CHAPTER 5.
SUMMARY AND CONCLUDING OBSERVATIONS

5.1 This report has examined the extent and causes of poverty reduction during the period 1998–2004 using data from a variety of sources – the national accounts as well as household budget, labor force, and other household surveys. Using HBS data from several surveys during this period and an absolute poverty line, it finds that Latvia has come a long way in improving the living standards of its population. Sustained and robust growth has moved the country closer to income convergence with the EU25 average income level, and the gains from it have been widely shared across the entire population. In addition, the analysis presented in this report points to a number of preliminary policy implications, as summarized below:

5.2 Sustaining Latvia’s impressive growth performance is key to consolidating achievements in poverty reduction: The Latvian economy has performed quite well over the past decade. Growth during the past five years has been particularly high: real per capita GDP increased by almost 50 percent, seven times the increase in the EU overall. The labor market provided the primary channel through which the benefits of this rapid economic growth were shared widely across the population. Rapid increases in productivity and earnings, and more recently an increase in total employment, have been the main channels for sharing the benefits of high growth across the population. Increased labor market flexibility in recent years is indicated by the various positive trends evident in the economy, with all three of the main labor market indicators—labor force participation rate, employment rate, and unemployment rate—continuing to show positive trends.

5.3 As a result, Latvia has achieved substantial progress in poverty reduction, with an estimated 325,000 people moving out of poverty over this period. As with many other countries throughout the world, the experience of Latvia illustrates vividly the dramatic impact that sustained high rates of shared growth can have on improving living conditions, even over a relatively short time period. Looking ahead, it would be important for the government to mitigate any risks that might threaten the sustained growth that Latvia has enjoyed in recent years. In particular, growth in the economy at present may be running ahead of potential, owing to rapid credit and wage growth, which has resulted in large current account deficits and relatively high inflation recently. Bearing these risks in mind, it would be important for the government to take early action to counter any adverse developments that might threaten the economy’s long-run prospects for high and sustained growth.

5.4 Complementarity between relative and absolute poverty measures: Poverty estimates based on an absolute poverty measure show a rapid decline in poverty over the period 1998 to 2004 because of the economic growth that occurred during this period. However, one of the consequences of this growth was that median incomes increased as well. As a result, poverty estimates linked to this measure (i.e. relative poverty measures, such as the Laeken indicators) show no change in poverty during this period. Both relative and absolute poverty measures have
their uses, and in fact are useful complements in providing valuable information regarding evolution of living standards in the country. While the former helps shed more light on whether living conditions in the country have improved among the poorer segments of society in relation to a norm defined based on prevailing living conditions (i.e. relative to median income, regardless of whether living standards have changed in relation to an absolute objective standard), the latter measure shows whether these poorer groups are better-off in absolute terms (i.e. regardless of whether their living conditions have changed relative to other population groups).

5.5 Looking ahead, given the importance placed on this set of indicators in the European Union, the Latvian government will no doubt continue to use the Laeken indicators to track changes in poverty over time. In addition, however, tracking changes in living standards using an absolute poverty measure also merits serious consideration, since these two sets of poverty indicators provide useful complementary information on changes in living conditions. In the absence of an official poverty line in Latvia defined in absolute terms, this report has used a poverty line of 28 LVL per month in 1998 prices. However, as noted in the report, this poverty line was defined in 1998 based on circumstances which prevailed in Latvia at that time. In line with considerable improvements in living conditions over time, the government may want to consider revising this upwards to reflect the country’s more comfortable situation today.

5.6 Inter-regional fiscal transfers for social assistance? As shown in chapter 4, municipalities in Latvia that have the most funds available to pay for social assistance may not necessarily be the ones whose residents need this assistance the most. This finding illustrates the dilemma in local government financing of social assistance benefits. On the one hand, the principle of subsidiary decision-making in the provision of social assistance is desirable. It helps ensure that municipalities plan their budgets and expenditures carefully, that they do not end up lobbying the central government for large transfers. On the other hand, however, municipalities with the most funds are not necessarily the ones whose residents are most in need of social assistance. Given the present fiscal arrangements in Latvia where social assistance transfers are financed entirely from local government resources, there may be some scope for the national government to introduce some equalizing fiscal transfers, especially given the substantial income gains achieved in recent years.