I. INTRODUCTION

Latvia regained its independence from the former Soviet Union in August 1991. Since then, it has begun the slow and arduous path of replacing the centrally-planned, socialist system with an economic structure based on free-market principles. Latvia began this transition "in a difficult environment characterized by macroeconomic imbalances inherited from four decades of central planning and disruptions caused by a sharp contraction of trade with Russia and other states of the former Soviet Union." Further, Latvia was left with a detriment in trade terms.
“resulting from the sudden adaptation of world market prices for energy and raw materials, and the existence of many inefficient industries.”

An economic goal of the current Latvian government is to manage a smooth transition into a market economy. Measures adopted by Latvia to achieve this goal include controlling inflation, limiting the growth of the state budget deficit, promoting foreign investment, moving forward with privatization, and building a legal and regulatory infrastructure comparable to those in advanced industrialized countries. Unfortunately, the slow process of privatization is a primary reason for the lack of considerable progress in implementation of these economic reforms in Latvia. The Ministry of Economics has pinpointed deep crises in the majority of state-owned enterprises, such as “delays in structural reforms, a lack of proper legislation on immovable property,” and other relevant laws as reasons for the downturn in Latvia’s gross domestic product.

This comment seeks to describe the evolution of privatization as it pertains to different sectors, small enterprises and large enterprises. Further, it analyzes current approaches that are being used to accelerate the privatization process. This comment will first outline the initial privatization legislation that was passed when Latvia regained its independence. Second, it will outline the problems that have slowed the process. Third, this comment will survey legislation that has been passed within the past year to alleviate some of the problems and difficulties that the initial legislation promoted.

II. BACKGROUND

Even with the collapse of communist rule, Latvia has been rather successful in avoiding a deterioration in government finances that often accompany significant deficits, inflation, and overall macroeconomic instability which normally result from such a revolution. Despite the fact that Latvia lacks energy, it has evolved to enjoy a standard of living superior to that of its neighbors in the former U.S.S.R., and promises an agricultural potential (particularly in lumber, textiles and agro-industry), and service potential (particularly in tourism, banking, insurance and

1. ECONOMIC REFORM AND PUBLIC INVESTMENT IN LATVIA, STATEMENT FOR THE WORLD BANK MEETING IN PARIS 1 (May 19, 1994).


transit) that is quickly revive. Above all, it possesses well developed human resources with a conscientious quality labor force.  

For most of the republics of the former U.S.S.R., and particularly Russia, Latvia remains the obvious maritime and transit route to Northern Europe and the United States. This is due to six reasons. First, Riga has the only container port between St. Petersburg and Poland. Second, newly-established ferry services linking Riga to Scandinavia and Western Europe allow overland trucking easy access to Russia, the three Baltic States, and Belarus. Third, railroads and highways from Riga to Moscow and St. Petersburg are good. Fourth, Riga has the largest airport in the region and is steadily expanding air links with Western Europe. Fifth, it is the only city in the Baltic to have regularly-scheduled direct air service to the United States. Finally, the European Bank for Reconstruction and Development has financed expansion of the main airport runway to enable B747 aircrafts to land at the airport in Riga starting in the summer of 1994. Latvia is a transit point for many goods, and the volume of transit is bound to increase once Russia succeeds, even partly, in managing its economic and political crisis. "Transit cargo already accounts for more than 90% of the cargo handled in the ports of Ventspils, Riga and Liepaja, and for 70% of the cargo transported by railways."

Latvia's medium term prospects for output recovery in the public sector appear good, even though the level of unemployment has increased due to the tremendous decrease in industrial activity. This decrease in industrial activity was caused by the closure of the Soviet market for such goods. Fortunately, private sector dynamism has often compensated for

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6. Id. at 3.
7. See ECONOMIC REFORM AND PUBLIC INVESTMENT IN LATVIA, supra note 1.
8. This is stated conservatively since gross domestic product at constant prices continues to decline. By the end of 1993, it was 80.1% of the previous year's level. In examining different categories of production in comparison with 1992, the highest level of GDP (the smallest percentage decrease) was reached for services (89.5%), supply of electricity, water and gas (89.0%), but the lowest for construction (50.2%) and the mining industry (50.0%). LATVIJAS BANKA ANN. REP. 5 (1993).
9. Industrial output, in terms of constant prices, decreased by 38.1%. When one examines the growth in industrial output per month, the decline had apparently leveled out in the period from September until November, but decreased again by 6% in December compared to November. LATVIJAS BANKA ANN. REP. 6 (1993).
10. At the end of 1993, 76,700 unemployed persons were registered in Latvia, which was 5.8% of the employable population. The number of persons out of work grew approximately 2.5
this decrease by absorbing these newly laid-off workers. As a result, several thousand private enterprises have already been created chiefly in retail trade and services.

Recovery still has a long way to go. Buying capacity did not attain 1991 levels, although wage increases were above consumer price index increases. According to the World Bank Social Protection Identification/Preparation Mission statistics, the poverty level has gone up from 4-5% of the total population to 35% of the population. Furthermore, according to information provided by EC-PHARE, "direct investments per one inhabitant in Latvia between 1991 and the middle of 1993 were much less than the average for the rest of Eastern Europe.

These statistics clearly indicate that in order to remedy these problems, Latvia will need to depend on investments from the government and the private sector, as well as from abroad. The World Bank estimates that in order to "realize an annual growth rate of 4-5% in Latvia's domestic product, the share of investments in the GDP must increase by 22% in the coming years."

In furtherance of this realization, the government has decided to increase public investment expenditure from a low of 0.8% to about 3% of times. Slightly more than 25,000 (32.9% of all unemployed) have been out of work for more than 6 months. Women comprised 53.2% of all unemployed. During the first half-year, the number of unemployed grew rapidly. In the first seven months of 1993, it was on average 14.1% monthly, in August-October the number remained steady, and started growing again by 2.9% in November and by 2.3% in December. As of May 1994, 6.6% of the working age population of Latvia was registered as unemployed; the government estimates total unemployment (those registered plus the "hidden" unemployed) at 9%. Press release by American Chamber of Commerce in Latvia, July 6, 1994.


To protect vulnerable groups from the impact of the transformation of the economy, the government is taking steps for the development of an effective social safety net. Present reforms aim at establishing a system in which means-tested social benefits more specifically aimed at low income groups play a larger role. As a reflection of the government's concern for social assistance the 1994 budget includes anticipated social assistance payments equivalent to about 1.75% of GDP, up sharply from about 0.75% of GDP in 1993.

12. THE SURVEY OF LATVIA'S ECONOMY AND PROGNOSES FOR ECONOMIC DEVELOPMENT, supra note 3, at 4.


GDP in 1995 because Latvia has low levels of debt. The government will also devote a tremendous amount of energy and resources to privatization, because it “considers privatization as the crucial element in promoting the private sector to lead in economic development and efficiency.” In particular, transfers of state property are expected to result in stimulating investment activity and facilitating the reabsorption of workers.

The government will also focus on attracting foreign investment. A liberal foreign investment law has been enacted. The Latvian Development Agency has been set up to attract foreign investment and to provide “one-stop” services to foreign investors. Although foreign investment remains modest, there are signs of optimism.

Scandinavian clients are showing up in increasing numbers to benefit from distribution costs significantly lower than in the capitals of the Nordic countries. Many buyers are also coming from other republics of the former Soviet Union, (because practically everything is available in Riga, and Moscow is less than 1000 km away).

The United States, Germany, Sweden, and Switzerland continue to provide the largest investments to Latvia. Hopefully, this will continue, as foreign trade will play an essential role in the national economy and the living standards of the population.

III. ECONOMIC REFORM

In the midst of economic fury, Latvia faces the daunting task of developing a completely new legal, financial, tax, and regulatory infrastructure. “The economic reform program has been undertaken in

16. BUSINESS WITH LATVIA, LATVIAN DEVELOPMENT AGENCY, May 1994. Through November 1, 1993, the government of Latvia has borrowed USD 184.8 million from foreign creditors. Foreign credits and official credit guarantees amounting to USD 316.8 million for Latvia have been approved, including an SDR 54.9 million stand-by arrangements with the IMF. On October 1, 1993, Latvia’s official foreign exchange and gold reserves were valued at USD 336.2 million. Trade Act Report Highlights - Latvia, Statement from the U.S. Embassy, Riga, at 4 (Oct. 1993).

17. ECONOMIC REFORM AND PUBLIC INVESTMENT IN LATVIA, supra note 1, at 5.

18. Id.

19. Id. at 6.


21. Id.

22. THE SURVEY OF LATVIA’S ECONOMY AND PROGNOSES FOR ECONOMIC DEVELOPMENT, supra note 3, at 5.
stages."23 Initially, "an independent tax system was established in 1990."24 The establishment of the tax system was followed by a liberalization of prices and elimination of subsidies in 1991 and 1992. "Measures were then implemented to achieve macroeconomic stability through tight fiscal and monetary policies and currency reform."25 "Once this was accomplished in the middle of 1993, attention has been focused on structural reforms and the promotion of economic growth."26

The creation of a stable national currency was one of the most important achievements for the Latvian government and the Bank of Latvia in 1993.27 Based upon International Monetary Fund guidelines, the Bank of Latvia has exercised monetary restraint that has created one of the world's strongest currencies, with the lat appreciating 44% against the United States dollar and 41% against the German mark between January and September of 1993.28 Inflation rates dropped from 958.6% in 1992 to 34.8% in 1993, to 12.3% in the first five months of 1994, with only 0.2% growth in May and 2% growth in June.29

Based upon foreign reserves equal to twice the value of all lats in circulation, the Bank of Latvia has guaranteed full convertibility of the lat, with no restriction on the import, export, exchange, or use of foreign currencies inside the country.30 As a result, 1993 was characterized by a rapid inflow of convertible currencies to Latvia. The Bank of Latvia purchased 272.2 million United States dollars more than it sold, in comparison to only 20.9 million in 1992. In consideration of the possibility that the growing exchange value of lats can negatively affect exports, the Bank of Latvia exercised tight monetary policy by restraining the appreciation of the lat, thereby ensuring its stability in the currency market.31 As a result, the strength of the lat and the inherent increase in

23. ECONOMIC REFORM AND PUBLIC INVESTMENT IN LATVIA, supra note 1, at 4.
24. Id.
25. Id.
26. Id.
27. The economic situation in Latvia during 1993 was complicated. The volume of production continued to decline in nearly all the branches of the national economy, and the level of unemployment rose. Nevertheless, a considerable reduction in inflation should be noted as a positive development, alongside with the successful completion of currency reform. This may reasonably be considered the main achievement of the monetary policy implemented by the Bank of Latvia during 1993. LATVIJAS BANKA ANN. REP. 4 (1993).
30. Id. at 3.
purchasing power has provided the foundation upon which the Latvian economy can grow.

As Latvia makes striking progress toward economic stability, the government is working to complete reforms that will lay the foundation for this modern market economy. As Vilfred Talvic, World Bank Vice President for Central and Eastern Europe, emphasized, "the main goal of Latvia's government should be to ensure the development of the infrastructure and a social production system."32 Lars Jeurling, chief of the World Bank Regional Mission to the Baltic Countries in Riga, Latvia, agreed, stating that improvements in the financial sector and private sector are critical to provide the necessary environment for restructuring privatized enterprises so that they can face international competition.33

Talvic further emphasized, "critical to the successful development of Latvia's national economy is political unity in priority issues of property matters and privatization."34 This type of unity is essential to promote investments from the private sector as well as from foreign investors.35 Based upon these recommendations and on the fact that Latvia's privatization process has been slow-moving it has become one of the top priorities in the government's economic reform movement.36

IV. PRIVATIZATION - THE BEGINNING

Property reform began in 1990 with changes to the constitution, which reintroduced guarantees against confiscation or other infringements of an individual's property rights.37 This was followed by legislation to transfer state-owned assets to private individuals or organizations (privatization), and to restore nationalized property to its previous owners (restitution).38

The direction of Latvia's privatization program has changed frequently, yet the basic privatization principles, established with the

32. The World Bank and the Latvian Ministry of Economics organized a seminar in Riga on April 14, 1994 where Vilfred Talvic, Vice President for Central and Eastern Europe spoke. BUSINESS WITH LATVIA, LATVIAN DEVELOPMENT AGENCY, May, 1994, at 1.
34. See BUSINESS WITH LATVIA, supra note 32, at 1.
35. See Jeurling, supra note 33, at 15.
38. Id.
March 20, 1991 resolution, State Property and Basic Principles of its Conversion, have remained constant. This resolution stated:

1) State property privatization will be carried out according to the particular characteristics of individual industrial sectors.

2) Restitution rights will have priority over the privatization laws. Property rights for nationalized or alienated property as of June 17, 1940 can be resumed by any former owner or by his legal heir, regardless of his present citizenship.

3) Privatization of unclaimed state property or property that does not have former owners has to be carried out on the basis of the redemption of property objects for local currency of the Republic of Latvia and other means of payment in operation.

4) Permanent residents of Latvia will be able to purchase a limited share of a state-owned property using privatization certificates.

5) A special privatization fund will be formed from income gained from the privatization process, to help promote the activities of newly established private enterprises.

6) Privatization has to be carried out openly, under the supervision of authorized public representatives of the municipal privatization commissions.39

Furthermore, privatization occurred in the following two phases: privatization of buildings, and privatization of land. Land ownership in Latvia is limited exclusively to Latvian citizens. Foreign nationals may lease land upon which a building stands for a maximum of ninety-nine years. However, both citizens and foreign nationals may purchase houses, individual apartments and factories. The Civil Code of 1937, reintroduced October 1, 1992, provides that enterprises may purchase buildings from other enterprises, private persons, state or local governments.40

40. COOPERS & LYBRAND, supra note 37.
Under this system, the various ministries owned state enterprises and were the initial decision makers in the privatization of these enterprises and their property. This system was characterized by delays, confusion, overlap of various ministry responsibilities, and arbitrary decisions. Furthermore, the situation regarding land ownership proved to be unsatisfactory throughout this process. Reportedly, the government is considering new legislation regarding land ownership.

V. RESTITUTION

The regulation of land restitution was divided into those laws covering land in rural areas, and those laws covering land in urban areas. Laws covering rural areas were initially adopted on November 21, 1990 and expanded with the July 7, 1992 law, “On Land Privatization in Rural Regions.” The main purpose of this legislation was to: (1) provide a guaranteed foundation for agricultural development; (2) restore property rights to the rightful owner as of July 20, 1940 or their heirs; (3) provide citizens the opportunity to obtain property for proper compensation; (4) protect the ecological system currently existing on such lands; and (5) respect the current tenants and governmental interests. If it proved impossible to restore ownership of a certain tract of land, the owner received restitution in the form of land of equal value or financial compensation.

Laws covering urban areas, enacted on November 20, 1991, repealed all laws and decrees passed since July 21, 1940 which affected the nationalization of land. The purpose of this legislation was to: (1) provide for the systematic denationalization, conversion, privatization and restitution of urban lands; (2) reorganize the legal, social and economic aspects of urban land ownership to promote rational utilization and development of such properties for the common good; (3) provide the legal foundation for such property rights, including guaranteed respect for property borders delineated in the land registry; (4) restore property rights to the rightful owners and their heirs; and (5) protect objects of historical and national significance. Under the law, the land is transferred from the

42. See COOPERS & LYBRAND, supra note 37.
43. IRIDA TOMSONE, SERTIFIKATI UN PRIVATIZACIJA (CERTIFICATES AND PRIVATIZATION) 28 (1993).
44. Id. at 31.
45. Id. at 37.
federal level to the local municipal government, where the restoration process will be accordingly monitored and controlled.

The Law for Denationalization of Buildings was passed October 30, 1991, with an effective date of January 1, 1992. It provided former owners and their heirs, regardless of citizenship, 46 the right to reclaim any nationalized houses. Buildings, apartment blocks and private houses exceeding 170-220 square meters were nationalized in 1940. 47 These buildings could not be alienated, reconstructed, renovated or demolished until all restitution rights were resolved. Furthermore, if any rooms within the building have become unoccupied, no new tenant relationship, legal or otherwise, could be established until privatization had been completed. 48 Existing tenants, upon payment of rent not to exceed that delineated by the Cabinet of Ministers, could not be evicted until after seven years from the time of the privatization, unless a replacement of comparable value was found. 49 Aside from this hindrance, the condition that the property subjected to denationalization could not be privatized until the deadline for making claims had passed also considerably slowed the privatization process. 50

VI. PRIVATIZATION CERTIFICATES

To further complicate the privatization process, the legislation introduced privatization certificates on November 4, 1992. The law aimed to create a legal foundation for the participation of Latvia's citizens in the government and municipal privatization process by developing a payment methodology with privatization certificates. These certificates are issued to Latvian citizens that reflect length of residence in Latvia, and to owners and their heirs as a form of restitution for nationalized and unlawfully occupied properties that will not be returned. Further, politically repressed individuals receive certificates as delineated by the May 13, 1992 status determination law, which defines entitlement based upon the

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47. ANDRIS GRUTUPS, KA ATGUT NOLAUPITO (HOW TO REGAIN STOLEN PROPERTY - A JUDICIAL EXPOSITION ON HOW PROPERTY IS RETURNED TO LAWFUL OWNERS IN LATVIA) 5 (1991).

48. See Tomsone, supra note 43, at 44.

49. Id.

length of time spent in political confinement, exile and concentration camps.51

The value of the certificate equates to an ownership of 0.5 square meters of an average apartment or a nominal value of 28 lats. A certificate account can be opened at the Latvian Republic Savings Bank or Latvian Republic Land Bank. Only through these accounts can certificates be inherited, bought, bequest or devised. These Banks must insure that an individual only has one certificate account. Therefore, those requesting any transaction with certificates must show a line of inheritance and ownership. The option to open such an account expires December 31, 1996.52

A Latvian citizen will receive one certificate for every year of residence in Latvia up until December 31, 1992, irrespective of how many actual years were spent in Latvia. In addition, every person who was a Latvian citizen, as of June 17, 1940, receives fifteen certificates. Any offspring, regardless of age and citizenship, also receive fifteen certificates, as long as one parent was a citizen of Latvia on June 17, 1940. Any resident born outside of Latvia, or one who does not have Latvian citizenship will receive five certificates less than the calculated time he or she has resided in Latvia. Anyone that immigrated to Latvia after reaching retirement years, which is fifty-five for women, sixty for men, and has not been employed at least five years in Latvia will not receive any certificates. If a resident, who was not born in Latvia nor is a citizen of Latvia, has documentation that indicates he invariably resided in Latvia prior to June 17, 1940, he is entitled to certificates in a similar fashion to anyone who had Latvian citizenship as of June 17, 1940.53

Up until recently, privatization certificates and their use have been a bit of an anomaly. As Uldis Klauss, consultant to the Latvian Bank stated,

I am very pessimistic about the certificate system. The government at present needs funding to develop its infrastructure and technology. State-owned property, therefore, should be sold rather than purchased with certificates. Unfortunately, the certificates will not provide anything in regards to forwarding these goals. In

51. Id. at 9.
52. Id. at 10-11.
53. Id. at 11-12.
effect, by issuing these certificates the government is reverting back to socialism principles.\textsuperscript{54}

As of yet, no certificates have been used to acquire ownership in any private or state-owned enterprise. By April 1994, 45\% of the population had received these certificates.\textsuperscript{55}

\section*{VII. SECTORAL PRIVATIZATION - AGRICULTURE}

Structural reform has proceeded most rapidly in agriculture and in the privatization of collective farms. The Law on Privatization of Fisheries and Collective Farms, passed on June 21, 1991, provided that agricultural enterprises be converted to entrepreneurial enterprises allocating shares in the property to members of the collective farm and former owners of the property.\textsuperscript{56} Employees received shares based upon the labor input and time worked at the farm. The members of the newly formed entrepreneurial companies would then have a chance to buy the property and tangibles of the company through shareholding. The legislation proposed a promotion of independent management by former collective farmers.\textsuperscript{57} Financial resources obtained from the privatization was used to pay off the respective liabilities of the enterprise, with the remaining monies to be transferred to a state fund that is independent of budgetary constraints.\textsuperscript{58}

Over 53,800 private farms have been established and most remaining collective farms transformed into private joint stock companies.\textsuperscript{59} However, many of Latvia's new farmers are operating at subsistence levels due to lack of financial resources and credit.\textsuperscript{60} As a result, agriculture did not attain 1992's level of production as gross domestic product reached only 85.9\% of 1992 levels. Production of the major products in the livestock and animal husbandry sector decreased by 24.2\% for meat, 17.6\% for dairy products, and 35.0\% for eggs.\textsuperscript{61} More than 260,000 hectares of farmland remained unseeded due to the

\textsuperscript{54} Interview with Uldis Klauss, U.S. Treasury Department Delegate to the Development of the Central Bank of Latvia, in Riga, Latvia (July 1994).
\textsuperscript{55} \textit{ECONOMIC REFORM AND PUBLIC INVESTMENT IN LATVIA}, \textit{supra} note 1, at 6.
\textsuperscript{56} See Privatization in Latvia, \textit{supra} note 50, at 3.
\textsuperscript{57} \textit{Id.} at 4.
\textsuperscript{58} \textit{Id.}
\textsuperscript{60} \textit{Id.}
\textsuperscript{61} \textit{LATVIJAS BANKA ANN. REP.} 5 (1993).
destruction of many of the collective farms. Adding to these problems is the fact that while control over urban and rural property is being returned to former owners, the legal right to urban property has not been established, and mechanisms for title registration, sale and mortgaging of real property are not yet fully developed.

Privatization of agricultural foodstuff processing, such as milk, meat and bread, was further regulated by independent laws that took into consideration the specific nuances of each enterprise. Based upon two resolutions On the Privatization of Milk Processing Plants, passed April 15, 1992, and January 27, 1993, respectively, state owned milk collecting and processing enterprises were privatized in two rounds. In the first round, a 1940’s functioning dairy cooperative society was allowed to resume operation, including the processing plants associated with such societies. During the second round, those milk processing plants that had not been claimed by these societies as of April 1, 1993, were transformed into joint-stock companies and sold on the basis of 70\% of shares going to milk producers, 10\% to the employees and 20\% to other persons or legal persons.

Based upon the laws, On Privatization of Meat Processing Plants passed May 18, 1993 and On State Bread Producing Plants passed June 1, 1993, the Ministry of Agriculture formed separate privatization committees for bread production and meat processing plants to oversee and coordinate the privatization of these specific industries. Both types of plants were converted to state joint-stock companies and shares sold according to the order specified by the Ministry of Agriculture.

VIII. SECTORAL PRIVATIZATION - BANKING

Underlying the obvious changes to property ownership and business ownership are those of the Latvian banking system. The Latvian banking system underwent a separate privatization process of the former Bank of Latvia branches in 1993. The Bank of Latvia comprised forty-nine branches until the 1992 passing of On the Bank of Latvia law. Under the auspices of this law, the Bank Privatization Commission of Latvia and the Bank Privatization Fund of Latvia organized and implemented the

64. See Privatization in Latvia, *supra* note 50, at 4-5.
65. Id. at 5.
process of separation and privatization by legally ceasing commercial banking activities in 1993.

On May 10, 1993, the Bank of Latvia passed these branches to the Bank Privatization Fund of Latvia where their claims and liabilities were monitored. In 1993, eleven of these were sold in auctions to functioning commercial banks, namely, Banka Baltija, Parekss-Banka, and Olimpija. In addition, eight independent commercial banks were formed out of fifteen former branches by attracting new private capital. At the end of 1993, the recently established Rezekne Commercial Bank (formed out of five former branches) was merged with the commercial bank Banka Baltija. One of the branches was liquidated, and the privatization of one branch had not yet been completed by the end of 1993. The remaining twenty-one branches were united in a new government-owned commercial bank Latvijas Universala banka.66

The Bank Privatization Fund of Latvia received payments totalling 4.6 million lats from the privatization of the branches. Out of this amount, 2.3 million lats were applied to cover losses arising from guarantees issued by Saldus Branch, and to make provision in the Universal Bank of Latvia for the bad debts of these privatized branches. The rest of this revenue (2.3 million lats) was used to augment the statutory capital of the Universal Bank of Latvia.67

The effects of this privatization were evidenced in interest rate decreases and the creation of a more favorable environment for the extension of credit. There was a slow, though definite, reduction in interest rates charged by commercial banks on credits during 1993. With inflation falling, the Bank of Latvia cut its refinancing eight times during 1993 - from 120% at the beginning of the year to 27% in October. Commercial banks followed this reduction much more slowly, keeping interest rates high on short-term credits.68 Annual interest rates on credits to enterprises and private persons were generally above 100% at the beginning of the year; they were around 80% during the third quarter and fell to 60-70% on average toward the end of the year.69 The continued high interest rates on credits imposed by commercial banks may be

67. The share of the Universal Bank of Latvia in the national banking system was considerable; it ranked among the ten largest Latvian banks. Nevertheless, the successful performance of this bank was hindered by the bad credits in its credit portfolio alongside with other problems. As a result, the World Bank has offered assistance to rectify the situation, and to develop it further. Id. at 27.
68. Id. at 11.
69. Id. at 12.
explained by the very high levels of risk incurred due to economic instability in the commercial sector, as well as the high interest levied by already signed deposit agreements. The range of interest margins imposed by various commercial banks was extremely wide, sometimes from 6% to 360%. It is clearly evident such credit rates at commercial banks do not promote investment into the national economy and loans on such conditions are not acceptable for the majority of manufacturers.

Ongoing efforts to restructure and rehabilitate the former branches of the Bank of Latvia will continue by the strengthening of bank supervision and development of a securities market. The legislative basis for securing of loans by collateral will be improved through the adoption of land property and land titling laws for legal entities. With these measures and the promotion of competition by opening the banking sector to foreign banks, the government hopes to bring down the presently high interest rates on issuance of credit.

IX. SMALL SCALE PRIVATIZATION

Small scale privatization has also helped the Latvian economy because Latvia’s growing private sector is estimated to account for as much as 25% of the country’s gross domestic product. In the World Bank’s experience, new private enterprises are perhaps the most dynamic force in promoting economic growth.

Small company privatization was carried out according to the November 5, 1991, Law on Privatization of Municipally Owned Retail, Public Eating Places, Service Establishments and Small Businesses. The law denotes that municipal privatization committees organize the privatization of qualifying enterprises within their jurisdiction. Such committees select the enterprises to be privatized, analyze the operation of such enterprises, determine the initial selling price with specified criteria for the purchaser, and set the form of privatization. Businesses are sold by

70. Id.
71. THE SURVEY OF LATVIA’S ECONOMY AND PROGNOSSES FOR ECONOMIC DEVELOPMENT, supra note 3, at 3.
72. ECONOMIC REFORM AND PUBLIC INVESTMENT IN LATVIA, supra note 1, at 5.
73. As of July 18, 1994, Latvijas Banka has granted licenses to two foreign banks - the German Bank Dresdner Bank (agency license granted in March) and the French Bank Societe Generale (active commercial operation license granted in July). Normunds Lisovskis, Societe Generale sanemusi LB licenci darbibai Latvija (Societe Generale has been granted a license to operate in Latvia from the Latvian Bank), DIENAS BIZNESS, July 18, 1994, at 17.
75. Jeurling, supra note 33.
a range of methods including tender, auction, sale to employees or sale to another business entity. Bidders for the business are required to have resided in Latvia for a minimum of sixteen years. Initially only very small businesses with no more than ten employees were eligible for privatization. The scope of the law was widened when this size limitation was relaxed under an amendment adopted in 1992. Although privatization began slowly during the first quarter of 1992, it accelerated during the remainder of the year and by the last quarter of 1993, an estimated 70% of all small businesses had been transferred into private ownership.

To further promote this sector, the government is in the process of setting up business support centers with the aid of EC-PHARE. This program is intended to provide training, technical expertise and financial assistance to small and medium size enterprises.

X. LARGE PRIVATIZATION

Unlike the progress in small scale businesses, the pace of privatization of large enterprises has been slow. Large privatization in Latvia began in 1991, with partial price deregulation, a liberalization of foreign trade, and the introduction of various legislation. It has proceeded, however, at a relatively slow pace, and the primary reasons for this, as stated by government officials, include non-existing central privatization authority and a general lack of precise privatization legislation.

The large scale privatization was further stalled throughout most of 1992 and 1993, by a series of political, legal, and institutional obstacles, including delay in the settlement of restitution claims because of the citizenship issue; confusion about the currency was to be used to acquire assets and uncertainty about which government ministry had responsibility for the privatization of a particular enterprise. Other obstacles included complicated procedures, poor institutional framework, poor marketability

76. COOPERS & LYBRAND, supra note 37.
77. Id.
78. Id. at 18.
79. Id.
80. Id.
81. ECONOMIC REFORM AND PUBLIC INVESTMENT IN LATVIA, supra note 1, at 6.
82. Id.
of the products of many state firms, high investments to restructure these enterprises into commercially viable units, and difficulties in the settling of debts between firms and the banking system. According to the State Statistics Committee, only thirty-five large state-owned enterprises or 15% of the total earmarked enterprises for privatization had been privatized by November 1, 1993. As of April 22, 1995, eighty-five large state-owned enterprises had been privatized amounting to approximately 19.1 million lats.

The initial laws regulating large privatization, On the State and Municipal Property Privatization Commissions and On the Privatization Order of Objects of State and Municipal Property (Enterprises) were passed on March 17, 1992, and June 16, 1992, respectively. The Czechoslovakian model was used as a basis for these laws. These laws delineated the various methodologies that an enterprise can undergo to be privatized and set the informational requirements for each privatization proposal. The laws further defined the process by which approval must occur, the methods of financing for privatization, and the procedures to which penalties were not adhered.

This case by case privatization process was decentralized and could be initiated from "the bottom up" by any private entrepreneur or enterprise manager. The government compiled and accepted annual lists of enterprises and separate structural units which could or could not be privatized, based upon the proposals made by these enterprise managers or branch ministries. Of the 1,270 enterprises listed for privatization in 1993, 712 were deemed privatizable while 558 enterprises were not. Accordingly, the government had the right to add or delete enterprises to this list.

Once an enterprise was deemed privatizable, any person or legal person (even foreign) could prepare a privatization proposal based upon the enterprise's prospectus, within three months of the initial offering date. Such proposals were submitted to the branch ministry which had the oversight function for the respective enterprise. Unfortunately, such proposals often were delayed or deemed nonfeasible because they did not

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85. ECONOMIC REFORM AND PUBLIC INVESTMENT IN LATVIA, supra note 1, at 5.
86. Id. at 20.
89. BUSINESS WITH LATVIA, supra note 39.
90. PRIVATIZATION IN LATVIA, supra note 50, at 6.
consider the burdens of freeing these enterprises from incompetent management, shoddy products, disputed title claims and payrolls padded with thousands of unnecessary workers. If the respective ministry approved the project proposal based upon the development principles of a particular ministerial branch, the project was introduced to the Ministry of Economics. Once approved by this ministry, the proposal became the official document by which the particular privatization activities had to be carried out. Subsequently, a privatization commission was formed to perform the valuation and oversight functions of the particular privatization method.

Based on the fact that numerous state institutions were involved, that often these institutions performed overlapping functions, and that often these institutions and ministries had differences of opinion, the privatization process continued at a snail’s pace.

XI. ESTABLISHMENT OF THE PRIVATIZATION AGENCY

With the creation of the Privatization Agency (P.A.) by passage of its statutes on March 29, 1994, responsibility for the privatization of large enterprises was transferred to the P.A. Similarly, responsibility for the privatization of large municipally-owned enterprise was transferred to municipal privatization commissions (P.C.), based upon the February 26, 1994 law “On State and Municipal Privatization Commissions.” The goal of these institutions (in particular the P.A.) was to consolidate, within one institution, the privatization process. In addition, by providing a more professional centralized approach to this process, under the auspices of the new law “On Privatization of State and Municipal Enterprises” passed on February 17, 1994, the government hopes that state enterprise privatization would be accelerated. The new law further declares that the key objectives of the privatization of state-owned property in Latvia are to create a favorable environment for the activities of private capital, and to narrow the scope of state entrepreneurial activities.

The P.A. reports to the Minister of Privatization, who is directly supervised by the Ministry of Economics. Enterprises under the control of


92. See Ekonomikas ministrijis valst ipasuma privatizacijis politikas dalas, supra note 87, at 2.

93. Id.

94. Privatization in Latvia, supra note 50, at 3.

95. BUSINESS WITH LATVIA, supra note 39.
individual branch ministries are either transferred directly to the P.A. for immediate privatization or to the State Property Fund (SPF), where they are held until such time as they can be privatized. The P.A. is responsible for supervising all aspects of the privatization process including: (1) evaluating the privatization projects submitted by potential investors, (2) determining any conditions that are to be attached to the privatization of particular enterprises, including the main principles for its restructuring and development, (3) determining any claims for restitution of state-owned property, (4) organizing tenders and auctions, which include disseminating information about the company to the general public, reviewing purchase bids and negotiating sales agreements, (5) receiving privatization receipts, and (6) supervising the operation of sales contracts. Privatization may involve an entire enterprise, or parts of an enterprise, and can be achieved through a number of different methods, including: (1) sale by tender public auction or auction to selected bidders, (2) transformation into a limited liability or joint stock company and sale of shares, (3) by contributing the assets of an enterprise to a joint venture; or (4) closure of an enterprise and liquidation of its assets. The number of state owned enterprises to be privatized amount to several hundred, of which 417 are on the list of enterprises that are not to be privatized.

The new privatization law further denotes that any physical person or registered entity, with private equity capital exceeding 25% (even foreign), can propose upon and acquire state-owned property. The buyer must prove his solvency (i.e. purchasing power), must not be indebted to the state, and the purchase agreement must specify the financing arrangements, with the proper mechanisms of investment guarantees. The P.A. will determine whether such enterprise can be bought by a deferred payment structure, or whether immediate payment is required. The law does not give priority for staff and management to buy shares in enterprises to be privatized. In turn, the buyer has the right to refuse acquisition of certain fixed assets and working capital, which he is not able to use in the further operations of the company. Transactions that are connected with privatization and transfer of the ownership to new owners are exempt from any state or municipal taxes.

96. COOPERS & LYBRAND LATVIA - A BUSINESS AND INVESTMENT GUIDE 18 (Apr. 1994). The SPF also holds those state assets that will not be privatized. Id.
97. Id.
98. Id.
99. Id. at 2.
100. Privatization of Latvia, supra note 50, at 3.
101. Id.
The P.A. will evaluate applications for the privatization of a state-owned company according to several specific criteria. These include the conditions of work, employee training, number of vacancies to be produced, the amount and purpose of the proposed investment, and environmental protection safeguards. Once certain criteria are met, the P.A. will conclude an agreement and land lease with the buyer thereby transferring ownership and liabilities of the enterprise. From the time the P.A. has been established, twenty to twenty-five enterprises will be introduced publicly for privatization every three weeks. The Cabinet adopted its first set of twenty enterprises on May 17, 1994. As of July 20, 1994, more than 200 proposals have been received at the P.A.

XII. NEW PRIVATIZATION METHODOLOGY FOR THE PRIVATIZATION AGENCY - THE SPECIFICS

With the creation of the non-profit joint stock company, the Privatization Agency, privatization procedures have been modified based upon the following procedures:

1) Approval Process - any individual or legal entity can submit a proposal for privatization of all or part of an enterprise. The P.A. registers submitted privatization projects and sends confirmations. The P.A. examines all proposals and prepares a resolution for consideration by the Cabinet of Ministers. If the Cabinet approves the resolution, the enterprise can then be privatized. The Cabinet of Ministers may add requirements to the privatization of these approved enterprises.

2) Preparation for Privatization - if approval is given, control over the enterprise is transferred from the State Property Fund or Branch Ministry to the P.A. This must occur within two weeks of the resolution using official hand-over documentation. These documents include a balance sheet of the previous quarter, an inventory list, a list of the liabilities and responsibilities of the enterprise, as well as information concerning land and its utilization rights. While under the control of the P.A., the managers of an enterprise are prohibited from taking certain actions, such as disposing of assets or accepting large liabilities, without the prior approval of the P.A. Thereafter, the P.A. provides an announcement to the mass media, known creditors, banks in which the

102. LATVIAN BUSINESS GUIDE, LATVIAN DEVELOPMENT AGENCY 58 (Apr. 1994).
103. COOPERS & LYBRAND, supra note 96, at 1.
enterprise has accounts, the Enterprise Register, and the municipality, on whose territory the state enterprise is located, about the privatization of the enterprise. The P.A. sets and publishes the deadline for receipt of privatization projects and other documents. The P.A. is required to provide potential investors with the information required to prepare a privatization project for an enterprise. The P.A. is also required to settle any restitution claims and determine whether any preemptive ownership rights exist over the assets.

3) Privatization Projects - a privatization project must be prepared for each enterprise by each potential investor and submitted to the P.A. The project must include the name and address of the enterprise that is to be privatized, the proposed method, means of payment and timetable for privatization, an indication of the future operation of the enterprise after privatization (or business plan if sold by tender or auction to selected bidders), and information about the individual or legal entity submitting the privatization project.

4) Valuation of Privatization Projects - the P.A. receives all the privatization projects and determines the conditions pertaining to the privatization. The preliminary sale price is determined by the P.A. with reference to a valuation in accordance with the Law on Procedure of Valuation of State and Municipal Enterprises passed February 26, 1994. The preliminary valuation must, upon the request of the P.A., include a valuation of all assets and liabilities, including off-balance sheet liabilities. This valuation will determine the initial offering price. If an attempt at privatization is considered unsuccessful based upon this valuation, the P.A. may adjust this valuation without prior approval of the Cabinet of Ministers.

5) Sale Procedure - if there is more than one acceptable privatization project, the enterprise is sold by tender, public auction or auction to selected bidders. If the means of sale is auction with selected participants, then the conditions of selection of participants must be attached. In order to be considered in selected participant auctions, applicants must submit a business plan to be evaluated by the P.A. and a 10% security deposit calculated on the initial offering price. If the means of sale is tender bidding, then the terms of reference must be attached. The bidder must submit a tender bid, including a business plan for the enterprise along with a draft sales contract. The decision of a tender commission is final and may not be altered or withdrawn. If there is only one acceptable privatization project, the enterprise can be sold directly to the applicant. The P.A. may set a minimum price under which the enterprise will not be sold. Payment can only be made in lats or privatization certificates. If privatization is not completed within the
timetable specified in the privatization project, the P.A. may change the conditions attached to the sale and/or extend the timetable for privatization.

6) Monitor and Management - the P.A. has the right to purchase back privatized companies in cases where the new owner does not operate the enterprise according to the sales contract. The P.A. also has repurchase rights if the new owner resells the enterprise within three years of privatization. According to regulations defined by the Cabinet of Ministers, unprivatized assets and enterprises are either managed by the P.A. until privatized, handed over to the local municipality or institution, or returned to the State Property Fund. New enterprise owners, who are citizens of Latvia, have first right-to-buy options on state or municipal land. The new owners also have the right to lease land at rents determined by agreement between the parties, on which the enterprise is located. The owner has the obligation to sign a lease contract with rents not to exceed those delineated by the Cabinet of Ministers. Disputes in regard to these matters are settled judicially. If a land owner, who has signed a lease contract with the owner of a privatized enterprise, sells the leased land, then the enterprise owner has a pre-emptive right to buy the land.

XIII. NEW PRIVATIZATION METHODOLOGY FOR PRIVATIZATION COMMITTEES - THE SPECIFICS

Based upon the February 26, 1994, “On State and Municipal Privatization Committees,” the Municipal Privatization Committees are the highest ruling body for municipal enterprise privatization. Separate committees may be formed for individual enterprise privatization. This executive committee, which must include at least one union representative, decides which enterprises are to be privatized, adjusts enterprise valuation as necessary to expedite privatization, and approves privatization proposals. Any unresolved disputes at the committee level are decided by the Ministry of Economics.

The function of a Privatization Committee is to manage the privatization process, possibly with the assistance of experts. The division of responsibilities among the members is collegial. Voting is open with resolution adopted by simple majority. The Chairman of the Committee

105. This can include any person who is furthering a specific federal interest, which includes but is not limited to defense, healthcare, culture, or education.

106. See COOPERS & LYBRAND, supra note 37; see also BUSINESS WITH LATVIA, supra note 39; Maris Kivsons, Vaists Mantas likvidesanas kartiba, DIENAS BIZNESS, July 15, 1994, at 4.

has the right to delay the adoption of decisions and have them re-examined. The Cabinet of Ministers may halt any privatization process on the request of the Ministry of Economics within a month of the resolution by the individual privatization committee or the municipal executive committee.  

XIV. ANALYSIS OF NEW METHODOLOGY

Although the New Law on Privatization of State and Municipal Enterprises allows for three methods of privatization: the sales method, the private capital method, and the investment method, the Cabinet of Ministers has only passed regulations for the sales method. As a result, investors looking for creative alternative financing mechanisms have, up until now, been barred from the privatization process. Furthermore, as economist Karlis Briviba states, "Unresolved customs problems, astronomical credit costs, high tax rates, high currency valuation and energy prices are not allowing either local or foreign firms to expand existing production or develop new production, and often interfering with the privatization process." Briviba predicts that even with the expedition of the privatization process, Latvia is coming to an economic crisis level.  

Janis Naglis, P.A.'s general director, further states that there are other logistics problems that are currently facing the P.A. First, if privatization had been started much sooner, the continued viability of many state-owned enterprises would have been much higher. Second, although many enterprises are required to be transferred to the SPF, many have not been as of July 22, 1994. Third, for some enterprises, no one knows who is presently managing them. Fourth, valuation of the respective enterprises has been very tedious and time-consuming, because finding a competent expert to do such a valuation has been very difficult. Fifth, because of the relative ignorance of the populace in terms of knowing what a stock or dividend is and their right to participate in the privatization process, many individuals have not been involved in the privatization process. The establishment of the P.A. was based upon the premise that the economy can only recover with a private sector initiative.

110. Id.
112. In the liquidation of one firm, Elsmira, the P.A. was able to find only one firm, Invest Riga, who was able provide the expertise to valuate the radioelectronic firm. Id.
which, in the past, had not proceeded as quickly as it should have. Therefore, in order for the agency to meet its goal to privatize 75% of state-owned enterprises by the end of year 1996, (which amounts to approximately one privatization per working day for the next three years), many of these problems will need to be resolved.

Foremost to this success will be the full utilization of certificates in at least 100 privatization projects, where approximately 50% of their value will be purchased with these securities. At present many individuals have their certificates, but are not able to use them, except to sell them for currency. Therefore, it will be critical to develop a mechanism for the realization of this goal.

It is hoped that the formation of the Riga Stock Exchange, with the help of France, will provide a network where these securities could be exchanged. If things proceed as planned, the first securities transactions will occur sometime in October. With the development of a computer network, it is hoped that each region will be able to follow such stock activity daily. The French Stock Exchange is currently working with the Riga Stock Exchange to develop the structure and regulations for adopting the continental model which is present in most European exchanges. Naglis, along with many others, believe it may be too late for this process because companies such as Baltijas Vertspapiru Nams and Olevs - Investe are speculatively purchasing certificates for 0.5 lats or even less in the rural areas (even though nominal worth of the certificates is 28 lats) and thereby shifting the concentration of enterprise ownership to only a select few.

Privatization certificates will not be the entire solution to Latvia's economic woes. Enticement of foreign investment into the privatization process will be critical. Presently two firms Coopers & Lybrand (with funding coming from the European Bank for Reconstruction and Development and EC-PHARE programs) and Roland Berger are trying to entice foreign investment. In addition, it is hoped that with the aid of experts, this new methodology will not only allow the government the opportunity to sell the better enterprises, but those that are taxing the government budget with large debts and ecological problems. Furthermore, it is hoped that the politics of the different factions of the coalition government will not interfere with the process.

113. Mikelsons, supra note 104.
114. Id.
116. Mikelsons, supra note 104.
As a final note, one of the Privatization Agency's top priorities will need to be the fair privatization of two entities: The Latvijas Nafta (Latvian Petroleum), which is laden with an $18 million credit, and the Latvian Universal Bank whose bad credit portfolio is currently being guaranteed by the government. Furthermore, to prevent losses for seasonal enterprises, it will be critical to privatize such enterprises before the harvest. In addition, the privatization agency must further promote the use of local materials rather than imported goods in order to help the current economy. Priority should also go to partially completed construction sites. Only the future will determine whether this new privatization methodology will answer these problems.

XV. CONCLUSION

Despite these new laws, it remains to be seen whether the privatization process will be accelerated and whether economic development will be stimulated as a result. It is clear that Latvia has come a long way in the three years since gaining independence. Latvians, as well as the international community, have already recognized that their country is a gateway to the markets of the Commonwealth of Independent States countries. But Latvia's future will strongly depend on the continued development of a strong and viable economy. Latvia could become the "Hong Kong of Russia" or rather the "Switzerland of the Baltics." Like Hong Kong, Latvia is attracting attention as a stable platform for business, favorably situated next to an economically powerful, yet in many ways troubled, neighbor. In contrast to Hong Kong, Latvia sees a European future for itself, and it has taken the first step toward membership in the European Union by initialising a Free Trade Agreement with the European Union on June 20, 1994. With Latvia's entry into the European Union on the horizon, it will only be a matter of time before the completion of successful economic reform which will attractively position Latvia to become a successful competitor with respect to two major markets - Russia to the east and Europe to the west.

117. Only Parex Bank has officially submitted a privatization proposal regarding the Latvian Universal Bank. Other possible interested parties could be Latvijas kapitala banka, Ogres and Liepaja commerce banks. Mikelsons, supra note 104.

118. Id.