

Latvia 2040

Four Future Scenarios

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Latvia 2040
Four Future Scenarios
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FOREWORD



Aigars Rostovskis
(Phd),
Supervisory
Board Chairman,
LaSER Think Tank

Growing geopolitical instability, global uncertainty and the otherwise complex international situation, as well as the lacklustre trajectory of Latvia's growth, are the main reasons for the founding of this think tank. Evidently, a critical point has been reached in Latvia, where a number of private individuals are ready to invest their financial resources, professionalism, knowledge, time and other activities in establishing and running a think tank.

Latvia's security and long-term growth are threatened by the non-existence of nationwide targets and actionable policies in economic realms, public administration, demography and security, which can only be rectified by decisive government policy oriented towards long-term economic growth, which will propel a modern Latvian State and society that is secure, thriving and European.

The think tank's main objective is to devise new, innovative and research-based policy ideas, foster public opinion and offer Latvia's policy executors solutions built on analysis for the development of the country. Our motivation is the security of Latvia and the prosperity and welfare of its peo-

ple, and through the work of the think tank we hope to precipitate more dynamic economic growth, and to help Latvia become join the ranks of the European Union's Top 10 wealthiest countries by no later than 2040, maintaining the country's geopolitical course among the community of European nations and NATO.

The Think tanks values – Freedom = Knowledge + Justice + Enterprise – are vital in the process of social development and decision-making. Through research, various events and active communication, the think tank plans to have a positive impact on socio-political processes and decision-making, propelling Latvia towards faster growth and welfare. It will educate and inform socio-political process stakeholders, voters and other interested parties, organising debates, meetings, presentations and other contemporary forms of discourse. The think tank will serve as an open system for the evaluation of various ideas, helping to formulate better quality policies.

I am confident that our work will foster debate within society, and in political circles among opinion leaders, and that this will all help Latvia to improve!

SUMMARY

Global driving forces



Geopolitics

Countries are more intransigent in their positions in various realms (military, economic, technological, etc.) resulting in more conflict situations.



The Green Deal and transformation of the energy system

The EU has chosen to implement the Green Deal and to be the leader in the realm of the environment and green technologies, which will require adaptation, but will also create development opportunities.



By 2023, the volume of environmental technologies required by the local market and produced by domestic businesses



Technological development

More data is being generated that can be used to develop technologies that tackle many significant problems for humanity (e.g. increased labour force productivity, reduced global warming and climate changes), but the application of technologies can also be destructive.



Data created in **one minute**:
Shares on Instagram (2022)



Democratic backsliding

Since 2005, the number of countries whose situation has deteriorated in terms of freedom annually exceeds the number of countries in which improvements have been observed.

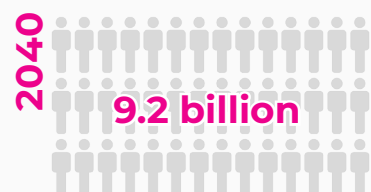


Percentage of world's population living in free countries in 2023



Demographics and global migration

People from regions with growing populations, but less opportunities, continue to seek more favourable conditions elsewhere.



The global population size in 2024
(but the growth tempo will fall)

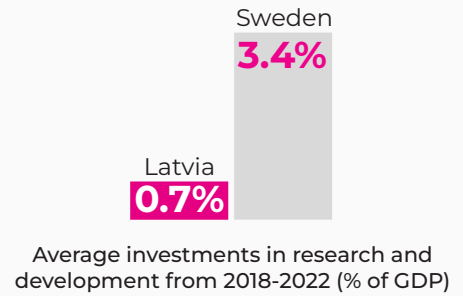
The goal of this report is to stimulate strategic thinking about the future of Latvia. *Foresight* is an important tool in long-term political planning and formulation with the objective of seeking solutions today for tomorrow's challenges. During the past decade, institutionalization of *foresight* has been observed in European countries, including in Estonia and Lithuania, but Latvia stands out in that *foresight* is not systematically used in state policy planning.

Local driving forces



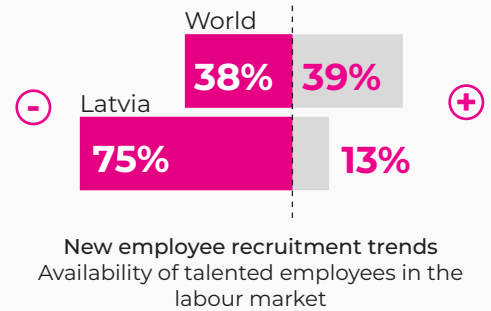
Innovations and use of new technologies

In some fields at least, we should be among the technology leaders – opportunities and development niches should be taken advantage of.



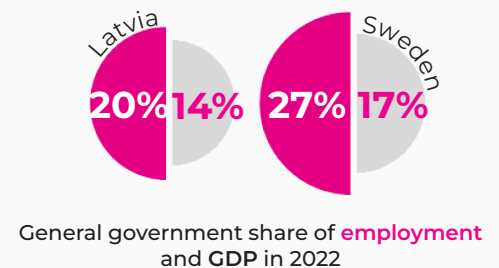
Human capital

Concrete must be replaced with smart investments in human capital that are profitable for both individuals and society as a whole.



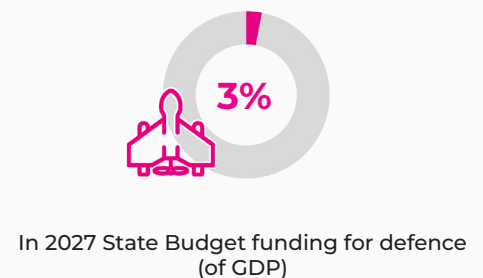
Lack of trust in the political system

More efficient public administration would help business competitiveness and increase inhabitants' quality of life.



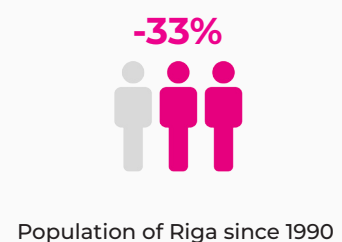
Budgetary pressure

Society is ageing, but defence expenditures are growing and are likely to continue to do so.



Riga as the driving force for the growth of the whole of Latvia

Riga's global competitiveness will determine Latvia's growth and hence that of its regions.



Scenarios



INTRODUCTION

The task of future studies is not only to collate trends, but also influence the future by creating reasoned arguments for decisions made in the present.¹

What is Latvia's future vision?

This question is asked increasingly often. Thirty years ago Latvia's politicians and society had a clear vision of the future – Latvia's return to a united Europe and its place in the western world. One after another, Latvian governments implemented complex but necessary political, economic and legal reforms, and earlier than expected in 2004

Latvia joined the European Union (EU) and the North Atlantic Treaty Organization (NATO). Similarly complex reforms were adopted on the road to joining the Eurozone in 2014, joining the Organization for Economic Cooperation and Development (OECD) in 2016 and performing a complete overhaul of the banking sector after 2018.

What do these reforms have in common? They were all directed by external experts.

Latvia has found it difficult to independently formulate coherent, real and attainable visions for the country's future. This is largely because there are few institutions capable of articulating a vision. The Saeima founded a small Analytical Service only in 2017.² In 2024, the State Chancellery is only now planning to develop its own Analytical Service. The State President's office has little research capacity. Political parties do not spend money on research and developing detailed programmes. Universities and scientific research centres are oriented towards academic not policy studies. Latvia has few think tanks with the capacity to generate ideas and visions.

Accordingly, Latvia is in a unique situation – it has an internationally positively and even comparatively highly rated political

system and bureaucratic institutions, but also a long (compared to Lithuania and Estonia) stagnant economic system, which now significantly lags behind its immediate neighbours. In 2023, Stockholm School of Economics in Riga Lecturer Morten Hansen pointed out that if Latvia's GDP had grown at the same pace (3.3% annually) since 2006 as Lithuania's GDP, Latvia's economy would be EUR 10 billion bigger, and the State Budget would be approximately EUR 3 billion better off.³

Although membership of the EU confers unlimited access to the EU single market, it does not guarantee rapid economic growth. The examples of Greece and other EU states in the Mediterranean region are testament to this. However, the case of Ireland shows that a real, cohesive, harmonised and

¹ Latvijas Nacionālā enciklopēdija. 2024. Nākotnes pētījumi. <https://enciklopedija.lv/skirkklis/2508-n%C4%81kotnes-p%C4%93t%C4%ABjumi->

² In 2023 the service published three research studies and eight reviews, meaning one report per month.

³ Morten Hansen. 2023. How to increase tax revenue by 3 billion EUR without raising tax rates. Žurnāls "Iri". <https://ir.lv/2023/07/17/how-to-increase-tax-revenue-by-3-billion-eur-without-raising-tax-rates/>

well-executed vision can lead to rapid and sustainable economic growth.

In 2024, Latvia is at a crossroads. Policy-makers are encountering several strategic long-term challenges – the war in Ukraine, Russia’s aggressive rhetoric, political uncertainty in the US, recession and economic stagnation – that will impact Latvia’s long-

What is foresight?

Foresight, also known as strategic forecasting, is an important tool in long-term policy planning and formulation. The objective of foresight is to seek solutions today not only for contemporary, but also future challenges. Needless to say, thinking about the future is complicated, and it cannot be predicted with certainty. We can even confidently assert that for the most part our forecasts will be incorrect. However, the future is shaped by people’s choices and action today.

During the past decade, one has been able to observe foresight institutionalization in

Structure of the report

This “Four scenarios for Latvia” report combines brainstorming, survey, data analysis and document research elements, in order to map possible transformations and changes in Latvia up to 2040. The first part of the report analyses and describes the Latvian state model, using the contrast between state functional realms and institutional capacity proposed by Francis Fukuyama. The realms to which Latvia allocated budgetary funds are outlined, comparing Latvia’s set priorities with the choices made by other countries. Using population survey data, the report outlines public expectations in relation to state and personal responsibility.

The second part describes ten driving forces (five global and five local) that will influence Latvia’s future development up to 2040. The scenario formation process started with the identification of the most significant driving forces that will influence Lat-

term growth. The goal of this report (as well as our think tank) is to stimulate strategic thinking about Latvia’s future, determining the main international and national trends and factors that drive it, where they are seemingly being directed, and how they could mutually interact. Future scenario narratives are an important scientific approach of foresight.

Western countries and in particular in EU institutions and EU member states. Maroš Šefčovič is the first European Commission Vice-President in charge of strategic foresight, whose task is to lead the Commission’s work in the realm of *strategic foresight*.⁴ The European Parliament Research Service (EPRS) has a Strategic Foresight Unit.⁵ The countries in the eastern part of the Baltic Sea (Sweden, Finland, Estonia and Lithuania) are among the world’s leaders (see Map 1). Latvia stands out in that foresight is not systematically used in state policy planning.

via’s development in future. In the February and March, the *LaSER* think tank organised three brainstorms with business, public administration, higher education and science and non-governmental organisation representatives in which several important driving forces were discussed and identified.

The third part of the report offers four future scenarios for Latvia, illustrating some of the ways how the driving forces mentioned in the study can interact, creating challenges and opportunities for decision-makers. These scenarios provide an opportunity to discuss and ascertain the tasks that will be necessary for the attainment of specific results. In considering the future, we can foster the changes that we wish to see. It is not in power to change the past, but the decisions we make today change the future. The future is in our hands.

Map 1

State foresight institutions in countries in the eastern part of the Baltic Sea

In 1973, the Future Commission established by the Swedish Government recommended to found a Future Studies' Secretariat under the State Chancellery. In 1987, the secretarial was transformed into an independent institution – the Institute for Future Studies.⁶ The Government commissions future studies from it – for example, in November 2011 the Swedish Government established the Swedish Future Commission with the objective of determining Sweden's future challenges up to 2050.⁷

Finland has a state foresight network, which unites Finland's foresight researchers and institutions.⁸ The network is coordinated by the Prime Minister's office and the Finnish innovation fund *Sitra*. Since 1993, every four years upon starting work, the new government prepares and submits a report to Parliament about the future, whose objective is to ascertain the issues that will be important for decision-making and to which special attention must be paid in future. The Future Commission operates under the aegis of the legislator.⁹

In 2016 Estonia adopted a Foresight Law, which established a Foresight Council, which consists of research, technology and business experts and a Foresight think tank in the Estonian Parliament.¹⁰

In 2020, a *Future Commission* was founded in the Lithuanian Seima with a broad portfolio of foresight duties.¹¹ In 2019, Lithuania's Research and Education Monitoring and Analysis Centre (MOSTA) was transformed into the government's Strategic Analysis Centre (STRATA). One of its main activities is foresight research.¹²

⁴ European Commission. Strategic Foresight. https://commission.europa.eu/strategy-and-policy/strategic-planning/strategic-foresight_en
⁵ EPRS Strategic Foresight and Capabilities Unit. <https://epthinktank.eu/author/eprsglobaltrends/>
⁶ Institute for Future Studies: <https://www.iffs.se/en/>
⁷ Swedish Future Commission report: <https://mediamanager.sei.org/documents/Publications/sei-report-hallding-swedeninaworldofgrowinguncertainties.pdf>
⁸ Finnish Foresight Network: <https://www.foresight.fi>
⁹ Finnish Future Commission: <https://www.eduskunta.fi/EN/valiokunnat/tulevaisuusvaliokunta/Pages/default.aspx>
¹⁰ Estonian Foresight Law: <https://www.riigiteataja.ee/en/eli/509022018003/consolide>
 Estonian Parliament Foresight Think Tank: <https://arenguseire.ee/en/>
¹¹ Lithuanian Seima Future Commission: https://www.lrs.lt/sip/portal.show?p_r=38859&p_k=2
¹² STRATA: <https://strata.gov.lt/en/>

1. CURRENT SITUATION

The influential American scholar Francis Fukuyama proposes using a two-dimensional model to analyse and compare different models of the state. One axis arranges countries according to the range of the services and functions they produce. Although Fukuyama asserts that a single hierarchy of state functions does not exist, when considering this dimension of the model, one must be mindful that there are functions that it is critically important for a country to provide (e.g. state defence, public order and security, public health, etc.). There are functions which it would be desirable for a country to undertake (e.g. establishment and maintenance of a pension system, provision of general education, provision of free and fair competition, etc.), and then there are functions whose place within the realm of state functions is bound to prove polarizing (e.g. support for professional sport, subsidising businesses, asset reallocation, etc.) and whose implementation is a choice not a duty. The second dimension of the model is related to institutional capacity – the

ability of a country to formulate and implement policy initiatives; to draft and issue laws, as well as to ensure their implementation in practice; to execute efficient public administration with minimal bureaucracy; to eradicate corruption and to be open and transparent in its activities.¹³

Using Fukuyama's model, countries can be divided into four quadrants. Latvia is currently in the third quadrant with a relatively wide range of state functions, but with limited institutional capacity. In this report, we will compare Latvia with the other Baltic States and the Nordic countries. The US and the Nordic countries will serve as examples of the second square in Fukuyama's breakdown: countries with a broad range of functions and high state institutional capacity. In turn, the US is characterised by Fukuyama as a prototypical country in the first quadrant with high institutional capacity, but a comparatively limited range of state functions. An example of a country in the fourth quadrant could be Sri Lanka, where due to

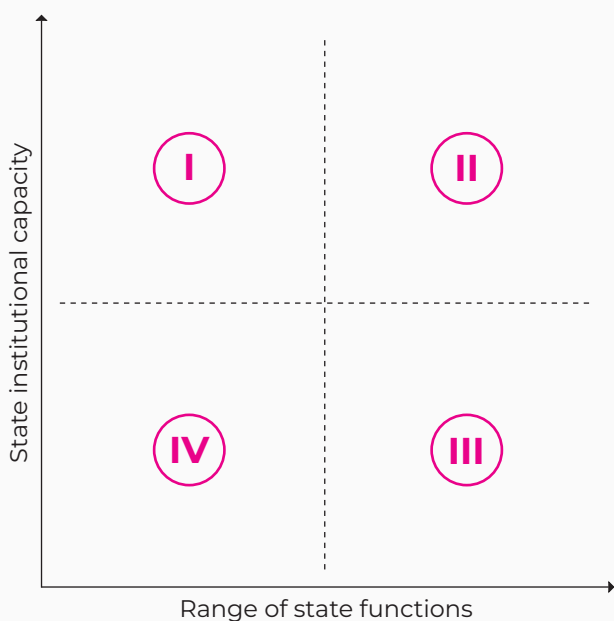


Figure 1
State functional realms and efficiency

Source: Adapted from Fukuyama, F. 2004. *State-Building: Governance and World Order in the 21st Century*.

¹³ Fukuyama, F. 2004. *State-Building: Governance and World Order in the 21st Century*. Ithaca, NY: Cornell University Press

imprudent government policies and debts, the range of state functions is extremely limited and institutional capacity is low.

The task of this section, on the one hand, is to outline which general government functions Latvia allocated budgetary funds to,

and to compare Latvia’s priorities in terms of general government expenditures with the choices made by other countries. And, on the other hand, using population survey data, to outline what public expectations are in relation to the state and personal responsibility.

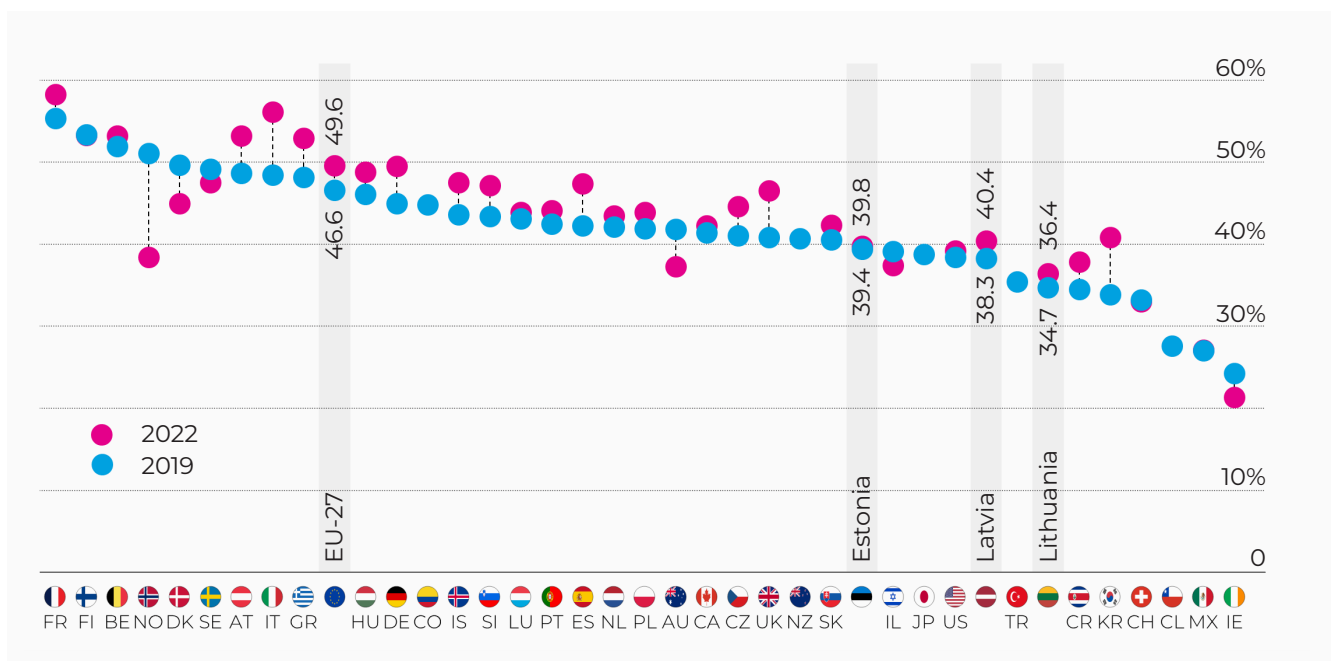
General government share of GDP

The general government expenditures of OECD and EU member states vary; comparing them can highlight differences in the economic structures of these countries. Firstly, more often than not, in relation to Gross Domestic Product (GDP), general government expenditures are often anti-cyclical or at least stable, therefore that ratio to GDP tends to increase during economic crises. In 2022, average government expenditures among EU-27 countries in relation to GDP amounted to 49.6%, which was still 4 pp higher than before the Covid-19 pandemic in 2019. Secondly, countries differ.

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Figure 2
General government total expenditures in OECD member states in 2019 and 2022 (% of GDP)

Data source: OECD, Eurostat



Comparing the Baltic States, it is clear that since the global financial crisis, Lithuania's ratio of general government expenditures to GDP is slightly lower than in Latvia and Estonia, which are largely attributable to faster economic growth in Lithuania. However, in all three Baltic States, general government expenditures in relation to GDP are below the EU average, especially in high spending countries like Sweden.

Globally, there are an increasing number of companies whose revenues exceed the funds available to the governments of the Baltic States. However, in the local Baltic market in terms of current assets along, not taking into account the much wider roles, which are afforded to governments in free

market economies, the significance of all governments is considerably bigger than that of any individual country. Of course, statistically combining businesses in industries or through professional non-governmental organisations in associations, their importance grows. If one compares the Baltic governments, it should be noted that Lithuania's general government revenues are approximately 1.7 times bigger than the revenues of the Estonian and Latvian governments, and that in absolute figures, in 2022 the general government revenues of Estonia, which has a population almost 30% smaller than that of Latvia, were slightly bigger than those of Latvia.

Functional breakdown of general government expenditures

General government expenditure breakdown is standardized and detailed, therefore expenditures can be compared internationally. Examining the breakdown of general government expenditures in the Baltic States and Nordic countries by government function over the past 20 years, one can observe a certain continuity among countries domestically. Since expenditures include both current expenditures and capital investments, in individual years when investments have been made in the construction of new infrastructure, expenditures can be bigger, but, comparing average five year metrics, the changes are mostly relatively small.

The share of social security expenditures has increased in all the Baltic States over the last twenty years. It has reached the highest level in Lithuania, where in the period from 2018 to 2022 on average 38% of annual total government expenditure were allocated to social security, which is the same amount that the more parsimonious Nordic countries allocate to social security. By way of comparison, although they have increased, US social security

expenditures make up only 23% of total general government expenditures. In turn, the proportion of education expenditures in all the Baltic States has declined. In the past five years, it averages 13%–15%. These changes are partly related to the ageing of society – there are more retirement age people (age-related expenditures are the biggest social security expenditures) and less school age children. Due to the impact of external circumstances, in recent years there has been increasing pressure to increase defence expenditures, whose proportion among the total expenditures of the Baltic States has also grown. By way of comparison, of the funds available to them the Nordic countries allocate relatively less to defence, whereas the US allocates more. It is more difficult to implement internally-determined policy initiatives, especially those oriented towards long-term development, which provide for an increase in the ratio of some component of general government expenditures. For instance, Estonia, which spends more on research and development (R&D) than Lithuania and Latvia (in 2022, Estonian government expenditures on R&D came to 0.72% of GDP, while Lithuania's equivalent

Table 1

Top 10: Baltic States' general government revenue and turnover of the most valuable non-financial companies in 2022 (million EUR)

Note: Chart includes non-financial companies from among the Baltic Top 2023 most valuable companies, ranked according to their turnover in 2022.

Data source: Eurostat, top10.lv

Chart ranking	Government	Revenue, turnover (million EUR)	Company
1.	Lithuania	24 070.4	
2.	Estonia	13 975.2	
3.	Latvia	13 924.1	
4.		6 502.8	VILNIAUS PREKYBA, UAB
5.		4 381.3	IGNITIS GRUPĒ, AB
6.		2 218.2	EESTI ENERGIA, AS
7.		2 154.3	KONCERNAS ACHEMOS GRUPĒ, UAB
8.		1 936.0	WILLGROW, UAB
9.		1 894.5	RIMI GROUP
10.		1 841.8	LATVENERGO, AS

expenditure were 0.33% and Latvia's – 0.24%), has not been able to implement its political undertaking to increase government expenditures on R&D works to 1% of GDP.¹⁴

If we compare the structure of general government expenditures among countries, it is noteworthy that the Baltic States allocate more than the Nordic countries of total expenditures to maintaining public order and security. Latvia, and Estonia in particular, spend more on culture, but only Latvia – on housing and community amenities,

as well as on economic activities, among which the most significant are transport expenditures. Compared with the other Baltic States and Nordic countries, the proportion of health sector expenditures is lower in Latvia. During the period from 2018 to 2022, Latvia's general government has allocated an average of 12% of total expenditures annually to the health sector. By way of comparison, regionally Norway and Denmark spent the most – 17%. However, the US spent even more on health, i.e. 24% of expenditures.

Personal responsibility and the role of the state

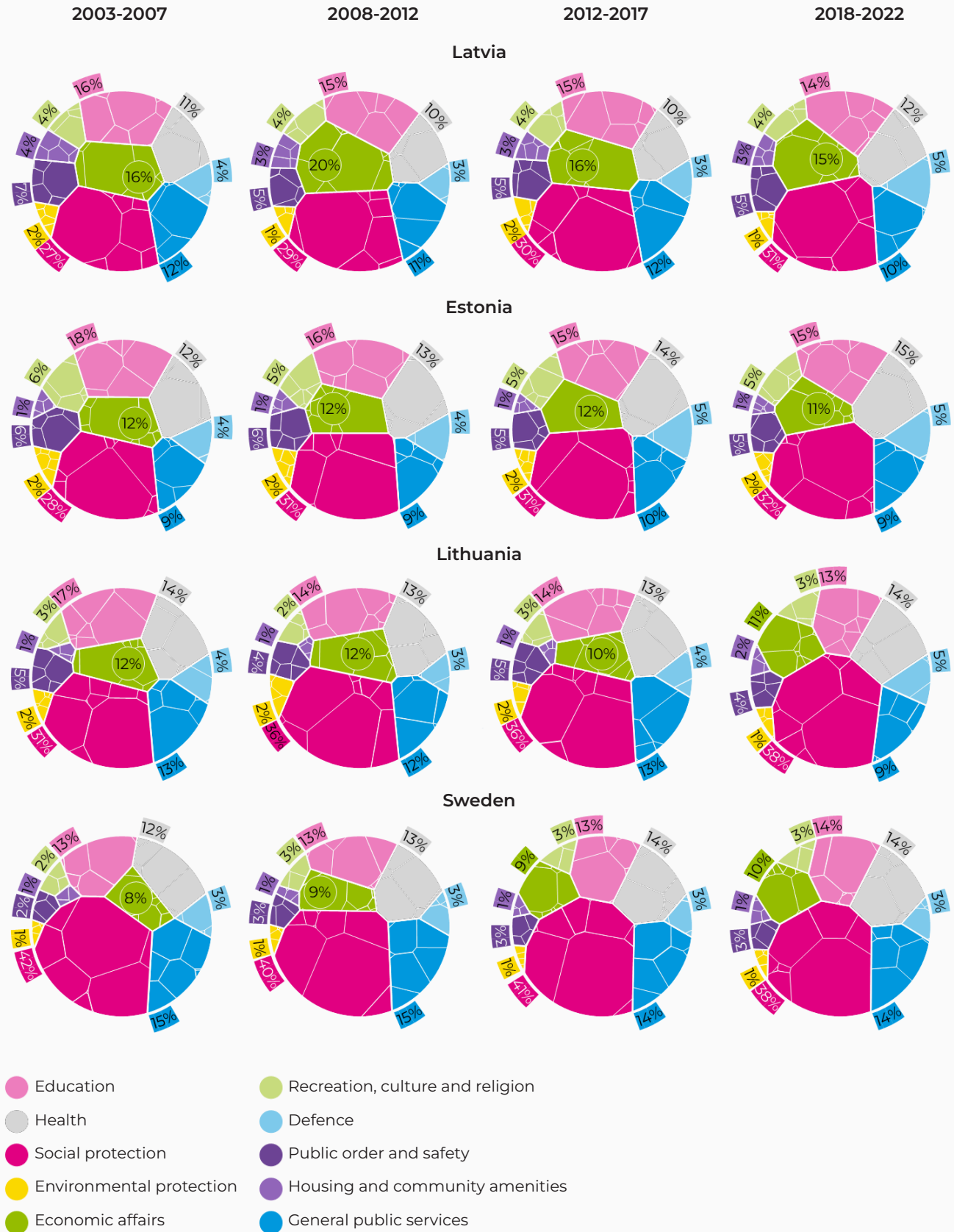
In this section, we will try to outline and compare public opinion internationally regarding various issues related to the role of the state, including regarding the division of responsibility between individuals and the state. From the viewpoint of individuals, at least in the short term, not only through the normative environment, but also through the range of goods and ser-

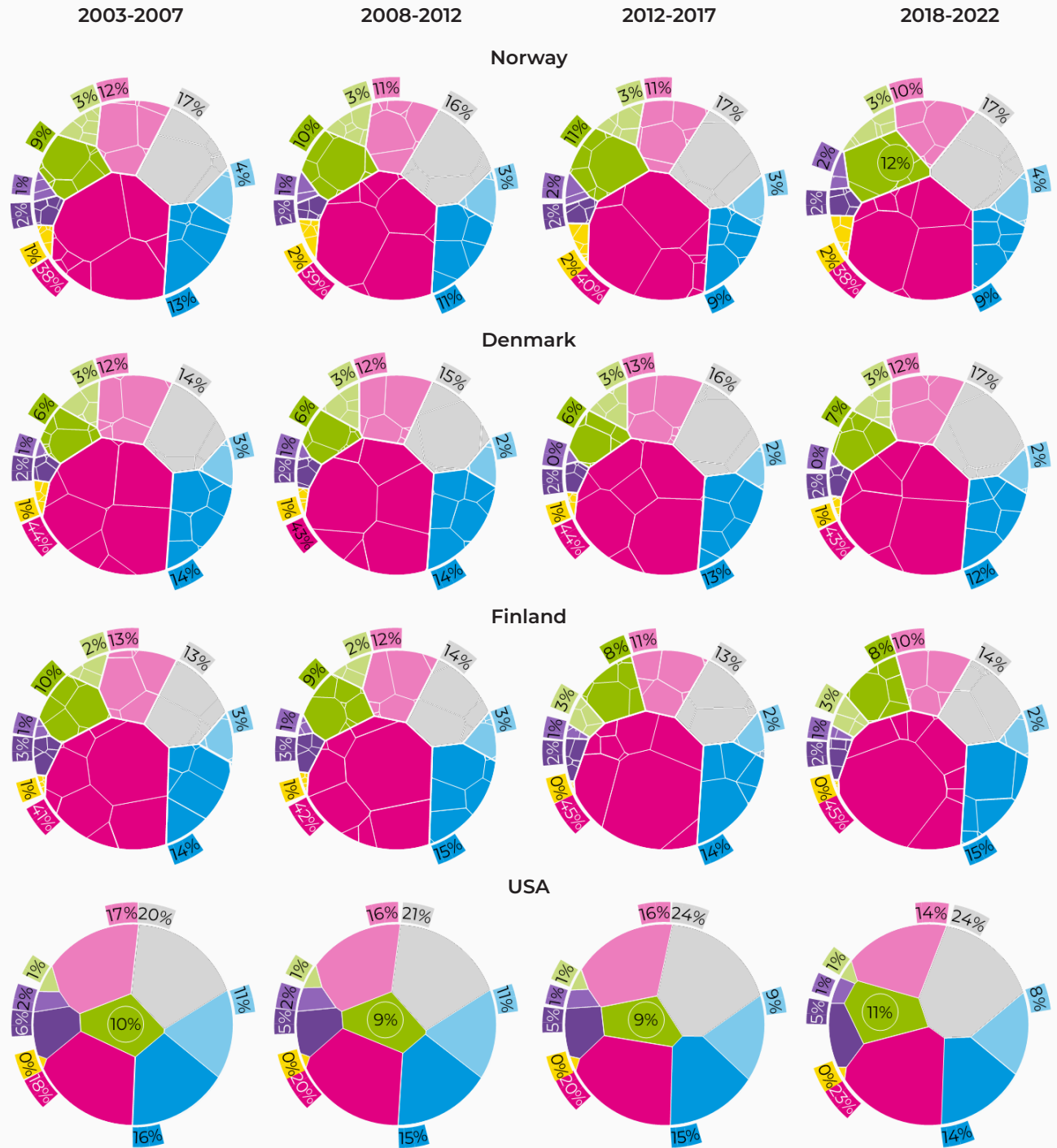
vices produced and the realms in which it actively functions, the general government offers a prevailing order of things, which to a considerable extent the public must accept as given and permanent, adapting its conduct and behaviour accordingly. Data from the World Values Survey allows us to consider how people in various countries perceive the hierarchy of these things.

¹⁴ European Commission. 2019. Peer Review of the Estonian Research and Innovation System. Final Report. https://www.hm.ee/sites/default/files/documents/2022-10/pr_estonia_-_final_report_.pdf

Figure 3
 General government expenditures by government function from 2003–2022
 (% of total expenditures)

Data source: Eurostat





The most recent world values' surveys were conducted in the period from 2017 to 2022, including in Latvia. Among other things, respondents have assessed their attitude towards competition and cheating on taxes. One might expect that in well-functioning market economies, people would recognise and appreciate the benefits conferred by mutual competition, and would also be ready to pay taxes, in order to resolve societal challenges and provide various public goods. At least at opinion level, just like their counterparts elsewhere in the Baltic States and in the Nordic countries, Latvia's inhabitants most believe that competition is good and cheating on taxes, if the possibility exists, is unjustifiable. However, in Latvia the share of those with a favourable opinion of competition (responses from 1 to 5) is 10 percentage points lower than in the leading country in this respect, i.e. Sweden, while the share of those who condemn cheating on taxes (responses from 1

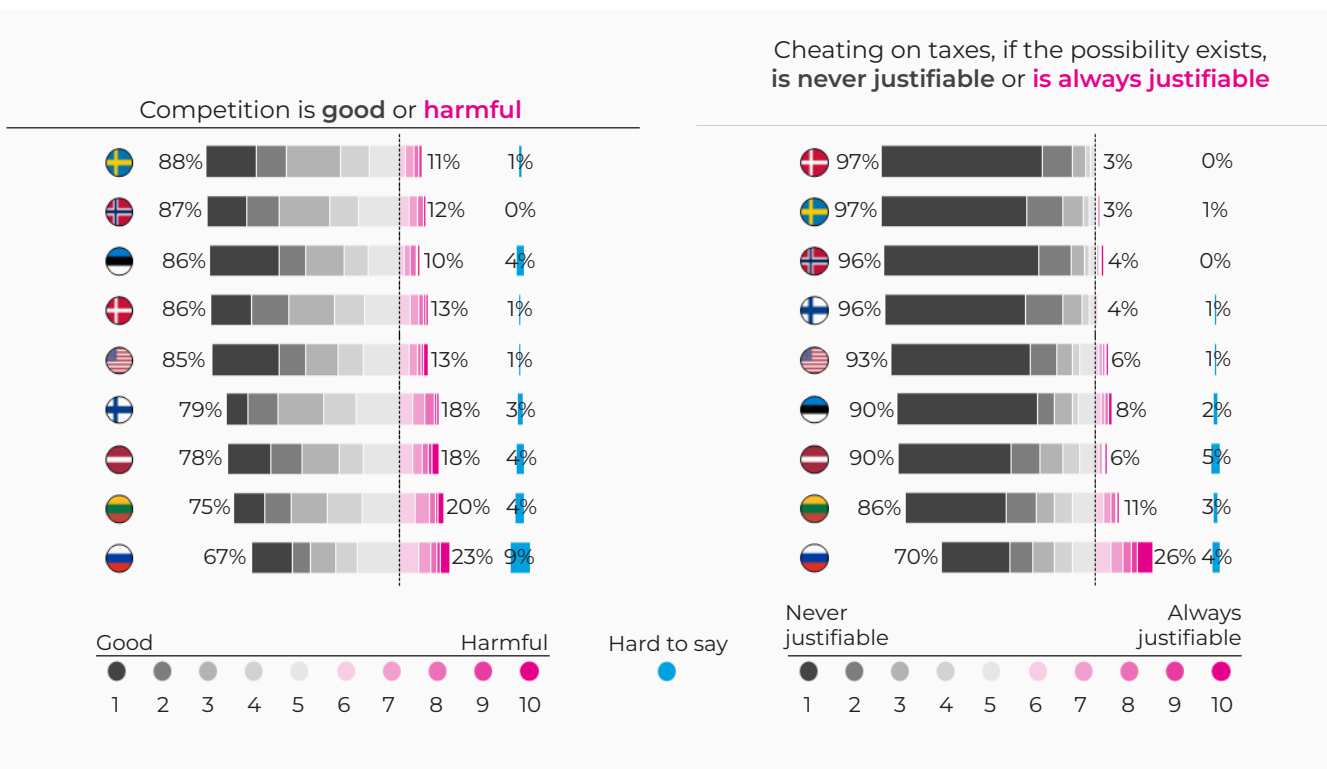
to 5) is 7 percentage points lower than in Denmark, where the greatest proportion of people condemn cheating on taxes. By way of comparison, US public opinion is similar to that in the Baltics and Nordic countries, whereas Russia's¹⁵ are prepared to justify cheating on taxes to a significantly higher extent, and do not trust competition and point to it being harmful.

Needless to say, public opinion does not always correspond to public action. Macroeconomic assessments of the size of shadow economies in European countries show that in 2022 that shadow economy in the Baltic States amounted to 20–23% of GDP, while in the Nordic countries it was twice as small – 10–11% of GDP.¹⁶ In turn, calculations based on surveys of entrepreneurs in the Baltic States show that in Latvia most of the shadow economy is made up of “envelope wages” (46.7% of the total shadow economy in 2022). In 2022, the average proportion of

Figure 4

Inhabitants' assessments of competition and cheating on taxes

Data source: World Values Survey 2017-2022. Data obtained by means of a representative public survey. In Latvia, field work was performed by the Sociological Study Institute in May 2021.



¹⁵ A survey of inhabitants in Russia (field work: CESSI, Moscow) conducted in 2017 before Russia's full-scale invasion of Ukraine, but in any case its results should be interpreted with caution.

¹⁶ Schneider F. 2022. New COVID-related results for estimating the shadow economy in the global economy in 2021 and 2022. International Economics and Economic Policy 19, 299-313. <https://doi.org/10.1007/s10368-022-00537-6>

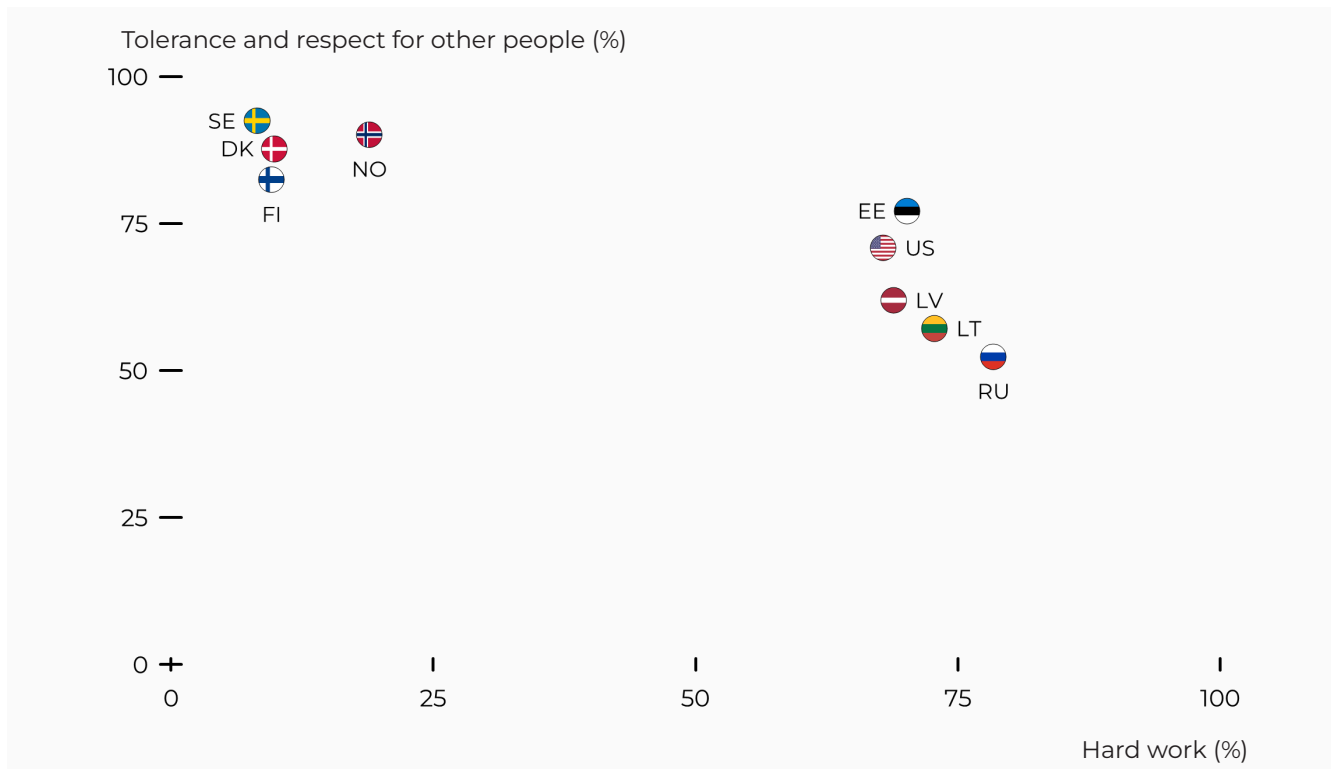
wages received by employees and paid by businesses, which is hidden from the state was 25% in Latvia.¹⁷

In the World Values Survey, inhabitants are also asked to choose qualities which, in their opinion, children should be encouraged to learn at home. Comparing the Nordic countries and the Baltic States, it is evident that tolerance and respect towards other people is highly appreciated in the Nordic countries (in all the Nordic countries, this was chosen by more than 80% of surveyed inhabitants). This quality was also recognised as being important and one that should be taught to children at home by quite a lot of respondents in all the Baltic States, however their number, especially in Latvia (62%) and Lithuania (57%), is lower than in the Nordic countries. In the Baltic States, a large proportion of the population

would like a love of work to be instilled in children at home – in all the Baltic States more than 60% of respondents chose this. The ratio of love of work does not exceed 20% in any of the Nordic countries. It should be noted that there are qualities regarding which opinions in the Baltic States and Nordic countries are very similar. For example, a large proportion of inhabitants (over 75%) in all countries believe that children should be encouraged to acquire a sense of responsibility. One could say that in the European Union (EU), the Baltic States are akin to second generation immigrants and are overtaking their parents and attaining a higher quality of life.¹⁸ Compared to when we initially joined the EU, we have a better understanding of the prevailing institutional order, but we have not lost our drive to strive to attain a better future for ourselves and our future generations.

Figure 5
Inhabitants’ assessments of the qualities that children should be encouraged to learn at home (% of respondents who ticked the relevant qualities)

Notes: In the survey, the question was formulated as follows “Here is a list of qualities (eleven in total) which children can be encouraged to learn at home. Which five would you say are the most desirable for a child to have? Please choose up to five!”
 Data source: World Values Survey 2017-2022. Data obtained by means of a representative public survey. In Latvia, field work was performed by the Sociological Study Institute in May 2021.



¹⁷ Sauka, A. un Putniņš, T. 2023. Ēnu ekonomikas indekss Baltijas valstīs 2009.-2022. gadā. https://www.sseriga.edu/sites/default/files/2023-05/Enu_ekonomikas_indekss_2009_2022.pdf

¹⁸ Abramitzky, R. and Boustan, L. 2022. Streets of Gold. America’s Untold Story of Immigrant Success. New York: PublicAffairs.

As far as the role of the state is concerned, there are realms where individual solutions are either impossible or are not optimal, and where a more effective result can be attained through mutual collaboration, as the Covid-19 pandemic demonstrated at local community, national and international levels.¹⁹ In preparing this report, we conducted a national survey to ascertain public opinion regarding the division of responsibilities in overall general government functional categories, which are used in budget planning. Respondents had to evaluate opposing assertions and, using a ten point scale, indicate which assertion they agreed or disagreed with more or less. Of the general government functions assessed, those surveyed envisage the greatest state responsibility in the realms of social security, as well as public order and military defence. However, in providing for education, health care, as well as a pension

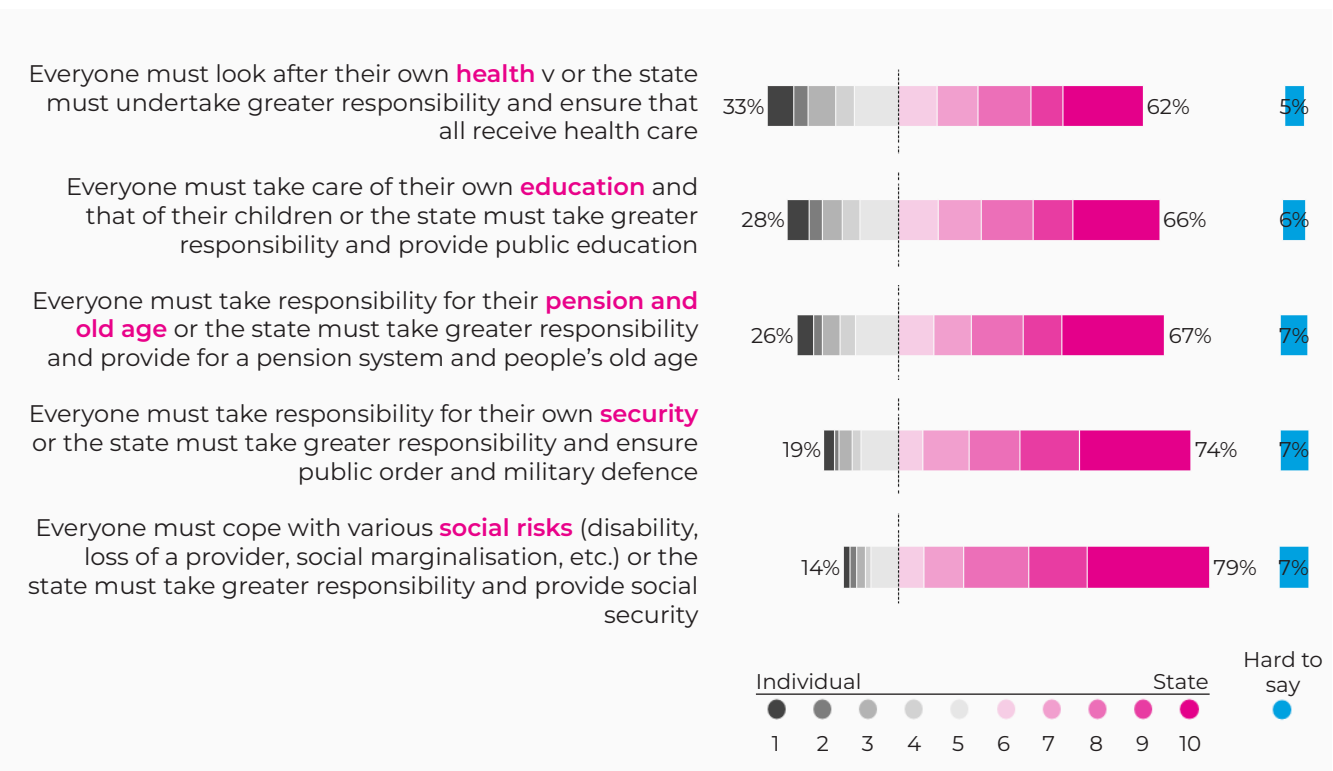
system and inhabitants' old age, more than 60% of respondents expect the state to undertake greater responsibility, not each individual member of the public.

Overall, one must conclude that although the opinions of the public in the Baltic States slightly differ from the view point of the inhabitants of the Nordic Countries, they are not diametrically opposed and could converge even more given closer mutual cooperation. Likewise, differences among the Baltic States are not overly pronounced, although under certain conditions they could be used to set them apart from one another. For example, the comparatively high number of inhabitants surveyed in Estonia who believe that children should be taught tolerance and respect towards other people at home could be used to stress that Estonia has closer ties to the bloc of Nordic countries than Latvia or Lithuania.

Figure 6
Assessments by Latvia's inhabitants regarding the division of responsibility between individuals and the state

Note: The question used in the survey was formulated as follows: "Opposing assertions regarding various issues are collated in the following table. Which assertions do you agree more with? Please read the assertions and evaluate your views in these categories."

Data source: Representative survey of the Latvia's inhabitants (n = 1005), field work conducted by SKDS in March 2024



¹⁹ OECD. 2023. Ready for the Next Crisis? Investing in Health System Resilience. <https://doi.org/10.1787/1e53cf80-en>

2. GLOBAL DRIVING FORCES

Geopolitics

The global order is changing, with existing and new players of international importance adopting strict, oftentimes confrontational positions, and with the basic principles of global economic integration being called into question.

Competition for influence in the global space will increase up to 2040 and tensions will likely reach Cold War level. No country will be capable of domination in all the world's regions and spheres of influence (military, economic, technological, etc.).²⁰ As a result, there is a significant risk that countries will become increasingly over-confident and involved in various conflict situations, including military conflicts.²¹ Right now, the global situation is significantly more uncertain and unsafe than it was at the start of this century. Data collated by researchers at Uppsala University regarding military conflicts with the involvement of national governments shows that not only has the number of conflicts increased, especially inside countries with the involvement of foreign countries, but so has the number linked to conflicts. With the start of the Israel-Hamas War, the situation continued to deteriorate in 2023 for which data has not yet been collated.

Of particular importance to Latvia is the rebirth of authoritarianism in Russia, along with its extended war in Ukraine. Russia's actions indicate that it is preparing for long-term military conflicts, and one cannot preclude the possibility of a confrontation with

NATO in the Baltic Sea region.²² This would significantly impact all spheres of life, ranging from national defence policy through to the mental health of the public not only in Latvia and the other Baltic States, but all over Europe.

Geopolitics is closely linked to the global economy. For several decades now, the global economy's centre of gravity has been shifting eastwards. During the period from 2000 to 2021, the region of India and the Pacific Ocean, which includes China and India, was responsible for 53% of global economic growth, North America for 19%, and Europe for just 9%.²³ This trend will continue in the near future. However, in recent years mutual cooperation between the US and China, which allowed this transformation of the global economy to take place has evolved into obdurate competition with threats to turn into open conflicts.²⁴ The growth in protectionism and tariffs has prompted international companies to seek opportunities to diversify and shorten their supply chains, but a return to autocracy as the leading economic paradigm is unlikely. The level of global economic integration is so powerful that for the time being even military conflicts and economic sanctions

²⁰ National Intelligence Council. 2021. Global Trends 2040: A More Contested World. <https://www.dni.gov/index.php/gt2040-home>

²¹ WEF. 2024. The Global Risks Report 2024, 19th Edition: Insight Report. <https://www.weforum.org/publications/global-risks-report-2024/>

²² Weaver, G. and A. Kendall-Taylor. March 5, 2024. What NATO allies must do to prepare for Russian aggression. Politico. <https://www.politico.eu/article/nato-allies-prepare-russia-aggression-defense-military/>

²³ UK Department for Business and Trade. 2023. Global Trade Outlook. <https://www.gov.uk/government/publications/global-trade-outlook-february-2023-report>

²⁴ Goodman, P.S. Nov. 14, 2023. The Rise and Fall of the World's Most Successful Joint Venture. The New York Times. <https://www.nytimes.com/2023/11/14/business/us-china-economy-trade.html>

Figure 7
 Military conflicts with the involvement of state governments from 2002–2022

Data source: Uppsala Conflict Data Program (UCDP), 2023

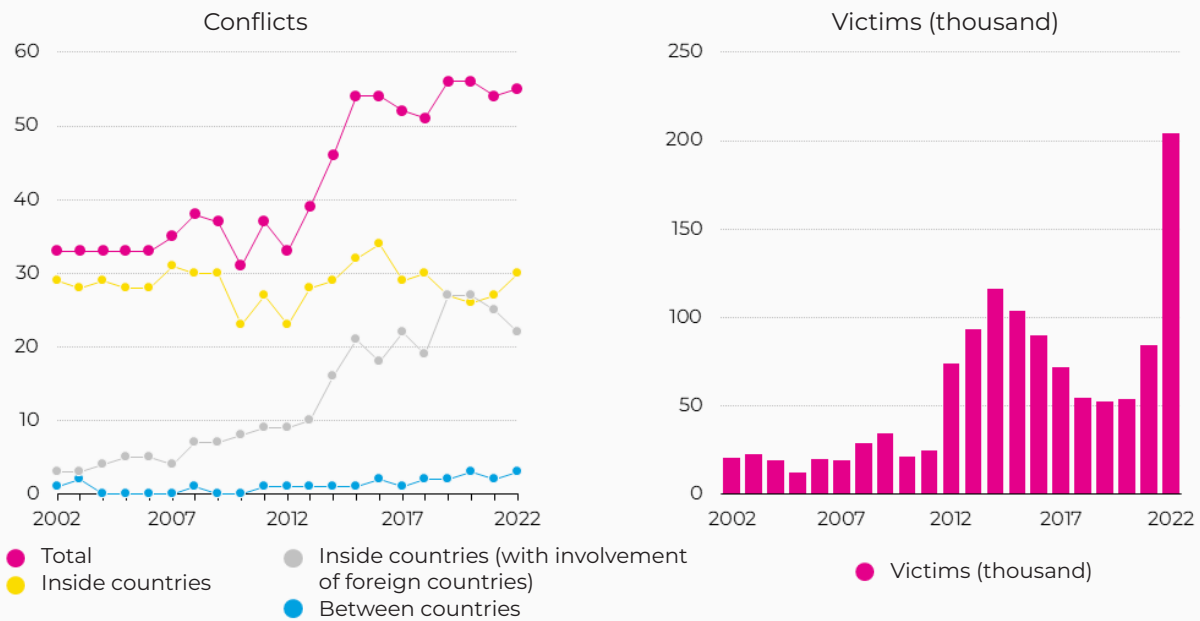
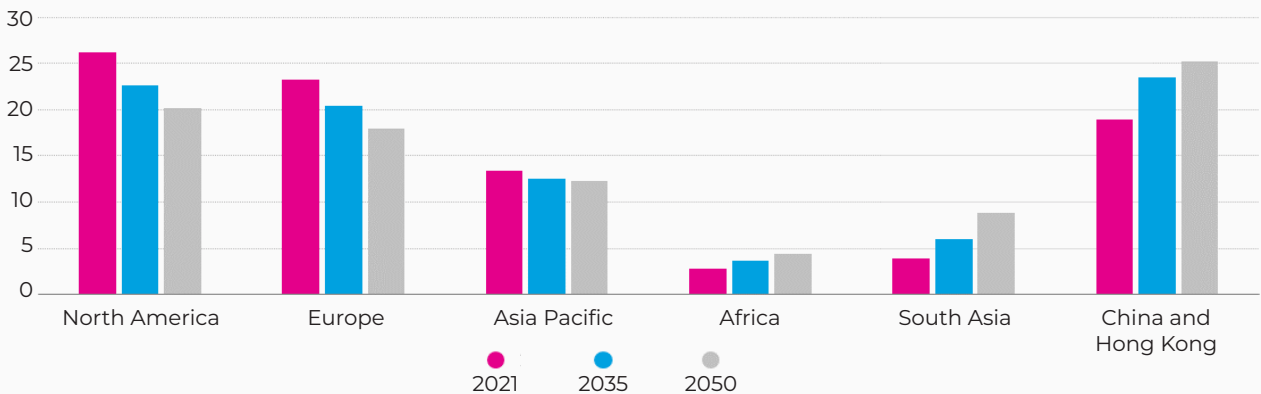


Figure 8
 Gross Domestic Product in global regions in 2021, 2035 and 2050 (% of global GDP)

Data source: UK Department for Business and Trade, 2023



cannot completely prevent certain international trading channels from functioning.²⁵

The role of international institutions (UN, World Bank, World Trade Organization and others), whose decision-making mech-

anisms have proved to be ineffective is declining. In contrast, individual non-state players (non-governmental organisations, religious groups, technology giants and their owners), who have the resources and the ability to impact global processes, are becoming more influential.²⁶

²⁵ Bruegel. 2024. Emerging countries have replaced most of Russia's lost trade with advanced economies. <https://www.bruegel.org/analysis/emerging-countries-have-replaced-most-russias-lost-trade-advanced-economies>
²⁶ Sanger, D.E. and E. Lipton. Nov. 19, 2023. The White House May Condemn Musk, but the Government Is Addicted to Him. The New York Times. <https://www.nytimes.com/2023/11/19/us/politics/elon-musk-white-house-pentagon.html>

The Green Deal and transformation of the energy system

The EU has chosen to implement the Green Deal and to be the leader in the realm of the environment and green technologies, which foresees transformation of the existing economic model and energy system.

The global average air temperature continues to increase. Forecasts indicate that by the start of the 2030s, it could reach 1.5 °C above the global average air temperature mark of the pre-industrial period, which is mentioned in the Paris Agreement as being such that measures should be taken to ensure that it is not breached.²⁷ Some researchers believe that it could happen sooner.²⁸

The 1.5 °C mark set in the Paris Agreement is a political goal that has not been achieved. However, this political failure will have tangible consequences related to various environmental threats. Moreover, their division will not be equal. For example, countries located closer to the Equator will suffer more from increased temperatures.²⁹

The Global Risk Assessment Report published in 2024 by the World Economic Forum (WEF) points out that four out of the five most significant risks that the world will encounter in coming decades are related to the environment. In order to assess the severity of various threats, the WEF surveys experts and leaders from the realms of business, public administration, science, international organisations and civic society. Significantly, representatives from all the aforementioned fields stressed that

environmental problems were the most significant.³⁰

The European Union is a global leader in the realm of the environment and climate action. It has set an ambitious goal to attain climate neutrality by 2050, at the same time providing for the investment of funds and the development of net zero industry. For example, the net zero emission industry act, which EU institutions are currently working to ratify, includes a target by 2030 to ensure that at least 40% of the net zero emission technologies required by the EU (in wind energy, solar thermal energy, batteries, hydrogen, carbon dioxide capture and storage, and in other fields) are produced by domestic companies. In order to achieve this objective, it is planned to ease legal regulation for the production of these technologies, as well as to support EU enterprises and to protect them from unfair international competition.³¹

The transformation of the economy, and that of the energy sector closely linked to it, resulting from climate changes has begun, but historical evidence of the replacement of energy sources globally indicates that transformations are gradual and usually continue for several decades.³² In order to implement the transformation of energy

²⁷ IPCC. 2023. Summary for Policymakers. In: Climate Change 2023: Synthesis Report. Contribution of Working Groups I, II and III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change [Core Writing Team, H. Lee and J. Romero (eds.)]. IPCC, Geneva, Switzerland, pp. 1-34, doi: 10.59327/IPCC/AR6-9789291691647.001

²⁸ Hansen, J., Sato, M. and Kharecha, P. 2024. Groundhog Day. Another Gobsmaekingly Bananas Month. What's Up? <http://www.columbia.edu/~jeh1/mailings/2024/Groundhog.04January2024.pdf>

²⁹ UNDP. 2022. Human Climate Horizons. <https://horizons.hdr.undp.org/>

³⁰ WEF. 2024. The Global Risks Report 2024, 19th Edition: Insight Report. <https://www.weforum.org/publications/global-risks-report-2024/>

³¹ Proposal for a Regulation of the European Parliament and of the Council on establishing a framework of measures for strengthening Europe's net-zero technology products manufacturing ecosystem (Net Zero Industry Act). <https://data.consilium.europa.eu/doc/document/ST-6269-2024-INIT/en/pdf>

³² Smil, V. 2017. Energy Transitions: Global and National Perspectives, 2nd Ed. Santa Barbara, California: Praeger.

Figure 9
Global average air temperature anomalies from 1850–2023 (°C)

Note: Temperature anomalies are calculated as differences between the average temperature in the respective year and that of the 20th century (1901–2000). Data source: NOAA National Centers for Environmental information

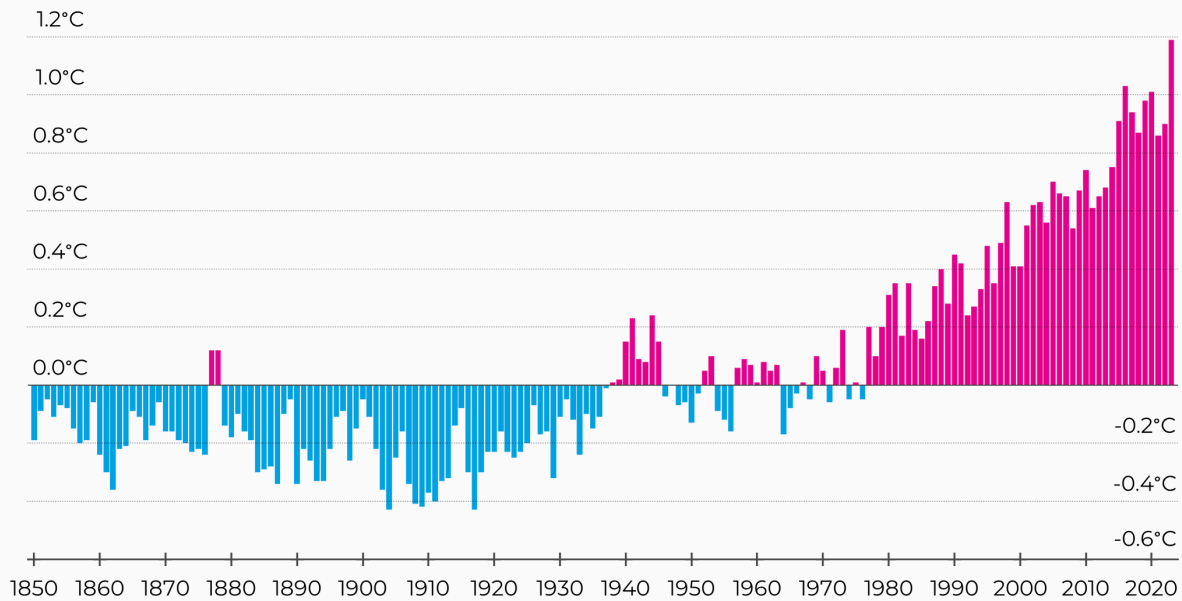
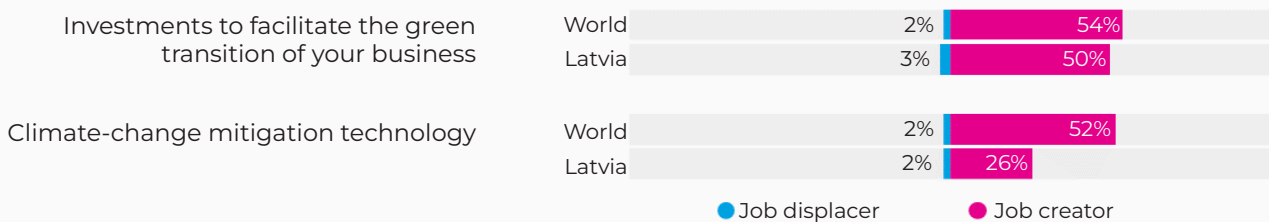


Figure 10
Foreseeable impact of macro trends and technologies on workplaces from 2023–2027

Note: Companies (%), which stated in the survey that specific macro trends and technologies will generate or replace jobs. Companies with a neutral position are not shown in the chart. Data source: WEF



sources at macro level, significant investments are required.³³ Meanwhile, at corporate level, there will be those that already profit in the short-term. For example, the total global capacity of wind farms installed in the period from 2013 to 2022 has more than tripled, reaching 906 GW.³⁴ This opens up extensive development opportunities for globally competitive Latvian companies like Aeronex, which provides maintenance for robotic wind turbines. There could be

more such companies in Latvia. According to the results of a WEF survey of businesses, similar to elsewhere in the world, although the green transformation will generate expenditures for Latvian companies, among other things it will also generate new jobs. However, in Latvia there are fewer businesses that can create jobs due to the impact of technological developments reducing climate changes.³⁵

³³ Schnabel, I. 2023. Monetary policy tightening and the green transition. <https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp230110~21c89bef1b.en.html>

³⁴ GWEC. 2023. Global Wind Report 2023. <https://gwec.net/globalwindreport2023/>

³⁵ WEF. 2023. Future of Jobs Report 2023. <https://www.weforum.org/publications/the-future-of-jobs-report-2023/>

Table 2

5 most important global risks in the next 10 years

Note: Experts had to evaluate the impact of various global risks over coming decades, using a seven point scale.
Data source: WEF, survey of experts conducted in September 2023

Chart ranking	Risk	Risk category
1.	Extreme weather events	Environmental
2.	Critical changes to the Earth systems	Environmental
3.	Biodiversity loss and ecosystem collapse	Environmental
4.	Natural resource shortages	Environmental
5.	Misinformation and disinformation	Technological

Technological development

With the help of existing and rapidly emerging technologies, it may be possible to resolve many of humanity's problems, but their application could also be destructive.

During the next twenty years, technologies will continue to develop, changing our daily lives, and potentially helping to resolve many fundamental problems. For example, increase labour productivity in the same amount as electrification or prevent global warming and climate changes. However, in conditions, where the revenue of tech developers and opportunities to secure investment are dependent on the overall enthusiasm generated by a specific technology, it is hard to predict the development of technologies. For example, artificial intelligence – systems characterised by reasonable behavioural models (the ability of learn, make judgments and solve problematic situations) – could potentially develop so that this technology is used as an assistant by most employees for the performance of routine and repetitive tasks, allowing them to concentrate on creative assignments and innovations. This would make it easier and open up opportunities for anyone to become a scientist or inventor. However, there is also an alternative possibility – arti-

ficial intelligence could replace workers in certain professions, facilitating reallocation of revenue in favour of tech owners, without particularly increasing workforce productivity, but instead fostering income inequality, or mainly finding applications in entertainment.³⁶ In turn, investment analysis of climate technology companies (although less investments have been made in such companies in recent times)³⁷, shows that since 2015 private investments have been allocated more to experienced companies with patented solutions, thus driving up investors' profits, but also making it more difficult for innovative companies to secure funding in the early phases of their development.³⁸

Regardless of the nature of specific technological development scenarios, data is being generated and accumulated in unprecedented volumes. This will open up opportunities for the development of various services, goods and solutions, simultaneous to ongoing concerns about

³⁶ Brynjolfsson, E. and G. Unger. 2023. The Macroeconomics of Artificial Intelligence. IMF Finance & Development.

<https://www.imf.org/en/Publications/fandd/issues/2023/12/Macroeconomics-of-artificial-intelligence-Brynjolfsson-Unger>

³⁷ PwC. 2023. State of Climate Tech 2023: How can the world reverse the fall in climate tech investment?

<https://www.pwc.com/gx/en/issues/esg/state-of-climate-tech-2023-investment.html>

³⁸ Cornelli, G., J. Frost, L. Gambacorta and O. Merrouche. 2023. Climate tech 2.0: social efficiency versus private returns. BIS Working Papers No. 1072. <https://www.bis.org/publ/work1072.htm>

property rights, privacy, access and market concentration. Data and changes in the service sector have facilitated the growing trade in new services (ICT, research, financial, etc.), as a consequence of which exports of new services have more quintupled since 2000, and especially so after the financial crisis of 2007–2008.³⁹

A battle is taking place for the resources necessary for technological development (talented employees, knowledge and natural resources), which will intensify in the near future. This struggle is closely linked to

geopolitical changes and the mutual rivalry between the US and China.⁴⁰ Although the technologies' market is dominated by tech giants based in the world's largest economies, who are trying to monopolise various segments of the market ⁴¹, smaller market players have the chance to become part of the global added value generation chains of technology development. For example, in the artificial intelligence technologies segment, in terms of the level of private investment attracted vis-à-vis GDP during the period from 2015 to 2020, Finland and Estonia are not that far behind the market leaders – US, China, and Israel, etc.

Figure 11
Data generated every minute

Data source: Domo, <https://www.domo.com/data-never-sleeps>

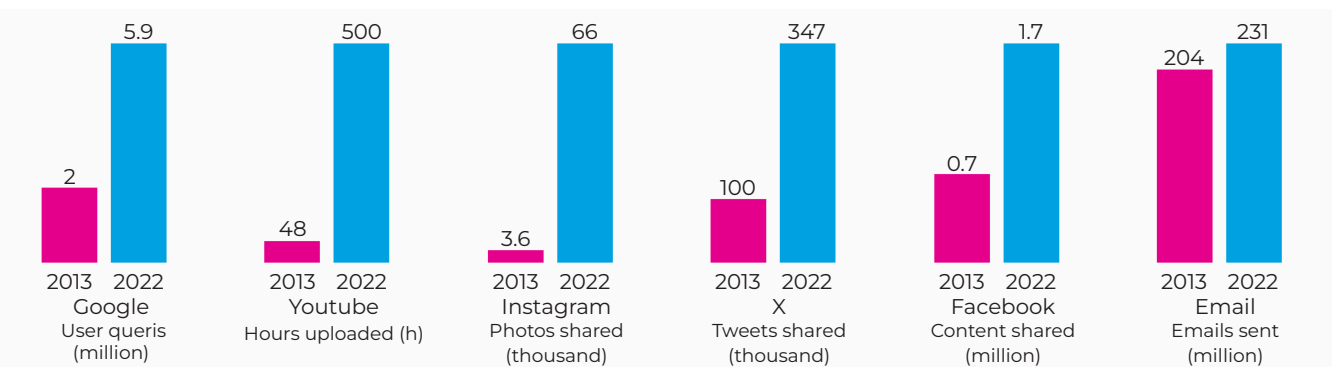
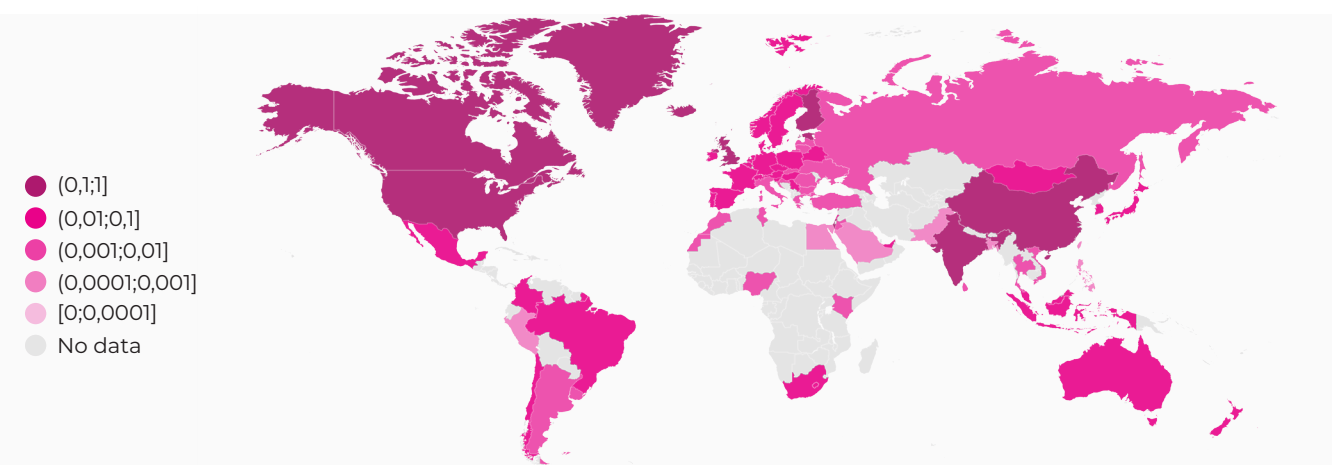


Figure 12
Total private investment in Artificial Intelligence technologies from 2015–2020 (% of GDP)

Data source: Cornelli, G., J. Frost, and S. Mishra. 2023. Artificial Intelligence, Services Globalisation and Income Inequality. BIS Working Paper No. 1135. <https://www.bis.org/publ/work1135.pdf>



³⁹ Mishra, S., I. Tewari, S. Toosi. 2020. Economic complexity and the globalization of services. *Structural Change and Economic Dynamics*, Vol.(53), 267-280. <https://doi.org/10.1016/j.strueco.2020.03.002>
⁴⁰ National Intelligence Council. 2021. *Global Trends 2040: A More Contested World*. <https://www.dni.gov/index.php/gt2040-home>
⁴¹ Elliott, V. and B. Barrett. Mar21, 2024. The US Sues Apple in an iPhone Antitrust Blockbuster. <https://www.wired.com/story/doj-sues-apple-antitrust/>

The downturn in democracy

The proportion of democratic regimes globally is falling and democracy is facing challengers such as polarization of opinions and extremism.

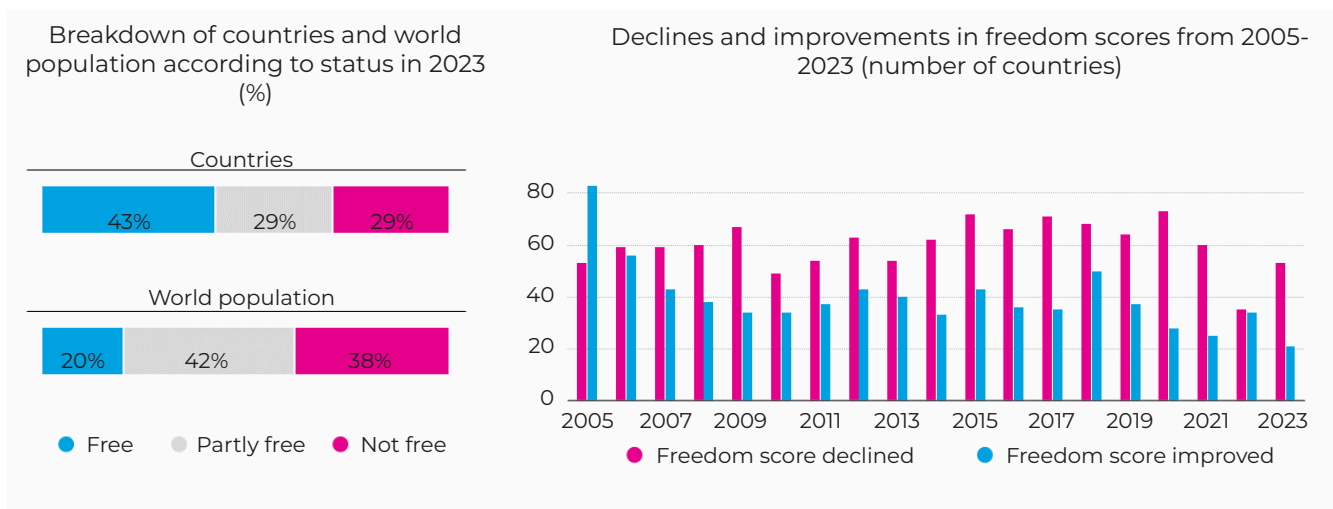
According to the US-based Freedom House Think Tank, after assessing political rights and civil freedoms, in 2023, 83 countries around the world can be considered to be free. 34 of these free countries are in Europe and one of them is Latvia. Several of the world's biggest countries in terms of population are not free (e.g. China and India). Therefore, although the proportion of free countries is relatively high (43%), they are home to only 20% of the world's inhabitants. Since 2005, every year the number of countries in which the situation is deteriorating in terms of freedom exceeds the number of countries in which improvements can be observed. In 2023, freedom assessments fell in 52 countries, and this impacted one fifth of the world's inhabitants. In almost all cases, the reduction in the freedom assessment was precipitated by an assault on pluralism, which manifested itself in the form

of manipulation of elections and violence.⁴²

Polarization of opinions sourced from like-minded groups is widespread and continues to grow. Such polarization is often closely linked to a lack of tolerance, as well as the denial of mutual discussions and the possibility of compromise, which are so vital to the democratic process. Behavioural models of this ilk give rise to an increasing likelihood that the democratic process is becoming dysfunctional and will result in political impasses.⁴³ Domestic provocateurs and foreign agents exploit polarization of opinions to spread confusion, reduce people's mutual trust and faith in democratic institutions. Such provocative campaigns thrive on people's connections in the digital environment, which is susceptible to the application of cyberpsychology, using various rapidly progressing technological

Figure 13
Assessments of freedom and changes in them in countries around the world

Note: Increases or reductions in assessments of freedom do not always correspond to change in the status (free, partly free, not free) of a country's classification.
Data source: Freedom House



⁴² Freedom House. 2024. Freedom in the World 2024: The Mounting Damage of Flawed Elections and Armed Conflict. https://freedomhouse.org/sites/default/files/2024-02/FIW_2024_DigitalBooklet.pdf
⁴³ UNDP. 2024. Human Development Report 2023/2024. Breaking the Gridlock: Reimagining Cooperation in a Polarized World. <https://hdr.undp.org/content/human-development-report-2023-24>

solutions.⁴⁴ As a result, apathy is increasing among the public along with a reluctance to get involved in resolving issues of social importance. In order for the situation to improve, responsible communication practices need to be introduced, critical thinking skills must improve, and controllable platforms for constructive social dialogue have to be built.⁴⁵

An ever-increasing role in the democratic process is being played by politicians as personalities, who often cast a shadow over the political parties they represent.⁴⁶ To a certain extent, this makes politicians more accessible to society. At the same time, the political process is becoming increasingly reminiscent of a popularity contest, giving rise to the risk that debates about socially

significant issues will be left in the background or avoided altogether. Likewise, with the heightened focus on personalities, the institutional environment is not sufficiently appreciated, because people get the feeling that certain problematic situations can only be resolved by a specific politician or, on the contrary, that another politician is not suitable for any role.

At the same time, geopolitical changes (Russia's invasion of Ukraine, China's economic growth, albeit retaining a repressive political regime) have precipitated the realization of the acute necessity to protect democratic values, as well as to seek solutions to increase participation and to improve the decision-making process.⁴⁷

Demographics and global migration

People from regions with a rising population and limited business and employment opportunities will seek more favourable circumstances elsewhere.

The United Nations (UN) forecasts that the global population will continue to increase and will reach 9.2 billion in 2040. However, the pace of growth will continue to fall, and situations will vary in various regions of the world. China's population is already falling, and by the mid-2030s the population size will start to fall throughout the East Asia and Southeast Asia region. Since 2023, more people now reside in India than in China, but there too, as throughout the region of Central Asia and South Asia, population growth rates are declining. In Europe too, the population size is falling and will continue to do so. In contrast, the population of Sub-Saharan Africa is not only rising, but its rate of growth will increase until the

mid-2040s, as a result of which in 2030 the Sub-Saharan region of Africa will be responsible for half the increase in the size of the global population. The median age of the population in Africa is 19 years, whereas in Europe it is 42 years.⁴⁸

At the same time, the quality of life is developing and is significantly different in less-developed countries. As a result of the Covid-19 pandemic and other global upheavals, in 2020 and 2021 for the first time since the calculations have been made, there was a reduction in the value of the UN-published global Human Development Index (HDI)⁴⁹. Assessments for 2023 show that in many countries the

⁴⁴ Van Bavel, J., S. Rathje, E. Harris, C. Robertson and A. Sternisko. 2021. How social media shapes polarization. *Trends in Cognitive Sciences*, Vol. 25 (11). <https://doi.org/10.1016/j.tics.2021.07.013>

⁴⁵ Sitra. 2023. *Megatrends 2023. Understanding an era of surprises*. https://media.sitra.fi/app/uploads/2023/03/sitra_megatrends-2023_v3.pdf

⁴⁶ Garzia, D., F. Ferreira da Silva and A. De Angelis. 2022. Partisan dealignment and the personalisation of politics in West European parliamentary democracies, 1961–2018. *West European Politics*, Vol. 45(2). <https://doi.org/10.1080/01402382.2020.1845941>

⁴⁷ Sitra. 2023. *ibid.*

⁴⁸ United Nations, Department of Economic and Social Affairs, Population Division (2022). *World Population Prospects 2022*, Online Edition.

⁴⁹ Human Development Index calculations take into account per capita gross national income, the foreseeable length of inhabitants' lives and the level of education.

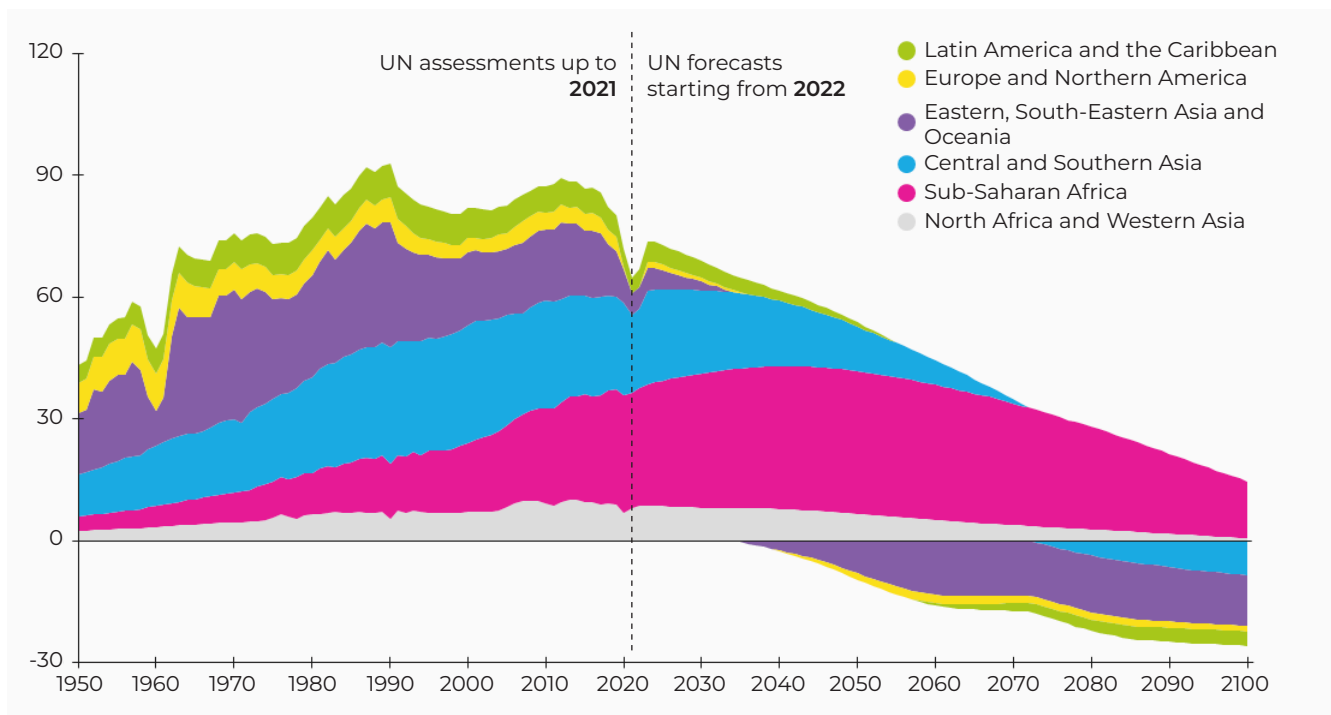
situation has improved and the global index value has exceeded the 2019. However, the improvements are uneven – all the OECD and other developed countries have recovered, but approximately half of the less-developed countries are still below the 2019 level, and inequality between developed and least developed countries, which had fallen since the start of the 21st century until 2019, continues to grow.⁵⁰

While less-developed countries seek growth opportunities, in developed countries there is increasing talk of restricting consumption and growth.⁵¹ However, most income inequality is made up of domestic inequality rather than inequality between countries. In 2020, approximately two third of global income inequality was linked to domestic inequality. Moreover, the greatest domestic income inequality is in the regions of the Middle East, Africa and Latin Amer-

ica.⁵² Accordingly, at the individual level in the world's less developed regions, the lack of economic opportunities combined with the unfavourable impact of climate changes is generating and will continue to generate pressure to seek opportunities for a better quality of life elsewhere. Migration flows are hard to predict, because they are closely linked to national migration policies, which are prone to change. Recent experience shows that the majority of migration is linked to employment. For the most part, people from countries with average incomes are relocating to countries with high incomes, in order to receive bigger wages, and to send part of their income become to their home countries.⁵³ The second migration flow is comprised of refugees fleeing military conflicts and other catastrophes. As shown by Russia's invasion of Ukraine, changes in the geopolitical situation could significantly increase this flow.

Figure 14
Changes in population sizes in global regions from 1951–2100 (millions)

Data source: United Nations, Department of Economic and Social Affairs, Population Division



⁵⁰ UNDP.2024. Human Development Report 2023/2024. Breaking the Gridlock: Reimagining Cooperation in a Polarized World. <https://hdr.undp.org/content/human-development-report-2023-24>

⁵¹ Hickel, J., G. Kallis, T. Jackson, D.W. O'Neill, J.B. Schor, J.K. Steinberger, P.A. Victor and D. Ürge-Vorsatz. 2022. Degrowth can work - here's how science can help. *Nature*, 612(7940), 400-403. <https://doi.org/10.1038/d41586-022-04412-x>

⁵² World Inequality Lab. 2021. World Inequality Report 2022. <https://wir2022.wid.world/>

⁵³ National Intelligence Council. 2021. Global Trends 2040: A More Contested World. <https://www.dni.gov/index.php/gt2040-home>

3. LOCAL DRIVING FORCES

Innovations and use of new technologies

The development of the Latvian economy has reached the level, where to ensure future growth, in some fields at least it will be necessary to consistently use or create the most modern technologies in the world.

Better technologies make it possible to use the resources available to a country more efficiently. Technologies can either be created locally or created elsewhere, in which case they can be adapted to meet your requirements. In any case, one has to anticipate that investments will be required to introduce new technologies. Macro level data regarding investments in research and development testify that in this regard Latvia is lagging behind the leading countries significantly. During the past five years, Latvia has annually invested an average of 0.7% of GDP in research and development, whereas the corresponding investments made by leading countries exceed 3% of GDP. Our neighbouring countries of Lithuania and Estonia also invest more than Latvia in research and development. The majority

of research and development investments are usually made by companies. Of the comparable countries, Latvia and Lithuania are the only ones whose proportion of total investments by government and the higher education sector exceeds the investment made by businesses.

Meanwhile, the public investments have not been effective. Assessing business innovation support policies, the State Audit Office has concluded that the public funding (EUR 681 million) invested in business innovations during the period from 2014-2020 has not accomplished its objective of improving business competitiveness and productivity. The auditors acknowledge that while the range of support measures offered is sufficiently broad and similar to

Figure 15
Average investments in research and development from 2018–2022 (% of GDP)

Note: USA data are for the period from 2018–2021.
Data source: Eurostat

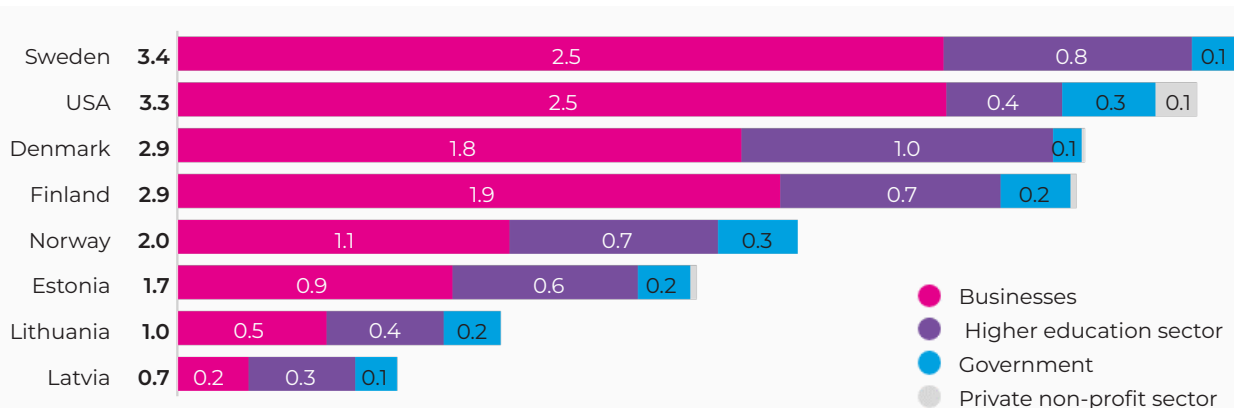
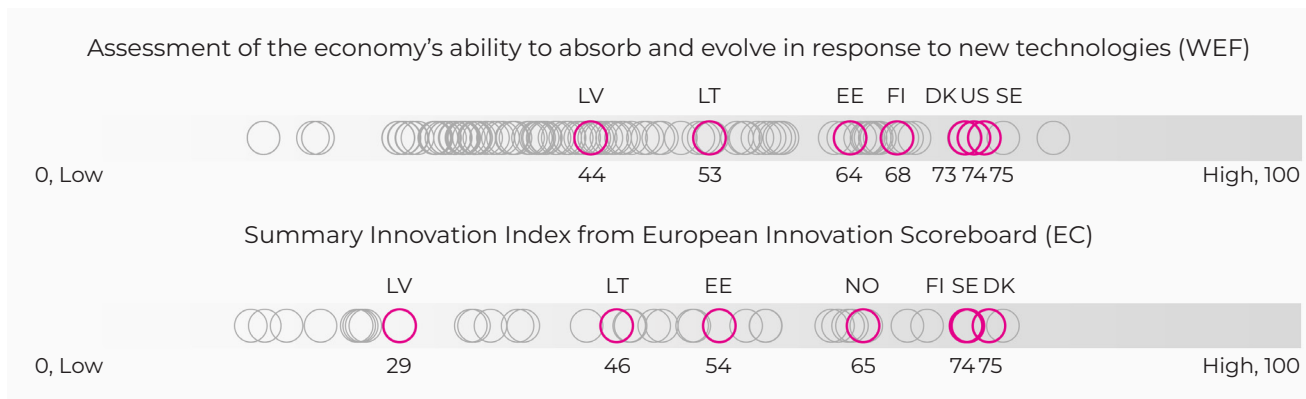


Figure 16
Assessment of innovation systems in international comparisons

Note: Scale used for assessment is [0;100]
 Data source: WEF, EC



measures offered elsewhere in the EU, the results are unsatisfactory. One of the reasons mentioned is the weak link between the result metrics and the attainable policy goals.⁵⁴

In international comparisons of innovation systems, Latvia lags behind both the Nordic countries and the other Baltic States. For example, the summary assessment of Latvian innovation in the European Com-

mission's European Innovation Scoreboard 2023 was 29, which is equivalent to only 53% of the EU-27 average indicator, and which ranks Latvia alongside Bulgaria, Romania, Poland and other countries among "Emerging Innovators".⁵⁵ Likewise, the World Economic Forum (WEF) rates the ability of the Latvian economy to adapt and develop to the point of technological progress lower than the ability of the Lithuanian, Estonian and Nordic economies to do so.⁵⁶

Human capital

Investments in human capital can be profitable for individuals, and society as a whole, but they must be prudent and results-oriented.

Investments in human capital, which improve people's skills and aptitudes, increase productivity and ultimately economic growth. However, benefits tend to manifest themselves in full in the long-term, and investments must bear fruit (e.g. better test results), as opposed to merely increasing the amount of time spent on training.⁵⁷

The results of the international schoolchildren's assessment programme PISA show that compared to the equivalent group of youngsters who took the test in 2018, the group of fifteen year old Latvian adolescents, who took the test in 2022, have approximately the same reading skills, slightly better knowledge of natural sciences, and

⁵⁴ State Audit Office. 2023. Performance Audit No.2.4.1-32/2021 "Is entrepreneurial innovation policy planning and implementation efficient and does it foster increased business productivity and competitiveness?" <https://lrvk.gov.lv/getrevisionfile/29729-F-V3tNt7cMMHDDbKgWHWCeFkiRLTdqU9.pdf>

⁵⁵ European Commission. 2023. European Innovation Scoreboard 2023. <https://data.europa.eu/doi/10.2777/119961>

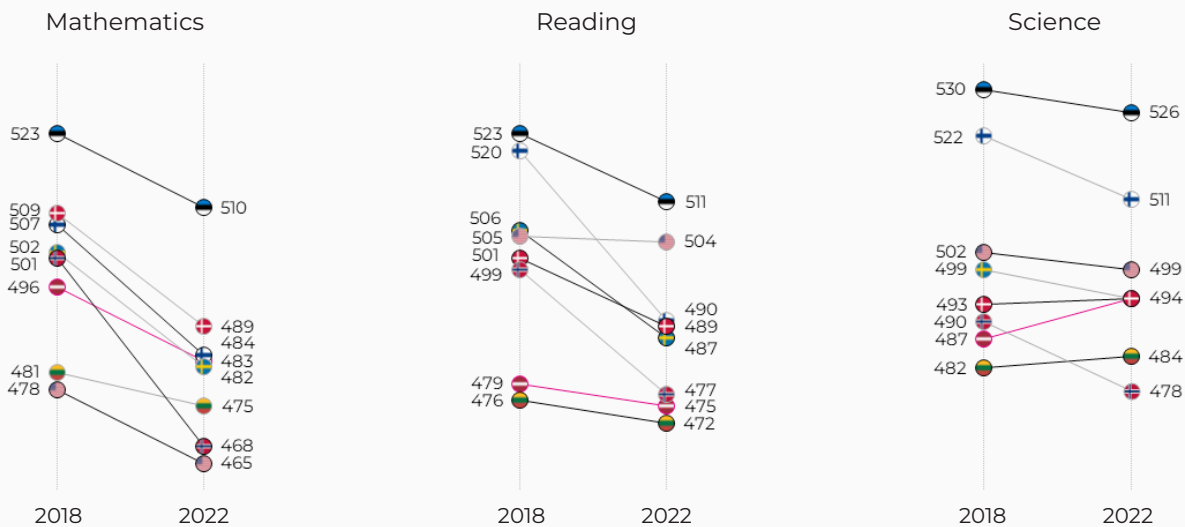
⁵⁶ WEF. 2024. The Future of Growth Report 2024.

https://www3.weforum.org/docs/WEF_Future_of_Growth_Report_2024.pdf

⁵⁷ OECD. 2022. Value for Money in School Education Smart Investments, Quality Outcomes, Equal Opportunities. <https://doi.org/10.1787/f6de8710-en>

Figure 17
PISA results in mathematics, reading and science in 2018 and 2022

Data source: OECD



worse knowledge of mathematics. Among the Baltic States and Nordic countries, Estonia stands out, with the best results in all PISA sections. However, compared to 2018, there was a statistically significant decline in Estonia's results in both mathematics and reading.⁵⁸ Of course, the teenagers who took the test in 2022 were studying during the Covid-19 pandemic. To a certain extent, this makes the results harder to compare, but, perhaps, in-depth data analysis will provide a clearer picture of how schools differ in various countries and what their contribution is to the youth education process.

If one looks at human capital from an entrepreneurial perspective, currently, and in all probability in the immediate future too, on average it will be harder to find talented young employees in Latvia than elsewhere in the world. It will be easier to raise the qualifications of existing employees and to try to prevent the flight of employees to other businesses.

Logically, more so than elsewhere in the world (+23 pp), in the next five years Latvian

businesses plan to engage in the improvement and requalification of their employees' skills. In their qualification upgrading and requalification campaigns, alongside skills training (e.g. analytical thinking), Latvian businesses include courses aimed at fostering attitudinal changes (e.g. encouraging thirst for knowledge). However, in contrast to the prevailing practice in the rest of the world, they focus less on artificial intelligence and big data training, as well as the development of creative thinking.⁵⁹

If we want to ensure that investments in human capital deliver the biggest possible return, we need to focus more on analysis of the results of the educational process and find solutions that will work in specific instances, aware that they could also require significant financial resources. For example, there is an acute need for information about which children suffered the most from changes in the teaching process during the Covid-19 pandemic, and what can be done to recover these losses, and so that children grow up have more opportunities to find good jobs or to develop their businesses.

⁵⁸ OECD. 2023. PISA 2022 Results (Volume I). The State of Learning and Equity in Education. <https://doi.org/10.1787/53f23881-en>

⁵⁹ WEF. 2023. Future of Jobs Report 2023. <https://www.weforum.org/publications/the-future-of-jobs-report-2023/>

Figure 18
New employee hiring and existing employee development and retention trends from 2023–2027

Note: Companies (%), which stated in the survey that prospects are positive or negative. Companies with a neutral position are not shown in the chart.
 Data source: WEF

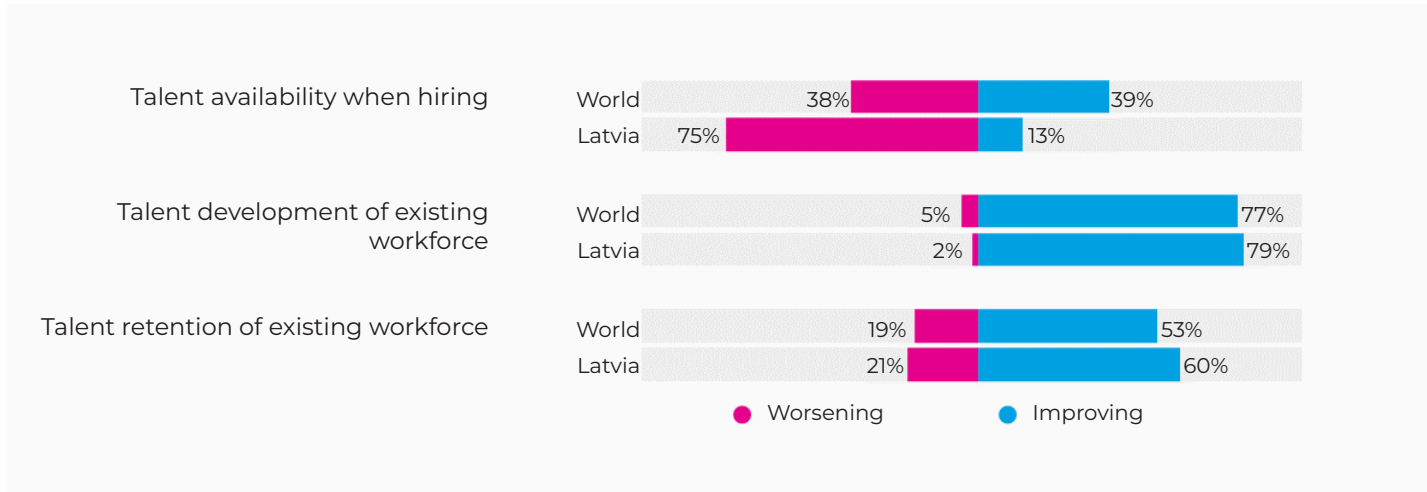
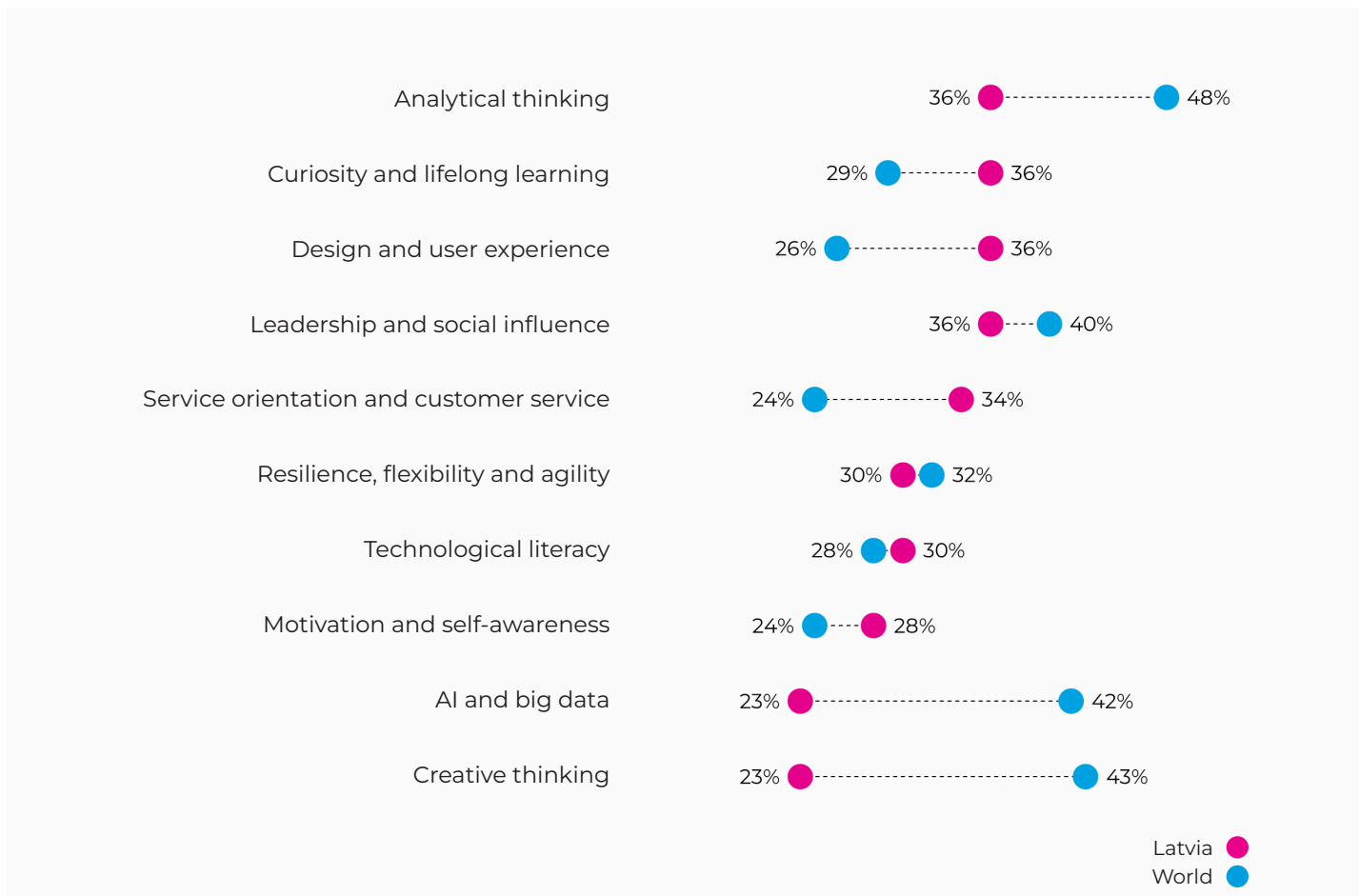


Figure 19
Upskilling and requalification from 2023–2027

Note: Companies (%), which have included the relevant skills and aptitudes in their skill improvement and requalification strategies.
 Data source: WEF



Lack of trust in the political system

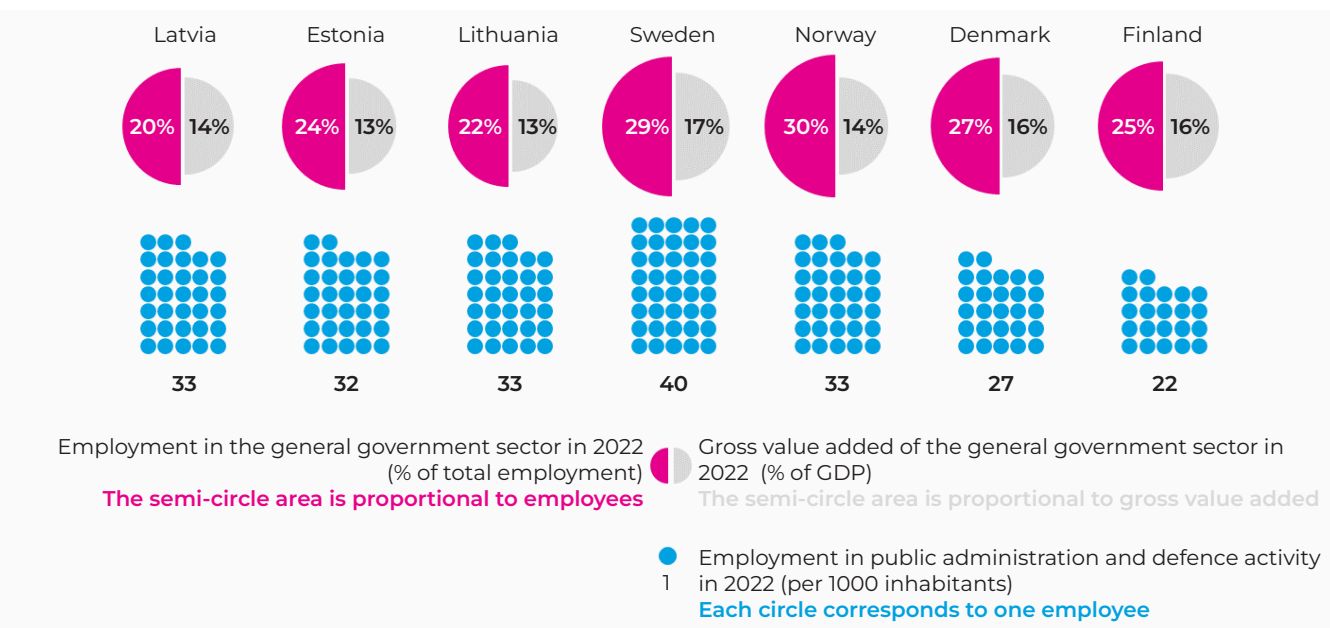
While the private sector will be the main generator of added value, the efficiency of the state and municipalities will also have a significant bearing on the competitiveness of businesses and inhabitants' quality of life.

Regardless of what we do for a living, in various ways we all encounter services provided by the state. Although, naturally, there are cases in which these services meet our expectations, overall one often hears dissatisfaction with bureaucracy and demand exists for improvements in quality. In a free market economy, the majority of added value is generated by the private sector. This economic structure is also characteristic of Latvia, where during the past twenty years, in terms of added value, the general government sector's ratio to GDP has exceeded the 15% mark only in individual years during economic crises. In all likelihood, the respective proportions of the public and the private sectors are not

going to change significantly any time soon. In contrast, as an employer the general government sector plays an important role. In Latvia, it provides 20% of all jobs. In Lithuania and Estonia, comparatively more employees are employed in the general government sector than in Latvia, whereas in Sweden and Norway the sector's share of total employment reaches 30%. According to the World Economic Forum (WEF), the ability to empathise and actively listen to one's conversational partners is increasingly prized in the job market, along with the aptitude to train and pass on experience.⁶⁰ These are things that people are still better able to do than machines and which are also vitally important in the sectors (education,

Figure 20
The share of general government and public administration in employment and the economy in 2022

Note: General government sector (S13) employment and gross value added data are from non-financial national accounts (nasa_10_nf_tr), while public administration and defence (O chapter, NACE 2nd edition) employment data are from labour force surveys (lfsa_egan2).
Data source: Eurostat



⁶⁰ WEF. 2023. Future of Jobs Report 2023. <https://www.weforum.org/publications/the-future-of-jobs-report-2023/>

health, social care, etc.), in which the state and municipalities, both in Latvia and in many other places around the world, play an important role.

However, from the perspective of the competitiveness of the state and inhabitants' quality of life, it is vital that, when engaging in the provision of services and the production of goods, the general government sector does so efficiently. In Latvia, both governmental and municipal bodies fail to engage in the systematic assessment and improvement of their work. For example, one of the conclusions of the audit conducted by the State Audit Office into state support for adult education is that training programmes to date have not been targeted with the objective of increasing Latvia's human capital and the productivity of its labour force. A second conclusion is that by preventing the overlapping of the functions of the State Employment Agency (SEA) and the State Education Development

Agency (SEDA) in implemented adult education projects, savings of EUR 3.6 million could have been made.⁶¹ Regardless of the recommendations of the State Audit Office, the formal approach to the requalification of the labour force that is so vital these days and the overlapping of functions may also be maintained during the EU fund planning period.⁶² In turn, according to Latvijas Banka, there are countries that can perform the more narrowly defined function of public administration with fewer human resources than Latvia. In 2022, in Latvia, 33 employees were employed in public administration and defence per 1,000 inhabitants. By reaching the average public administration employment ratio of the leading six countries, Latvia could employ almost 17,000 fewer public administration employers than in 2022.⁶³ Public demand exists and will continue to grow for a political system that would make it possible to better identify and prevent public administration inefficiency.

Budgetary pressure

Russia's ongoing aggression in Ukraine and its readiness for a long-term confrontation with the West, as well as public ageing will generate growing pressure on the state budget.

Security will continue to have a significant bearing on our everyday lives for the foreseeable future. The Law on National Defence Funding stipulates that in 2027 and in the years thereafter, state budget funding must meet 3% of GDP.⁶⁴ Since the adoption of the law in 2014, and as a result of increased state budget funding allocated to defence, the law has already been amended (upwards) twice and could also be amended in future. According to experts, increased strategic defence spending by

Europe's NATO member states could help to prevent attacks and would certainly be less costly than engaging in a military conflict.⁶⁵

In the face of increased defence expenditures and incomes that are not increasing, there will be less funds available for other government functions. The situation is further exacerbated by demographic forecasts. Latvian society is ageing. In 2022, in Latvia, the old age dependency ratio, which shows the number of retirement age

⁶¹ State Audit Office. 2023. Performance Audit No.24.1-28/2022 "Is adult education achieving the goals set for it and does it correspond to the requirements of the job market?" https://lrvk.gov.lv/lv/getrevisionfile/29674-aXG8JkMeWey4rSzxQU_G5KPDJZNNLrEm.pdf

⁶² State Audit Office. 2024. The State Audit Office objects to the formal approach to adult education "reforms". <https://lrvk.gov.lv/lv/aktualitates/valsts-kontrole-riebilst-pret-pieauguso-izglitibas-reformu-formalo-pieeju>

⁶³ Latvijas Banka. 2024. Experts' discussion "How to achieve durable growth for the Latvian economy?" https://www.makroekonomika.lv/sites/default/files/2024-03/Uldis_Rutkaste_Ekspertu_saruna_MARTS_2024.pdf

⁶⁴ Law on Financing National Defence. <https://likumi.lv/ta/id/267469>

⁶⁵ Weaver, G. and A. Kendall-Taylor. March 5, 2024. What NATO allies must do to prepare for Russian aggression. Politico. <https://www.politico.eu/article/nato-allies-prepare-russia-aggression-defense-military/>

inhabitants per 100 inhabitants of working age, was 31. It is forecast to be 39 in 2030, and 45 in 2040.⁶⁶ Pensions are an important public expenditure item, and forecasts indicate that in future in Latvia, there will be more pensioners per each inhabitant of each age. Of course, age in itself does not mean that people can be active and employed. However, data shows that in Latvia, the skills of middle-aged and older men

in particular, their engagement in lifelong education, health self-assessments and employment level are comparatively low.⁶⁷ The experience of Nordic countries shows that these indicators can be improved, but this will also require an increase in government expenditures for health care, lifelong education and other active job market policy initiatives, as well as their more efficient and effective expenditure.

Figure 21
Actual and planned national defence funding from 2014–2027 (% of GDP)

Data source: Law on Financing National Defence

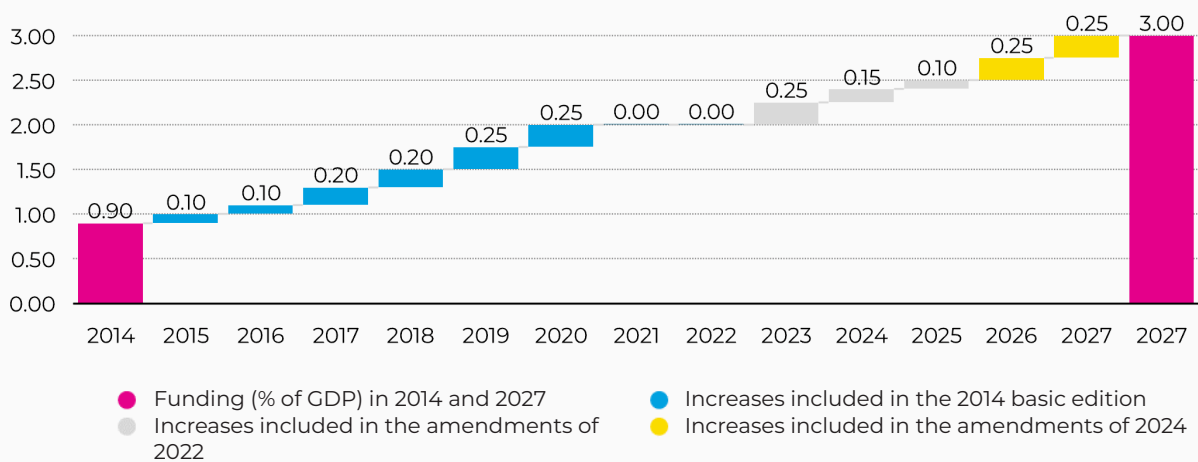
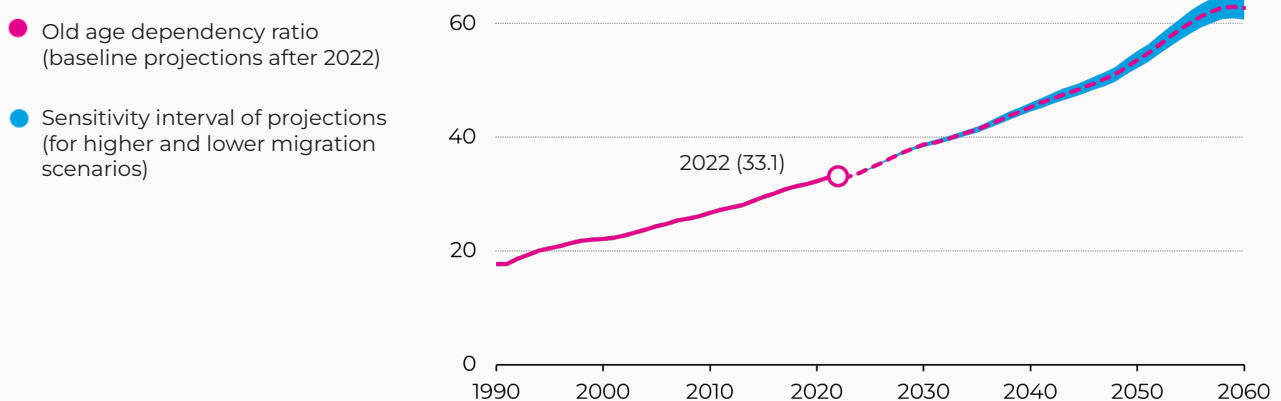


Figure 22
Actual and projected old age dependency ratio from 1990-2060 (per 100 inhabitants aged 15-64)

Note: The old age dependency ratio is calculated as the ratio of senior citizens (65 years old and older) per 100 inhabitants of working age (15-64); values after 2022 are Eurostat projections
Data source: CSP, Eurostat



⁶⁶ Eurostat. 2023. Projected old-age dependency ratio.

https://ec.europa.eu/eurostat/databrowser/view/tps00200__custom_10537285/default/table?lang=en

⁶⁷ Krasnopjorovs, O. 2024. How to achieve DURABLE Latvian economic growth? The way to empower human capital. <https://www.makroekonomika.lv/raksti/ka-panakt-noturigu-latvijas-tautsaimniecibas-izaugsmi-cilvekkapitala-specinasanas-cels>

Riga as the driving force for the Latvia's growth

There has to be something there – reach out and get it...

Gustavo

Cities are the engines of national economies. They offer opportunities to concentrate skills, knowledge and technologies, which could potentially benefit businesses, their employees and all urban inhabitants.⁶⁸ Riga has extensive opportunities to develop this vital agglomeration of economic components. However, the track record since the regaining of independence has not been successful. As a case in point, consider population dynamics, i.e. the vehicle for the knowledge required to drive development. In this respect, Riga is more reminiscent of Kaunas than Vilnius and Tallinn. From 1990 to 2022, in terms of its population size, Riga has become one third smaller. Meanwhile, in the past decade the populations of both Tallinn and Vilnius have tended to increase.

In recent years, attempts have been made to highlight Riga's potential in various formats. For example, the Certus Think Tank and Ēter Strategy have pointed out the advantages that could be provided by the development of a housing fund within the territory of Riga's railway commuter belt. Increasing population density within the commuter belt could foster the revitalisation of the city centre and turn Riga into a compact residential metropolis.⁶⁹ In turn, economists from Latvijas Banka have concluded that, even with the current population size and available funding, in Riga the quality of life could be improved by concentrating on aspects of vital importance to the city such as governance, safety and the urban environment.⁷⁰

Nationally, Riga is often juxtaposed with the development of Latvia's regions. This approach puts the brakes on Riga's growth, because the whole of Latvia only stands to benefit if Riga becomes an internationally competitive Nordic metropolis. Some benefits would not be generated automatically; for instance, not only would investment be required to ensure that the regions have access to the abundance of knowledge concentrated in Riga, but this beneficial concentration of knowledge would first need to be built.

As far as the future is concerned, Riga is primarily not just a place that is marked on a map, but people who are ready to identify with it. The more different connections Riga can succeed in establishing and maintaining, the more useful solutions it will be possible to create. Viewed from this perspective, the providers of benefits to Riga will be Rigans, who currently live and work elsewhere in the world, concurrently maintaining their connection to their friends and business partners who have remained in Riga, as well as young people who have gone abroad to study or who have come to Riga to study, and people who have been forced to take up residence in Riga due to Russia's invasion in Ukraine. Riga also has its young Argonauts⁷¹ – enterprising professionals, who are constantly in touch with global knowledge and technology centres. To a great extent, the answer to the question of whether or not we will be able to fulfil Riga's potential, is dependent on whether or not Riga becomes an attractive place for these various connections to link up.

⁶⁸ Rosenthal, S. and W.C. Strange. 2020. How Close Is Close? The Spatial Reach of Agglomeration Economies. *Journal of Economic Perspectives*, Vol.34(3), 27-49. <https://doi.org/10.1257/jep.34.3.27>

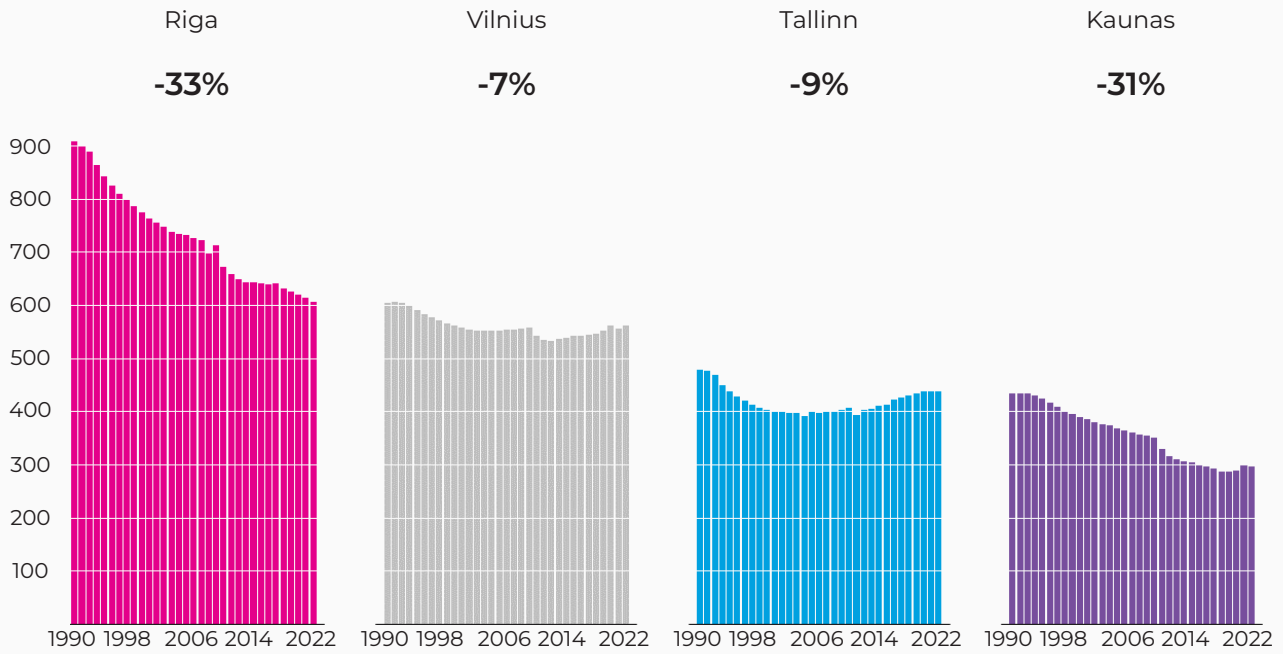
⁶⁹ Certus un Ēter Strategy. 2020. Riga X. <https://www.rigax.lv/>

⁷⁰ Latvijas Banka. 2022. Experts's discussion: How can Riga not lose out in the Baltic contest and regain its status as a European metropolis? <https://www.makroekonomika.lv/eksperetu-sarunas/eksperetu-saruna-ka-rigai-nezaudet-baltijas-sacensiba-un-atgut-eiropas-metropoles>

⁷¹ Saxenian, A. 2006. *The New Argonauts: Regional Advantage in a Global Economy*. Cambridge, MA: Harvard University Press.

Figure 23
 Population of the cities of the Baltic States from 1990-2022 (thousand)

Data source: Eurostat



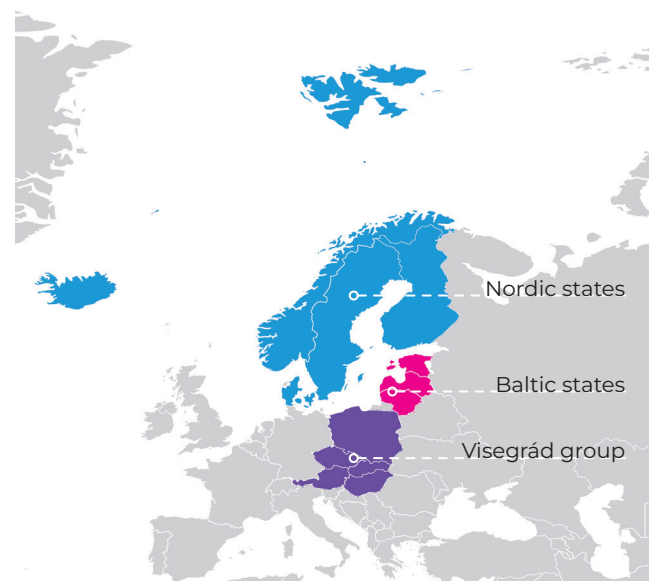
4. SCENARIOS

Scenario 1. A Baltic Tiger

Russia's war on Ukraine saw the three Baltic states swiftly deepen and enhance their cooperation throughout the 2020s. This intense collaboration initially focused on the defence sector as the Baltic states constructed a new joint Baltic Defence Line on their eastern borders, deepened their already established cyber-security cooperation and undertook major joint military procurements. This positive cooperation, to which both politicians and public could clearly see the benefits, then shifted into other key projects of mutual benefit, with unexpectedly rapid completion of the Rail Baltic project in 2030 and the decision to form a joint cross-Baltic rail management company. The Estonian and Lithuanian governments bought into airBaltic, wiping out its debt to the Latvian government, and creating a pan-Baltic flag carrier. The three states further integrated their energy markets through common investments in wind, hydro and nuclear energy infrastructure. A Baltic football league saw Latvian football clubs grow the economic muscles needed to regularly compete in European football. A single, Baltic foreign direct investment (FDI) agency, with an American national at the helm, replaced the three national agencies. It markets the 6 million+ Baltic region as a tightly integrated, connected, modern, and innovative digital region.

Emboldened by encouraging experiences of cooperation and international leadership, Baltic leaders experimented with ever more innovative, bold, and creative forms of integration. The Baltic states aligned their tax systems and competition between the three is now focused on the comparative quality of available infrastructure, human capital, innovation and productivity rather than tax-dumping. As FDI temporarily

Map 2
Northern Europe



slowed in the mid-2020s economic policy-makers refocused their efforts away from attracting international businesses to the region to focusing on the more difficult challenge of supporting domestic businesses in their efforts to develop new products and services and reach new international markets.

In the diplomatic field, the three states shared the costs of building architecturally distinctive *plyscrapers* (tall, substantial buildings constructed from wood), known as “Baltic Houses” and hosting joint Estonian, Latvian and Lithuanian diplomatic representations in key global cities including Washington D.C., Beijing, London, Paris and Seoul.⁷² A striking 25,000 seat national sports stadium on the banks of the Daugava River in Riga, entirely constructed from Latvian wood, has become the city's calling

⁷² Similar to the pan-Nordic Embassy building complex in Berlin. <https://www.nordischebotschaften.org/nordic-embassies-berlin>

card to the world. International demand for Baltic designed high-concept wooden constructions has boomed hand-in-hand the growing international *zeitgeist* for sustainability.

Regional ties were institutionalized in even deeper political cooperation in the existing Baltic cooperative institutions – the Baltic Council of Ministers and the Baltic Assembly – with the priorities of the former bought into line with the standing committees of the latter. These institutions were key in pushing for more deeply integrated Baltic energy networks, Estonian and Lithuanian investments in airBaltic and creating a common Baltic health system. Politically, the Baltic states use their newfound political confidence to navigate between the Nordic 3 and the Visegrad 4 in the European Council of Ministers.

These economic, political and cultural integration efforts attracted international attention with the three states receiving further positive international media attention for offering a secure home for Ukrainian refugees, who were swiftly and successfully integrated into the labour market, education system and broader society. At the same time, generous military and financial aid to Ukraine in its war with Russia, and consistent diplomatic support, saw a new generation of Baltic politicians emerge as European thought leaders driving efforts to modernize NATO and reform the European Union.

A new and positive common Baltic identity emerged based on technological achievements (such as all three countries adopting digital voting in elections and moving all public services online), harmonious cross-border-cooperation and a unique common culture that binds the pagan with the modern. In the 2030s previous international fads for Nordic food, design and culture (such as *fika* and *hygge*) were replaced by demand for Baltic culture. The Baltic midsummer celebration (*Jāņi* in Lat-

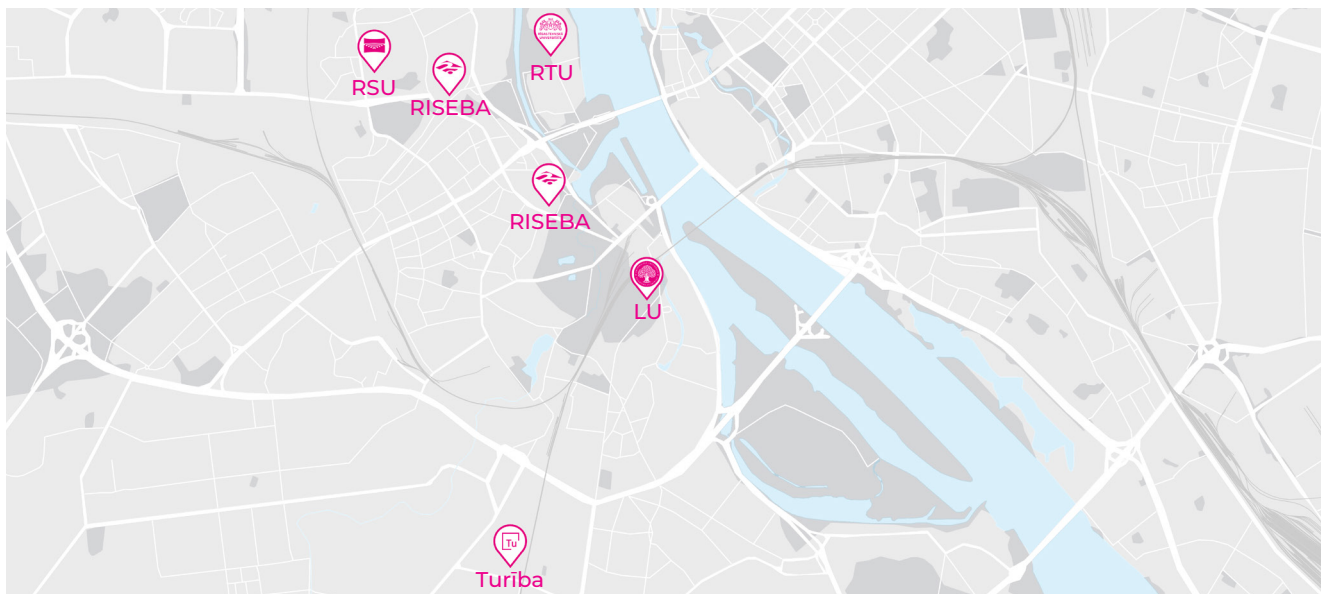
via, *Saint Jonas* in Lithuania and *Jaanipäev* in Estonia) became an international event and tourists flock to the Baltic states for the long summer nights and the refreshingly cold winters.

Latvia, the geographic centre of the Baltic region, has been the greatest beneficiary of deeper ties between the three states, as Estonia pivoted away from Finland and Lithuania away from Poland. Riga naturally emerged as the beating economic and trading heart of this dynamic new European region. Latvia's political leaders returned to the 2007 branding strategy developed by Simon Anholt, the creator of the nation branding concept, based on boosting the international image of Riga.⁷³ European funds, while they were still available, were refocused on building Riga's competitiveness as the driver for Latvia's economy (in the same way that relations with Finland and Poland are additional drivers for the Estonian and Lithuanian economies). As the Baltic states integrated and developed an international reputation for dynamism and innovation, both Baltic and international businesses relocated to Riga. The new concert hall in the former Kongress Nams lies at the heart of a new cultural quarter in the centre of Riga. The development of the Skanste and Andrejsala regions met demand for office space in the centre of Riga. The administrative merger of the city of Riga with the closest suburbs resulted in a larger city budget and significant improvements in the cohesion of transport planning and school-level education outcomes. Riga's 15 year olds consistently score among the ten best-performing nations in the OECD PISA test.

The left bank of the Daugava River –the Riga Knowledge Mile – has been transformed into the higher education hub for the Baltic region. 60,000 students (including 15,000 international students and thousands of young people from Latvia's diaspora) study in the three public and two private universities located in the Knowledge Mile.

⁷³ Simon Anholt prepared a nation-branding report for the Latvian Institute in 2007. The report controversially described outsiders seeing Latvia and the Latvians as "people I don't want to know living in a country I don't want to visit making things I don't want to buy." He concluded that Latvia could not be "branded" and that, instead, Latvia's policy-makers should focus on Riga: "One should play to one's strengths, and Latvia's great public strength is unquestionably Riga. The correct balance, therefore, is to preserve Latvia and promote Riga." Simon Anholt. 2007. A Competitive Identity for Latvia: Interim Strategy Paper. Latvian Institute: Riga

Map 3 Riga Knowledge Mile



A cluster of research institutions, conference and seminar facilities, start-up houses are also located in the Knowledge Mile, as well as the European Medicines Agency, which relocated to Riga from Amsterdam in the late 2020s. Riga has emerged as a European health, medical and pharmaceutical services, research, training and production centre. As was the case in the nineteenth century, Tartu University is the intellectual centre of the Baltic states for the humanitarian and social sciences. But Riga is the hub for the STEM and business management disciplines. New, innovative businesses seizing new opportunities in the growing environment and AI fields develop in the Knowledge Mile. Latvia's regional universities have been restructured as technical colleges that provide a professional education and operate hand-in-glove with the needs of local employers.

Much of this change was driven by the cluster of new think tanks and research services that mushroomed in the 2020s. The Latvian Parliament's Analytical Service has grown to a staff of 30 that offers parliamentarians a full spectrum of strategic foresight, ex-ante, ex-post and impact assessment research services while the Analytical Service in the Cabinet of Ministers similarly caters to the research needs of the executive. Changes in the law on political parties have forced the

major political parties (which have grown in size and reach thanks to legal changes mandating a minimum 2,000 members for parties competing in national elections) to spend a quarter of their public financing on research and programme development. The major parties now resemble *institutions* rather than *projects*. Several new privately funded think tanks participate in a lively and fact-based policy debate that has led to better, more sustainable policies. These think tanks encouraged the major reforms to Latvia's political system that have resulted in stronger and more representative political parties that are more grounded in society and a resulting increase in political trust and a modest rise in political participation.

The steadily growing economy and positive image of the Baltic region has seen a significant part of the diaspora return to Latvia. Indeed, Latvia, and the Baltic states more broadly, also grew more attractive for immigrants from both EU states and third countries. The main beneficiary has been Riga which has developed into a major cosmopolitan urban hub to rival Stockholm and Copenhagen. Latvia's regional towns and villages, however, have continued to decline in population. A two-speed Latvia has emerged, with salaries and opportunities far higher in the Riga Metropolitan Region

than elsewhere in Latvia. However, a decision in the mid-2020s to seize on the opportunities offered by Artificial Intelligence (AI) and other technological developments has allowed for those living in Latvia's region to continue receiving qualitative public and private services.

Government expenditure to GDP modestly grew from 40.4% in 2022 to 45% in 2040, as Latvia's politicians committed to investing a growing part of their GDP to defence and

security. Latvia's bureaucracy was gradually trimmed following the successful introduction of a *Fast Stream* programme that recruited elite young, and productive, university graduates to public service and accelerated their promotions in order to bring in new, modern and efficient management practices that minimized bureaucratic procedures and led to a smaller, flexible, professional and more productive civil service that was quick to adopt modern management principles.⁷⁴

Scenario 2. Nordic Latvia

In 2040 Latvia is one of eight Nordic states, having joined the official forums for Norden cooperation – the Nordic Council of Ministers and the Nordic Council – together with Estonia and Lithuania in 2030. This move came on the back of a mid-2020s agreement between Latvia's elite and society that the country's future would be best served by joining the club of Nordic nations (as was the case of Finland after World War Two). Estonia's leaders had long before come to a similar conclusion and had been pushing Estonia's Nordic identity since the late 1990s, declaring Estonia as the “New Nordics” and even discussing adopting a new flag with a Nordic cross (slightly off-centre towards the hoist).⁷⁵ Lithuania, following a similar debate to that in Latvia, and turned off Visegrad cooperation by Hungary's slide into authoritarianism, also chose a Nordic direction. Nordic political leaders, having interacted with their Baltic colleagues in the Nordic-Baltic 6 (NB6) format in the EU for twenty years, and then having enhanced their political and security cooperation in NATO following Sweden (2024) and Finland's (2023) accession to the organization, supported the expansion of the Nordic club after the three Baltic states had committed to adopting the “Nordic model” of state. The de-russification language, culture and economic policies of the 2020s had firmly set the Baltic states on a western/northern trajectory.

Map 4
The New Norden in 2040



These plans of “becoming Nordic” had initially been greeted with a high degree of public scepticism in both the Baltic states and the then five Nordic nations. However, in the 1990s Latvia's membership of the EU and NATO had seemed equally unlikely if not even impossible. In 1997 U.S. Senator Bernie Sanders quoted Lawrence Eagleburger, a former U.S. Secretary of State in the last year of George H.W. Bush's presidency in 1992-1993, as stating that

⁷⁴ The United Kingdom's Civil Service Fast Stream is acknowledged as best practice: <https://www.faststream.gov.uk/index.html>

⁷⁵ Andres Simonsen. 2015. The Case for an Estonian Nordic Flag. Estonian World. <https://estonianworld.com/opinion/a-case-for-an-estonian-nordic-flag/>

“if we ever think of bringing the Baltic states into NATO we ought to have our heads examined.”⁷⁶

Yet despite the scepticism of some U.S. and European politicians, Latvia joined both organizations just seven years after Sanders’ speech. In contrast, a determined focus on reshaping the Baltic political and economic models along Nordic lines proved to be relatively straightforward.

The initial focus was on a convergence of the Nordic and Baltic economic models. The rapidly rising costs of simultaneously supporting Ukraine in its war with Russia (at a time when U.S. support for Ukraine wavered) and strengthening domestic defence on the eastern border at a time of low global economic growth, saw Latvia and the other two Baltic states radically reshape their tax systems. Budget expenditures began to rise and tax rates gradually converged with the Nordics (see Table 3).

Between 2022 and 2040 Latvia’s government expenditure to GDP has grown to 50% of GDP converging with rates in the Nordic states. This was primarily funded by increases in the headline personal income tax (PIT) rate from the current 31% to 50%, as well as rises in individual capital gains taxes and the VAT standard rate. All increases were opposed by business owners and employers’ associations, although trade unions and public sector workers welcomed the changes.

Nordic-level tax rates initially dampened

	2022	2040
Denmark	45.8 %	46 %
Finland	53.3 %	54 %
Sweden	47.5 %	48 %
Latvia	40.4 %	50 %

economic growth in Latvia. First, relatively significant levels of distrust in government and already high tax avoidance rates (as evidenced through a stubbornly high shadow economy) saw a rise in personal tax avoidance schemes. Government tax income fell well-behind initial expectations. Growth in the size of Latvia’s civil service following the tax rises led to further public scepticism. Some were also disappointed as cigarettes, alcohol and cars (and petrol!) significantly rose in price.⁷⁷ Second, modestly increased tax revenues were enough for Latvian governments to delay critical reforms, such as consolidation of the rural schools network and new policies on the distribution of EU cohesion funds. Nevertheless, funding for education, research and innovation as well as healthcare did increase and by the mid-2030s the positive impact of these investments was starting to be felt in the economy. Foreign direct investment rates, initially held-back by stubbornly low productivity and high taxes, began to pick up hand-in-hand with positive productivity indicators as Latvians became both better educated and healthier.

These economic reforms were accompanied by significant political reforms. There had been some debate on calling a new Satversmes Sapulce (Latvia’s 1922 Satversme is the second oldest constitution in Northern Europe after Norway’s 1814 constitution).⁷⁸ However, Latvia’s conservative voters rejected calls for sweeping constitutional change in a 2027 referendum on the issue. Instead, politicians decided to symbolically reboot Latvia’s democracy by

Table 3
General government total expenditures in 2022 and 2040 (% of GDP)

Note: 2022 values are from Eurostat (https://ec.europa.eu/eurostat/databrowser/view/gov_10a_main/default/table?lang=en), while 2040 values are authors’ projections for Nordic Latvia scenario.

⁷⁶ Bernie Sanders. June 10 1997. If NATO is expanded, our allies must pay more of the costs. Congressional Record Vol.143, No.80. <https://www.congress.gov/congressional-record/volume-143/issue-80/extensions-of-remarks-section/article/E1159-6>

⁷⁷ In March 2024 the electric Tesla Model Y long-range cost 57,000 EUR in Denmark and Finland and 54,000 EUR in Sweden, but just 48,000 EUR in Latvia. These prices would converge over the following years.

⁷⁸ All other Nordic/Baltic states adopted new constitutions in the second half of the twentieth century (e.g. Sweden in 1974, Estonia and Lithuania in 1992 and Finland in 1999).

Table 4
Key tax rates in Latvia and the Nordic states in 2024 and 2040 (%)

Data source: PWC. 2024. Worldwide Tax Summaries. <https://taxsummaries.pwc.com/>

	CIT in 2024 (and in 2040)	PIT Headline rate in 2024 (and in 2040)	VAT Standard rate in 2024 (and in 2040)	Individual Capital Gains Tax Rate in 2024 (and in 2040)
Denmark	22 %	52 %	25 %	52 %
Finland	20 %	55 %	24 %	30-34 %
Sweden	20.6 %	52 %	25 %	30 %
Latvia	20 % (20 %)	31 % (50 %)	21 % (25 %)	20 % (50% aligned with PIT rate)

building a striking new Saeima building on AB Dambis. Modest changes were made to the constitution leading to a decentralization of the increasingly bloated Latvian state apparatus (Sweden, Denmark, Finland and Estonia had the highest share of government employment as a percentage of all employment in the EU in 2020.⁷⁹ The new Nordic states followed suit). The Latvian Ministry of Transport was moved to Daugavpils while the Local Government Ministry moved to Rezekne, Agriculture was relocated to Dobeles and Education and Science was moved to Liepaja.

Other significant reforms, intended to boost Latvia's regions, saw the relocation of the Riga Technical University to Cesis and the tax authority to Ventspils. However, these reforms were not an unequivocal success, with all the de-centralized units struggling to attract senior-level staff while, without the attraction of city life in Riga, the flow of international students to Cesis Technical University slowed to a trickle. However, refugee and third country migration numbers grew as Latvia's adoption of a Nordic identity attracted increasing numbers of immigrants to relocate to the Baltic. Moreover, Latvia's ageing population required a growing number of tax-paying workers

to fund the generous Nordic-type benefits now available to Latvians. As a result, Latvia's population modestly increased and the average age declined. At the same time, however, it also brought an increasing number of social conflicts only partially mitigated by Latvia's larger and more active civil society and a higher level of social capital (mutual trust). Far-right anti-immigration parties grow in strength.

In the second half of the 2030s the tax-income driven investments in health-care, education and public infrastructure kick-in and the Latvian economy grows energetically and becomes more attractive to international investors. As a recognized Nordic state, Latvia increasingly integrated into the Nordic value-chains that were increasingly "brought home" due to the disruptions to global geopolitics. Some Latvian businesses see a benefit to their increased tax payments and exports have a greater added-value with a "Made in the Nordics" label. However, others oppose the high taxes and new, anti-tax parties emerge to challenge the Nordic model adopted in Latvia.

⁷⁹ Eurostat. 2021. Government Employment. https://ec.europa.eu/eurostat/cache/digpub/european_economy/bloc-4d.html?lang=en

Scenario 3. Listless Latvia

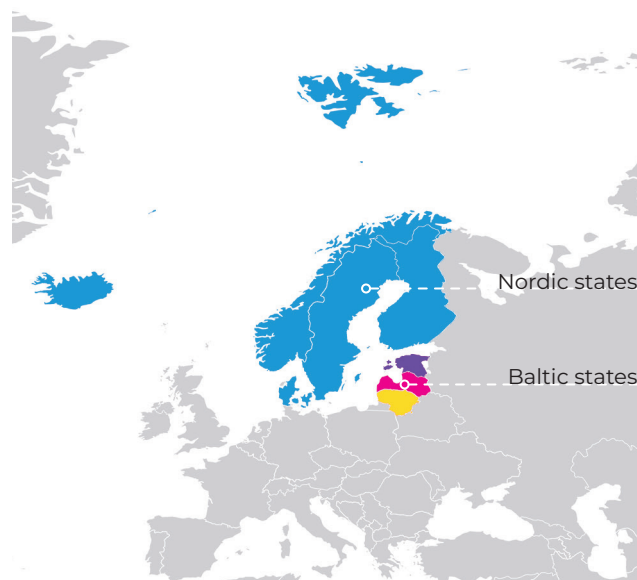
The Latvia of 2040 is very similar to the Latvia of the first 30 years of renewed independence. The Latvian economy continues to grow, albeit more sluggishly than neighbouring Estonia and Lithuania. Latvia's governments often serve a full four-year term of office, although few major reforms are undertaken.

Tax rates have remained largely unchanged throughout the period and the share of government expenditure to GDP remains at 40%. Political actors expanded the scope of public benefits after caving in to public demand. However, doing more with the same amount of money has led to unchanging low outcomes in health and education. Latvia continues to have the lowest life expectancy at birth in the Baltic states⁸⁰ and the largest life expectancy gender gap in the European Union (with Latvian men expected to live an average of ten years less than Latvian women).⁸¹

Nevertheless, Latvia continues to attract FDI as a result of having lower taxes and lower salaries than its neighbours. The Latvian workforce is less productive than its neighbours, but it is also much cheaper. Rail Baltic, Latvia's sea ports and Riga airport mean that Latvia has a solid logistics infrastructure (although roads are increasing in disrepair). The economy grows modestly.

The budget gap between Latvia and Estonia continues to widen (the 2024 Estonian budget came to almost 13,000 EUR per capita while Latvia's is 8,700 EUR. This almost 40% difference is maintained over the following years). Latvians continue to look at Estonians with deep envy and ask – why do we lag behind? Public disenchantment remains high. However, with investment in education and research remaining low, ironically there are no available funds to research this critical question.

Map 5
Status Quo in Northern Europe



School education remains of varying quality. The elite gymnasiums, primarily based in Riga, continue to produce high school graduates that walk into elite universities in the UK and the USA. However, a growing number of parents send their children to private secondary schools that have created more modern study environments and are quicker to adapt to global education trends. Secondary schools in Latvia's rural regions, however, struggle to find teachers for STEM subjects (especially after a wave of school teacher retirements in the early 2030s) and a significant attainment gap, as evidenced by centralized testing, grows ever bigger. A poor level of maths knowledge leads to a continuing struggle to produce enough STEM university graduates to feed Latvia's labour market. Foreign direct investors complain about a shortage of qualified human capital.

Latvia's regional schools continue to contract in student size as Latvia's demography continues to follow the long standing

⁸⁰ Eurostat. 2024. Life expectancy at birth 1980-2022.

https://ec.europa.eu/eurostat/statistics-explained/index.php?title=File:Table01_Life_expectancy_at_birth_1980-2022_v1.png

⁸¹ Eurostat. 2024. Gender Gap Life Expectancy at Birth 2021.

<https://ec.europa.eu/eurostat/statistics-explained/index.php?title=File:Gender-gap-life-expectancy-at-birth-2022V1.jpg>

trends of declining, ageing and urbanization. In 2040 Latvia's population stands at just 1.6 million and the average age has risen to 46.5 (from 44 in 2024).⁸² Three quarters of the population (up from two-thirds in 2024) lives in the Riga Metropolitan region. However, the capital city continues to suffer from a lack of domestic investment as Latvia's governments continue to spend the remaining, albeit much reduced, EU funds (which have been redirected towards Ukraine and Moldova) in Latvia's regions. The falling population in Latvia's rural towns and villages does not generate the tax base needed to maintain the swimming pools, concert halls, museums and other cultural and recreation infrastructure built up during Latvia's first twenty years in the European Union. Retraining, life-long education and entrepreneurial support programmes go into a similar decline.

Rural areas continued to empty out as people relocate to the cities, particularly the Riga metropolitan region. However, with a reduced population of 550,000, Riga is now the third largest city in the Baltic states, trailing Vilnius (660,000), Tallinn (555,000), but still ahead of Kaunas (340,000). The lack of investment in public infrastructure and low tax base means that Riga looks shabby and comparatively underdeveloped. This further encourages young professionals to relocate to the suburbs that circle Riga and are well funded with public infrastructure, thanks to 75% of the personal income tax of residents being sent to the suburban local authorities. These professionals continue to travel to Riga for their work, using the city's infrastructure (and not paying for it), but live in the suburbs. However, Riga remains a comparatively wealthy region in Latvia and a significant part of its tax income continues to be redirected to the even poorer peripheral regions.

Latvia's neighbours economically benefit from the comparative decline of Riga and a trickle of pan-Baltic businesses follow the example of Luminor Bank and relocate to either Tallinn or Vilnius. Lithuania's new flagship airline – airLithuania – attracts avi-

ation traffic away from Riga airport and to the new airport that serves the Kaunas and Vilnius region. The key institutions of Baltic political cooperation – the Baltic Council and the Baltic Assembly – continue operating, but there are few new initiatives beyond cooperation in the defense sector (which remains the most important element of Baltic cooperation, although Lithuanian and Estonian defense analysts complain that Latvia does not pull its weight in terms of the size and capacity of its armed forces). As Lithuania and Estonia have grown in wealth, they have fewer interests in common with Latvia, outside of defense issues.

Latvia's political system remains unchanged. There are a high number of political parties (with only 200 members needed to register a party, it is easy to create a new party and with parties polling above 2% in a national election having access to public financing, party leaders are highly motivated to maintain political structures even after a poor election result) and the parliament remains fragmented. An ideological mish-mash of parties is needed to form any government coalition and this lack of ideological cohesion makes it almost impossible to undertake substantive reforms. The exception comes when a reform is pushed by one of Latvia's international partners – then the public sector zips into life and successfully executes any reform plan. As a result, Latvia is seen as a solid international partner that lives up to its international commitments and uncritically adopts European Union directives and regulations, even when they may be against Latvia's national interest. Latvia balances its budget and plays by the European Central Banks' fiscal rules. It continues to be true that every generation of Latvians lives better than the previous generation. However, it is also true that the Estonians and Lithuanians have a higher standard of living.

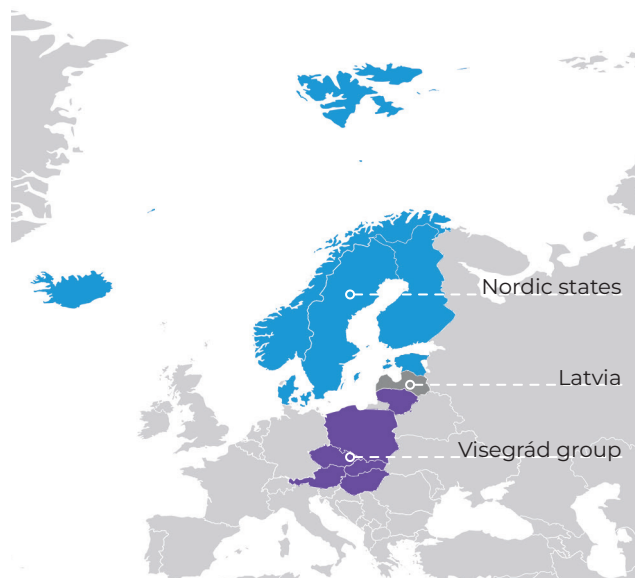
⁸² Eurostat 2024. Population and Ageing. https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Population_structure_and_ageing#Median_age_is_highest_in_Italy_and_lowest_in_Cyprus

Scenario 4. Lonesome Latvia

The 2020s were a decade of great global uncertainty. Global geopolitics shifted as China asserted its influence in Asia, and beyond, while Russia tested the resilience of NATO, the European Union and the West. The U.S.A.'s commitment to its European allies remained under a question mark. The global economy slumped and demand for Latvia's goods and services plunged in key export markets. European Union funds, which played such a key role in developing Latvia's infrastructure and human capital for two decades, were redirected to the EU candidate countries Ukraine and Moldova.

The Latvian government responded by cutting taxes in a bid to attract foreign direct investors and appease local businesses whose profits had slumped. In 2040 the government expenditure to GDP ratio has fallen to 30%, one of the lowest rates in the EU. At the same time, however, the government budget was strained by defence costs, an unfavourable demographic pyramid (a growing number of pensioners and a shrinking number of working-age men and women) and having to fund infrastructure development from national funds. At the same time, pensioners remained the most active voters and their demands remain unchanged – higher pensions and benefits as well as improved healthcare – and all political parties acceded to these demands. However, this left the government budget stretched, funding social services, primarily directed at pensioners, and government functions from a declining tax income. Spending on defence actually declined despite a time of international insecurity. Young people, frustrated by lack of investment in schools, universities and education in general, as well as few dynamic job opportunities, came into conflict with pensioners and a new societal divide opened up. The number of young people passing the national conscription test continues to decline, negatively impacting the size and readiness of Latvia's military forces. The overall mood in the country remained downbeat.

Map 6
Visegrad Lithuania, Nordic Estonia,
isolated Latvia



There was a change in the regional political environment. Estonia energetically pursued its vision of joining the Nordic club of nations. It integrated ever more closely with Finland, co-financing (alongside private and Chinese government investors) a 103 kilometre long undersea tunnel between Helsinki and Tallinn which was first envisioned by the Angry Birds game inventor Peter Vetserbacka in 2018. The completion of the tunnel was a game-changer in the region. The new HelTal metropolitan area had a (fast-growing) population of over one million people and became the most important urban area in the Baltic states, superseding Riga and Vilnius as the logical place to locate a regional business headquarters. The new high-speed rail link between the now merged Helsinki and Tallinn airports (known as HelTal airport) saw transit air traffic increasingly relocated from Riga airport (RIX) to HelTal. RIX saw a gradual decline in passenger numbers as HelTal catered to both low-cost (in Tallinn) and legacy (in Helsinki) carriers. The Estonian government bought into Finnair (renamed FinEst) and the airline launched multiple routes from RIX in a bid to push airBaltic from the market.

Map 7 Helsinki-Tallinn metropolitan area



Lithuania increasingly turned to Poland and joined the Visegrad group of countries (alongside Poland, Hungary, Czechia and Slovakia). The busiest Rail Baltic freight traffic is between Lithuania and Poland, as improved transport connections to Poland fuelled increased trade between Lithuania and Germany. Lithuania turned its back on Nordic-Baltic cooperation having realized that its interests in the EU are more closely aligned with the Visegrad states than the Nordic nations.

This left Latvia internationally isolated from its Baltic neighbours who reoriented both their political interests and, increasingly, their trade focus away from Latvia, which appears to be the only remaining Baltic state. Latvia's commitment to European and Western values falters and it experienced a period of democratic backsliding. The idea of a strongman leader, like Singapore's Lee Hsien Loong (who has held the prime minister's post since 2004 and whose father, Lee Kuan Yew, similarly held the post for over 30 years), who can give political direction and certainty and make long-term decisions gained support in society.⁸³ After all, in the early 2020s almost half (48%) of all Latvians agreed with the statement

that it is very good/fairly good to "have a strong leader who does not have to bother with parliament and elections" (three times more than the 16.8% of Estonians who similarly approved of a strong leader.⁸⁴

Following the example of Victor Orbán's Hungary, the strongman leader of a party appealing to those disappointed with Latvia's development won forty seats in the Latvian parliament and formed a three-party government coalition with holding two-thirds of parliamentary seats, that redrew Latvia's electoral borders (to favour Latvia's regions where the leader has much of his support), appointed favourable judges to courts and political cronies to key domestic security posts and control of the public media. Public employment actually increased, as the strongman rewarded supporters with public jobs. Corruption increased. Elections continued to be held and votes counted legally, but international election observers point out that political competition is skewed in favour of existing leaders.

The European Commission acted against democratic backsliding in Latvia through

⁸³ Opinion polls indicate that there is less support for a strongman leader like China's president Xi Jinping or Russia's Vladimir Putin, but the Singaporean model of authoritarianism, or even that of Hungary, is seen far more positively.

⁸⁴ World Values Survey 7: 2017-2022. At the same time, it should be made clear that in the same survey a far greater majority of Latvians (81.2%) agree with the statement that it is very good / fairly good to "have a democratic system".

the Conditionality Regulation Measures, which allows the EU to cut off an EU Member State from receiving EU money if it breaches principles of the rule of law.⁸⁵ While EU cohesion and structural funds had already largely dried up to a trickle, this move left Latvia's farmers without access to EU support and further cut funds to Latvia's already beleaguered research community. Russia and China offered to step in and provide financial support to Latvia to make up for the budgetary shortfall. However, Latvia's international reputation was hit and western investors seriously considered relocating to one of Latvia's two more dynamic neighbours. Businessmen from China and the post-Soviet states eyed up new economic opportunities in Latvia, which still offered a foothold into the EU's Single Market.

This political and economic drift continued to hit Latvia's demography. Internally,

Latvians continued to head to Riga. The swimming pools, museums and cultural centres constructed in Latvia's small towns and villages have become tourist attraction "white elephants", much like the regional "ghost" airports constructed in Spain, and elsewhere in the EU, and similarly in disuse. With few jobs, and a deteriorating public infrastructure, Latvia's regions became increasingly unattractive for workers and businesses alike. However, with dwindling professional opportunities in Riga, many professionals have trampolined to the dynamic HelTal metropolitan region or to the western Europe facing Lithuania. Both benefit from being close to home. This shift of talented human capital from Latvia to its Baltic neighbours further boosts their economies but threatens to push Latvia into a spiral of decline.

⁸⁵ Regulation (EU, Euratom) 2020/2092 of the European Parliament and of the Council of 16 December 2020 on a general regime of conditionality for the protection of the Union budget. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.LI.2020.433.01.0001.01.ENG&toc=OJ:L:2020:433:TOC>

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The objective of the Latvian Strategy and Economic Institute (*LaSER Think tank*) is to develop and offer Latvian policy-makers new, innovative and evidence-based policy ideas.