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Post-crisis economic governance in Latvia: the European Semester, the Balance-of-Payments programme, and euro accession convergence

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Abstract

Following-up on Latvia's formal adoption into the Eurozone this July 2013 and the regular European Semester policy coordination cycle, the paper explores recent economic governance in Latvia – the only country which has been under three distinct EU economic governance frameworks. Aside the euro accession convergence procedure and the European Semester, Latvia recently also accomplished the Balance-of-Payments (BoP) programme as it faced a default in 2008. Covering the time period approximately from early 2011 to mid-2013, the paper aims to explore the procedures and implications of these three frameworks, as various economic policies have been designed by collaborations between the national authorities, on the one hand, and Brussels institutions, on the other. By 'process tracing' via the relevant policy documents and 'elite interviews' with policy makers in Riga and Brussels, the paper finds that until Latvia's formal accession to the Eurozone this summer the Latvian government – inspired by a particular set of rationales and ideas prioritizing 'market confidence' and 'financial stability' – has exercised considerable discretion, strategically cherry-picking the governance frameworks to comply with its preferences. Specifically, the government secured compliance with the euro accession inflation target at the cost of (postponing) urgent reforms in social policy, as set out by the Country-Specific Recommendations (CSRs). Latvia's social policy was also compromised, as the national authorities instrumentalized EU conditionality in fiscal policy, pushing it to the extreme – effectively, beyond the formal targets determined by the Commission. The paper concludes that contrary to the common critiques on European integration as essentially a neoliberal market-making project, the Commission has overwhelmingly played the role of social advocate in Latvia. Meanwhile, in practicing an extreme version of market radicalism, it is the Latvian technocratic elites that have been the most austere towards the Latvian society.

List of abbreviations

BoP	Balance of Payments (program)
CSR	Country-Specific Recommendation
DG ECFIN	Directorate-General for Economic and Financial Affairs
DG Employment	Directorate-General for Employment, Social Affairs and Equal Opportunities
ECB	European Central Bank
EMU	Economic and Monetary Union
ERM	Exchange Rate Mechanism
EU	European Union
FDL	Fiscal Discipline Law
GDP	Growth Domestic Product
GMI	Guaranteed Minimum Income
IMF	International Monetary Fund
NRP	National Reform Programme
MoU	Memorandum of Understanding
MTO	Medium Term Objective
OCT	Optimum Control Theory
OMC	Open Method of Coordination
SMoU	Supplemental Memorandum of Understanding
PIT	Personal Income Tax
VAT	Value Added Tax

Introduction

Recently, economic governance at the EU level has become increasingly complex. Responding to the Euro-crisis, the Commission has initiated a set of enforced fiscal policy coordination tools, considerably narrowing down the discretionary powers of the member states in economic policy (Armstrong, 2013). Although, this increased "hardness" from the "fiscal" domain to some extent has spilled-over to the social domain (Bekker, 2013); governance of social policy, being mostly subject to Open Method of Coordination (OMC), still considerably lags behind (Vandenbroucke et al., 2013). In the meantime, the euro accession convergence criteria have remained the same as those devised back in 1992.

In order to shed a light on this increasingly sophisticated and at the same time very uneven governance architecture, the paper looks at the case of Latvia, the only European country which has recently been subject to three distinct economic governance frameworks. Firstly, facing a default due to the repercussions of the global financial crisis, Latvia entered the Balance-of-Payments (BoP) (bailout) programme. Secondly, despite the most dramatic recession in the EU, Latvia did not abandon its ambition to join the Eurozone. Thirdly, like any other member state, Latvia is subject to the European Semester – an annual policy coordination cycle between the member states, the Commission and the Council.

Now, just after Latvia's formal adoption into the Eurozone and the end of the regular cycle of the European Semester, the paper aims to explore, firstly, how these three governance frameworks have operated in Latvia, and what the interactions are between them. Secondly, the paper aims to explore how the 'agency' of authorities in Riga, on the one hand, and Brussels, on the other, has played out in the economic policy making process under these three frameworks.

By 'process tracing' via the relevant documents and 'elite interviews' with top officials at key national ministries and the Commission, the paper finds that, first, somewhat counterpoised to the argument of increasingly stringent pan-European fiscal governance (Armstrong, 2013), as determined from above by the Commission, the Latvian national authorities have kept significant discretion in such areas as budgets and taxes, not to mention social assistance. Secondly, contrary to the critiques of European integration as essentially a market-making project (Hyman, 2011); (Pochet & Degryse, 2012); (Scharpf, 2010), and the Commission as an ideological entrepreneur selling the market idea as a solution to all problems (Jabko, 2006), in Latvia, the Commission has predominantly played the role of "social" advocate. The paper argues that it is the Latvian technocratic authorities themselves that have behaved in the most detrimental way towards the Latvian society.

More specifically, the paper finds that the Latvian authorities acted strategically, cherry-picking the most rewarding governance frameworks. Partially, in order to comply with the euro accession criteria, the Latvian government effectively derogated from its commitments under the auspices of the European Semester, thus failing to address the problems of poverty and inequality, in regards to which Latvia scores among the worst performers in the EU. Among other things, the VAT cut implemented to secure the compliance with the Maastricht inflation criterion to some extent was carried out at the cost of various long-pending reforms in social policy – most conspicuously, the increase in the non-taxable threshold for the lower paid. As a matter of fact, they instrumentalized the EU's conditionality in fiscal policy, pushing it to the extreme – well beyond the targets determined by the Commission.

As regards the organization of the paper, firstly, I will introduce some theoretical approaches in the light of which the analysis will be built. Secondly, I will briefly lay out Latvia's peculiar pre-crisis background, which as I argue, was responsible for the formation of the strong bias towards "optimum control" solutions. Thirdly, I will trace the policy making process capitalizing on the relevant documents and interviews with key officials in Riga and Brussels. Finally, I will conclude and propose some recommendations for optimizing economic governance at the EU level.

1. Theoretical accounts

As for the theoretical framework, the paper overwhelmingly draws on interest-based "rational" approaches on the one hand and ideas-based approaches on the other. The interest-based approaches hereafter deal with 'optimum control theory' (OCT), as developed by various Italian economists – the so-called "Bocconi Boys" ([1]). On the other hand, the ideas-based analysis mostly draws upon the notions of 'constructivist political economy'. However, it should be noted that these "rational" and "ideational" approaches are not considered to be mutually exclusive, but complementary, where the latter provide content for the former.

1. According to Mark Blyth (2013), the economics tradition of the Bocconi University of Milan goes back to the mid-century Italian economist Luigi Enaudi, as he was the founder of a school of public finance economics what later would be called public choice economics. However, the modern argument for austerity has been developed by the second-generation of Bocconi graduates, most prominently – Alberto Alesina, Franceso Silvia Ardagna, Guido Tabellini, and Roberto Perotti (Blyth, 2013).

1.1 Interests

1.1.1 Optimum control theory (OCT) I: the standard version

Basically, OCT centres on the old debate of "rules vs. discretion" regarding governance principles in monetary and fiscal policy. The main dilemma is whether governments should be given freedoms in fiscal policy (discretionary spending) or in monetary policy (money supply) or rather – for purposes of financial stability and market confidence – they should discipline themselves by assigning the execution of fiscal and monetary policy to an independent institution. The departure point of OCT is the notion that politicians' preferences change over time. In OCT's vocabulary it is called the "dynamic inconsistency" problem, where policy is dynamically inconsistent whenever it is subject to a constraint involving expectations that policy makers can manipulate with (Kydland & Prescott, 1977). According to OCT, mutually exclusive policy routes followed by politicians over time create uncertainty in the markets, both domestically and internationally. In addition, as OCT argues, politicians may have an interest in using the freedoms of discretionary fiscal or monetary policy to pursue their own goals or agenda; for instance, adjusting to election cycles (Baumol & Blinder, 2011). Thus, OCT considers governments as "rational addicts" who voluntarily enter into strict intergovernmental regulations on monetary policy standards, in order to create a credible commitment (Schelkle, 2006).

1.1.2 OCT II: uses of Europe and *vincolo esterno*

Another variant of OCT is the concept of vincolo esterno (external constraint). It concerns situations when an external constraint can be used by the local elites in order to obtain support and legitimacy for painful reforms that would not be politically feasible otherwise. A classic case of vincolo esterno in practice is Italy – a regionally fragmented country with highly turbulent domestic politics, a polarized party system, and weak state institutions. In order to get over the obstructive problem of party dominance, the Italian domestic technocratic elite shared the belief of the need for externally imposed economic discipline, and found it in the conditionality of the euro (Dyson & Featherstone, 1996). Along the same lines, Ferrera and Gualmini (2004) have termed Italy's quantum leaps of adjustment a "rescue by Europe". By anchoring the country's destiny to that of other more pacified and stable market democracies, the "integrationist elite" wanted to put the domestic polarization under control. Overall, the EU anchor served a double function. Firstly, it offered incentives for reorientation of economic, social and political attitudes from below (related to the four freedoms of labour, goods, capital, and services); secondly, it gave the "integrationist elite" precious resources from above to legitimize difficult policy measures. As a result, the increasing pressures from the ultimate 'carrot' (in the form of accession into EMU), and the ultimate 'sticks' (in the form of higher interest rates and currency depreciations whenever the markets expected that Italy would devalue), led to significant upgrades in organization of the labour market, as well as in the fiscal and social policy domains (Ferrera & Gualmini, 2004, p. 18).

1.1.3 OCT III: hierarchical conditionality

As for the third variant of OCT, the paper distinguishes 'hierarchically imposed conditionality'. The idea is that international lenders may deem it necessary to bind the hands of the local political authorities whose discretion (acting as "rational addicts") needs to be restricted. Probably, the most illustrative examples of hierarchical conditionality are the notorious structural adjustment programmes, imposed by the IMF and the World Bank to Latin America in the 1980s, and Asia and Russia in the 1990s. However, some argue that (the conditionality attached to) the EU's recent bailout loans (for instance, to Ireland, Greece and Portugal) by and large display the same pitfalls (Greer, 2013). A similar argument has been made in regards to the EU's bailout conditionality to the countries in Europe's periphery – namely, Romania, Hungary and Latvia. According to Lütz and Kranke (2010), these lending policies effectively amounted to a European rescue of the Washington Consensus ([2]).

1.2 Ideas

However, "interests" (as referred to by the "rational" OCT accounts above) may not be given but rather may derive from collectively held ideas and beliefs. According to constructivist political economy, ideas are pivotal in shaping the social, economic and political world. The world is not purely material, but non-material as well, and accordingly social phenomena might intervene between actors and material structures. According to constructivists, by taking 'interests' as a departure point of analysis, rational theories are not able to account for social change. Moreover, assuming that actors hold essentially different sets of interests, collective action is possible only under an overarching idea (Abdelal et al., 2010). Explaining the birth of the euro, McNamara (1998) argues that the member states could not have materially derived preferences on the European monetary institutions before the very institutions were actually established. Hence, ideas were as pivotal as interests; and in fact, the former gave content to the latter ([3]). Moreover, ideas and interests were tightly interwoven and mutually reinforcing (McNamara, 1998).

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2. Lütz and Kranke (2010) observe that while the IMF partially relaxed its formerly tight stance on economic conditionality attached to its loans, the EU was an active promoter of orthodox measures in return for loans to the countries that were designated to join the single currency area and therefore had to meet certain criteria.
3. Tracing back the process of European monetary integration, McNamara argues that in the late-1970 a new free-market policy consensus spread among European leaders, which re-defined state interests on cooperation and induced political leaders to accept domestic policy adjustments necessary to stay within the system. After the oil-price shocks in the 1970s, European governments abandoned the Keynesian models that focused on employment and growth, instead giving way to monetarist ideas, prioritizing low inflation and fixed exchange rates. Finally, as McNamara argues, a powerful example for

As will be argued below, the three variants of OCT have played a major role in Latvia's recent economic policy. Firstly, the Latvian government has extensively relied on "external constraints" both in regard to fiscal and monetary policy, in order to gain market confidence and financial stability. Secondly, the rich supply of EU disciplinary constraints has been extensively instrumentalized by the Latvian elites as the last resort in order to implement progressive reforms. Thirdly, "external constraints" have also been imposed from above (predominantly by the Commission) via the bailout conditionality and the CSRs. Nonetheless, as will be shown below, the "optimum control" rationality has been embedded in a particular set of laissez faire beliefs – a dominant economic ideology in Latvia since its transition to a market economy in 1991.

2. Specifications

Before going further, several specifications need to be made regarding research focus, conceptualizations, data sources and methods of analysis. Then the three governance frameworks that recently have been or still are effective in Latvia will be briefly introduced.

2.1 Data and methods

As for methodology, the analysis capitalizes on 'process tracing', which is according to George and Bennett (2005), the most appropriate tool to identify causal chains and mechanisms. By examining histories, archived documents, interview transcripts and other sources, one is able to see whether the causal process a theory hypothesizes is in fact evident in the sequence and values of the intervening variables (George & Bennett, 2005). As for data, mainly two types of sources are used. Firstly, I draw upon the public policy coordination documents issued by the authorities in Riga and Brussels. Another major source of data is 'elite interviews' – according to Tansey (2007), a particularly important 'process tracing' approach, allowing to explore policy developments at the highest level of government. Seven key officials have been interviewed. On the side of Brussels, the interviewees are four economists at the Commission (Directorate-General for Economic and Financial Affairs (DG ECFIN), and the Directorate-General for Employment, Social Affairs and Equal Opportunities (DG Employment). On the national side, three interviews were held with top officials at the Ministry of Economics, the Ministry of Finance, and the Ministry of Welfare.

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the European governments to emulate was provided by the post-war experience of Germany with a strong emphasis on stable currency effectively guaranteed by an independent central bank (McNamara, 1998).

2.2 Introducing the governance frameworks

a) Euro accession convergence

In order to qualify for the Eurozone, a member state has to comply with five convergence (Maastricht) criteria. As regards price stability, the inflation rate may not be more than 1.5 percentage points above the rate of the three best performing member states. As regards sound public finances, the government budget deficit as a percentage of GDP may not exceed 3%, while government debt as a percentage of GDP may not exceed 60%. The long-term interest rate on government bonds may not be 2 percentage points above the rate of the three best performing MS in terms of price stability. Finally, a member state has to participate in the ERMII mechanism for at least 2 years without severe tensions (Commission, 2013e).

b) The BoP programme

The idea behind the Balance-of-Payments (BoP) programme is to provide mutual assistance (bailout funds) to a non-euro area Member State in existing or seriously threatening difficulties in regards to its balance of payments (Commission, 2013a). The BoP programme in Latvia was formally finished by early 2012, since when Latvia has been subject to 'post-programme surveillance', hosting the Commission's inspections twice a year. Although, the programme conditionality became less strict, the Commission still keeps a say on the country's economic governance. Surveillance is to be run until around 75% of the EU-funded loans are repaid, and is aimed at "close monitoring of risks that could jeopardize macro-economic stability and hence affect the repayment capacity" (Commission, 2012a).

c) The European Semester

The European Semester is a yearly cycle of economic policy coordination, according to which each year the Commission undertakes a detailed analysis of member states' programmes of economic and structural reforms and provides them with recommendations. The European Semester starts at the end of the year when the Commission adopts its Annual Growth Survey, setting out EU priorities for the coming year. In March, EU heads of state and Government issue guidance for national policies. In April, member states submit their plans for sound public finances (Stability or Convergence Programmes) and measures in areas such as employment, research, innovation, energy or social inclusion (via National Reform Programmes (NRPs). In May and June, the Commission assesses these programmes and provides CSRs. These recommendations then are discussed by the Commission and endorsed by the Council. The Council formally adopts the CSRs by the end of June or early July (Commission, 2013f). In addition, the European Semester incorporates various initiatives, constituting the so-called 'new European economic governance' architecture – a set of instruments for enhancing economic and budgetary coordination between the member states ([4]).

3. Preparing for OCT solutions: the relevance of the Latvian financial crisis

This paper argues that the recent technocratic governance in Latvia overwhelmingly has been inspired by OCT. Hence, due to the essentially technocratic mission of the Dombrovskis' government (i.e., budget consolidation via internal devaluation) which was by and large accepted by the public, I will not enter into an analysis of Latvian domestic politics, instead I will look at the policy choices taken at the core of the Latvian "government" ([5]). However, before that we need to clarify the conditions under which various "optimum control" solutions have constituted the 'logic of appropriateness', both for Latvia's government and the general public. I argue that the OCT-inspired choices Latvia made from 2008 onwards, and, more importantly, the lack of contestation of these choices can be properly comprehended only within the context of the era of profligacy which began in 2004 and the worst economic recession in the EU just four years later.

3.1 Background

On May 1, 2004, Latvia joined the European Union. In 2005, Latvia pegged its currency to the euro by joining the ERMII exchange rate mechanism ([6]). Investors' optimism abounded and the country was flooded with foreign capital. By 2007, four banks accounted for three quarters of the

4. As regards fiscal policy, the new architecture by and large provides for an enforced version of the Stability and Growth Pact. Most pronouncedly, it has been embodied in the Fiscal Compact, the Two-pack and the Six Pack. Meanwhile, the new governance framework also takes into account macroeconomic conditions and indicators. Under the Six Pack's Macroeconomic Imbalance Procedure, member states are obliged to eliminate various internal and external macroeconomic imbalances (among other things, these imbalances may concern trade, public debt, private sector credit flows and debt, changes in housing prices, investment, net exports, total financial sector liabilities and unit labour costs). The Euro-plus pact – another recent initiative – provides for fostering competitiveness and employment, contributing to sustainability of public finances, reinforcing financial stability and tax policy coordination (Council, 2011).
5. As regards the period from 2009, by the terms "government", "authorities" or the "ruling elite", hereafter I predominantly refer to the duo of PM Valdis Dombrovskis and the Minister of Finance, Andris Vilks. Initially, the latter was a chief economist of SEB Bank (the second largest Swedish bank in Latvia) and served as an economic adviser to Dombrovskis. Later – in 2010 – Vilks accepted Dombrovskis's invitation to become the Minister of Finance. Vilks has been working in this position ever since.
6. Within ERM II, the exchange rate of a non-euro area Member State is fixed against the euro and is allowed to fluctuate only within set limits. Yet, in order to exclude any space of localized discretion, the Central Bank of Latvia established 1% fluctuation band – much narrower than the formally allowed threshold of 15% (Commission, 2005).

banking assets in the Latvian economy, three of which – Swedbank, SEB and Nordea – were of Swedish origin (Aslund & Dombrovskis, 2011). Large scale lending to the Latvian private sector boosted the internal demand. From 2005 to 2007, Latvia experienced a double-digit real GDP rate growth, which at the time was the fastest in the EU. From 2004 to 2007, Latvian GDP grew by 34%. In just couple of years, the property prices increased fourfold, while nominal wages doubled. At the eve of the financial collapse Latvian consumer price inflation reached 18% (Commission, 2012c). By most measures, the Latvian credit boom outsized all other credit booms from 2000 to 2006, expanding annually from 37% to 64% (Aslund, 2010) ([7]). Consumerist ecstasy dominated the country and its people (Asare et al., 2006); (Rozenvalds & Ijabs, 2009). Besides the private sector, the profligacy spirit was echoed heavily in the public sector. From 2006 to 2008, public spending increased on average by 20% per year. Eventually, increases in public wages were even higher than in the private sector, in 2007, reaching 40% (Dovladbekova, 2012).

After the collapse of Lehman Brothers, the unfolding global financial crisis in Europe first affected the most-exposed countries with the largest current account deficits and foreign debt. Within the EU, the first victims were Hungary, Romania and Latvia. As a result of the tightening of domestic bank lending, a freeze of liquidity and weak external demand, in 2009 alone, the Latvian economy shrank by 18%. The decisive blow was the collapse of the domestic Parex, Latvia's second largest bank with the biggest domestic market share within the EU. Due to Parex's huge exposure to the Latvian economy, the government felt compelled to nationalize and recapitalize it. However, facing the possibility of running out of its foreign currency reserves, Latvia called the IMF and the European Commission ([8]).

Ideologically, the crisis turned the spirit of consumer ecstasy on its head. The virtue of spending transformed into a virtue of extreme parsimony, resulting in strict aversion to excessive public deficit, Keynesianism, and discretionary spending in any form. In the public consciousness, the bitter experience of living beyond one's means watered the soil for the fiscal discipline and restraint. Although the crisis first of all was rooted in the excesses in the private sector concerning the Swedish banks and their massive lending to Latvian households; in a public discourse, overwhelmingly, the (former) government and society at large were blamed. Disproportionate

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7. The fast credit expansion was triggered by several factors. Firstly, Latvia had high economic growth and an attractive business climate. Secondly, the pegged currency regime made investments virtually risk free. Thirdly, the credit boom was fed by a sharp decline of real interest rates (which eventually became negative), due to rising inflation. Fourthly, for the three Swedish banks Latvia offered higher returns compared to their home market. Fifthly, at the time both the US Federal Reserve and the European Central Bank (ECB) exercised very loose monetary policy. Finally, the Latvian credit boom was not considerably constrained neither by Latvian nor Swedish financial regulators (Aslund & Dombrovskis, 2011, p. 20).
8. The total stabilization package consisted of 7.5 billion euro, and was provided by the IMF (1.7b euro), the European Commission (3.1b), a coalition of Nordic countries (1.8b), the World Bank (400m), the Czech Republic (200m), and the EBRD, Estonia and Poland (100m each) (Aslund, 2010); (Aslund & Dombrovskis, 2011, p. 33).

responsibility for the financial mess was put on individuals (Rozenvalds & Ijabs, 2009, p. 20) ([9]). Arguably, the profligacy era was a crucial precondition for the wide acceptance of OCT-related policy choices onwards.

3.2 Conditionality and adjustment

As regards the conditions of the Latvian bailout, the most controversial and polarizing issue was the Latvian exchange rate policy. While the Commission (together with Latvian neighbours) argued for keeping the peg, the IMF insisted on devaluation, as keeping the peg would not be politically and socially feasible (Lütz & Kranke, 2010); (Raudseps, 2012). Still, as a surprise for many, e.g. see Krugman (2008), Roubini (2009), and Rogoff (2009), Latvia eventually chose the painful path of "internal devaluation", adjusting the imbalanced economy by massive cuts in public services ([10]). Along the lines of OCT, the option of external devaluation was consensually rejected by the Latvian ruling elites. In the light of OCT, prioritizing "market confidence" and "financial stability", this decision made perfect sense. Moreover, austerity was seen as a highly appropriate and necessary treatment after the era of profligacy; e.g. see (Aslund & Dombrovskis, 2011).

Partially, as a result of the massive consolidation executed by the newly posted government led by Valdis Dombrovskis ([11]), in two years the Latvian economy shrank by approximately 25%. Public wages were cut by 20%, then by another 5%. The expenditure of the ministries was significantly reduced. The number of government agencies was reduced from 76 to 39. Support functions for the public sector were centralized. Unemployment rose from 5.3% in the fourth quarter of 2007 to

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9. Illustratively, Latvia's official report on state of the nation "Review of National Development 2008/2009", published in the midst of the crisis, focused on different aspects of "responsibility". In regard to the financial crisis, the report overwhelmingly lamented the individual practices of excessive "spending" and "consumption". To quote the report: "The recent years have luminously represented a strategy held by individuals to increase personal welfare. In essence, the strategy centres on "spending". […] This strategy has been represented by taking loans from the banks, real estate purchasing, money depositing, and health and life insurance. […] By the beginning of the 21st century, consumerism established itself in Latvia. The society which had long been living under conditions of scarcity, was eager to master the new modes of consumption [...] Consumption is not an abstract invasion of Western culture, but real practices of acquiring and spending financial assets, undertaken by Latvian people" (Rozenvalds & Ijabs, 2009, p. 21).
10. The formal reasons for declining devaluation were that, first, Latvian exports had a high import content; second, a high share of private sector debt was denominated in euro; thirdly, several domestic banks could have thus followed Parex bank; and, finally, devaluation would not incentivize solving Latvian structural problems (Commission, 2012c).
11. However, it has to be noted that in the first years of the BoP programme there were major clashes between the national authorities and the lenders, regarding the scale of consolidation. Effectively, it took some threats by the IMF and the Commission to suspend the bailout financing in order to make the Latvian government accept the immense budget cuts. For a comprehensive overview of the bailout negotiations from an insider's perspective, see (Raudseps, 2012).

more than 22% in 2010 (Weisbrot & Ray, 2010). Property prices fell by up to 70% (Commission, 2012c).

The social costs of the recession were immense. Many become literally enslaved to the banks, due to recursive loans, as their mortgage had lost its value due to the market crash, while the nominal loans owed to the banks remained at the pre-crisis levels. However, Latvians displayed a surprising stoicism. Discontent overwhelmingly was shown by exercising the "exit" option, leaving the country on a massive scale – effectively, "voting with feet" (Hudson & Sommers, 2011). According to Dzenovska (2012), emigration in Latvia served the function of symbolic protest against the current order when other modes of political action or participation were not available or imaginable in the individual or collective repertoire (Dzenovska, 2012, p. 84); (Sprance, 2010). Latvia's recession was followed by the largest recorded population decrease in recent history. Due to migration and negative natural reproduction, the Latvian population shrank by 84.4 thousand – by 1.9% in 2009 and 2.1% in 2010 (CSB, 2012) ([12]). Dozens of towns in Latvia's periphery are almost desolate (Dzenovska, 2012). According to some, the massive scale of emigration in combination with the low birth rate is threatening the long-term viability of the nation (Sommers, 2009); (Hudson & Sommers, 2010).

The austerity measures were to a considerable extent accepted by the domestic public. The mainstream public discourse prevailingly appealed to the irresponsibility of consumers, instead of the 'agency' of the foreign banks, or, more plausibly – the 'structural' and systemic reasons, such as unfettered capital flows into a small and open economy, and the failure of regulatory institutions; e.g. see (Aslund & Dombrovskis, 2011). In addition, austerity was ascribed a somewhat moral quality. Put in Mark Blyth's (2013) words, the Latvian public uncritically bought the idea that "austerity is the penance – the virtuous pain after the immoral party" (Blyth, 2013). After the so-called "Seven fat years", a new ideology on "good economic policy" was born, favouring fiscal restraint and parsimony (Aslund, 2011) ([13]). This went hand-in-hand with a variety of OCT rationales, focusing on disciplinary effects via external constraints. On the bright side, the large cuts served a useful function of wiping out the huge inefficiencies accumulated in the boom years. Representing the logic of vincolo esterno, the crisis delivered the necessary momentum for various reforms which then were implemented in just a few months (Commission, 2012c, p. 83).

12. Meanwhile, according to Mihails Hazans (2013), a leading Latvian statistician, in 2011 alone Latvia lost around almost two times as many people. Moreover, there has been no evidence that the scale of migration would considerably diminish (Hazans, 2013).
13. Anders Aslund (2011) – one of the most ardent austerity advocates – argues that in the Eastern European financial crisis "populism has not been popular" because "the population understands the severity of the crisis and wants a government that can handle the crisis just as forcefully". In order to prove this, Aslund notes that two of the most ardent anti-crisis governments (in Latvian and Estonia) won the parliamentary elections in 2010 and 2011. Meanwhile, the big losers, except Hungary in 2010, have been parties that have tried to exploit populism (Aslund, 2011).

Eventually, the Latvian case was made into a world-scale success story of 'internal devaluation' as the most appropriate solution for a banking crisis. The Commission, the IMF and various pro-austerity pundits endorsed Latvia as an example to follow elsewhere. The Latvian experience was even more impressive given that the centre-right coalition led by Dombrovskis was re-elected with a large margin in October 2o10. Dombrovskis become a celebrity among West European leaders, and was even called by the European People's Party "a good EC president candidate" (The Baltic Course, 2013a). Despite the huge social costs, his position on the adequacy of austerity remained constantly uncritical and endorsing throughout the crisis period: "It seems that our strategy is working. […] Now we're the fastest growing economy in the EU" (The Guardian, 2012).

3.3 Reasons for the euro

The horrendous crisis, the painful consolidation and harsh social implications, however, did not diminish the Latvian authorities' ambition to join the euro. To some extent, the causality chain may be considered as reverse – the government rejected the external devaluation option because of the euro (Blanchard et al. 2013). The reasons for joining the euro by and large aligned with those on consolidation a few years earlier. In the context of surprising levels of public acceptance of the budget cuts and structural reforms, the authorities simply kept reiterating the same OCT-inspired rhetoric as before, emphasizing 'financial stability' and 'market confidence' which expectedly would result in increasing levels of investment and economic growth ([14]). In order to justify the euro, the authorities also complained about the adverse pressures from speculations with the lat, resulting from the devaluation risk as perceived by the markets ([15]). Euro accession was also made a national security issue, concerning perceived threats from Russia. The argument was that the large ethnic Russian population living in Latvia and the huge non-residential banking deposits (mainly from Russia) were sufficiently important reasons for further integration in the EU structures (Financial Times, 2013b) ([16]). Not without relevance was the example of Estonia – Latvia's neighbor who managed to adopt the euro by 2012 ([17]).

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14. Valdis Dombrovskis: "Without financial stability, the banks are not lending, companies are worried, not investing, and you get a deeper recession" (The Guardian, 2012). Or: "When a country loses control over its budget and the trust of financial markets, there is no other way. You first see what you need to do to restore financial stability, because it is a precondition for economic growth" (EUObserver, 2012).
15. By the onset of the crisis, as Latvia's economic situation deteriorated, a massive short-selling of Latvian currency took place, thus making the maintenance of the peg even more difficult.
16. For instance, Latvian MEP Roberts Zile has argued that closer integration in the European core would reduce some of the risks from direct or indirect third-country influence given that around one half of all deposits in Latvia come from non-residents – mainly from the CIS region. However, he also acknowledged that, unless special protection measures were not implemented, by joining the Eurozone such risks would only increase (Zile, 2013). Many are still concerned of Latvia's potential to become the next Cyprus or Spain (Financial Times, 2013a); (Ošlejs, 2013). As assessed by the ECB: "In the financial sector, the reliance by a significant part of the banking sector on non-resident deposits as a source of

However, public acceptance to the euro over time has remained extremely low. Shortly before the application deadline, only 33% of the Latvian population viewed the possible euro accession as positive, while 63% saw it as negative. Crucially, accession within the government's proposed time framework was supported by only 10% of the population (TNS, 2012) ([18]). Some voices, most prominently, from the parliamentary opposition, called for a referendum (to decide on the euro). Yet, the Prime Minister strictly rejected the idea: "It is not worth even asking, the outcome would be negative" (Delfi.lv, 2013). According to the authorities, Latvia already had made its choice regarding the euro by voting to join the European Union in 2003.

4. Post-crisis dynamics: OCT in practice

Arguably, the dynamics described in the previous chapter were crucial in setting the ground for "optimum control" solutions. This chapter aims to render an overview of the post-crisis economic policy choices in Latvia. Firstly, I will address fiscal policy; then policy choices for euro accession convergence, and finally, the implications of the first two on social policy will be looked at.

4.1 Fiscal policy

In recent years, Latvia's fiscal policy has been about consistent overachievements. On the one hand, these overachievements by and large seem to have been due to the positive economic dynamics in Latvia's trading partner economies; on the other hand, the overachievements have been due to a deliberate action by the Latvian government. As a matter of fact, along the OCT lines of prioritizing financial stability and market confidence, the government even exceeded the fiscal targets formally determined by the Commission.

4.1.1 Overachievements "by luck"?

By the end of 2010, the Latvian Parliament (Saeima) approved the 2011 budget, envisaging the general government budget in the amount of 5.4% of GDP, a considerably lower target than the

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funding, while not a recent phenomenon, is again on the rise and represents an important risk to financial stability" (ECB, 2013).

17. Estonian President Ilves on the euro: "It's given investor confidence […] If you're willing to follow the rules, it's a great currency" (Bloomberg, 2013b).
18. 10% (of the population) supported the euro and believed that the euro had to be implemented as soon as possible, 25% viewed euro introduction as positive however not in the coming years; 26% rather did not support euro introduction, 37% totally objected introduction of the euro, 1% did not have an opinion on the issue (TNS, 2012).

previously planned 6% of GDP. By April 2011, the government decided on additional fiscal consolidation measures, reducing the deficit to 4.5% of GDP (NRP, 2011). For 2012, the budget deficit target initially was set at 2.5% of GDP, instead of 3% of GDP, as required by the Excessive Deficit Procedure (NRP, 2011). By early 2012, the budget deficit target for 2012 was reduced to 2.1% of GDP (NRP, 2012). However, despite the ad hoc supplementary budget in mid-2012 which provided for additional expenses, the actual budget deficit in 2012 was merely 1.2% of GDP (Commission, 2013b).

A 'buzz-word' both in the public policy coordination documents and the statements by the officials is "better-than-expected economic growth", as Latvia extensively benefited from the positive economic conditions in its main trading partner economies. After the economic crisis, Latvia's growth resumed from mid-2010. In 2011, the Latvian GDP grew by 5.5%; in 2012 – by 5.6%, thus representing the most rapid economic growth in the EU (Convergence, 2013d). However, contrary to the testimonials by various advocates of austerity, suggesting that Latvia's "success story" has been due to deliberate structural reforms and budget consolidation via internal devaluation, e.g., see Aslund (2013) and Lagarde (2012), to a large extent, the exceptional economic growth seems to have been beyond the control of the government ([19]). As admitted by an ECFIN economist: "to some extent, Latvia was just lucky" (Interview, 2013e). On the same note, Blanchard et al. (2013) specify that the improvements in the tradables sector came much more from productivity increases rather than nominal wage decreases. Still, one may argue that nominal devaluation would have led to less pressure to firms to increase productivity (Blanchard et al. 2013).

Some role in increasing revenue was played by the declining share of the shadow economy; yet, the actual significance of it is rather difficult to establish, due to methodological limits (Interview, 2013e) ([20]). In addition, the fiscal overachievements were due to rather prudent macroeconomic predictions. As admitted by an ECFIN economist, the Commission acted strategically, by deliberately setting rather conservative targets (Interview, 2013d). The exact relevance of each of these factors remain unclear; yet, generally, officials in Riga and Brussels agree that the national authorities tended to see windfall revenue as caused by their deliberate actions, for instance,

19. As acknowledged by a top official at the Ministry of Finance – "compared to other countries, economic growth in our trade partners was considerably higher; it is still more positive than in other member states. Basically, due to this, our growth in 2011 and 2012 was the highest in the EU" (Interview, 2013b).
20. Another factor of 'luck', contributing to better-looking budgetary numbers was that implementation of some of the planned investment projects turned out to be slower, thus postponing some of the expenditure which was already included in the budget (Interview, 2013e). In addition, in 2012 Latvia did not have any major non-planned expenditure, such as the takeovers of Parex Banka, Hipoteku Banka, and AirBaltic in the previous years. Additionally, the budget of 2012 turned out to be unexpectedly good, due to accountancy dynamics of the reclassification of the formerly collapsed Parex bank (currently, AS Reverta). The reclassification had a one-off deficit increasing impact amounting to 0.5% of GDP, not anticipated before. Without this effect, the deficit in 2012 would have been even below 1% of GDP (Commission, 2013c).

regarding fighting the shadow economy, while Commission's experts rather explained the unexpected growth as being due to structural reasons (Interview, 2013b); (Interview, 2013d).

4.1.2 Uncertainty, safety margins and "optimum control"

However, the fiscal overachievements were also due to deliberate "agency" by the policy makers. In fact, the budget targets were set at more stringent levels than was formally required by the BoP programme and the Excessive Deficit Procedure. Thus, for 2011, the budget target was set at 5.4% of GDP, instead of 6% of GDP; while for 2012, the target was set at 2.5% of GDP – well below the 3% threshold.

Evidence as regards the extent to which the initiative for more stringent budget targets came from the government or the Commission is mixed. According to a national official, the budget deficit target for 2012 was deliberately lowered from 3% to 2.5% of GDP in order to provide a safety margin against the imminent uncertainty and unpredictability of the Latvian political process ([21]). Opting for less expansive fiscal policy to some extent was also related to Latvia's commitment to comply with the Maastricht deficit criterion for joining the euro ([22]). Last but not least, along the lines of vincolo esterno, it served the function of disciplining the government itself. As acknowledged by a national official, the fiscal safety margin indeed did imply a lost opportunity of spending; however, keeping politicians' hands tied seems to have had some value per se (Interview, 2013c) ([23]). Meanwhile, fiscal prudence was also encouraged by the Commission. As admitted by an ECFIN economist: "It was clear that there was a space for a more ambitious fiscal policy; and we believed that this helped the government in reducing debt and thus provide better yields for the government bond issues" (Interview, 2013g).

Along the same lines, an even more straightforward case of OCT was the adoption of the Fiscal Discipline Law (FDL). As a derivative of Treaty on Stability, Coordination and Governance (the Fiscal Compact), the FDL effectively imposed more stringent fiscal discipline than was allowed by the rules, and appears a highly celebrated fact by the Latvian technocrats. According to the Fiscal Compact, a country's MTO of budget deficit can be -1% of GDP, provided that a country's public

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21. A national official: "Nobody really knows how one or another political power would perform before or after the budget adoption. Therefore, everything is planned with a certain reserve margin. Because, if the folks come with an ultimatum of [give us extra] 20 million, you simply have to get the money. This is why we always securitize against such situations" (Interview, 2013c).
22. An economist at the Commission: "Of course, everybody was aware of the Maastricht convergence criterion. Since Latvia is a small and volatile economy, everybody was aware of that this would be the budget on the basis of which the euro decision would be taken. They didn't want to risk, so they put some safety margin there" (Interview, 2013e).
23. A national official: "Let's put it like that – all these plans on [the adoption of] the euro made it possible to put the ruling powers in a kind of frame because there are always desires and needs... The question remains, of course, where the optimum line is" (Interview, 2013c).

debt is significantly below 60% of GDP. Given its relatively low debt level (46.0% of GDP in 2011; 40.7% of GDP in 2012), Latvia perfectly well complied with the provision ([24]); yet, the government set the MTO at a stricter threshold -0.5% of GDP. As admitted by officials at the Commission, on the side of the Latvian government, this was a purely voluntary choice (Interview, 2013d); (Interview, 2013e).

The reasons for such a radical step again by and large echo OCT. The FDL clearly embodies a 'hand-tying' rationale, addressed to both current and future governments, minimizing fiscal discretion to the lowest degree possible. As explained by an official at the Ministry of Finance, by submitting to even narrower margins of fiscal discretion than required by the Commission, Latvia "wanted to be more ambitious" (Interview, 2013b). For the financial authorities, the FDL effectively guaranteed that "the state would not return to this, let's call it "fiscal blackguardism", anymore" (ibid). Another national official adds that by determining the acceptable threshold of fiscal space by constitution, the FDL effectively saved the authorities from "unnecessary" disputes, particularly from the opposition: "Before the budget making process was a total chaos... […] Certainty is the most important thing. Overall, I believe that the adoption of the FDL is very beneficial to Latvia" (Interview, 2013c). The importance of certainty has also been stressed at the Commission. However, while national officials seem to be more occupied with uncertainty in domestic politics, the Commission was rather concerned with potential disparities between macroeconomic forecasts and real economic developments. As one can never be sure what the exact potential growth would be, it is always useful to have a reserve margin (Interview, 2013g).

In any event, whether initiated on the national or Brussels side, the overwhelming emphasis on financial stability in order to please the markets and subsequently expect higher investor confidence has constituted the dominant rationale behind Latvia's recent fiscal policy. Moreover, by capitalizing on the positive dynamics in its main export markets (thus allowing Latvia to boost the most rapid growth in the EU), the government's "optimum control" strategy seemed to work, at least in its own terms. By obtaining better yields and lower borrowing costs, Latvia was able to issue debt already in 2011 and to pay back the debt to the IMF by the end of 2012 (IMF, 2012) ([25]).

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24. An official at the Ministry of Finance: "It is acceptable to have -1 % if a country has a low debt level which essentially corresponds to Latvia. However, Latvia wishing to be more ambitious in its fiscal policy committed that the MTO would be -0.5" (Interview, 2013b).
25. On 5 December, 2012, Latvia issued a 7-year bond in the amount of EUR 970 million at a historical low yield of 2.89%. The bond issuing followed one notch rating upgrades by S&P and Fitch. The bond proceeds were earmarked for pre-payment of the whole outstanding liability to the IMF. It was planned that the remaining part would top up the government reserves, as a buffer to the forthcoming repayments under the BoP programme (Commission, 2013a).

4.1.3 National discretion and derogations

The record of Latvia's economic policy choices though remains somewhat controversial. On the one hand, as regards the success of 'internal devaluation', Latvia became a highly celebrated case among the austerity prone governments and international institutions. On the other hand, the Latvian case displays considerable derogations from the Commission's rule – not only regarding social policy, but also regarding "financial" issues, such as budgets, taxes and pensions. In fact, at times the Latvian authorities acted strictly against the Commission's preferences.

As briefly mentioned above, against the Commission's recommendations to implement the budget "as envisaged" (Commission, 2012a), by September 2012, the government opened the budget and increased the revenue and expenditure targets by respectively 1.6% and 1.4% of GDP. Additional spending was allocated to a wide range of sectors, including transport, agriculture, old age pensions, healthcare and fighting of the shadow economy. New expenditure items were provided for around 0.5% of GDP, amounting to 100 million euro (Commission, 2013a). The supplementary budget was strongly disapproved of by the Commission, as it posed risks for repayment of the bailout debt (Interview, 2013d); (Interview, 2013e). Although, the budget revenue was indeed better than expected, nobody really knew what the situation would be at the end of the year. Moreover, the Commission expected economic slowdown (as it turned out – falsely) in the second half of the year, as the crisis in the euro area was developing. The Commission preferred leaving safety margins in order to provide certainty. As succinctly put by an ECFIN economist: "Positive surprises are welcome while negative surprises sometimes can be punished" (Interview, 2013g) ([26]).

Another fiscal derogation from the 2012 budget "as envisaged" dealt with pensions. Earlier, as the crisis set in and people became unemployed and/or emigrated, and compulsory state social contributions in the first pillar rapidly decreased, the government had reduced the contribution rate to the second pillar from 8% to 2% (Volskis, 2012) ([27]). It was planned that 6% contributions to the second pillar would be restored from 2013 (NRP, 2012). Nonetheless, in the given time

26. However, the reasons behind the supplementary budget need to be considered in the context of the methodological disputes between Riga and Brussels, regarding future growth projections. As noted by an official at the Ministry of Finance – due to different methodologies, the Latvian authorities tended to be more optimistic, arguing that in 2011 and 2012 the economy has been under its potential (Interview, 2013b). On the other hand, as noted by a Commission's economist, Latvia had an interest to say that it had not reached the potential, otherwise it would have to apply a more restrictive fiscal policy (Interview, 2013d). Another economist at the Commission added that the Latvian government simply had to face that the revenue would not improve forever (Interview, 2013e).
27. The second pillar is a defined contribution arrangement (obligatory to the younger ones) financed by part of the contribution that would otherwise go the first pillar pension. The third pillar comprises voluntary defined-contribution savings arrangements (Vanovska, 2006).

frame, contributions to the second pension pillar were restored only at 4%. According to the Commission, it ran "contrary to previous commitments by the authorities under the (BoP) program as well as more recent Country-Specific Recommendations" (Commission, 2013a). In response, the government explained that, given that the balance of the social budget had been permanently negative from 2009, the transition back to 6% to the second pillar was made gradual in order to more rapidly accumulate assets in the special budget. Accordingly, Latvia undertook to introduce 5% rate of contributions to the second pillar in 2015, and 6% in 2016 (NRP, 2013, p. 12). Eventually, the Commission not only accepted the derogation, but also allowed Latvia to derogate from the pre-set MTO for 0.5% of GDP for the amount of funds Latvia needed to continue the pension reform (the decrease of revenue in the budget, due to the increase of contributions to the second state funded pension pillar) ([28]).

4.2 The euro accession convergence procedure

Euro convergence as the third governance framework Latvia has played an extremely important role in recent economic policy. The commitment to comply with the euro accession criteria had significant implications on other governance frameworks and policy issues. On the part of the government, euro accession convergence was certainly perceived as more compelling, compared to the other governance frameworks. The national authorities again exercised considerable levels of "agency", effectively ignoring some of the commitments under the BoP programme or the European Semester. Interestingly, as noted by the Commission, such derogations in the name of accession into the Eurozone were implicitly justified by the fiscal overachievements (Commission, 2013a). Yet, what the two seemingly exclusive strategies had in common was the "optimum control" bias.

4.2.1 National discretion and derogations

A pivotal aspect in Latvia's convergence to the euro and one of the centres of contestation between different governance frameworks was inflation. The priority of inflation to the Latvian prospects to join the Eurozone and the need for strategic action in 2010 and 2011 was repeatedly emphasized by the Minister of Finance, Andris Vilks. According to him, control of inflation was a strategic priority ([29]), and compared to the other convergence targets – the most evasive one ([30]).

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28. An ECFIN economist: "Because Latvia has made reforms in the pension system, in the second pillar, as a reward for that, the Commission allowed Latvia (just like Lithuania and Poland) to add this part, approximately 0.5% of GDP, (which goes to the private pension funds) to the budget deficit. Therefore, the coming years, *de facto* the MTO will not be 0.5% but around 1%" (Interview, 2013d).
29. Andris Vilks: "Inflation is very important factor we have to take into account in order to ensure that [...] it would not […] obstruct euro adoption" (Vilks, 2011).
30. Andris Vilks: "Inflation, not the budget consolidation, might turn out to be the biggest stumbling block. […] Inflation is more volatile and fluid [than budget consolidation], and it is much more difficult to find the right recipes [to fight it]" (ibid.)

An effective reminder to Latvian authorities on the need for inflation curbing measures was the Lithuanian experience in 2006 when Lithuania failed to join the euro because of 0.1% derogation from the specified inflation target, due to unexpected world market fluctuations. The Latvian government was extremely averse to replicating such a scenario, committing itself to eliminate all obstacles to the euro at any cost (Leta, 2010). Tax policy was crucial ([31]). In order to avoid an unexpected rise of prices, the envisaged strategy included a coordinated action between the major organized society groups ([32]).

The most conspicuous measures to curb inflation concerned manipulations with value added tax (VAT). Already in 2010, Vilks came with the idea that if VAT was to be increased at all, it had to be done in 2011, as in 2012 it could have endangered the possible compliance with the inflation target (Leta, 2010). Accordingly, from January 2011, the VAT rate was raised from 21% to 22%, while the lowered VAT rate was raised from 10% to 12%. Nonetheless, by mid-2012, as Latvia became the most rapidly growing economy in the EU, a potential risk emerged that the inflation target could be missed. The government again acted correspondingly, decreasing the VAT rate from 22% back to 21% from July 2012.

However, the government's position on reasons behind the VAT cut seems ambiguous. According to the official version, VAT was cut in order to maintain Latvia's competitiveness vis-à-vis Lithuania and Estonia ([33]). Nonetheless, it somewhat speaks against the VAT increase for one percentage point just a year earlier ([34]). A revealing post-factum description on reasons behind the VAT cut was given by a senior official at the Ministry of Economics. Although, the façade reason for the VAT cut indeed concerned Latvian competitiveness, yet, the reality was different: "Rather it was done because of the wish to curb inflation, considering Latvia's will to join the Eurozone from 2014. In the middle of 2012, inflation was the main obstacle to complying with the Maastricht criteria" (Interview, 2013a). The same rationale behind the government's decision to decrease VAT was noted at the Commission (Interview, 2013d). Along the same lines, some national economists raised concerns of the costs of the compliance with the criteria. Some argued that the compliance

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31. Andris Vilks: "As regards the coming budgets, no doubt, we cannot implement a tax policy that could raise inflation. This applies to the consumption tax or any other tax. […] The sooner we can push inflation down to a certain level, the better for all" (ibid.)
32. Andris Vilks: "Unless there is strong tripartite collaboration and agreement between the government, employers, and employees […], Latvia will not succeed in decreasing inflation to the level needed to introduce the euro" (Vilks, 2011).
33. However, the need to decrease Latvia's abnormally high PIT for long has been a central concern and recommendation of the Commission, the World Bank and the IMF in order to improve Latvia's competitiveness vis-à-vis Estonia and Lithuania. As a matter of fact, PIT rates in Latvia's neighbour countries indeed are lower (15% in Lithuania, 21% in Estonia) than in Latvia (24% after the 1% cut by 2013) (The Baltic Course, 2013b).
34. In addition to the standard VAT increase of 3 percentage points and the reduced rate of 5 percentage points in January of 2009, there was a further VAT increase of 1 percentage point of the standard rate and of 2 percentage points for the reduced rate in January 2011 (Commission, 2013b).

with the Maastricht criteria took place at the expense of state development. According to Gatis Kokins, a leading Latvian economist, the compliance with the euro accession targets was achieved technically – in letter, rather than in spirit. Moreover, it came at the cost of dragging economic growth. In Kokins' words, Latvia effectively "shot in its foot" (Ir, 2012) ([35]).

Moreover, the VAT cut ran contrary to the strategy of shifting the burden of taxation to other sources, limiting further opportunities for the Latvian government to reduce taxes on labour. Meanwhile, the government set a three-year strategy to decrease the personal income tax (PIT) from 25% to 20% by 2013 (Commission, 2012a), (Council, 2012a). Even though, in the 2012 NRP the government had mentioned tax policy as one of the major instruments for poverty reduction, for instance, in the form of increasing non-taxable PIT threshold, increasing tax reliefs for dependents or introducing progressive income taxes, the mid-2012 tax changes a few months later did not reflect these considerations (Commission, 2012b). The Commission did not hide resentment (Commission, 2013a) ([36]).

4.2.2 Other "special" measures?

However, evidence suggests that the government's activities in order to curb inflation may have gone beyond taxes. First of all, some depreciation of prices was partially delivered by a freeze of pensions, public sector salaries ([37]), and caps on social benefits, thus "implying a diminishing ration of government expenditure to GDP" (Commission, 2013b). As admitted by the economists at the Commission, as another contributing factor served the delay of the planned excise tax increase (Interview, 2013d); (Interview, 2013g). On top of that, according to a source at the Commission, the Latvian government had a non-binding "gentlemen's agreement" with the major stake-holders in the economy to keep the price level under control. Of course, one has to take into account that the business sector, including the banks and the employers' associations, were in favour of the

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35. Gatis Kokins, an economist: "Our philosophy is double-faced and we are aware that our economy is not in such good order so as to be in the common market with the common currency; yet we try to find ways to achieve that by technical means. Nonetheless, we have to understand that we are complying with the Eurozone criteria only in letter, not in spirit" (Ir, 2012).
36. To quote a post-programme surveillance report "…[b]etter economic and budgetary results, coupled with the end of close surveillance under the BoP, have led to some complacency, a relaxation of efforts and a lack of steadfastness of the authorities, resulting in several policy steps that go against the Council CSRs and commitments made in the last SMoU: this in particular concerns tax cuts decided in May which were not included in the Convergence Programme submitted only shortly before, the announcement of the 3-year strategy to lower the PIT rate, while postponing plans to raise PIT non-taxable thresholds to help the lower-paid, the 2012 midyear supplementary budget with measures contrary to the CSRs adopted by the Council just weeks before (only partial reversal of second pillar contributions from January 2013), and planned reductions and decentralisation of financing of the Guaranteed Minimum Income (GMI) from 2013" (Commission, 2013a).
37. As regards the public salaries, the Commission, among other things, had proposed Latvia increase the salaries in the public sector, so as to retain the best employees and prevent brain drain. Yet, Latvian authorities so far have rejected it.

euro from the outset, and hence were motivated to meet the convergence criteria anyways. Meanwhile, the national authorities tended to reject any possibility, whether theoretical or practical, of deliberate action from the part of the government (except regarding the VAT cut). Similarly, the government has also denied that qualifying for the euro would require an exceptional effort which would not be necessary otherwise (Vilks, 2013a).

4.2.3 Compliance "by luck"?

Eventually, however, Latvia complied with the Maastricht target with a significant reserve of 1.4%. In April 2013, the inflation reference value ([38]) was 2.7%, while the average inflation rate in Latvia during the 12-months to April was 1.3% (Commission, 2013b, p. 26). Thus, Latvia's inflation rate turned out to be less than half of the reference value ([39]). Fortunately for the Latvian government, at the crucial period of assessment of inflation, in the late 2012 and the early 2013, the prices of oil and food in the world markets significantly dropped, depreciating the price levels in Latvia (Interview, 2013c); (Interview, 2013d). As one of the poorest countries in the EU, Latvia is especially vulnerable to commodity prices, since food and energy products compose a relatively large share of its consumer basket. In recent years, Latvia's inflation rate has fluctuated strongly due to volatile commodity price movements and a very intense business cycle. For instance, as the cycle turned and the global commodity price shock set in, inflation rose from -2.8% in April 2010 to 4.8% in May 2011. From that peak, again due to commodity prices, annual inflation fell to -0.4% by April 2013 (Commission, 2013b, p. 26). Effectively, in April 2013, Latvia represented the highest economic growth and the second lowest inflation in the EU (Commission, 2013d).

Indeed, the compliance with the Maastricht inflation criterion turned out to be beyond the control of the government, making the effects of any deliberate action by the government marginal ([40]). Yet, as specified by economists at the Commission, if Latvia had met the benchmark only on the basis of the VAT cut, the Commission might have declined the application to the Eurozone, on the condition that the inflation target "was not met in a sustainable way" (Interview, 2013g); (Interview, 2013e).

4.3 The dissensions over "social" policy

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38. The reference value was calculated as the average of the 12-month average inflation rates in Sweden, Latvia and Ireland plus 1.5 percentage points (ibid).
39. Beneficially to Latvia, Greece was excluded from the list of the best performers (according to which the reference value this year was estimated), since its inflation deviated by a wide margin from the euro area average, reflecting the severe adjustment needs and the exceptional situation of the Greek economy (Interview, 2013g); (Commission, 2013b).
40. For instance, as regards the VAT cut, the latest Convergence Report on Latvia's readiness for the euro, assuming "full and immediate pass-through", the average disinflationary impact of the VAT reduction during the reference period was estimated around 0.5 percentage points (ibid.)

Social policy has been a major axis of dispute between Brussels and Riga. Somewhat unexpectedly, as far as Latvia is concerned, the Commission has often played the role of "social advocate". This is at odds with the critiques picturing the Commission as essentially a neo-liberal entity, prioritizing investors' confidence and promoting the market as the superior organization principle. One may be struck by the consensual resentment from the economists at the Commission, caused by Latvia's persistent resistance to a more progressive social policy. Especially surprising is that complaints over Latvia's flaws in social redistribution have been expressed not only by an economist at the DG Employment, but also by economists at the ECFIN – no doubt, one of the most prone to liberalization of markets departments at the Commission. As the Commission has constantly been advising the Latvian authorities to differentiate social policy across various groups in order to decrease inequality or poverty, the national ministries have constantly declined it.

These collisions between the Commission and the national government, however, make more sense if apprehended against the backdrop of Latvia's miserable performance across various social indicators. Compared to other EU countries, Latvia's spending on social protection remains relatively low. In 2009, Latvia spent around 13% of GDP on social protection, while the EU average was around 21% of GDP. Especially low is spending on social assistance spending (2.3% of GDP) (World Bank, 2013d) ([41]). After the crisis, Latvia had the second highest rate of materially deprived people in the EU – 49.1%. More than 30% of the population have been found to be severely deprived. Latvia follows Italy (3.7 pp) and Greece (3.7 pp) as regards the increase in the proportion of persons at-risk-of-poverty or social exclusion in 2011, as compared to 2010 (2.0 pp) (Eurostat, 2013).

4.3.1 The clash of authorities: "social" Brussels vs. "austere" Riga

To begin with, not all fiscal options for "social" spending were taken advantage of by the government. As allowed by the bailout conditionality – besides payback of the bailout loan, any unexpected windfall revenue could be spent on several other issues, including social policy. The MoU documents stipulated that any "unexpected" money, firstly, could have been allocated to lower the targeted budget deficit; secondly, the money could have been spent on boosting capital investment, including realization of EU funds. Thirdly, the money could have been transferred to

41. Moreover, according to the World Bank (2013), social assistance programmes cover too few of the poor persons, while universal programs benefit the relatively rich. Unemployment benefits continuously play a limited role as a source of income protection during the severe downturn, as coverage of unemployment benefits in Latvia is among the lowest in EU and OECD countries. Moreover, according to the World Bank, the Latvian authorities' concerns about benefit generosity as having economy-wide unemployment impact "are often exaggerated, particularly after a deep recession" (World Bank, 2013d).

active labour market policies and social safety net measures (MoU, 2009) ([42]). However, the government predominantly chose to concentrate on early payback of the loan, representing a clear OCT rationale – aimed to gain market confidence, and hence roll over the debt for lower rates. As put by an economist at the Commission: "We have been emphasizing (also under the [BoP] programme) that they have to give more for social needs [and] training for the unemployed... However, the government did not listen to us. Rather they were looking forward to get better budget numbers" (Interview, 2013d). Meanwhile, according to other sources at the ECFIN, the Commission was rather more concerned with how to make social policy more targeted and progressive. As put by another economist at the ECFIN: "It is not necessarily that the Commission is for more spending; I would say that it is for "better" spending" (Interview, 2013e).

In 2011, responding to the lenders' critiques, Latvia (on paper) aimed, among other things, to reduce the tax burden on the economically active population, and the population groups at risk of poverty; to raise the personal income allowance for dependent persons and to introduce a differentiated personal income tax. Also social protection for families with children would be provided, as well as participation in the labour market encouraged (NRP, 2011). However, little of that was achieved in practice. According to 2012 CSRs, Latvia still spent relatively little on social protection, while social transfers had only a limited effect on poverty reduction, since a large share of them was redistributed back to middle and high income earners. In addition, spending on means tested benefits was low; while the role of social safety net had been partially fulfilled by temporary low-paid public jobs (Commission, 2012a); (Council, 2012a). As regards Latvia's social policy, Brussels has remained rather reproachful (Commission, 2013c) ([43]). Almost the only actually implemented social policy measures appreciated by the Commission were the active labour market policies and training for the unemployed, and the incentives to reverse the declining demographic trends (Commission, 2013a) ([44]).

A major 'apple of discord' between the Brussels and Riga has been the GMI benefits and housing allowances. During the crisis, following the recommendations by the Commission and the World

42. To quote the BoP's Second addendum to the Memorandum of Understanding: "Any additional revenue or savings achieved relative to deficit targets should be used to achieve a lower-than-targeted budget deficit or, after consultation with the EC and IMF, to accelerate EU funds expenditure within the budgetary deficit targets set above, or increase funding for active labour market and social safety net measures" (MoU, 2010).
43. In its latest staff working document the Commission resents that: "40% of the population is at risk of poverty or social exclusion, and little direct action has been taken on this front in the last year. Unemployed people and families with children are particularly vulnerable, as social benefits are poorly targeted, with a large share going to the wealthiest people. There are high disparities across local governments in providing social assistance and weak incentives to for social benefit recipients to go back to work" (Commission, 2013c).
44. The government relaxed maternity/paternity allowances, increased minimum paternal benefit to EUR 150, child care benefit to EUR 150, and PIT allowance for dependants to EUR 115 (Commission, 2013a).

Bank, the GMI payment was taken over from the local municipalities by the government and the amount was substantially increased from 27 to 45 lats (EUR 64) for children and to LVL 40 (EUR 57) for adults. Initially, it was envisaged that co-financing from the state budget would be provided till the end of 2012; for housing allowances – till April 30, 2012 (NRP, 2012). However, as from 2013 the government decreased the GMI to LVL 35 for all and gave the administration of GMI back to the local municipalities. The Commission was disappointed (Commission, 2013a). In general, the critiques on Latvia's GMI management have been shared by the recent study by the World Bank (2013a) ([45]).

Relatedly, a huge source of controversy between Riga and Brussels was the uncoordinated policy measures in the middle of 2012. The Commission was irritated by the potentially adverse social implications of the tax cuts (VAT and PIT), as the plans to raise non-taxable thresholds of PIT in order to help the lower-paid were effectively put off (Commission, 2013a); (Commission, 2013b, p. 30). The Commission was especially worried that these changes did not address the long-pending necessity to alleviate the tax burden on the poor, as Latvia's especially high tax wedge for the lower-paid created a disincentive to work (Interview, 2013e); (Interview, 2013f). The VAT cut also effectively cancelled out the possibility of raising the non-taxable income for the lower-paid. As put by an economist at the Commission: "there are too many low wages [in Latvia], and that the tax wedge on labour is highest for people with the lowest income. That was a good opportunity to help them a bit already then" (Interview, 2013d).

Somewhat unexpectedly, we have seen that relative to the Latvian authorities, the Commission has played the role of "social advocate". This runs against the very rich supply of critiques of the EU as essentially a neoliberal market-making project, which has substantially disintegrated the well-established European welfare state institutions, as they developed after the WWII; e.g. see Hyman (2011), Höpner & Schäfer (2012), Pochet & Degryse (2012), or Scharpf (1999, 2002, 2010) ([46]). Indeed, in the context of the argument about the Commission as an entrepreneur of

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45. As found by the World Bank (2013), the GMI in Latvia are well targeted at the poor, but at the same time it is small and reaches only a fraction of the 'needy'. The unsatisfactory results of GMI have been contributed to by faulty design; for instance, the restrictive eligibility criteria and delegation of financing responsibilities to the municipalities (World Bank, 2013b); (World Bank, 2013c). Moreover, according to the World Bank (2013), the recent reforms to the GMI scheme represent "a significant reversal of gains achieved during and following the crisis" (World Bank, 2013d).
46. According to Fritz Scharpf (1999), European integration has been very successful in dismantling the post-war controls of national governments over their established economic boundaries. By constitutionalization of the competition law, the Commission and the European Court of Justice have been heavily engaged in market making; while, on the other hand, they have deprived the national governments of their traditional "market correcting tools". As a result, social policies supported by democratic majorities have been depleted by the international competition regimes (Scharpf, 1999). Along the same lines, Höpner and Schäfer (2012) argue that market-enforcing integration (along with European non-discrimination policies) has asymmetrically benefited by "integration through law" (Höpner & Schäfer, 2012); also see Scharpf (2010). Moreover, as noted by Hyman (2011), the Lisbon Strategy and EU 2020 are neoliberal projects, and the neo-liberal implications of European integration in

market as solution to all ills (Jabko, 2006), it is rather unexpected at least to hear an ECFIN economist criticizing Latvia's extreme version of laissez faire approach to economy (Interview, 2013d). Apparently, the Latvian ruling elites are embedded in a particular set of notions and beliefs on social policy. I will address them in the next chapter.

4.3.2 Interests idealized

In the context of the disputes above, it seems that economic policy, whether "fiscal" or "social" may not be considered only in purely rational categories. The answer to the question why the Latvian government committed itself to such an excessive consolidation, going beyond the thresholds imposed by the BoP conditionality, as well as why the Latvian government has been so reluctant to pursue more distributive social policy – seems as much grounded in interests as in ideas.

Many have argued that in retrospect after the transition to a market economy, Latvia's economic policy has been market-oriented, in a somewhat radical form. According to Jeffrey Sommers (2009), the 'Anglo-American' model of economic organization has enjoyed an uncontested acceptance by the ruling elites. Similarly to other post-socialist countries, such as Russia and Poland, an important role in determining the "neo-liberal turn" was played by American consultancy. Meanwhile, Latvia was a specific case as liberalization of markets was a part of a Latvian pro-nationalist programme (Sommers, 2009). As argued by Bohle and Greskovits (2009), on the side of the Latvian politicians, threatened by the Soviet leadership's outright hostility to Baltic independence, the main advantage of the new democratic capitalist democracy was the sharp contrast with the socialist past. Market radicalism was crucial for defence of the newly acquired independence, resulting in rapid economic restructuring, a meagre welfare regime and nationalist social contract (Bohle & Greskovits, 2009).

After 20 years, the Anglo-American notions on market supremacy characteristic to the early 1990s are still present in the ruling circles. By and large, the authorities' 'logic of appropriateness' does not seem to go far beyond the doctrine of orthodox neoclassical supply-side economics ([47]).
As regards fiscal policy, by submitting to an exceptionally stringent fiscal rule, the government followed the normative appeal of the notion of 'balanced budget' – according to a national official,

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general have become increasingly unencumbered by any pretence of a social dimension (Hyman, 2011). Eventually, Pochet and Degryse (2012) even claim that none of the reforms adopted in Europe during the 2010-2012 period represents an improvement in social legislation. Moreover, the actual purpose of the reforms has been to dismantle whole areas of the European Social model (Pochet & Degryse, 2012).

47. As inferred from the statements by Vilks and Dombrovskis, basically it rests on two principles. Firstly, a country should aim at fiscal sustainability and market confidence. Secondly, in order to achieve the two, structural adjustments have to be carried out as rapidly as possible (Vilks, 2013a); (EUObserver, 2012); (Financial Times, 2013b).

a value in its own right in the government circles (Interview, 2013c) ([48]). Similar beliefs on the ultimate importance of "stable currency" have been dominant in Latvia's choices in monetary policy. Nevertheless, as I would like to argue, neo-liberal ideas have had a strong impact on Latvia's social policy, regarding how economic benefits are to be re-distributed. As we have seen before, the resistance of Latvian authorities to care more for the poor or to address inequality has not always been related to the lack of funds – most prominently this has been seen regarding the windfall revenue and the tax cuts ([49]).

Moreover, the capture of the Latvian ruling elites in laissez faire ideas has been explicitly noted from outside. As noted by an ECFIN economist, the lack of progressiveness in Latvia's tax policy to a large extent has been due to "laissez faire thinking, but in an exaggerated form". The economist continues: "There is a big difference between what Riga thinks about social policy, and what the local governments think about that. In Riga, the rhetoric is like: those who don't work – they are to blame, they don't need help, they are lazy, they only live from state benefits etc. Meanwhile, the situation in the countryside is totally different" (Interview, 2013d).

Of course, we cannot exclude that to some extent the Latvian authorities' beliefs depend on domestic politics, and are derived from the preferences of the Latvian society as a whole. To put in another way, the government may have been resistant to the Commission's calls for more redistributive social policy also because some groups in society are not in favour of it. Asked why Latvia had declined to implement more redistributive social policy, an economist at the Commission noted that differentiated and targeted social policies are more difficult to administer, and, perhaps more importantly, the proposals for more redistributive social policy have traditionally been opposed by the political opposition, and, accordingly, its constituencies. As explained by the ECFIN economist, this puts the national administration in an uneasy position: "It is not possible to cut pensions; only to increase them" (Interview, 2013g).

5. Findings and conclusions

48. The effect, however, appears somewhat paradoxical. Although, 'counter-cyclical fiscal policy' is extolled as a virtuous practice both by the national government, e.g. see (Convergence, 2013d), and the Commission, e.g. see (Commission, 2012b); the actual space for carrying out such a policy in order to set-off the effects of economic bust, has been eliminated to the minimum.
49. As noted by an ECFIN economist: "On the one hand, the government says that they do not have a fiscal space, and therefore they cut the GMI; on the other hand, the government apparently has a fiscal space to lower the personal income tax for 5 percentage points, which is quite a lot, if you think about it" (Interview, 2013e).

We have seen that from the part of the national authorities, economic governance in Latvia overwhelmingly has taken place under the banner of Optimum control theory (OCT), implying 'financial stability' and 'market confidence' as top priorities and aims per se. As argued above, the rationality of the variants of OCT is embedded in a particular set of beliefs. Thus, 'interests' and 'ideas' are not exclusive, but complementary factors.

Perhaps the most lucid example of the standard version of OCT has been the persistent commitment to join the euro throughout the crisis. While Latvia was experiencing the most severe recession in the EU, having harsh implications on social sustainability, the Latvian authorities refused to use their discretionary powers in monetary policy – at the time, the most powerful tool still under the national sovereignty. Instead, it was decided to focus on calming down the markets, lowering the borrowing costs and decreasing the public debt. As reasoned by the authorities – the distrust in the markets in the form of short-selling of the lat currency, worked towards a self-fulfilling prophecy, emptying the foreign reserves at the national bank.

In the same vein, the Latvian authorities represented an OCT bias in fiscal policy. Although, under the Fiscal Compact, Latvia was allowed to have the MTO of structural budget deficit at -1% of GDP, given its relatively low public debt; the national authorities voluntarily chose to set the MTO at -0.5% of GDP. By this, the space for a counter-cyclical fiscal policy to accommodate any country-specific conditions or unexpected events, not to mention decreasing the astonishing poverty levels in the Latvian society, was eliminated to the minimum. Another example of OCT was the decision to transfer the windfall budget revenue from "better-than-expected" economic growth to early payback of the bailout loan. A notable exception to this OCT-inspired parsimony though was the mid-2012 supplementary budget when additional spending was provided for a wide range of purposes.

An equally important rationale in Latvia's recent economic policy appears to be the "use of Europe" when EU conditionality was strategically instrumentalized by the national authorities in order to push through painful reforms. Similarly to Italy, which constantly has been suffering from dysfunctional institutions and polarized party politics (Dyson & Featherstone, 1996); (Ferrera & Gualmini, 2004), the Latvian elites needed a disciplinary mechanism imposed by an external institution in order to implement unpopular policy measures. Such disciplinary mechanisms were found in a variety of European governance tools, such as euro accession convergence, the BoP programme, the Excessive Deficit Procedure and the Fiscal Compact.

A central finding of the paper is that in Latvia the euro accession convergence and the European Semester constituted a competing relationship, as effectively, from the part of the government, the first was complied with at the expense of the second. Specifically, in order to secure the compliance with the Maastricht inflation criterion, the government decreased VAT, thus narrowing the palette of options to help the poor as was consistently advised by CSRs. Although the role of the VAT cut, due to an unexpected drop in world commodity prices eventually turned out to be marginal; it still served the function of postponing the increase of non-taxable income thresholds for the lower paid.

Overall, we have seen that hierarchical conditionality as determined by the European Commission, whether aimed at securing economic or social goals has shown limited effectiveness as it allocates considerable discretion to member states. In all policy spheres – whether concerning fiscal or social policy, or euro accession convergence – the Latvian government has showed "agency", effectively derogating from the fiscal lines set out by the Commission. Moreover, the extremely good success in budget consolidation was used by the Latvian government to justify derogations in other fields, specifically, in regards to social policy and euro accession convergence.

Eventually, against the backdrop of an extreme version of OCT-informed market radicalism practiced by the national authorities, the Commission, non-typically enough has been playing the role of "social" advocate. While Brussels did impose quite drastic financial consolidation on the Latvian state, it also called for more targeted and differentiated social policy so as to eliminate poverty and inequality, in regard to which Latvia is one of the worst performers in the EU. Yet, by pursuing the ideals of 'market confidence' and 'financial stability', the national technocratic elites to a large extent remained unresponsive. Ironically, despite the fact that EU economic governance frameworks themselves are designed on the basis of OCT (to discipline the member states via a means of "external constraints"), the costs incurred by various OCT-informed measures, as pursued by the Latvian authorities, at times have been far from acceptable to the Commission (also the World Bank and the IMF). Although it does not necessarily imply that the Commission called for more spending, but rather "better targeted" spending, under the auspices of the BoP programme Latvia was allowed to allocate unexpected revenue from "better-than-expected" economic growth to various social measures, among other things. Yet, at least till Latvia's formal adoption into the Eurozone these opportunities by and large remained unutilized. In the end, somewhat unexpected conclusion may be drawn that as far as Latvia's recent economic policy is concerned (particularly in 2011, 2012 and 2013), it is the national authorities themselves that have been the most austere to the Latvian society.

5.1 Implications and relevance at the EU level

These findings have direct implications on the new European economic governance architecture as a whole. The case of Latvia shows that the national authorities are able to exercise a considerable discretion and the effectiveness of hierarchical conditionality as imposed by the Commission is limited. It is especially so in policy areas beyond the quantitative targets, as broadly determined by the Stability and Growth Pact or Macroeconomic Imbalances Procedure. As far as a government complies with the formal narrowly specified criteria regarding budget deficits, public debt or other macroeconomic imbalances, the Commission's capacity to shape the agency of the national authorities according to its preferences appears to be insufficient and ineffective. Especially weak is the Commission's rule in the realm of social policy. Due to the lack of enforced and binding rules, the Commission may not be able to effectively shape social policy outcomes at the national level. As we have seen in the case of Latvia, the national authorities were able to successfully resist the Commission's persistent calls for more distributive and targeted benefits.

Hence, a major challenge for economic governance at the EU level is the uncertainty of social policy preferences of the national level. It has to be noted that initially OMC was hailed as an instrument for addressing common European concerns while respecting national diversity of employment and social protection systems (Zeitlin, 2005). The relative "softness" of OMC, among other things, was supposedly to serve the function of protecting the national social welfare institutions from market pressures imposed by European integration; e.g. see (Degryse, 2012), (Höpner & Schäfer, 2012). However, in Latvia this mechanism has played out in a somewhat opposite way, as the authorities took advantage of the "softness" of the OMC, in order to stick to Latvia's scantly funded and deficiently targeted social programmes. What the case of Latvia tells us is that socially adverse policies may be imposed not only "from above", as determined by EU institutions, but also "from below", as carried out by the national elites.

Last but not least, Latvia's case raises several concerns about the adequacy of the Maastricht criteria. As illustrated above, compliance with the inflation criterion may be attained due to external conditions, only loosely related to the actual economic condition domestically. In fact, Latvia was "saved" by international factors well beyond the control of the government, especially given the relatively high share of energy and food products in Latvia's consumer basket. Secondly, the Latvian case shows that compliance with the criteria may be acquired via technical means at the disposal of the national government or the parties holding vested interests in the common currency (such as the banking sector or organized business). Given the massive fall in world commodity prices, the effect of the deliberate actions by the Latvian government to curb inflation eventually turned out to be marginal; nonetheless, it was pivotal in terms of externalities it had on other policy fields. Finally, although the Commission is concerned whether a member state achieves the convergence targets in a "sustainable way" (Commission, 2013b), only "financial" and "fiscal" indicators are taken into account, while leaving any "social" indicators out of the assessment procedure.

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5.2 Final remarks

Although, the Latvian experience is unique and exceptional in many respects (the particular historic background, the national divisions, the almost simultaneous operation of the three governance frameworks, among others), it may provide relevant lessons for other EU member states, as well as illuminate potential implications of economic governance at the EU level. First of all, the Latvian case displays a considerable weakness in EU social policy governance relative to the much more stringent fiscal policy governance. As after the Euro-crisis, coordination between various macroeconomic governance tools has become increasingly enforced, governance of the "social" by and large has remained the same. Moreover, as the Latvian case exemplifies, the national authorities themselves may choose to enforce compliance with the "fiscal" and "macroeconomic" targets (and even exceed them) at the cost of deviating from the social ones. This, in effect, may constitute a double pressure on social sustainability at the EU level. Similarly, social sustainability at the EU level may be impeded due to the lack of assessment of "social" indicators under the euro accession procedure, especially, if the compliance with the euro convergence criteria is enforced by interested parties at the national level at the expense of "social" targets.

In any event, what the Latvian experience shows us is that pan-European governance of the "social" should definitely be a policy-makers' concern. Moreover, it appears so given the increasing diversity of the composition of member states in the EU, and, relatedly, the uncertainty of "fiscal" or "social" policy preferences (as constituted by rationales and ideas) held by the national authorities. However, it should be clear that an enforced "one-size-fits-all" approach to policy-making, in order to balance out the inequality between enforcement of "fiscal" and "social" policy or minimize the possibility of socially adverse derogations at the national level, cannot be a proper solution. The ability to account for local specificities and conditions is key in order to provide effective and adequate policies, both in the "fiscal" and "social" realms.

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