While the impact of the 2008 global economic crisis has been varied across nations, it is unmistakable that Latvia was among those hardest hit with unemployment topping 20 percent and a considerable contraction in gross domestic product (GDP) from 2008 to 2010. But the tide has ostensibly turned with the country completing the International Monetary Fund’s (IMF) stabilization program in December 2011, and the government projecting growth of approximately 5 percent for 2011. So how did Latvia accomplish this turn around as others in Europe remain mired in economic turmoil?

To appreciate this economic recovery, it is necessary to understand the comprehensive cultural, economic, political and social transformation Latvia experienced as it gained independence from the Soviet Union in 1991, having been occupied by the communists since 1940. For individual Latvians and the collective society, the change from a repressive world of subjugation to one of freedom and opportunity was profound and defining. For Andrejs Pildegovics, the Latvian Ambassador to the U.S., the memories from that period are vivid and remain part of their cultural DNA. He added that with independence restored there was a sense the Latvian people must be vigilant in safeguarding their freedom and autonomy.

Despite their westward reorientation, their Soviet legacy dominated Latvia economically in 1991. With independence reclaimed, the GDP of Latvia fell by approximately 50 percent. In looking back, Pildegovics describes the circumstances as one where “we’ve been climbing from a fairly difficult situation.” One key milestone in this climb was Latvia’s ascension to the European Union (EU) in 2004 which launched a period of stellar economic growth grounded in neoliberal policies that replaced the former centrally planned system. For three years, Latvia averaged double digit economic growth.

This success drew acclaim and earned Latvia and its neighbors Estonia and Lithuania the moniker—the Baltic Tigers. Unfortunately, this rapid growth served as the beginning of a traditional boom and bust cycle. Lacking capital controls, foreign capital poured into Latvia starting in 2004 which substantially drove up wages and salaries, overheated consumption, and ultimately led to credit and real estate bubbles. When the global liquidity crisis hit, Latvia was one of the first casualties as unemployment, inflation and debt all increased significantly while GDP fell 25 percent between 2008 and 2010, and one of the country's largest banks, Parex Bank, collapsed and was taken over by the state.

In addition to seeking support from the IMF, EU and others that topped $10 billion, Latvia moved aggressively to implement a policy of internal devaluation largely through draconian austerity measures. In their book, How Latvia Came through the Financial Crisis, authors Anders Aslund of the Peterson Institute for International Economics and Latvia's Prime Minister Vadis Dombrovkis write, "The cuts in public expenditures were enormous: a real cut of 25 percent of most current spending. All public wages were to be slashed by 25 percent in nominal terms. Pensions were frozen in nominal terms in 2009."

Efforts to introduce similar reforms in other countries have often been met with civil unrest and, in some cases, outright violence. Barring one incident of civil disobedience, there has been a considerable amount of understanding from Latvia's public that the severity of the austerity programs was necessary to restore stability and confidence. Aslund and Dombrovkis describe the austerity campaign as acquiring "an almost revolutionary zeal." Ambassador Pildegovics added, "I don't think this means that Latvia is a nation of masochists, but it is a sign that Latvians understand the root of the crisis. I think our society realized that we had to change certain things in our habits and to be more diligent in our consumption."

The economic crisis seems to have rekindled a collective sense of a shared future similar to the nationalistic attitude of Latvians living under the Soviet system. And while there has been political turmoil and heated debates, including extraordinary elections in July 2011 when the President dissolved the Parliament, there has been continued support for the austerity measures regardless of who has been at the political helm. There has also been widespread political support for a long sought Latvian objective—adoption of the Euro.

Latvia's currency, the lat, has been pegged to the Euro since 2005 intending to facilitate trade and investment, foster stability and temper inflation. In the throes of the crisis, many economists were encouraging Latvia to devalue its currency, i.e. weakening it by abandoning the peg and allowing it to float, to avoid total economic collapse. Fearing that its plans to adopt the Euro would be imperiled as well as potentially bringing about high inflation and debt default, Latvia rebuffed pleas by these experts to discard the fixed exchange rate. With Latvia’s economy growing for six consecutive quarters, it appears the decision has paid off and places Latvia’s goal of joining the euro zone in 2014 on a realistic course.

The pain and sacrifice that Latvians have had to endure during the economic crisis are very real. But they do seem to be approaching the light at the end of the tunnel and hope the decisive actions taken and structural reforms implemented will only make their Baltic nation of 2.2 million more competitive and durable for future generations. As to the signs of improvement and what lies ahead, Ambassador Pildegovics remarked, “We hope that this trend will continue. There is a new sense of hunger for new opportunities. We hope that it will lead the new cycle in our development.”

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