activities were introduced in the health care within the social security net: 100% compensation of patient co-payment for those whose income does not exceed LVL 120, and 50% for those whose income does not exceed LVL 150. This support refers also to purchase of prescribed medicines included in the list of state-reimbursed medicines.

Social security net only partly solves the problems raised by the economic crisis and government's activities aimed at the consolidation of the state budget. Although something has been done regarding social protection, the support is too low due to the limited resources. In most cases it is aimed at the survival, but not for the welfare of people.

INDIVIDUALS' RESPONSE

The working population feels insecure about their future as many people have been affected by the wage cuts, and uncertainty still remains concerning the retention of the work place. New risk groups whose incomes have undergone a significant decrease during the crisis, join those risk groups already in a crisis situation (the disabled, pensioners, in particular single pensioners, the long-term unemployed, single-parent families and families with many children, the homeless, ex-convicts). Mostly, these are employees of the public sector – teachers, police officers, health care employees.

People responding to the crisis and the government's decisions, choose different individual survival strategies. The population becomes increasingly more convinced that they can rely only on themselves or informal contacts and the state and policies implemented by the government cannot be trusted.

According to experts, during the crisis there has been evidence of considerable growth of "grey economy" that constituted approximately 40% of GDP in 2009 (data by A. T. Kearney). In its turn, the survey of Latvian enterprises undertaken by the Applied Information Service in March–May 2011 reveals that more than one third or 37% of managers, owners of enterprises, accounting, financial and other specialists participating in the survey believe that in Latvia the shadow economy even exceeds 50% while 29% think that it fluctuates between 40% and 49%. In reply to the question about the causes of the shadow economy 80% of interviewees express the view that the shadow economy exists because businessmen are forced to enter the shadow economy zone because they have to survive, 76% express the supposition that the cause of the shadow economy is high taxes while 75% believe that part of the economy has ceased to be "white" because it is not clear where the money paid in taxes to the national budget goes. (*Uzņēmēju vairākums...* 2011)

Thus, activities in the "grey zone" have become a way of survival for part of the population. The economic crisis has created new features in tax payment matters. Before the beginning of the crisis, the main problem was the dishonest attitude of employers or tax evasion, and the emphasis in politics was laid on the education of employees about the protection of their rights so that taxes were paid for them and in a social risk situation the employee would receive the required state social insurance benefits. Employees were motivated to make official tax payments and trust in the social insurance system grew resulting in the considerable growth of social insurance payments (the insurance payment salary was increased) in 2007 and 2008.

During the crisis there is evidence of a change in the attitude of employees. In the context of the shadow economy the so-called "wages in envelopes" in the private sector have already become a norm in Latvia. Another new trend that can be observed in the labour market is that those employees, who now have received their wages officially until now, demand that employers transfer to "wages in envelopes" (Sauka 2011).

Likewise, in the in-depth interviews undertaken among the population tax evasion is justified and substantiated as a kind of response reaction and a protest against the policy implemented by the government in the conditions of the crisis (results of the in-depth interviews 2009):

“You may not reduce financing to all sectors, increase taxes without providing benefits, and say that we must be patient ... And blame us for the existing situation” (male, 45).

“In my opinion, when facing a difficult situation, no one but my family will help me and will care for me. It's useless to speak about the state support, as the population is not its priority. This ‘brightening’ is sad, but this is the reality” (female, 39).

“... When you look at reduction of pensions, at reduction of child care and family benefits, it is horribly to realize that you live in such a country. And even more – you do not want to bring up children in such a country, where you cannot feel sure neither for your pension, nor child care benefit and future of your children...” (male, 23).

“Personally I grudge even a santims (cent) paid in taxes for the state” (male, 41).

Experts explain this change of attitude among employees by the impact of several factors. One of them is that employees are incapable of covering their daily expenses, pay utility bills and repay loans by the officially received salary. Another factor is lack of trust in the state social insurance system in general in view of the dramatic changes that the government and the Parliament introduced in 2009 and 2010 contrary to their earlier promises not to touch social insurance payments. Moreover, the population is not convinced that benefits and pensions will not be subjected to further cuts. The survey of the population conducted by the Free Trade Union Association in March 2009 about various issues of employment relations (the executor of the survey was the SKDS) show that slightly more than half of respondents (52%) would be ready to receive salaries in “envelopes”, much less – 35% of respondents disagree with such proposal, but 13% could not answer. Upon the assessment of the issue of the shadow economy experts have come to the conclusion that the situation has become so dangerous that even if the state starts undertaking active measures, a large part of the population will not resume tax payments (LBAS. Latvijas iedzīvotāju aptauja 2009. gada marts).

Emigration is another typical survival strategy employed by the population in the conditions of a high unemployment rate and the decline of social security. In contrast to those countries where in the conditions of crisis those inhabitants who had gone abroad in search of employment, returned, in Latvia it is just the opposite – even notwithstanding the economic decline in practically all member states, the number of inhabitants leaving the country in search of employment abroad continues to grow. As it has been indicated by authors of the book “EU Labour Markets After Post-Enlargement Migration”, during the period from 2004 till 2008 76 thousand adults from Latvia received social insurance numbers in Great Britain and Ireland; approximately 4 thousand per year register as migrants in other countries of the European Economic Area (EEA). After the culmination point in 2005, the departure of the labour force from Latvia declined during 2006–2007, again becoming intensive at the beginning of the economic crisis in 2008 and in particular in 2009. In the first quarter of 2009, the number of citizens and non-citizens of Latvia registered in Great Britain (4.4 thousand) was much higher than in any preceding quarter. Even in Ireland which had been hit by the crisis particularly severely, during the first eight months the number of registered inhabitants of Latvia (2.5 thousand) was the same as during the respective period in 2008. It is highly improbable that the current financial economic crisis will make emigrants from the new member states return home as their home country has been hit by the crisis as severely as or even more severely than their present host country. Moreover, these migrants are young, sufficiently qualified and mobile and it means that they could help reduce the unfavourable conditions caused by the crisis, settling down in

regions and sectors where their productivity would be at its highest. Information provided by the Employment State Service also confirms that 44% of the unemployed are interested in employment in the European Union and third countries (Lace 2010).

During interviews respondents recognise that departure from Latvia is often considered as a solution for the existing problems (results of the in-depth interviews 2009–2010):

“Yes, I am also one of those who will leave because there is no perspective here” (female, 21).

“I will use my knowledge in some other country as I do not want to go on living in such bad conditions as they are at present. I want to live at last, not to exist as it is done by a very large portion of the population in Latvia ...” (male, 30).

“I think that a person must use all options and at present it is also an option to find a job (abroad) as it is difficult to find a good well-paid job here. However, if the person could earn enough to be capable of settling utility payments as well as buying food... then people would not leave” (female, 49).

“I plan going to work abroad as I do not want to slave for santimi (cents) to be able to barely survive. I have a family and a small child and in Latvia it is not possible for only one person to earn a decent living. It is better to work abroad, and I do not have to worry if my family will have food to eat next week, next month...” (male, 27).

When emigrants are asked about their future migration intentions, another trend highlights – the percentage of migrants who would like to return to Latvia is decreasing (Apsite 2010). Notwithstanding the economic stabilisation tendencies at the beginning of 2011, experts point out that the emigration of the population of Latvia continues to increase and one of the main reasons is the high demands of employers to employees that are not commensurate with the low remuneration level (in many cases a qualified employee is offered only the minimum wage).

Thus, the state loses a considerable number of the population that will cause serious problems in future.

It can be concluded that the financial sustainability of the social insurance system is seriously jeopardized by the rapid fall in the number of the working population and incomes from salaried employment as well as the growth of the shadow economy. The above gives rise to very significant challenge for Latvia – the revival of the trust of the society in the basic principles of the social security system (in particular in the wake of fiscal consolidation measures undertaken by the government that introduced significant changes in the initial conditions for social contribution payers and recipients of social insurance payments and lowered, to a considerable degree, the motivation to pay taxes).

CONCLUSIONS

Since 2009, the necessity to dramatically reduce national budget expenditures and the budgetary deficit in Latvia has brought to the foreground the issue of the sustainability of the existing social insurance system and the rapid fall on the revenue side of the national special social insurance budget caused by the consequences of the economic crisis.

All of the government's taken measures significantly affect not only the current situation, but also have a long-term effect. The stabilisation of the economic situation in the country is not felt at the household level. Moreover, austerity measures undertaken by the government to redu-

ce the fiscal deficit were, to a large extent, undertaken at the expense of raising taxes and reducing salaries that has a long-term negative impact on the actual income level of the population.

Among others, one of the results of government's austerity measures is rising distrust of the population in the system of social security, especially social insurance. Government decisions which concern social insurance principles have reduced the motivation of people to pay taxes.

Future prospects are not optimistic and will bring unpopular decisions: changes (decrease) in social insurance benefits (because of the deficit in social budget), pension reform (increase of the retirement age from 62 to 65 is planned to start from 2016), changes in social assistance (decrease of benefits).

The existing situation can be characterised as 'Vicious Circle': existing problems and proposed solutions (seen by population as unfair) lessen population's trust in social policy in general, and the system of social security in particular, that leads to unwillingness to pay taxes, the decrease in opportunities in social sphere follow, and that brings to decrease of population's trust in social policy.

In view of the fact that the development of the state social insurance system was started in the 1990-ties, and a comparatively long period of time passed for the approbation of the system and gradually the trust of the society in the system was acquired, time and resources will be needed to restore the confidence and trust of the society in government decisions and the system in general.

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