

**Building legitimacy for economic policies in Latvia:
a question of disputed identity, "rhetorical action"
and the EU Competition policy**

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This thesis is dedicated to my dear Kārlis and Edgars

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Abstract

This thesis is based on a constructivist approach to economic restructuring in Latvia, with comparative insights from Estonia. The aim of the project is to apply constructivist epistemology and Frank Schimmelfennig's model of rhetorical action to study how ideas or discourses shape and reflect economic structures. The project is relevant, because economic restructuring in Latvia and post-communist contexts in general has been studied mostly with a political-economy approach. This thesis aims at offering an alternative perspective, a perspective that focuses on ideational and ideological aspects of post-communist transition and Europeanization as analytical categories.

The aim of the empirical analysis is to illustrate the general phenomena of interest here – the discursive creation of economic identity of a nation – creation of an 'economic self' in Latvia. This macro-level social construction is evident also in the micro-level, that will be illustrated with two case studies related to disputes on EU's Competition policy in Latvia.

Case studies were chosen as samples of the most vividly discussed issues in Latvia in the period after accession to the EU. The puzzle that will be addressed is the absence of such disputes or "rhetorical action" in Estonia, a structurally very similar system. This puzzle allows relating this study the current debates in Europeanization literature. The case of Estonia will be evaluated as an explanatory variable for the hypothesis, that misfit between Europeanization pressures and domestic social context trigger rhetorical action.

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Introduction

Development of national economies was one of the central motivations for the ruling elites early in transition. The Baltic economic model was based on market-liberalism that was “locked in” once the preparations for EU accession started (Feldman 2001, 2006).¹ This model refers to macro-economic stability and micro-level restructuring that is aimed at effective allocation of resources and change in economic incentive structures. To a certain extent, the goal of these policies was to change the way of thinking in society and promote “new ways of doing things.”

At the same time, these policies were not implemented in *a vacuum*. Economic restructuring has a lot to do with changes in shared ethical and moral values, or to put it differently, the social context. Rachel Epstein defines social context as mutually shared understanding about what constitutes a functional economic policy and legitimate distributional claims². In regard to the Baltic States, Feldman (2006) argues that the policies of economic restructuring enjoyed high popular support in society at large³. However, it is questionable whether regular citizens got the gist of the growth models, considering that they had lived all their lives in a planned-economy orchestrated from Moscow.

The **aim** of this thesis is to apply the social constructivist approach to uncover the process of what Ben Rosamond called “assertion of an economic self” in one of the Baltic State – Latvia. This notion of “an economic self” refers to an intensive discursive practice, and the discussion of this practice is related to important theoretical considerations about the role of ideas and discourses relative to interests in economic life.⁴

The “economic self” can also be understood as one aspect of collective identity that provides the basis for legitimacy needed to implement certain policies, creates structural conditions that *enforce* the claims of certain actors, and give them *access* to the process of shaping of economic policies.

¹ See Darden (2001) who argues that market-liberal and mercantile ideas were equally strong in Lithuania

² Rachel A. Epstein, “Cultivating Consensus and Creating Conflict,” *Comparative Political Studies* 39, no. 9 (November 2006): 19

³ Magnus Feldman, „The Baltic States: Pacesetting on EMU Accession and the Consolidation of Domestic Stability Culture.” In *Enlarging the Euro Area*, ed. Kenneth Dyson (Oxford: Oxford University Press, 2006): 128

⁴ Ben Rosamond, „Imagining the European Economy: „Competitiveness” and the Social Construction of „Europe” as an Economic Space,” In *New Political Economy* 7, vol. 7 (2002): 157

In the post-communist contexts, the creation of “an economic self” can be related to the political functions of national identity. Anthony D. Smith (1991) has argued that national identity is crucial for uniting the nation, defining its character and values, and the subsequent legitimating of legal, social and institutional order.⁵ David Landes argues that the “lack of firm identity, a sense of national purpose and collective identification with common interest”⁶ can be a major impediment to economic development in new states. However, Landes has focused largely on the mobilizing effect of nationalism, omitting the political implications and conflict potential of this ideology. Smith has rightly pointed out that “official nationalism” of state institutions can be aimed at ethnic assimilation of a perceived nation-state that is a major source of instability and conflict in modern times.

Smith’s and Landes’ arguments touch upon the general role of ideology in political and economic organizations. Douglass C. North, a scholar of economic history, has approached ideology with a transaction costs analysis. North claims that “costs of maintenance are inversely related to the perceived legitimacy of the existing system”⁷. Thus his theory intersects with Smith’s claim that ideological arguments are often used by the professional elite in order to create legitimacy. Similar to Smith, he also implies that legitimacy can not be simply imposed upon people or manipulated in to their minds. Ethical and moral judgments about what is fair, proper and equitable constitute the *ideological make-up* of individuals as members of economic and political organizations⁸. A successful ideology must provide a convincing image of the particular experience of various social groups and the larger system⁹.

It is not the purpose here “to go deeper” into concepts of ideology and consciousness, but rather to focus on the rhetorical use of identity-based and norm-based arguments in the public discourse, as that certainly matters for a smooth functioning of state and economic regime. As Landes has rightly argued, the change of economic structures is successful only if the “new ways of doing things” become embedded in society¹⁰, and this is indeed challenging for new states. The **research question** then is the following – what are the ideas that domestic social actors use in order to conceptualize, respond or resist structural change, and how do these ideational aspects shape the political

⁵ Entonijs D. Smits, *Nacionālā Identitāte* (Rīga: Sorosa Fonds Latvija, 2002): 25

⁶ David Landes, „Does it Pay to be Late?” In Jean Bataeu ed., *Between development and Underdevelopment* (Geneve: Publications du Centre D’Histoire Économique Internationale de L’Université de Geneve): 64

⁷ Douglass C. North, *Structure and Change in Economic History* (W.W. Norton, 1981): 53

⁸ Douglass C. North, *Structure and Change in Economic History* (W.W. Norton, 1981):

⁹ Ibid, 57

¹⁰ David S. Landes, „Why Are We so Rich and They so Poor?” Richard T. Ely Lecture, In *American Economic Review* (May 1990) 1-13

economy of the transition countries? I will focus on Latvia as a representative sample from the Baltic group.

As the focus here is on economic restructuring and the change of thinking, ways of doing things in the economy, in the empirical part I will study Competition policy area. In the post-communist context, establishing free competition was essentially linked to creating effective legal and institutional base that would protect free competition. Another aspect of competition regulations was the top-down impact of EU in this sphere that can be conceptualized as the first Europeanization pressure in the Central and Eastern European countries (CEECs). Estrin and Holmes (1998) argue that already in the European Agreements the adoption of EU's competition rules was defined a prerequisite for trade liberalization between EU and that CEEC's, and the successful rule adoption in this policy area was linked to EU-membership incentives¹¹.

Competition free from state intervention is the central premise of market-liberalism; however, the opinion in the literature is that certain regulation is necessary to protect society's interests.¹² This view is deeply embedded in the Competition regulations in the EU. Thus Latvia as a market-liberal economy and EU-member state should have little issues with these norms and regulations. Yet, this is not the case.

The puzzle that will be addressed with studying two cases from Latvia is defined in a comparative context. Namely, how to explain the observation that in Latvia there is high level of rhetorical action in the field of Competition policy (in the period after accession to the EU), however, no such rhetorical action in the same field can be observed in Estonia?

The study of two cases will allow to make inferences about the general phenomena – discursive creation of an “economic self” or economic identity of a state. It has to be noted that the puzzle will be studied with a primary focus on Latvia (*rhetorical action in Competition policy as the dependent variable*), while Estonia will be considered as an *independent or explanatory variable*.

This strategy is justified according to the **hypothesis** that *misfit between Europeanization pressures and domestic social context triggers “rhetorical action” based on contestation between different conceptions of national economic identity* (rhetorical action in the sense of Schimmelfennig's model that will be discussed in the

¹¹ Saul Estrin and Peter Holmes, *Competition and Economic Integration in Europe* (UK, USA: Edward Elgar Publishing): 3

¹² Jan Zielonka, *Europe as Empire* (Oxford: Oxford University Press, 2006): 85

theoretical part). Deeper reasons that could explain the absence of structural misfit in Estonia (e.g. the higher level of FDI, different export structure, institutional variables) will not be addressed, as this would exceed the scope conditions of this study.

Two aspects will be evaluated as features of “Estonian variable”— variation in domestic ideas and discourses about economic identity, and the spill-over effects of this identity-based variation into the pragmatic process of Europeanization. Latvia and Estonia are structurally very similar¹³ thus variation in ideas and spill-over effects has a great explanatory potential.

This research agenda is related to the theoretical debates in Europeanization studies on the proper methodology (and epistemology) in studying change in CEE states. On the one hand, the varying degrees of “fit” are studied using the methods of comparative politics. On the other, the methods of the “constructivist turn” are used to show how the shape and type of the polity emerging in the EU affects the national notions of democracy, state and economy (Christiansen, Jorgensen and Wiener 2001; Schmidt 2004).

According to the latter approach, domestic elite actors act as “intellectual entrepreneurs” and use norm-based arguments to relate the specific economic policies with the wider concept of national identity as well as the international democratic and market-liberal norms. The methodology of “rhetorical action” model of Frank Schimmelfennig (2001) will be used to understand the identity, interests and behavior of elite actors¹⁴.

Constructivist methodology and “rhetorical action” model will be discussed first chapter. This discussion will help to understand how the local political elites managed to “lock in” market-liberalism and, later on, Europeanization into the domestic political and social context. This issue will be discussed in the second chapter. The third the chapter will deal with case studies.

¹³ Latvia and Estonia are both former members of the Soviet Union; small economies; started transition to market economy and democracy at the same time; the progress towards accession in the EU has been roughly the same (Latvia managed to catch up with Estonia, although Latvia started accession negotiations two years later); the geographical location and even the climate is the same. It has to be noted that there are certain ethnic, linguistic and cultural differences between the two nations. Nevertheless, these aspects were crucial in the process of nation-building and redefinition of national identity that both nations conducted in a similar historical situation (the Soviet past) and facing similar future challenges (the need to modernize, return to Europe etc.) Thus the functional role of cultural variables is again very similar.

¹⁴ Frank Schimmelfennig, „The Community Trap: Liberal Norms, Rhetorical Action, and the Eastern Enlargement of the European Union,” *International Organization*, 55, Vol 1: 47-80

1. Social constructivism approach to identities, interests and behavior

The opportunity costs for the regular citizens to understand the exact content and effect of policies and actions that are conducted by political and technocratic elites would definitely exceed the benefits of this activity. Treaties, directives, and communications of the EU institutions are often understood by a limited circle of insiders.¹⁵ Thus in order to create support for reforms, the state must “create sentiments of wider resonance” (Landes, 1900). The concepts of nation-building and ideology intuitively imply that norms are created and applied discursively, thus appropriate methods should be used to analyze them. For this purpose the rationalist approaches that account mainly for “inputs” – material incentives will be augmented with insights from social constructivism that help to understand the process and “outputs”.

The discussion about the role of ideology in transformative processes in post-communist contexts can be positioned within the general theoretical agenda of social constructivism. This agenda can be understood as an *interface* of shared assumptions that constructivists borrow from two binary opposed poles in theorizing - rationalism and reflectivism. Rationalism is based on a deductive-nomological model of causal explanation, materialism, more or less strong rationality assumptions.¹⁶ Reflectivism, on the other hand, is the antithesis of rationalism, associated with an awareness of the political. The principal difference between the two poles is in the level of epistemology - it is manifested in the assumption of endogenous and exogenous interest formation, “a gap that offers little choice for synthesis.”¹⁷

The approach of constructivism is an attempt to establish “a middle ground” between these two poles. Ruggie (1998) argues: “constructivists hold the view that the building blocks of international reality are ideational as well as material.”¹⁸ The method of this theorizing is *intersubjective* – each constructivist position if formed by the distance

¹⁵ Thomas Christiansen, Knud Erik Jorgsen and Antje Wiener, *The Social Construction of Europe* (London: Sage Publications, 2001): 6

¹⁶ Ibid, 4

¹⁷ Thomas Christiansen, Knud Erik Jorgsen and Antje Wiener, *The Social Construction of Europe* (London: Sage Publications, 2001): 4-8

¹⁸ Ruggie (1998) as cited in Thomas Christiansen, Knud Erik Jorgsen and Antje Wiener, *The Social Construction of Europe* (London: Sage Publications, 2001): 3

to each pole.¹⁹ Thus the range of constructivist positions can be located on a semi-circle connecting the two opposed poles. According to Christiansen et al. (2001) this means that social constructivist approach would not seek to invalidate rationalist approach, but that it addresses the wider questions of the origin and reconstruction of identities, the impact of rules and norms, and the role of language and of political discourse²⁰.

This *middle ground* argument enables to map theoretical frameworks of EU-integration and Europeanization according to where they stand in relation to ideational and material “poles”. Preference will be assigned to models that offer a theoretical position that is able to “talk” to both poles of the continuum – the rationalist and the reflectivist, rather than assuming the incommensurable binary opposition between them. Constructivism offers a wide range of methodological tools – identity, speech-act, learning, persuasion and discourse. In line with the “middle ground” tradition, the choice of tools will be closer to the “softly rational” constructivism that connects the neo-functional theories of EU integration and social constructivism.

1.1. The “middle ground” theories

One such theory is Jeffrey Checkel’s notion of social learning. Although it is very close to the rationalist pole, he tries to combine rational choice and sociological institutionalist approaches in explaining how domestic actors respond to changes in supranational norms.²¹ Checkel’s socialization and social learning model stresses the role of “intervening variables” that are crucial in the national policy arena. From this perspective, particular conditions are necessary for social learning and change of behavior to occur – first, uncertainty about the problem at hand; second, the existence of an authoritative reference model and third, insulated institutional context.²² These conditions are conducive for the diffusion of new norms and learning process at the elite level. Risse (2000) has argued that all these conditions favor the willingness to learn, that is, change held beliefs or preferences on the basis of new information and arguments.²³

¹⁹ Ibid, 9

²⁰ Ibid, 12

²¹ Ibid, 16

²² Checkel (2001) as cited in Adrienne Heritier, “Europeanization Research East and West,” In *The Europeanization of Central and Eastern Europe*, ed. Frank Schimmelfennig and Ulrich Sedelmeir (NY: Cornell University Press, 2005): 203

²³ Risse (2001) as cited in Adrienne Heritier, “Europeanization Research East and West,” In *The Europeanization of Central and Eastern Europe*, ed. Frank Schimmelfennig and Ulrich Sedelmeir (NY: Cornell University Press, 2005): 203

Checkel's approach can be augmented with Marcussen's model of norm change through "critical junctures" that accounts better for the structural sources of uncertainty and emergence of reference models. "Critical junctures" model perceives norm change as response to a dramatic, destabilizing political or economic shock.²⁴ Shock is seen as a necessary precondition for norm change as the immediate effect of this destabilization is ideational vacuum. Precisely in this situation in which uncertainty could be seen as a defining feature, a number of competing ideas can be promoted through different norm diffusion mechanisms.

In terms of the constructivist map, "critical junctures" framework is similarly closer to the rationalist pole. The defining feature in this respect is that the depth to which the norms are institutionalized and adopted by actors depends of the effectiveness of socialization and social learning mechanisms. Flockhart's application of this model to the study of elite and mass socialization in Denmark focuses on the interests and motivation of actors. The use of methodological tools is congenial to constructivism, however, the formation of identity, interests and behavior is clearly separated from rhetoric and discourse.

This framework can be applied to understand how elites learned new norms after the fall of Soviet Union. However, it does not explain whether and under which conditions elite actors *internalize* norms so that they become constitutive and shape actor's preferences. Due to the "stickiness" of existing habits and ways of thinking and doing things, it is likely that new norms do not substitute the "old". New elements can be "patched up" by adding them and at the same time maintaining the old policy instruments, in a process that Heritier (2005) calls "layering".²⁵

Checkel claims that historically constructed domestic identities can create barriers to agent learning from regional/systemic norms²⁶ (2001 p. 565). However, one can claim that regional/system norms may represent a sort of a rival set of values to the already established habits and shared understanding. Schimmelfennig's (2001) "rhetorical

²⁴ Marcussen (2001) as cited in Trine Flockhart, "Critical Junctures and Social Identity Theory: Explaining the Gap between Danish Mass and Elite Attitudes to Europeanization". *Europeanization Studies Series of Occasional Papers*, 3 (2003) Available at: <http://ideas.repec.org/a/bla/jcmkts/v43y2005i2p251-271.html> (cited April 13): 8

²⁵ Adrienne Heritier, "Europeanization Research East and West," In *The Europeanization of Central and Eastern Europe*, ed. Frank Schimmelfennig and Ulrich Sedelmeir (NY: Cornell University Press, 2005): 201

²⁶ Checkel, J. T. "Why Comply? Social Learning and Identity Change," *International Organization*, 3 (September 2001): 565

action” helps to account for this situation, and this model will be discussed in more detail in the next section.

1.2. Drivers, brakemen and rhetorical entrapment

Schimmelfennig’s (2001) “rhetorical action” could be one of possible theories that help to explain institutionalization of “the winning set of ideas” among the elite and society at large. Within the constructivist middle ground, his framework is closer to the rationalist pole. Although he uses the constructivist methodology - speech-acts (official documents, speeches, declarations, and statements at press conferences²⁷), his analysis is based on rationalist assumptions about agency and structure, and an essentially rationalist causal explanation.

Nevertheless, the strength of his model is the assumption that actors are generally *weakly socialized* – they belong to a community whose constitutive values they share, however, it is not expected that collective identity shapes concrete preferences.²⁸ In the public space actors may express commitment to the community and interest in upholding its values and norms, however, the real interests and preferences of actors may contradict these speech acts. Actors often develop and instrumentally pursue egoistic material interests that compete with commitment to community values and norms²⁹.

Rhetorical action model is based on intersubjective epistemology that enables to account for the constitutive aspects of a normative regime. Schimmelfennig analyzed how liberal norms formed an important part of agent identities - the public image of the EU member states that had to decide about the inclusion of CEEC’s in the Union. However, in his analysis norms had a much more profound impact on actor’s identities, interests and behavior. Ultimately, he claims that the strategic use of norms determined the collective outcome of intergovernmental bargaining – the decision to enlarge the EU to 25 countries that would not have emerged “from the constellation of interests and power alone”³⁰.

The intervention of rhetorical action in the collective bargaining was possible due to the intersubjective meaning of the whole EU integration project. As Schimmelfennig rightly claims, since the beginning, European integration has been legitimized by the

²⁷ Frank Schimmelfennig, „The Community Trap: Liberal Norms, Rhetorical Action, and the Eastern Enlargement of the European Union,” *International Organization*, 55, Vol 1: 66

²⁸ Ibid, 63

²⁹ Ibid

³⁰ Frank Schimmelfennig, „The Community Trap: Liberal Norms, Rhetorical Action, and the Eastern Enlargement of the European Union,” *International Organization*, 55, Vol 1: 48

ideology of a pan-European community of liberal-democratic states³¹. As a result, these norms served a crucial role in arguing and persuasion. The “drivers” of enlargement could use rhetorical action as a way of shaming and entrapping the “brakemen”. The drivers - Germany, Great Britain and the CEE governments used *shaming tactics* vis-à-vis the brakemen, as the normative context of EU enlargement enjoyed wide resonance and legitimacy.³²

It has to be noted that rhetorical action model offers an international-level explanation. In particular, the brakemen felt “rhetorically entrapped” for two reasons. In case of defection they would lose legitimacy and credibility as members of the EU community of values. EU norms formed a substantial part of *the standard of legitimacy* of relevant actors. Second, the drivers took advantage of the disputed identity of the brakemen as *weakly socialized agent*. As the materially determined preferences of brakemen deviated from institutionalized norms, rhetorical action was effective in shaming and silencing these distributional claims.³³ The absence of competing speech acts is considered as the most important indicator of rhetorical entrapment.³⁴

This model is interesting in a general level in order to explain the role of ideology in decision-making and certain political processes. First of all, instead of looking for “true motivations”, the focus is on the strategic use of norm-based arguments and the causal effect of this process. Second, this model defines certain scope conditions in which rhetorical action is possible. And third, it offers analytical tools that help to conceptualize the interests, strategies of actors involved in rhetorical action, and to evaluate the outcomes.

The major weakness of Schimmelfennig’s models is that it does not account for the situations where the normative context is “layered” and actor’s identities are not fixed to one collective ideology. In particular, this refers to the Europeanization processes in the post-communist member states where European values and national identities could represent opposing, but equally strong ideologies (the same could be true for the “old” member states as well). Identities of domestic actors, their interests and behavior thus may be caught up in a dynamic interaction between two ideological platforms.

Miller (1995) argues that national communities can be separated from international communities by their shared notions of ethical values and principles. The

³¹ Ibid

³² Ibid, 50

³³ Ibid, 65

³⁴ Ibid, 60

political life in a state is based on a historical process of nation-based communication and the idea of the nation as an ethical community.³⁵ These shared notions are crucial preconditions for deliberation about common good and goals of political action. Thus communitarians claim that deliberation - the use of arguing strategies in political decision-making that rest on claims of factual truth and/or normative validity³⁶ is only possible in national level, or that cross-border deliberation is not empirically significant.

Nevertheless, the constructivist view is that international communities can emerge as a result of trust-building and a cross-border feeling of shared belonging.³⁷ Not only interests, but shared normative concepts matter in international politics. Neyer (2003) claims that in the EU member states have clear incentives to engage in cross-border deliberative interaction, because EU integration depends on cooperative exercise on governance and an effective solving of collective action problems. Empirical studies have shown that exit strategies such as vetoing and hard-bargaining are used as strategies of “last resort”³⁸.

Another aspect that necessitated upgrading of the rhetorical action model is the possible discrepancy between domestic and international legitimacy standard. In post-communist contexts the legitimacy standard may differ from the “old” European democracies and more likely is based on materialism and material values such as survival and security³⁹. In an empirical study Bjorklund and Luibiniene (2004) find no link between liberal attitudes towards morals and democratic trust in the Baltic States. Koroleva and Rungule (2004) find that in Latvia for 76% of citizens the top priority political value is economic growth that indicates economic survival and individual living standards as the central concerns in society. The virtue of norms and normative consistency thus emerges as a second-order priority.

Domestic values and shared understandings in society are crucial factors in political life and deliberation about political goals. This aspect is relevant when applying

³⁵ Miller (1995) as cited in Jürgen Neyer, „Discourse and Order in the EU: A Deliberative Approach to Multi-Level Governance, ” *JCMS* 41, no. 4 (2003): 700

³⁶ Ibid, 691

³⁷ Adler and Barnett 1998 as cited in Jürgen Neyer, „Discourse and Order in the EU: A Deliberative Approach to Multi-Level Governance, ” *JCMS* 41, no. 4 (2003): 702

³⁸ Ibid

³⁹ In a study of value-orientation in Baltic States (according to Inglehart’s “scarcity hypothesis”) Bjorklund and Luibiniene (2004) find that in all three states occurrence of post-materialist values is very low (correlated with the level of education, age). Thus authors infer that these are “closed societies” with lack of tolerance towards different social groups. Trust towards state institutions has the highest correlation with economic performance of the national economy and satisfaction of household economy. This indication is not so promising for stable democracy.

rhetorical action model to domestic context, where EU norms and national, local values may coexist. Rachel Epstain has argued that domestic social context may hinder the cultivation of consensus for the support EU policies and norms. In studying EU policy transfer and social conflict in Poland her strategy was to consider social context as a crucial intervening variable in rule adoption and deliberation about international norms. However, she claims that local norms are less powerful in conditions of uncertainty, characteristic to societies in an early phase of transition. Thus she claims that uncertainty about values, goals and preferences conditioned the argumentative power of international epistemic communities.

Thus we can conclude that both international and national norms are crucial in the *intersubjective* understanding and discursive construction of identity, however, the conditions of post-communist states (as defined by Checkel – uncertainty, existence of authoritative models, and the “critical juncture” after the dissolution of SU) opened up channels of socialization and social learning. In short – the identities and values are not static in these societies, or externalized from material conditions and interest, but rather created in a dynamic interaction.

For the purpose of the empirical section, it is important to add that domestic social learning and socialization is also conditioned by normative consistency at the international level. Epstain claims that “normative consistency limits target actors’ argumentative space for disagreeing with particular policy prescriptions”. Thus in studying EU policy transfer it is crucial to consider the level of normative cohesion at the EU level and in other EU member-states as that may impact deliberation strategies of domestic actors. Normative consensus at the EU level has the effect of conveying to states in transition which groups do and do not have legitimate claims in the distributional struggles.⁴⁰

With these qualifications and additions in mind, it is still possible to use Schimmelfennig’s rhetorical action to study the deliberation of Europeanization pressure on the one hand, and national values, identity, the social context on the other. The basic assumption of rhetorical action provide for equal respect to both ideational and pragmatic aspects, thus this model is appropriate for studying how ideologies are important for economic transition and restructuring of post-communist states.

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⁴⁰ Rachel A. Epstain, “Cultivating Consensus and Creating Conflict,” *Comparative Political Studies* 39, no. 9 (November 2006): 5

The next section is devoted to the possible objection that Schimmelfennig's rhetorical action is actually a model for "grand bargaining" and can not explain every-day politics in member states.

1.3. The need for "middle ground" in Europeanization theory

One objection to the use of rhetorical action in the post-communist contexts is the fact that Schimmelfennig elaborated the model of rhetorical entrapment to explain the EU enlargement that was essentially a grand bargain with a unique constellation of interests, actors and norms. Schimmelfennig (2005) together with Sedelmeier has elaborated a different approach for the purpose of conceptualizing Europeanization or "the dynamic of EU's conditionality" in domestic politics of CEE states. However, the impact of ideologies and strategic use of norm-based arguments is omitted in the approach to Europeanization of CEE states.

Instead, rhetorical action has a rather negative connotation in his approach to Europeanization. The strategic use of rhetorical action by domestic actors is conceptualized as the antithesis of proper Europeanization – it means that "domestic actors just "talk the talk" or pay lip service to the norm", and that they are not "truly persuaded by the norm."⁴¹ Thus one can infer that the possibility that the CEE actors become *weakly socialized agents* is seen as dangerous or at least in conflict with the preferred rule adoption models. Instead, a positive connotation is ascribed to social learning and lesson-drawing, when the CEE states themselves decide to adopt EU rules without the material incentives and pressure from EU.

The three models of Europeanization - external incentives, social learning and lesson drawing propose ways to predict the likelihood of rule adoption and the subsequent form of rule adoption. The motivation of domestic actors to adopt rules is structured according to the binary opposition between the two poles - logic of consequences and logic of appropriateness. The former assumes strategic, instrumentally rational actors who seek to maximize their own power and welfare, while the latter actors are motivated by internalized identities, values and norms.⁴² Thus rule adoption is not connected to a dynamic interplay between material interests and norms, and the authors have left out the *intersubjectivity* aspect of rule adoption. It can also be argued that the interplay between

⁴¹ Ibid, 8

⁴² Ibid, 9

top-down Europeanization pressures and domestic politics is beyond the scope of their research interest. Nevertheless, these models do not provide adequate methodological tools for the purpose of this thesis.

To some extent this observation can be justified with the tradition to distinguish between Europeanization West and East. As Heretier (2005) argues, the difference originates from the particular conditions of Europeanization East that is linked to democratic and economic transition, and the link with accession negotiations. Thus the research agenda of Europeanization East is focused on the one-way street of influence vis-à-vis EU policies (East) as opposed to the two-way street of influencing as well as being influenced (West).⁴³

It can be argued that Europeanization studies are generally based in binary oppositions (e.g. down-loading vs. uploading). Peter Mair (2004) has criticized other binary oppositions between Europeanization as *institutionalization* of “distinct forms governance at the EU level” and Europeanization as *penetration* “of European rules, directives and norms in national contexts”⁴⁴. He argues that these “two faces of Europeanization” constitute two opposing ends of a *single* Europeanization dimension. As it can be seen, the logic of theorizing is similar to Christiansen et al. all that used intersubjective epistemology to establish a constructivist middle ground between rationalism and reflectivism.

Mair (2004) proposes that the interrelation of both faces of Europeanization can be achieved with a different research focus that would necessitate a redefinition of the problem at hand and a different methodology. The focus of new research agendas, as he claims, should be Europeanization of areas where “politics arise” - understood as political mobilization, resistance and conflict. There is also the need to shift away from studying politics as problem of administrative efficiency and institutional appropriateness.⁴⁵ This tradition to perceive Europeanization as convergence or standardization is associated with the use of this concept in the comparative politics literature.⁴⁶ Thus it is evident that a certain “Europeanization interface” similar to the constructivist middle ground is also necessary.

⁴³ Adrienne Heretier, “Europeanization Research East and West,” In *The Europeanization of Central and Eastern Europe*, ed. Frank Schimmelfennig and Ulrich Sedelmeier (NY: Cornell University Press, 2005): 210

⁴⁴ Peter Mair, „The Europeanization Dimension,” *Journal of European Public Policy* 11 (2004): 339-340

⁴⁵ Peter Mair, „The Europeanization Dimension,” *Journal of European Public Policy* 11 (2004): 344

⁴⁶ Ibid, 342

After accession to the EU rule adoption has become increasingly connected to domestic politics, and Mair's (2004) suggestion is to perceive Europeanization as a new conflict dimension in domestic politics. He claims that the increased occurrences of divergence should not be explained as "misfit" – that is, that there are a variety of administrative, policy-based, or institutional reasons why various European proposals fail to match existing domestic practices.⁴⁷ Instead, it is important to explain how rule adoption is mediated through actor preferences, how Europeanization becomes a part of the domestic political conflict e.g. in the programs of national parties.

Europeanization conflict dimension is related to the conflict between the "core" and "periphery" states that attracted attention in structuralist analysis of Europeanization (Bohle 2002)⁴⁸. These claims have been challenged by the constructivists that argue that EU integration has blurred the traditional understandings of this core-periphery relationship. Geotz (2006) has argued that differentiation in the Europeanization experience in multi-country grouping is a moving target and key explanations for variation (territorial difference, dependence and distance) are themselves dynamic rather than static.⁴⁹

Although the question of asymmetric relationship is a relevant research topic, it will be excluded from the scope of this study mainly due to limited space and time. Nevertheless, the author is highly aware that the ideological or ideational concepts of Baltic economies intersect in with dependency dimensions in at least two respects – the energy dependency from Russia, and trade dependency from the EU. The material asymmetry or dependency (e.g. trade balance, export structure) will be exogenous variables as the central focus here is questions of why, how and for what purpose actors use norm-based arguments to deal with domestic Europeanization "misfits".

Finally, it has to be stated that for all these reasons, Europeanization will be conceived as a discursive process in this thesis. This approach conceives social power relations as "always dynamic, contradictory and contestable processes."⁵⁰ According to Lindstrom and Piroška (2004), Europeanization delimits the context and structures in

⁴⁷ Ibid, 344

⁴⁸ Klaus H. Goetz „Territory, Temporality and Clustered Europeanization," *Political Science Series* (April 2006) : 14

⁴⁹ Ibid, 14

⁵⁰ Nicole R. Lindstrom and Dora Piroška, „The Politics of Europeanization in Europe's Southeastern Periphery: Slovenian Banks and Breweries on S(c)ale. In *Queens Papers on Europeanization*, 4. Available at: <http://www.qub.ac.uk/schools/SchoolofPoliticsInternationalStudiesandPhilosophy/FileStore/EuropeanisationFiles/Filetoupload.38402.en.pdf> (cited April 10): 3

which applicant states' policies on Europe are directed and legitimated; however, this process is not a strictly top-down asymmetrical influence. Europeanization in terms of discourse and practice both constrains and enables actors, and interaction between these actors in particular domestic fields (Bordieu 1991; Leander 2001).⁵¹ The discursive approach to Europeanization is inline with the choice of methodology, as the rhetorical action model will help to show how norms are applied discursively and enables to take into account the possibility that actors may partially identify with international as well as national norms and values.

To sum up, the overall advantage of social constructivism is that it refuses to make simple linkages between material circumstances, interests and rhetoric. Structural and agential variables as discourse and rhetoric matter in the discursive construction of interests (Rosamond 2002)⁵². Thus the existence of objective, "underlying" interests can be rejected. Instead, it is crucial to understand how interests become objectified and what strategies agents use to prevail in the public discourse.

⁵¹ Ibid

⁵² Ben Rosamond, „Imagining the European Economy: „Competitiveness” and the Social Construction of „Europe” as an Economic Space,” In *New Political Economy* 7, vol. 7 (2002)

2. National identity and the “return to Europe” in post-communist contexts

Estonia and Latvia regained independence after the fall of the Soviet Union, and the post-communist restructuring has been mediated by questions of *who is the nation*, *what are the values and goals of this nation*, and certainly a great deal of “official nationalism”⁵³. It would be an interesting question for further research to find out whether the ruling elite actually realized the inherent instability and conflict potential of nationalism ideology. That is, whether the need to avoid the destabilizing impact of nationalism motivated the early choice to align with an “external anchor” for domestic economic and political reforms. The “heaviest” external anchor has been the EU that provided a legitimate source for domestic reforms. However, this legitimacy did not emerge *naturally* or spontaneously, as it was argued in the theoretical sections, but was conditioned by norm-based argumentation or rhetorical action.

Balcerowicz has called the period immediately after liberation as “extraordinary politics” that offers a window of opportunity for policy makers to pursue radical reforms (Balcerowicz, 1995). High political capital enables a certain electoral isolation of economic policy, necessary to kick-start liberalization and structural reforms⁵⁴. Nevertheless, the holistic nature of post-communist economic reforms implies a deep impact on vested interests and opportunity structures of elites. At the same time the implementation of reforms almost exclusively depend on the elite mind-set and actions. Looking from today’s perspective - how did the new elites in the two Baltic States perceive the tasks in economic sphere? How did they choose the appropriate model? And finally – how important was the task of creating support and understanding of the new economic system in society at large?

In regard to the Baltic republics, Smith (1991) he mentions the following variables that help to understand the motivation to claim independent state-hood from the Soviet Union and the rise of nationalism – the level of political oppression, democratic values and cultural type, possibilities of political mobilization, the presence or absence of

⁵³ Smith (1991) distinguishes between national identity as a cultural phenomenon, and official nationalism of state institutions that aims at uniting the people under one common idea of state and nation

⁵⁴ Lezlek Balcerowicz, *Socialism, Capitalism, Transformation* (London/New York/Budapest: the CEU press, 1995)

intelligentsia, and a “ready to use” ethnic history.⁵⁵ The role of intellectuals was pivotal in triggering the movements and proposing ideological agenda, however, as Smith notes, in the latter stages the professionals emerge as the central actors of nationalism.

The concept of nation as the political expression of national identity involves practical political action. Thus it is crucial to investigate how professional elites utilize nationalism for the pragmatic purpose of nation-building. It is a question of power and legitimacy that should not be subjected to the cultural and artistic aspects of nationalism in terms of analytical importance.

2.1. The post-communist experience

Regaining of sovereignty can be associated with certain initial tasks – securing territorial integrity and independence, defining the nation and elaborating a plan of economic development. What were the norms that served as guiding principles for dealing with these tasks? In line with the “critical junctures” theory the fall of the Soviet Union can be conceptualized as a destabilizing shock. The emerging ideational vacuum enabled the circulation of competing ideas that offered road maps for nation-building. However, the particular problem at hand and the context should be considered as well in for understanding the process how was the “winning set of ideas” chosen and institutionalized.

First of all, the problem at hand was essentially concerned with fundamental questions of identity, structure and security of the newly founded states. The underlying idea is to define a consensual community with shared understandings of what the state is for, how it is to function and where the border are (Keens-Soper 1989)⁵⁶. As it was shown above, the idea of nation can be understood as the political expression of national identity. Thus the nation constitutes the “collective subject” to which the actions of state can be logically related. Second, the particular context of state formation should be considered in the light of an antecedent variable – the democratic revolutions that preceded the state formation. The particular context and role of nationalism ideology of these revolutions was crucial, and had an impact in the subsequent nation-building process.

⁵⁵ Ibid, 152

⁵⁶ Judy Batt, „Introduction: Region, State and Identity in Central and Eastern Europe, ” in: *Regional and Federal Studies*, 12, No. 2 (Summer 2002): 1

It can be argued that the fact of regaining sovereignty *de facto* and later *de iure* changed the role of ideology and also the rhetorical action of elite leaders in the Baltic States. Once the actual sovereignty became realistic, the costs of using ethnic nationalism rhetoric decreased. This claim can be supported according to Checkel's theory of social learning that significant normative and behavioral change can occur once institutional insulation is attained (e.g. regaining sovereignty after the SU collapsed)⁵⁷. Nevertheless, it is rather obvious that the tasks of the new states were associated with nation-building and securing the irreversibility on sovereignty. The pragmatic tasks of state formation emerged as one of the central goals.

Batt argues that the regaining of independence in post-communist states was interpreted as the culmination of centuries' long struggle against imperial rule that fueled a resurgence of nationalism.⁵⁸ The nationalist sentiments were influential in reconstituting the states as territorial structures and defining their identity. However, the nation-building had a practical side to it as well that pertained to modernization of the political, economic and social life. In the subsequent process of nation-building both ideological and pragmatic aspects are closely related and reinforced each other.

The modernization dimension had a particular relevance in the post-communist contexts. Geertz (1993) has argued that the creation of consensual community or an experimental "we" consists of two dimensions – to promote the "indigenous way of life" and to align with "the Spirit of the Age."⁵⁹ Thus conceptualizations of collective identity that emphasize ethnic nationalism, pre-political, cultural, religious and linguistic markers of "belonging" can coexist with a modernization dimension. Both of these dimensions are a part of the creating a "collective subject" to whom the actions of the state can be internally connected.⁶⁰

These two dimensions of modern national identity – a national way of life and the modernization of life are certainly not harmony, thus it is in the hands of the political elite (or the professionals) to "define and negotiate the fit"⁶¹ between the two. The overall logic of post-communist transition in the political, economic and social sphere was dominated by the modernization imperative, as the communist system was largely

⁵⁷ Ibid, 2

⁵⁸ Ibid, 3

⁵⁹ Geertz (199) as cited in Batt, „Introduction: Region, State and Identity in Central and Eastern Europe, ” in: *Regional and. Federal Studies*, 12, No. 2 (Summer 2002): 4

⁶⁰ Ibid

⁶¹ The term borrowed from Kenneth Dyson, *Enlarging the Euro Area* (Oxford: Oxford University Press, 2006)

admitted as ineffective. In other words, the national identity had to be put into a wider perspective - that of modernity or “Spirit of Age”.

It can also be argued that an important motivation already during the democratic movements and also in the subsequent nation-building was the aim to create a better social life, economic prosperity and welfare. The model of this ideal was essentially Western capitalism. As a result, the redefinition of national identity – itself a multifaceted concept – easily melted with the concept of the “return to Europe”. This claim is supported by (Smith (1991) who has argued that nationalism easily melts with other ideologies – liberalism, fascism and communism, because nationalism entails not only a shared cultural identity, but also other dimensions of a perceived unified “whole” - social, economic and political collective identity⁶².

Batt argues that the construction of the modern national identity in post-communist contexts can be summarized with the concept of the “return to Europe”. She proposes to understand this concept as a multifaceted phenomena: in the *psychological level* it means asserting the essentially “European” character of the national identity; at the level of *domestic politics* it means establishing the social, political and economic frameworks for a way of life similar to those enjoyed in Western European countries; at the *international level*, it means acquiring the benefits associated with membership in international bodies such as the Council of Europe, the OSCE, and above all the EU and the NATO⁶³. Her understanding of this concept shows that “return to Europe” provided a reformulation of national ideals within modern political, social and economic framework.

Although the need to modernize was “felt” both at the intersubjective level, the role of political leaders and professionals was crucial in formulating practical political documents and making policy choices. In this respect, the role of professional elites is crucial, especially at the point when domestic adaptation to EU’s top-down effect had to be locked in the wider process of nation-building. The next section will briefly conceptualize the role of rhetorical action in this process. The limited space will not allow discussing details of complex phenomena such as Euroscepticism, the individual strategies of survival in market-liberal and post-communist systems, and details of economic policies that were adopted in transition period and pursued later on (macro-economic stabilization, liberalization and institutions building). However, the author

⁶² Entonijs D. Smits, *Nacionālā Identitāte* (Rīga: Sorosa Fonds Latvija, 2002): 22

⁶³ Judy Batt, „Introduction: Region, State and Identity in Central and Eastern Europe, ” in: *Regional and Federal Studies*, 12, No. 2 (Summer 2002): 4

recognizes that economic explanations and anthropology approach are equally valid and would provide important insights.

2.2. Social learning and initial choices

The goal of this section is to show how the initial crisis and destabilizing shock after the fall of the Soviet Union conditioned the change in economic regime and the adoption of the “winning set of ideas” in Latvia and Estonia.

Regaining full sovereignty presented an opportunity to chart a new course as the obligations to pursue the policies of imperialist Soviet power had ended.⁶⁴ However, the gap between “what is” and “what could” be does not close spontaneously. Even after independence, the IMF was skeptical about the viability of Baltic currencies (Feldman 2006). Nevertheless, economic restructuring has been fast and rather successful. How did elites define the initial tasks? What ideas and pragmatic interests motivated the initial choices in economic policies? Finally, the “fit” between national priorities and necessary reforms would not have been possible without acceptance in the society at large.

After the reestablished of independence in 1991 the Baltic States inherited economic structures “torn out, after six decades, from the unified Soviet space”⁶⁵ (Csaba 2005). Here transition started relatively later than in the Central European states, and the initial conditions were “worse” as there were practically no meaningful economic links with Western countries⁶⁶ (Campos and Coricelli 2002). Nevertheless, the initial prospects of economic development were seen as optimistic, the depth and duration of the “transformational recession” was not predicted yet.

These initial state of affairs represented ideal conditions for socialization and social learning process to take effect at the elite level, thus a significant political and economic “opening up to the West” followed. However, the particular historical environment can not be fully understood without considering the external and domestic constraints that policy makers were facing. As a result, the immediate security concerns and identity crisis of the newly formed states brought about a significant “closing down to the East.” The latter aspect is an assumption on the basis of the *nature* of nation-building process (as discussed in the previous section); however, the exact economic and political

⁶⁴ Jacoby Wade, *The Enlargement of the European Union and NATO: Ordering from the Menu in Central Europe* (Cambridge University Press, 2004): 21

⁶⁵ Lazslo Csaba, *The New Political Economy of Emerging Europe* (Akademai: Kluwe, 2005): 25

⁶⁶ N. Campos and F. Coricelli, “Growth in transition: what we know, what we do not know and what we should,” *Journal of Economic Literature*, 40 (3), (2002) 793

process will not be covered, because of limited scope and a different research agenda as defined in the introduction.

As it was noted in the introduction, the domestic structural “misfit” with market economy early in transition was high. However, the new domestic elites developed an ambition “to transform the economies from a model based on central planning and state ownership to some form of western-type capitalism.”⁶⁷ There was an overall optimism and belief that transition to capitalism will be relatively easy. This view could not attributed to the lack of knowledge, because initially also western policy advisors were optimistic about the prospects of future growth in post-communist states. Campos and Coricelli (2002) argue that the removal of the overwhelming apparatus of political control over economic activity could only mean prosperity in the medium term.⁶⁸ The post-socialist contexts were seen as *tabula rasa* that would be easily deregulated and filled with the new laws and institutions appropriate for a market-economy.

The post-communist transformation was to a great extent designed according to organizational models of international organizations and Western experts.⁶⁹ However, a prerequisite for emulation was a “receptive mind-set” of domestic elites as well as compatibility with domestic constraints. Darden (2001) claims that all governments in the post-soviet space were offered similar analysis and similar financial incentives from Western governments and financial institutions to adopt a liberal agenda. However, some choose to act on them while other did not⁷⁰. This puzzle has been a matter of speculation and empirical research. Darden (2001) in his study of 15 post-soviet republics controls for the explanatory value of such variables as *national identity, former experience with statehood, internal or external security considerations, and lobbying efforts of commercial interests*. However, none of them explain the overall variation, except for his original claim that state choices are rooted in *economic ideologies of local elites*. As a result Darden argues the “mindset” of elites who were in control of the state bureaucracy early in transition determined the formulation of national economic strategies.⁷¹

However, Darden does not address the question how were the *economic ideologies of local elites* formed? Precisely in this respect his explanatory variable looses

⁶⁷ Estrin and Holmes, *Competition and Economic Integration in Europe*, (Edwar Elgar publ., 1998): 4

⁶⁸ Ibid, 793

⁶⁹ Jacoby Wade, *The Enlargement of the European Union and NATO: Ordering from the Menu in Central Europe* (Cambridge University Press, 2004): 21

⁷⁰ Darden *Economic Ideas and Institutional Choice among the Post-soviet States*. Yale University, 2001.,

Available at: <http://www.yale.edu/leitner/pdf/2001-15.doc> > (cited April 20, 2007)

⁷¹ Ibid

meaning, as ideologies as essentially linked, created by, reinforced and shaped by the alternative explanations that he denies as unsatisfactory. As a result, a constructivist approach can invalidate a great deal of his economic analysis. Nevertheless, for the sake of categories and labeling, his typology of post-communist states will be used further.

Darden argues that *market-liberalism* was the dominant thinking in elite level in Latvia and Estonia, as well as in Kyrgyzstan, Georgia, partially Russian, Armenia and Lithuania. The cornerstone of market-liberalism the belief was that competition is the driving forces of economic growth. Thus the role of state in planned economies has to diminished substantially - the government must leave prices alone, avoid owning or subsidizing firms, enforce contracts, regulate responsibly, balance its budget, and remove trade barriers⁷². In addition, there was a perceived need to destroy or restructure state-owned industrial complexes and phase-out state support to industry (Darden 2001)⁷³. This thinking was in sharp contrast to mercantilism and organicism in other former USSR republics represented by “reactionary” political interests.

Nevertheless, a question can be asked – why did market liberalism survive as a dominant elite ideology in the Baltic States, but failed to prevail in the initially market-liberal Kyrgyzstan, Georgia, Russia and Armenia? The conditions for social learning and socialization as defined above to a large extent influenced the opening up to market-liberalism in the two Baltic States. The feeling of insecurity significantly conditioned this choice.⁷⁴ One of the most important factors that conditioned reforms in the Baltic States was the perception that through making linkages with Western organizations – EU and NATO, the irreversibility of national sovereignty could be secured.

In the literature the domestic consensus in the Baltic States is conceptualized as “stability culture” with strong domestic support (Feldman 2006)⁷⁵. Namely, that elite consensus was based on support for market-liberalism and Europeanization that provided the framework for politics and reforms and “tied together” political actors. An evidence for the existence of such unwritten agreement is that in many other post-Soviet states the political consensus conditioned the reactionary politics when “the nomenclature power

⁷² Shleifer and Treisman as cited in Keith A. Darden *Economic Ideas and Institutional Choice among the Post-soviet States*. Yale University, 2001., Available at: <http://www.yale.edu/leitner/pdf/2001-15.doc> (cited April 20, 2007)

⁷³ Ibid

⁷⁴ Economic hardships were augmented by uncertainty about political sovereignty in the period between *de facto* independence (first half of 1990) and coup d'état in Moscow or the so-called August putsch in 1991. This attempt failed and eventually Russia was the first to recognize independence of the three Baltic States *de jure*.

⁷⁵ Magnus Feldmann, “The Baltic States: Pacesetting on EMU and the Consolidation of Domestic Stability Culture”. In K. Dyson, ed. *Enlarging the Euro Area*. (Oxford: Oxford University Press, 2006)

was played out by political elites in order to re-establishing control over the emerging economy” (Smith 2006).⁷⁶

2.3. “Return to Europe” - because of rhetoric?

The concept of “return to Europe” represents a wide process of transformation; however, in practical terms this modern national identity implies predisposition to emulate authoritative models of the idealized political, social and economic life. This ideology opened up the channels of international influence on domestic politics. One of such international actors was the EU that offered authoritative models for emulation in the field of legislation etc. The Europeanization dimension – the domestic effects of EU’s incentives and top-down effect started in 1995 when the European Agreements were signed.⁷⁷ Early policy choices helped the Baltic States to join EU, and currently they are the most fit to join the EMU/Euro-zone, as it would lock in pre-existing policy regimes (Feldman 2006).

The top-down effect of the EU is often referred to as Europeanization. However, it is an ambiguous term as it was already discussed in previous theoretical sections. In the context of this section, it must be added that in the post-communist context Europeanization has a wider meaning. According to Grabbe (2006) Europeanization implies the process of actually joining the EU and the wider process of “return to Europe”. Thus Europeanization had a broader, existential and civilization meaning for the post-communist states and constituted the ideational and identity base of the practical processes of “return to Europe” (e.g. implementation of the *acquis communautaire*).

The overall motivation of the CEEC’s to “return to Europe” has a great explanatory power in theories that try to explain the puzzles of accession negotiations. Grabbe (2006) argues that the requirement to comply with EU norms, policies and institutional model was filtered through the wider processes of modernization and post-communist transition.⁷⁸

One way to illustrate that rhetorical action was crucial for linking Europeanization and the actual fact of joining the EU is by looking at the outcomes on EU membership

⁷⁶ A. Smith, “Articulating Neoliberalism. Diverse economies and everyday life in post-socialist cities”. In *Contesting Neoliberalism: Urban Frontier*, H. Leitner, J. J. Peck and E. S. Sheppard, eds. (online. 2007) New York: Guilford Press, 204-223. Available at: <http://www.geog.qmul.ac.uk/socialexclusion/pdf/cuf.pdf> (cited April 18, 2007): 4

⁷⁷ Jan Zielonka, *Europe as Empire* (Oxford: Oxford University Press, 2006): 21

⁷⁸ Heather Grabbe, *The EU’s Transformative Power* (Plagrave, 2006): 2

referendums in Estonia and Latvia (Mikkel and Pridham 2004)⁷⁹. Although in the pre-accession period these two Baltic States had shown less public enthusiasm for integration than other Central East European countries, the results with decisive pre-EU majorities went easily beyond expectations based on previous opinion polls.⁸⁰

Mikkel and Pridham argue that this outcome owed much to the convincing arguments in the political campaigns before the referendums. The arguments were essentially the premise that joining EU first and foremost was a “geopolitical choice” – abandoning international isolation that had strong historical overtones.⁸¹ The second premise was the fact that the pro-EU stance was implicitly and sometimes explicitly unfriendly to Russia and the strong Russian minorities were much less supportive for EU. Nevertheless, the impact of these premises was not straight-forward and the general sensitivity over national sovereignty necessitated active rhetorical action from the part of political elites.

What was the role of “return to Europe” identity in the “locking in” of the EU? Mikkel and Pridham claim that first of all, the sensitivity towards maintaining national sovereignty in part constituted the base of Eurosceptic arguments. The delegation of sovereignty to the EU was sometimes compared to the Soviet Union in its negative connotation as the giving up sovereignty to an imperial power. At the same time, this popular myth was the central theme of pre-referendum campaigns.⁸²

From the analysis of Mikkel and Pridham one can infer that the main solution for this negative association was the idea that the EU offered “soft security” for Latvia and Estonia. This argument is strongly related to the general paradigm of nation-building and connects to political goals of the pre-independence nationalism movement. In particular, although the issues of sovereignty and security were not as exigent any more, the need for security guarantees was linked to the inescapable geopolitical situation. Thus the EU was positioned as a supplement to “hard security” guarantees of NATO. However, the public discourse about economic aspects of soft security was focused in large to the material incentives of EU, rather than the external constraints emanating from the close proximity

⁷⁹ Evald Mikkel and Geoffrey Pridham, „Clinching the „Return to Europe”: The Referendums on EU Accession in Estonia and Latvia,” *West European Politics*, 27, no. 4 (September 2004)

⁸⁰ Ibid, 716

⁸¹ Ibid

⁸² Ibid, 722

and energy dependency from to Russia.⁸³ The “locking in” of Latvia and Estonia in the EU was conceived as the most viable strategy for economic development.

The channels of rhetorical action were mainly the party politics. Mikkel and Pridham (2004) argue that this locking in was possible due to the strong cross-party and elite support for EU accession. They argue that the driving force of the convergence towards a pro-EU stance was electoral incentives that necessitated the redefinition of the Eurosceptic position. In Latvia, the conservative *For Fatherland and Freedom/Latvian National Conservative Party* (TB/LNNK) had lost support in 2002 elections with a Eurosceptic stance, moved to a EU supporting position. In Estonia the two Eurosceptic parties - free-marketer Reform Party and the People’s Union had skeptical opinions towards the EU, but once in government, both have in fact backed the EU accession process.⁸⁴ Even the Centre Party in Estonia, which was deeply divided and ambivalent on the EU issue, shifted from its Eurosceptic rhetoric, stressing the need to put national interests first.⁸⁵

However, the electoral incentives argument seems unconvincing as the general attitude towards the integration into the EU was more associated with other non-EU issues e.g. the general trust towards national governments (Mikkel and Pridham 2004). The lower growth rates and living standards may have contributed to the fact that in the pre-accession period Estonia has consistently been one of the most eurosceptic of the candidate countries (European Commission 2001. 2003), and the levels of support in Latvia were lower than in most other candidate countries. This explanation could be tested in further research, as it seems that the high growth rates after the accession to the EU have in fact coincided with a dramatic increase in support for the EU in Estonia.⁸⁶

Mikkel and Pridham argue that additional explanations for party-politics require understanding the way international linkages with EU affected their behavior.⁸⁷ The strategies of Estonian parties to propose a Eurosceptic stance in elections and then redress

⁸³ Evald Mikkel and Geoffrey Pridham, „Clinching the „Return to Europe”: The Referendums on EU Accession in Estonia and Latvia,” *West European Politics*, 27, no. 4 (September 2004)

⁸⁴ Ibid, 720

⁸⁵ Ibid, 720

⁸⁶ F. Björklund and V Liubinienė, “Value change. Related to the process of Democratization in Lithuania, Latvia and Estonia”. In *Research Reports* 1,2004 Södertörn Högskola University College. Available at: http://svpep.epc.uu.se/testbed/record.xml?lang=sv&id=oai_DiVA.org_sh-77.xml (cited April 20, 2007); Ilze Koroleva and Ritma Rungule, Latvia. Democracy as an Abstract Value,” in *Democracy and Political Culture in Eastern Europe*, Hans Dieter Klingemann, Dieter Fuchs and Jan Zielonka (eds), (USA, Canada: Routledge, 2006)

⁸⁷ Evald Mikkel and Geoffrey Pridham, „Clinching the „Return to Europe”: The Referendums on EU Accession in Estonia and Latvia,” *West European Politics*, 27, no. 4 (September 2004): 723

to EU-optimists highlight the impact of Europeanization on domestic political processes. As Grabbe argue (2006) the domestic actors were locked in the preparation for accession and the negotiation process. The adoption of EU norms had changed the behavior of actors and institution, and the ultimate purpose of joining EU shaped the interests and behavior of actors. The motivation for this was the “return to Europe” as defined by Batt. Nevertheless, the “return to Europe” as a modern national identity in theory and in practice was rather silent about the proper mode and precision to which the European “ways of doing things” should be emulated.

It has to be noted that rhetorical action can not explain the whole motivation behind joining the EU, or rule adoption in EU policy areas. As Morten Hansen, the dean of Economics department in Stockholm School of Economics in Riga argues in the interview conducted for this thesis: “People in the former Soviet Union seem to be willing to endure very severe hardship without revolting, whereas in the west people may go on strike if there is just a little hiccup in the economy.”⁸⁸

After the accession to the EU the project of “return to Europe” has reached certain “saturation”. This does not mean that ideas of national interests are no longer important. Nevertheless, the conceptions of economic values, priorities are redefined and shaped according to the new challenges within the EU. Schmidt (2004) has argued in regard to the political leaders of the “old” Europe that they have been largely unsuccessful in communicating the changes in polity and economic decision-making after EU accession. Before agreeing with this pessimistic claim, the dynamic interaction and construction of different conceptions about values and priorities in economy will be analyzed in the centre of analysis in the empirical part that follows next.

⁸⁸ E-mail interview with Morten Hansen, Head of Economics Department, Stockholm School of Economics in Riga (conducted on May 22th, 2007)

3. Empirical analysis: rhetorical action in Competition policy area in Latvia

In economic criteria for membership in the candidate states were required to adopt the *acquis communautaire* in national legislations. Holscher and Stephan (2004) argue that the transition countries in Central and Eastern Europe literally downloaded laws and institutions of a market economy from the EU's "templates". As there were no anti-trust, bankruptcy, corporate and competition laws, and accounting regulations in planned economy, "institution-copying" offered the fastest solution for filling the vacuum.⁸⁹ Although previously the adoption of EU's regulatory policy was a technical matter that did not receive much media coverage, in Latvia Competition policy was recognized as the most important economic issue in 2006⁹⁰.

3.1. Methodology and case selection

I will analyze two cases from Latvia from period between 2004 and 2007 to explain the puzzle, as defined in the introduction. This analysis will also show the discursive construction of economic identity.

The first case study will be the case of tax-relief policy in airport "Riga" and **the second case** the dispute between local food producers and the large international retail chains in Latvia. I will summarize briefly the main events and investigate the arguments of relevant actors involved in these conflicts. Further I will show how norms influenced the choice of strategy – rhetorical action and the subsequent outcomes of argumentation.

The methodology of case analysis will be based on constructivist approach to discourses and socialization. As it was already discussed in the theoretical review Schimmelfennig's model of "rhetorical action" is an appropriate model for the research agenda of this thesis. Correspondingly, the classification of drivers and brakemen will be used to categorize the actors into two groups opposing groups. The methodology of rhetorical action model will help to draw a conceptual map of arguments in which the strategic interaction was framed. The process of argumentation and eventual outcomes will be interpreted in context of the research agenda.

⁸⁹ Jens Holscher, Johannes Stephan, „Competition Policy in Central Europe in the Light of EU Accession,” JCMS 42, no. 2 (2004), 347

⁹⁰ „The top-10 Events in Economy in 2007”, *National News Agency „Leta”* (December 30th, 2006)

The *drivers* in both cases are understood as those actors that identify with the EU norms and use them strategically in rhetorical action. On the contrary, *brakemen* are those actors that do not identify (or partially identify) with EU norms, and use a different set norms for argumentative purposes. In this case, the alternative normative base or conception is national identity and national values in the economy. It has to be noted, that according to the rhetorical action model, the preferences of both the drivers and brakemen are essentially material, egoistic or to put it in game theory terms – rational. Nevertheless, it will be shown that the normative context significantly shapes their behavior and choice of strategy for the advancement of their material preferences.

It has to be noted that in both cases actors use rhetoric action and the outcomes of strategic interaction are similar. However, in terms of the problematic at hand each case is different. The tax policy case can be conceptualized as a political affair or a business project of leading politicians. By contrast, the dispute between domestic producers and retailers refer to one of the main distributional conflicts in domestic economy – the local food producers vs. international distributors. The application of rhetorical action model helps to *normalize* these differences and enables to make inferences about the theoretical puzzle.

3.2. Case study I - The case of tax relief policy in Riga's airport

Economic beneficiary – the state-owned airline airBaltic

Since November 1st, 2004 the International Airport “Riga” started to offer airport tax cuts up to 80% for airlines that would carry over 250 000 passengers a year.⁹¹ A response to this incentive followed immediately - two low cost airlines Ryan Air and Easy Jet started their operations in Riga's airport.⁹² Interestingly, it was not Ryan Air or Easy Jet who ripped the major benefits of this favorable situation – the main beneficiary turned out to be the national airline airBaltic.

Air Baltic is a joint-stock company founded in 1995, who's major shareholders are Latvia's state and Scandinavian airline SAS that control 52.6 and 47.2 percent of

⁹¹ „The Numbers of airBaltic Passengers has Reached 1 314 414,” *National News Agency „Leta”*, December 2006, www.leta.lv (January 4, 2007)

⁹² „Demand to Abolish Tax Discounts in Riga's Airport,” *The Day*, September 2004 http://www.leta.lv/archive_item.php?id=... (5 January 2007)

shares respectively.⁹³ airBaltic performs direct flights from airports in Riga and Vilnius (the capital of Lithuania). As it carries approximately a half of the 2.5 million passengers that used Riga's international airport in 2006,⁹⁴ it is the only airline that receives the maximum tax discount – 80 percent. Ryan Air is the second biggest beneficiary, receiving 60 percent discount from airport taxes. Newspaper "The Day" has estimated that paying only 40% of airport taxes, Ryan Air earned extra 2.9 million Lats (5 million euros).⁹⁵

The official goal of the new tax policy was to "bring more foreign tourists to Riga" and "foster the development of Riga's airport"⁹⁶, however, it was especially beneficial for airBaltic. Discounts are calculated from the total amount of passengers carried in all directions, and air Baltic with its base in Riga had a comparative advantage to make full use of this policy. The "flag carrier" status ensured the greatest number of air connections from Riga's airport and this airline company was entitled to the maximum discount *ex ante*.⁹⁷

Beneficial tax relief is one of the factors that explain the outstanding growth of airBaltic. The numbers are very impressive - since 2000 airBaltic increased passengers carried in one month by 500 percent. It has also managed to withstand the competition of Ryan Air and Easy Jet. The data for the end of 2006 show that approximately 100 000 passengers flew Air Baltic monthly in 2006 (in high season), while only around 60 000 chose Ryan Air and 6 000 - Easy Jet⁹⁸. Consumer preferences might have contributed to air Baltic's success, however, airport tax relief policy offered another opportunity to cut costs and win in the competition with the most influential European low-fare airlines.

Favorable tax discount policy also helped air Baltic to compete with "traditional" airlines such as British Airways. In the route Riga-London air Baltic could offer a much lower price, as it had to pay 6 times less for airport services in Riga than British

⁹³ „airBaltic”: EC Directive Discriminates Fast Growing Air Carriers from New EU Member States,” *National News Agency „Leta”*, December 2006, www.leta.lv (5 January 2007)

⁹⁴ „Slesers: in Who's Interests is the Competition Board Working?,” *press release from the Minister of Traffic*, November 2006, http://www.sam.gov.lv/?cat=8&art_id=579 (January 5, 2006)

⁹⁵ „Ryanair ties with Riga are dubious,” *The Day*, September 2006, www.leta.lv (January 5 2007)

⁹⁶ „Decision on the Possible Violation of the Article 82 of the EC Treaty in Operations of State Enterprise „Airport Riga,”” *Competition Board of Latvia*, November 2006, http://www.kp.gov.lv/uploaded_files/2006/X134_2211.pdf (January 4 2007), 26

⁹⁷ *Ibid*, 22

⁹⁸ „The Numbers of airBaltic Passengers has Reached 1 314 414,” *National News Agency „Leta”*, December 2006, www.leta.lv (January 4, 2007)

Airways.⁹⁹ As a result, the general data of Riga's airport show that 1 314 414 people flew air Baltic in 2006. That constitutes a 380% percent increase, compared to 348 000 passengers in 2003.¹⁰⁰ Thus it is possible to conclude, that tax system has indeed induced a spurt growth of a national champion.

These facts present the success of a state-owned company and provide material for political leaders to build arguments in favor of the current tax relief policy. In the next section I will analyze briefly the major political beneficiaries that used the success of airBaltic and airport Riga in their political campaign for parliamentary elections in 2006. This analysis will provide a deeper insight in motivations of certain political actors to defend the *status quo* irrespective of conflict with EU competition norms.

Political beneficiary – the Minister of Traffic and his party (Latvian First Party)

AirBaltic and Riga's international airport was not the only beneficiary from the tax relief policy. The positive effects helped the party of the long time Minister of Traffic Ainārs Šlesers to win seats in the parliamentary election in fall 2006.

The increased supply of cheap airfares was one of the key elements of elections success for the political union of Latvian First Party/Latvian Way (LPP/LW). Changes in airport tax policy and subsequent success of low cost airlines was perhaps the only thing that Ainārs Šlesers could take credit for in front of the electorate. On campaign billboards and printed advertisements in mass media, Šlesers was visually compared to space ship "Shuttle". His rhetoric was full of "winged" expression such as "*People have grown wings*" when he referred to the recent positive growth indicators of Latvia's economy.¹⁰¹ This visual and rhetorical linkage helped LFP/LW to recover from very low public ratings, which were largely due to a generally negative opinion about the party leader Ainārs Šlesers himself.

Thus it is quite plausible that the successful development of Riga's international airport and air Baltic is the basic legitimacy standard of Minister of Traffic's. His public image was corrupted in April 2006 by media scandal that revealed his connection with bribery in local government elections. He was forced to resign from his post as Minister of

⁹⁹ „Decision on the Possible Violation of the Article 82 of the EC Treaty in Operations of State Enterprise „Airport Riga”,” *Competition Board of Latvia*, November 2006,

http://www.kp.gov.lv/uploaded_files/2006/X134_2211.pdf (January 4 2007), 22

¹⁰⁰ „The Numbers of airBaltic Passengers has Reached 1 314 414,” *National News Agency „Leta”*, December 2006, www.leta.lv (January 4, 2007)

¹⁰¹ Website of Advertising Agency „ZOOM” http://www.moov.lv/zoom.php?visitor_id=17903 (January 5, 2007)

Traffic. In spite of that, his party managed to win 10 out of 100 seats in the national parliament and 4 minister posts in the government. Šlesers regained office as Minister of Traffic in the new government that was formed in November 2006.

Shortly after elections – in November 2006, Latvia's Competition Council issued an official request to the government to change the tax relief policy as it violates EC treaties. This was the first time that an independent government agency applied its power, basing the argument on EU Competition rights. The effect of this intervention on the public debate between the Competition Council and Minister of Traffic will be examined in the next section, but before that a short summary of Competition Council's official decision will be presented.

The intervention of Competition Council

In November 2006 Competition Council received a complaint from six airlines appealing to a breach of EU Competition policy in regard to discriminatory tax relief policy. In the official decision of the Competition Council issued on November 22, 2006, the case of Riga's airport was compared to the tax relief policy in Portugal, where European Commission intervened to prevent unfair competition. The Commission decision 1999/199/EC was used as a guideline for evaluating the violation of competition rights. The conclusion was that tax policy in Riga's airport distorts trade between EU member states and can be regarded as discriminatory.¹⁰²

The extent of violation, as formulated in the official decision, was comparatively greater than in the case of Portugal. In the case of Portugal airports, Commission decided that the major beneficiaries are two national airlines that received 30 and 20 percent tax cuts respectively.¹⁰³ In the case of Riga's airport the two beneficiaries received substantially greater tax cuts – 80 and 60 percent for Air Baltic and Ryan air respectively.

Further, Competition Council also decided that the principle of granting discounts based on the number of passengers can not be justified with economic arguments. In short, providing service for airplanes requires fixed costs that are not reduced with increasing amount of flights or the scope effect. Competition Council ruled that "airport

¹⁰² „Decision on the Possible Violation of the Article 82 of the EC Treaty in Operations of State Enterprise „Airport Riga”,” *Competition Board of Latvia*, November 2006, http://www.kp.gov.lv/uploaded_files/2006/X134_2211.pdf (January 4 2007), 14

¹⁰³ „Decision on the Possible Violation of the Article 82 of the EC Treaty in Operations of State Enterprise „Airport Riga”,” *Competition Board of Latvia*, November 2006, http://www.kp.gov.lv/uploaded_files/2006/X134_2211.pdf (January 4 2007), 16.

tax discounts can be regarded to as discriminating prices for similar services” thus the economic motivation of the tax relief policy is questionable.¹⁰⁴ This conclusion was drawn, referring to the ruling of the European Court of Justice (in regard to the EC decision 1999/199/EC) that banned tax relief policy in airports based on the principle of quantity. Moreover, Competition Council stated that similar arguments from EC have induced the change of tax policy in airports of Spain, Finland and in Brussels.

Previous practice of EC and ECT prescribe a duty to national Competition authority “to do all that is possibly to *disapply* national laws that violate the EC Treaty (Clause 82.)”¹⁰⁵ Thus after the initiative of Competition Council, this case was immediately discussed in the government meeting that decided to “to work out a new, legally correct and economically justified tax policy”¹⁰⁶. In December 2006 tax discounts were discussed in government for the second time, however, at this point the Prime Minister had changed his opinion and supported the status quo. In particular, he supported existing tax discount policy, only adding that “all interested actors should find a compromise so that Latvia could avoid international trial.”¹⁰⁷ The issues with tax policy will be discussed in the administrative court only in September 2008.¹⁰⁸

Summary: Airport tax-relief policy

Driver – Competition Council

Brakemen – Minister of Traffic, management of airport “Riga”, airBaltic,

Interaction – rhetorical action

Intervening variables – *Realpolitik*, social context

Outcome – rhetorical entrapment of the driver

Solution – “uploading” national-level deadlock to the EU

¹⁰⁴ Ibid, 20

¹⁰⁵ „Decision on the Possible Violation of the Article 82 of the EC Treaty in Operations of State Enterprise „Airport Riga”,” *Competition Board of Latvia*, November 2006, http://www.kp.gov.lv/uploaded_files/2006/X134_2211.pdf (January 4 2007), 24

¹⁰⁶ „The Government Decides to Change Airport Discounts,” *The Day*, December 2006, www.leta.lv (January 5, 2007)

¹⁰⁷ „Government supports tax relief system in airport „Riga”, *National News Agency „Leta”*, (December 15th, 2006)

¹⁰⁸ Interview with Ieva Jaunzeme, Chairperson of the Competition Council of the Republic of Latvia (conducted on May 22nd, 2007)

3.2.1. Rhetorical action I

In the period between the publication of the decision of Competition Council (November) and the decision of the government to keep the status quo (December), the brakemen used rhetorical action in order to legitimate tax policy. Although in the official decision Competition Council appealed to normative consistency with the EU's competition norms and practice in evaluating tax policy in EU airports, this did not result in the change of discriminatory tax policy in Riga's airport. Thus it is possible to claim that Competition Council did not manage to "rhetorically entrap" the brakemen. This outcome can be understood by looking at the arguments that Ieva Jaunzeme, the Head of Competition Council used in the public debate about this issue.

The official decision of Competition Council established the legitimacy of the EU norms. However, in the public debate Ieva Jaunzeme refrained from using "shaming tactics", which would have been justified from a legal perspective. Namely, on a formal level the decision of government to disobey the request of the Competition Council clearly contradicted the normative obligations of Latvia as an EU member state. Instead, her strategy was to appeal to the society with a message that the resistance of political elite could result in legal proceedings and correspondingly - high costs from state budget. "One thing is clear, if the situation will not change, the responsibility for consequences – possible legal proceedings – will lay on the Ministry of Traffic".¹⁰⁹ This message hit the weak spot of Latvia's society as the government has lost many international court cases in the recent history.¹¹⁰ The blame for this loss is often laid upon corrupt politicians and attorneys. The major concern, however, is unjustified costs for the society.

In the media the necessity to change tax relief policy was associated with a threat of legal proceedings that Latvia is surely to loose, "because similar cases have been discussed and the opinion of ECT is clear".¹¹¹ This argument was associated the not only with the perceived social costs of international laws suits, but also with the general process of EU rule adoption. Thus a journalist claims that: "The people again will have to pay for attaining a legally flawless image for Latvia"¹¹². Publicly the need to comply

¹⁰⁹ „The Government Decides to Change Airport Discounts,” *The Day*, December 2006, www.leta.lv (January 5, 2007)

¹¹⁰ Ibid

¹¹¹ „Shame on Airport's discounts,” *Riga's Voice*, June 2006, <http://www.financenet.lv/zinas/latvija/article.php?id=54357> (January 5, 2006)

¹¹² „Shame on Airport's discounts,” *Riga's Voice*, June 2006, <http://www.financenet.lv/zinas/latvija/article.php?id=54357> (January 5, 2006)

with EU norms is perceived with resentment and a feeling of antipathy, as that is associated with material costs or money that could be spent for better purposes.

Nevertheless, the brakemen tried to avoid arguing about EU norms or lawsuits and shifted focus to domestic economic interests as the source of legitimacy. Minister of Traffic used such claims as a dramatic increase of fares to popular destinations such as London and Paris and the threat of exit of low-fare airlines that would stop the development of Riga's airport. Although currently there is no evidence for that these claims are true, the Competition Council hesitated to contextualize the official decision in relation to these domestic economic interests. The Council failed to construct a normative opposition to the speculative claims of the brakemen thus they did not feel "rhetorically entrapped" or constrained.

After the decision of the government to support the discriminatory tax policy, the Competition Council withdrew from the public debates about this issue altogether. However, the brakemen intensified their activities both in practice and in terms of rhetoric. In January the head of board in Riga's airport left his office and two weeks later the Minister of Traffic appointed the head of his bureau and party member Krišjānis Peters as the new director.¹¹³ The board was supplemented with two influential officials from other state institutions – Juris Kanels and Andris Ozols. In case of the latter, the government even issued a special permit to combine office in Latvian Development Agency and the Riga's airport¹¹⁴. Thus it was evident that the Ministry had certain plans and interests for the further development of the Airport, and that the tax policy was an integral part of these plans.

The Minister of Traffic and the new head of board of the Airport informed the media about the future plans of Riga's airport "to become the regional air traffic centre". In February 2007 they announced that Michael O'Leary, the president of Ryan Air has agreed to build a new runway and passenger terminal in the Riga's airport that would bring 500 million Lats (800million Euros) of investment for the development of infrastructure¹¹⁵. However, in March the officials of the airport announced that the Ministry of Traffic will invest 13,8 million Lats in extension of the existing runway.¹¹⁶ Later on the Ministry informed that they will develop a draft layout of their future plans

¹¹³ „The Head of airport 'Riga' leaves office”, *The National News Agency "Leta"* (January 16th, 2007);

„The new director will be Krišjānis Peters,” national news agency Leta, (January 23rd, 2007)

¹¹⁴ Ibid

¹¹⁵ „Ryanair agrees to invest in Riga,” *The National News Agency "Leta"* (February 7th, 2007)

¹¹⁶ „The runway in Riga's airport will be finished in 2008,” *The National News Agency "Leta"* (March 28th, 2007)

in the Airport and finance them with credit resources from international banks.¹¹⁷ There is no further information about the grandiose investment plans from Ryan Air. As this airline company was the second greatest beneficiary of the tax policy, it would have made sense to keep the status quo in order to attract further investments from this company. However, these expectations have not come true so far and Ryan Air has not announced their future plans in Riga.

Even after it was evident that Ryan Air is not eager for fast development of Riga's airport, the question of normative inconsistency was not further questioned. The Competition Council had already withdrawn from the public debate. The Ministry of Traffic and the management of the Airport continued to spread information about their future plans and economic gains from further development of the Airport, however, it is not clear whether they are realistic.

It has to be noted that in January the EU addressed Latvia's government with an official request to justify the legality of the existing tax policy. It is rather puzzling that the Competition Council did not attempt to use this official request for shaming the political elite. EU's request was published in one daily newspaper, where it was stated that "the Commission will respect the slow judiciary process of Latvian courts, but parallel to that an independent investigation will be conducted at the EU level."¹¹⁸ The head of Competition Council Ieva Jaunzeme reiterated the argument that Latvia "may have to pay a fine of many millions of Lats if this policy will be proved as illegal"¹¹⁹. No further attempts to shame the brakemen followed.

From this case we can infer that the argumentative space of Competition Council was limited by two factors. First of all the social context of this issue enabled the brakemen to identify with national values and economic interests rather than EU norms. Second, in the interview for the purpose of this thesis Ieva Jaunzeme defined the tradition of political practice in Latvia as *Realpolitik*¹²⁰. This was another constraining aspect for the driver, because rhetorical action is effective only if the brakemen partially identify with EU norms. By contrast, the behavior of brakemen corresponds that that of rational, value-maximizing actors (according to the logic of consequences) rather than

¹¹⁷ „Development through bank loan,” *Dienas Bizness* (March 29th, 2006)

¹¹⁸ Ibid

¹¹⁹ „European Commission can punish Latvia for tax policy in airport Riga”, *Neatkarīgā Rīta Avīze*, (January 1st, 2007)

¹²⁰ Ibid

behavior of weakly socialized agents. As a result the Competition Council could not use rhetoric action in order to frame the “legal” misfit into a “normative” misfit.

3.3. Case study II - The dispute between food producers and retail chains

First phase: the draft Law on Trade Organization

Public information about the draft Law on Trade Organization appeared in the end of 2005. The Law prescribed that the influence of large retailers would be limited by the introduction a new rule – *a substantial impact in the market* that would pertain to retail chains that have a 25% of market share or 70million Lats turnover annually.¹²¹ This norm would supplement the dominant position rule (40% of market share) that already exists in the Competition Law¹²².

In late 2005 Ministry of Economics announced its plans to send this law to the government and attain a quick approval in the Saeima (the Parliament of Latvia). The official reason for drafting the law, as explained in the media was to “solve the problems formulated in Ministry’s informative report “On competition in retail trade”.¹²³ The opinion of the Latvian Federation of Food Enterprises (further *Food Producer Federation*) was supportive of the law. However, they did not engage in public argumentation. The only public opinion about this law was expressed by the Jānis Stakens, the head of board of one of the leading retail chains VP Market that defined this law as discriminating and “shameful for Latvia as a country that is otherwise loyal to free market economy”.¹²⁴

Law on Trade Organization reappeared in the mass media during the government crisis in spring of 2006. As a result of this crisis, the party *New Era* of Krišjānis Kariņš, the Minister of Economics, left the government. The new Minister of Economics Aigars Štokenbergs was from the ruling *People’s Party* whose representative held the Prime Minister office. The new Minister of Economics A. Štokenbergs decided to stop the law, explaining this decision with a brief press release to the media stating that “the law would have a mutilating impact on the market”¹²⁵. This decision triggered a supportive reaction

¹²¹ „The law on Trade will make trading difficult”, *Diena*, May 11, 2006

¹²² „The law on Trade will make trading difficult”, *Diena*, May 11, 2006

¹²³ „Minister Kariņš meets with Federation of Food Producers”, *National News Agency „Leta*, October 19th, 2005

¹²⁴ „The law on Trade will make trading difficult”, *Diena*, May 11, 2006

¹²⁵ „The retailers can cheer”, *Diena*, (May 16th, 2006)

from the Federation of Local Governments.¹²⁶ However, “leading enterprises” expressed the opinion that this decision will threaten further development of the national economy¹²⁷.

These were the only two instances when public attention was aroused about the Law on Trade Organization. Thus it is not possible to talk about rhetorical action in the public expression of this concept and there are other reasons that explain the outcome, the change of government being one of the most obvious.

It can also be argued that the need to use rhetorical action was not recognized yet by the brakemen. In fact, the preparation of this draft law occurred “behind the scenes”. The activities of Food Producer Federation in regard to the draft of Law on Trade Organization were mainly channeled through their daily-base routines - such as seminars, meetings and conferences. As Arlita Sedmale, the Executive Director of the Federation told in the interview conducted for the purpose of this thesis, cooperation with Ministry of Economics in the elaboration of this draft Law was also related to routine procedures¹²⁸. Later on, the producers *informed* or *discussed* the draft of Trade Law with the Ministry of Economics, the Ministry of Agriculture and several other relevant actors. However, they did not use the strategy of rhetoric action in the public space to further their interests or find wider support their cause.

Summary: Draft of Law on Trade Organization

- to regulate large retailers with 25% market share or 70million Lat net turnover

Brakemen – Food Producers Federation, Minister of Economics Krišjānis Kariņš (*New Era*), leading officials from Ministry of Economics

Drivers – no coalition

Intervening variable – exit of New Era from government

Interaction – “behind the scenes”

Outcome – the new Minister of Economics Aigars Štokenbergs stops the Law

The second phase: draft amendments to Competition Law

¹²⁶ „Štokenbergs asks the representatives of local governments to show more active cooperation”, *National News Agency „Leta”*, (May 12th, 2006)

¹²⁷ „Turning the Back”, *Dienas Bizness*, (April 4th, 2006)

¹²⁸ Interview with Arlita Sedmale, Executive Director of the Latvian Federation of Food Enterprises (conducted on May 23, 2007)

The third time media attention was aroused in June 2006 when the Competition Council announced its plans to amend the Competition Law by introducing a new norm - relevant impact in the market. This norm would enable the regulation of market participants that do not fall under the definition of dominant position in the market – 40% of market share. The plan was to transplant the norms from the Trade Organization Law that had been “stopped” by the Minister of Economics into amendments to Competition Law (the Law was “open” at that time as amendments concerning administrative issues of the Council were discussed). The Head of Competition Council stated frankly in the media that: “the new function of the Council means that we will review complaints about Rimi and Maxima that have roughly 23% market share, if local producers will have the impression that these retailers have asked for “unnecessary payments”¹²⁹.

Thus doing the Competition Council took initiative in the dispute between retailers and producers. The information in the media signaled that “all interested parties agree to the new Law”¹³⁰. The Association of Retailers who expressed public opinion for the first time was supportive to this version of the law. In particular, the opinion of Henrihs Danusēvičs, the president of the Association was that “our only request is that the terminology in the draft law would be changed”.¹³¹

Ministry of Economics informed the media that the amendments to Competition Law were drafted in response to the request of the Food Producer Federation “to prevent that retailers impose unequal terms of contract to food producers”¹³². Anrijs Matīss, the deputy secretary of state in Ministry of Economics formulated two reasons for their support to the Law – first, to fulfill the requests of the domestic food producers, and second, to strengthen the authority of the Competition Council.¹³³

The Food Producer Federation changed their strategy from routine meetings with state official to a more open expression of their interests. Food Producer’s complained that requirements for local producers are different than for foreign suppliers to Latvia’s market. Currently retailers can send back damaged products, although the reason for that is improper storage at the supermarket, and there are retailers that pay for the delivered products after half a year. They argued that currently none of the local retailers that abuse their power unequally have a dominant position in the market – 40% of the relevant

¹²⁹ Ibid

¹³⁰ „Barriers to the Powerful”, *Dienas Bizness*, (September 12th, 2006)

¹³¹ „Do not want to tighten the belt”, *Dienas Bizness*, (June 26th, 2006)

¹³² „Barriers to the Powerful”, *Dienas Bizness*, (September 12th, 2006)

¹³³ „Compromise for Disagreement”, *Diena*, (June 20th, 2006)

market share as defined in the Competition Law. Thus the Competition Board can not intervene and prevent these abuses.¹³⁴

The public reaction from the retailers emerged at the point when the draft of the Amendments was already discussed in the Committee of Cabinet of Ministers. It is not the purpose here to discuss whether the actors that expressed their opinions against this Law did this voluntarily, nevertheless, their arguments can be interpreted in the context of the purpose of their behavior - to slow down or to stop the advancement of this Law.

Summary: Draft Amendments to Competition Law

- Introduced a new norm alongside the dominant position regulation – relevant impact on the market.
- Relevant impact would apply to enterprises with net annual turn-over at least 70 million Lats (100 million Euros) in the relevant market or a market share of 25%.¹³⁵
- The law would prohibit the abuse of relevant impact in the market that includes the imposition on unfair requirements or payments to suppliers.

Brakemen – Food Producer Association, Ministry of Economics, Competition Council

Drivers – Retailer Association, economists from Stockholm School of Economics in Riga, Foreign Investors Council, Ministry of Justice (although not in public),

Interaction – rhetorical action

Intervening variable – Competition policy reform at EU level

Outcome – rhetorical entrapment of brakemen

Solution – to “upload” the national-level deadlock to the EU

3.3.1. Rhetorical action II

The rhetorical action and outcome in the second case can be defined as rhetorical entrapment of brakemen, as their initial plan to amend Competition Law as fast as possible was slowed down. In fact, the draft Law is no longer seen as a viable solution¹³⁶. After a few months of rhetorical “ping pong” neither of the sides could completely silence the other. The draft Law was included in the agenda of the Government meeting for three

¹³⁴ „Protection for Producers”, *Diena*, (September 12th, 2006)

¹³⁵ Ibid

¹³⁶ Interview with Arlita Sedmale, Executive Director of the Latvian Federation of Food Enterprises (conducted on May 23rd, 2007)

times, however no decision was taken about the future of this law. Nevertheless, the outcomes could be interpreted as rhetorical entrapment, because without rhetorical action from the part of the drivers, the amendments to the Competition Law would have been passed, taking into account the structural power of brakemen` coalition (aligned with state institution supported).

The rhetorical “ping pong” was based on different conceptions of economic values and identity in Latvia. The brakemen appealed to local understandings such as the negative experience with “wild capitalism” in the early 1990ies, the nationalist sentiments in regard to local products and consumption traditions, as well as the national preference to develop local enterprises rather than to increase the profits to international firms. However, the drivers forced them to justify these claims vis-à-vis the European normative context – Latvia’s commitment to democratic norms, free, unregulated competition and the Competition policy of EU. As a result, the law-making process got stuck in dead-lock that us beneficial to the drivers.

The strategy of drivers was based on the weakest part of political regime in Latvia – lack of trust towards state institutions. The drivers expressed the opinion in the media that the Competition Council can not be trusted to regulate the market. Armands Rozenbahs, the vice-president of the Retailer Association claimed in an opinion article: “The new law will enable state bureaucrats to judge the fairness of unfairness of the contracts. This was previously the task of the courts.”¹³⁷ The public discourse picked up this idea and numerous publications speculated with the claim that the amendments to the Competition Law would increase “police power” of the Competition Council.¹³⁸ For example, article in a daily newspaper states that: “this institution has been practically unknown before; however, the new law will allow them to create damage to private property when it is “necessary””¹³⁹. The article claims that the law will “create a fertile ground for corruption and endless lawsuits questioning whether the damage of private property was or was not necessary.”¹⁴⁰

Thus the drivers attempted to shame the creators of this law as people who support corruption, surveillance and are principally opposed to values of free competition and democracy. This strategy was largely successful as the “ball” was on the side of Competition Council who had to do the explanation work. Most of the articles discussed

¹³⁷ „The consumer will pay for everything,” *Diena*, (August 28th, 2006).

¹³⁸ „Ignorance can be costly”, *Diena*, (June 26th, 2006)

¹³⁹ „Competition Council will have new powers”, *Rigas Voice* (June 25th, 2006)

¹⁴⁰ *Ibid*

EU Competition policy or the basic principles of competition regulation generally. The particular problem between retailers and producers was somewhat marginalized by the shocking realization that one of the basic norms market-liberalism and the very core of EU competition policy - the legal norms and practice is a huge “blank” for market participants.

Nevertheless, in the discursive interaction the Food Producers, as well as the Ministry of Economics stated clearly their understanding about the values and identity of national economy. In particular, the local consumer is interested in being able to choose among a variety of goods. If the retailers will be allowed to rule, there will be only one kind of milk on the shelves.¹⁴¹ The values of national economy were linked to several dimensions of the national identity - cultural preferences for certain food products and consumption pattern, social issues connected with the extinction of tradition life-styles in the country side and ethical judgments vis-à-vis the value of products made in the home country¹⁴²

The fact that the appeal to the national sentiment did not turn in to mass support for local food producers can be explained by the strong arguments of retailer that they used in order to credibly appeal to the material interests of local consumers, namely the considerations of economic security. As the perception in Latvia is that the current inflation rate is too high and that government is incapable of getting it under control¹⁴³, the retailers could credibly claim that if the law will be passed, the prices for products will increase and “the consumer will have to pay for this in the end”.¹⁴⁴

The intervention from the EU has not shifted the balance of power between the brakemen and drivers. According to the information in the media, on April, 2007 the Ministry of Economics had received a letter from the Commission that stated that the amendments to the Competition La in Latvia *could be* in conflict with several Articles of the EC treaty.¹⁴⁵ However, from the interview with Ieva Jaunzeme, the Head of Competition Council it is possible to presume that the attitude towards the question of

¹⁴¹ „Conflict between producers and retailers”, *Kapitāls*, (January 2nd, 2007)

¹⁴² „Protection for Producers”, *Diena*, (September 12th, 2006), „Let the small producer breathe!”, *Latvijas Avīze* (April 4th, 2006), „Plans to constrain supermarket power”, *Latvijas Avīze*, (May 3rd, 2006), „The Small Producers on their Knees”, *Dienas Bizness* (June 27th, 2006)

¹⁴³ „The consumer will pay for everything”, *Diena* (August 28th, 2006)

¹⁴⁴ „Conflict between producers and retailers”, *Kapitāls*, (January 2nd, 2007)

¹⁴⁵ „Commission: amendments to Competition law do not comply with EC treaty”, *Diena* (May 11th, 2007)

competition regulation is divided in the Commission as well, in particular between the Internal Market DG and Competition Policy DG.¹⁴⁶”

The solution for this deadlock will probably come from the EU. The main argument for uploading this issue to the EU was that the relationship between retailers and producers is problematic not only in Latvia, but also in other EU-member states.¹⁴⁷

3.4. Conclusions about the two case studies

Schimmelfennig's model predicted that the interests of actors are rational and material, despite the public utterances about their commitment to shared values. This prediction was confirmed in both cases. An alternative question can be raised - who has legitimate claims and what kind of behavior is justified in the public space in Latvia? What conception of national economic identity is dominant and legitimate? A number of observations from the two case studies may help to answer these questions.

First, the two largest retail chains that were directly affected by the draft Law never stated publicly what is that they do not like about the Law. Instead, their “spokesperson” was acting against his personal views and it was evident that he uttered the instructions of drivers, who were “sitting behind the scenes.” This situation made the claims of the head of Retailer Association incredible. The current deadlock can be explained by the negative reaction towards the retailer's methods of “arguing” (see interview with Arlita Sedmale).

Nevertheless, the presence of an alternative normative framework – EU Competition regulations and norms in this case helped the drivers to slow-down the process. Appealing to the EU norms drivers pressed the Food Producers to justify their claims with relation to Latvia as a market-liberal, small and open economy, which is also a member of the EU.

Second, in the case of airport tax policy, EU norms did not persuade the political entrepreneurs to justify their action. Thus the rhetorical action was asymmetrical and costs of provoking a normative debate with e.g. Minister of Traffic exceeded the benefits. As a result, the first case resembles a kind of *inversed rhetorical entrapment*. It means that tradition of power politics in Latvia conditioned the silence of drivers, because discussion about EU norms was unlikely to lead to norm-confirming behavior.

¹⁴⁶ Interview with Ieva Jaunzeme, Chairperson of the Competition Council of the Republic of Latvia (conducted on May 22nd, 2007)

¹⁴⁷ „Dispute between Retailers and Producers”, *Kapitāls* (January 2nd, 2007)

This outcome also shows that norm-complying behavior is not important for the standard of legitimacy of political actors in Latvia generally.

Third observation is that in both cases the lack of clear EU regulations was one of the factors that contributed to the outcomes. For that purpose the DG Transport is preparing a new directive that would limit tax policies in airports.¹⁴⁸ In the case of retailers and farmers, a similar proposal is circulating in the EU, although this initiative is mainly supported by a few member states¹⁴⁹.

¹⁴⁸ Interview with Ieva Jaunzeme, Chairperson of the Competition Council of the Republic of Latvia (conducted on May 22nd, 2007)

¹⁴⁹ Ibid

4. Explanations of the puzzle

Why did these disputes emerge in Latvia, but contestation in the field of food producing industry and air traffic sector can not be observed in Estonia? As the approach here is more sociological than economic, I will not scrutinize food production or air-port management in Estonia, but focus on the two aspects of “structural fit” in Estonia as defined in the introduction.

Explanation I: The spill-over of the “Finnish factor”

It can be argued that Estonians have had a clearer perception on how foreign advice¹⁵⁰ and economic models might help them to develop economically and become competitive in the global economy (Feldman 2000). This claim can be supported with the “Finnish factor”. The term refers to the exposure to Finnish capitalism already in Soviet times and the perception of “cultural belonging” to the developed Scandinavian countries. It can be argued that these two aspects conditioned early social learning and formation of preferences among the new political elite. Although Estonians started to form a certain notion of an ideal economic system already before independence, the subsequent policies of market liberalism can not be explained with the Finnish factor alone.

Feldman claims that already in 1987 Estonia drafted an ambitious proposal for economic autonomy based on the historical precedent of Finland’s special status in Tsarist Russia¹⁵¹. Feldman quotes Estonian Prime Minister T.H. Ilves who has argued that “there is a civilization border between Latvia and Estonia, with Estonia belonging to a distinct “Huntington sub-civilization”, together with Scandinavia and Britain.”¹⁵² In the interview for the purpose of this thesis Morten Hansen, the Dean of Economics department in Stockholm School of Economics in Riga argued that: “Estonians could be

¹⁵⁰ Feldman (2001) claims that Estonian and Latvian specialists who had lived in exile were brought into help create the new institutions, such as Juris Vīksniņš for the Bank of Latvia, and Ardo Hansson and Rudolf Jalakas in the case of Bank of Estonia (p. 550)

¹⁵¹ Magnus Feldmann, „The Fast Track from the Soviet Union to the World Economy: External Liberalization in Estonia and Latvia,” *Government and Opposition* (Autumn 2001) available at: <http://www.mtk.ut.ee/doc/vmtaiend1.doc> (cited on May 30, 2007): 553

¹⁵² Ibid, 544

inspired by Finland by watching Finnish television whereas Latvia did not have such a chance - thus Latvia and Latvian thinking remained more Soviet and for longer”¹⁵³.

It can be argued that the early socialization by the “Finnish factor” conditioned positive spill-over effects among the domestic elites through provoking debates about the ideas and necessary methods to turn Estonia into a competitive market economy. The “Finnish factor” played a crucial role in the formulation of an early domestic consensus about economic development. However Ratso (2005) claims that when choosing the optimal set of policies decision-makers took the risk of experimenting as well: “We don’t have a package of “must do’s” and “ready to implement””¹⁵⁴. Estonia applied the market-liberal model in a rather radical fashion by establishing a unilateral free trade regime, and was among the few countries with a free trade regime in agriculture (Feldman 2001). Ratso (2005) explains that the basic economic value was the ability of an enterprise to adapt itself to economic conditions and re-orientate to the West¹⁵⁵.

By contrast, in Latvia where the Finnish factor was absent, market-liberal model was applied with less precision and coherence. In particular, Latvia “flirted” with protective tariffs in the field of consumer goods and agricultural products, which is a major difference between the two countries. In other policy sectors e.g. full current and capital account convertibility, liberalization of FDI regime, and reorientation of trade no significant differences can be observed.

It can be argued that the free-marketer approach to agricultural sector in Estonia has induced an earlier socialization of local food producers (in terms of “thinking about the future survival”). The perception of a higher competitiveness of agricultural production in Estonia is closely related to the Finnish factor. The interview with Arlita Sedmale, the spokesperson of Latvian Food Producer Federation confirms this claim: “Such (*Finnish*) bakeries as Hanza and Fazer used to have one producer in each (*Baltic*) country, but now they have made great investments in Estonia and set up modern production equipment to produce, for example, toaster bread. As a result, a substantial

¹⁵³ E-mail interview with Morten Hansen, Head of Economics Department, Stockholm School of Economics in Riga (conducted on May 25th, 2007)

¹⁵⁴ Signe Ratso, “Miracle of Estonia: Entrepreneurship and Competitiveness policy in Estonia,” prepared for the for the Trade, Industry and Enterprise development Week, UNCE 2005 (available at <http://www.unece.org/ie/wp8/documents/maufor/Signe%20Ratso.pdf>): 14

¹⁵⁵ Ibid, 14

part of bread products that used to be produced in Lithuania or Latvia are made in one concentrated production facility in Estonia.”¹⁵⁶

Thus on a psychological or intersubjective level Estonians seem to be more prepared and capable to use the EU membership for productive purposes. The interview for the purpose of this thesis with Peeter Taamistu, the Head of Competition Board in Estonia highlights this claim: “Estonian farmers and food producers have gained a lot from joining EU’s Single market: possibilities to obtain financial means through different projects, compensations and subsidies, widening of market for selling their products etc. Almost the only negative things are EU milk quotas that influence the development of agriculture in Estonia.”¹⁵⁷

Thus we can draw a conclusion about the theoretical puzzle – rhetorical action in the field of Competition policy is absent in Estonia, because in Estonia there is a higher level of “fit” between Europeanization (and perhaps also globalization) pressure and the social context. The theoretical model of rhetorical action can be upgraded with the conclusion that domestic “misfit” (with its multiple facets: ideational, identity-related, normative and perhaps also material) induces rhetoric action by those actors who identify this “misfit” as the central obstacle to their material interests. The Europeanization context forces the brakemen to use rhetoric action in order redress distributional conflict into normative ones.

Explanation II: Effective socialization in Competition policy area

Europeanization of Competition policy area to a large extent confirms the first causal explanation – the spill-over effects of early socialization in Estonian by the “Finnish factor” and the subsequent convergence towards a shared commitment to market-liberalism. This can also be observed in Competition policy area. Ratso claims that “Estonian economy is very free and liberal, but at the same time following all European standards and laws on property rights”¹⁵⁸. These shared ideas about economy conditioned voluntary social learning and socialization in the field of Competition policy. This claim can be justified vis-à-vis the Latvia’s experience with Europeanization in

¹⁵⁶ Interview with Arlita Sedmale, Executive Director of the Latvian Federation of Food Enterprises (conducted on May 23, 2007)

¹⁵⁷ E-mail interview with Peeter Tammistu, Director General of Estonian Competition Board (conducted on May 25th, 2007). Answers provided by his representative Lea Tõntson

¹⁵⁸ Signe Ratso, “Miracle of Estonia: Entrepreneurship and Competitiveness policy in Estonia,” prepared for the for the Trade, Industry and Enterprise development Week, UNCE 2005 (available at <http://gwww.unece.org/ie/wp8/documents/maufor/Signe%20Ratso.pdf>): 14

Competition policy area, where social learning and socialization has in fact started with the two cases discussed above.

The claim that variation in ideologies and ideas mattered is supported by observation that the “downloading” of European norms (drafting Competition Law, setting up as the Competition Council etc.) has proceeded in similar fashion in both countries. The EBRD Competition policy index shows little variation in the intensity of rule adoption in Latvia and Estonia.¹⁵⁹ However, the EBRD data also confirm the claim that Latvia had relatively slower progress in the enforcement of Competition rules as compared to Estonia. This observation is confirmed in a cross-country study of Stefan Voigt (2006) where four objective indexes are used to compare competition policy indicators. Overall, both Latvia and Estonia have less effective laws and institutions in this field as compared to the developed EU countries¹⁶⁰. Nevertheless, Voigt’s index confirms that Estonia has a more rigid *per se* approach as opposed to Latvia who scores high with a more case-by case approach. The study of Schinkel and Thielert (2004) confirm the claim that Estonian Competition Council invested more effort in building legal stability and predictability that are crucial for the business environment (decreases the “risk premium from investments”)¹⁶¹.

Variation in domestic ideas mattered also because both states faced similar “Europeanization” pressures in this policy area - uncertainty about material benefits of

¹⁵⁹ The EBRD Competition policy index shows that Latvia started reforms of Competition policy earlier than Estonia – progress from 1 to 2 was observed in 1992 while in Estonia progressed to 2 points in 1993. In both countries there was no further development in this policy field as the index remained constantly low during the mid-1990ies. The 1999 marks a reform progress in Estonia (2.7 points), while the index remains at lower equilibrium (2.3) in Latvia for 5 years (from 1997 to 2002). Estonia entered the EU with index of 3.3, while did not Latvia lagged far behind with a slightly lower fit - index of 2.7. Source: EBRD statistics, (available at <http://www.ebrd.com/country/sector/econo/stats/sci.xls>)

¹⁶⁰ The values in Stefan Voigt’s four competition indexes range from 0-1 where 1 indicates higher degree of competition mindedness. According to this analysis Estonia and Latvia have a roughly equal formal basis of the Competition Law, which means the number of practices deemed to be anticompetitive. The difference is modest (0.365 Estonia; 0.243 Latvia), and both scores are lower than, for example in the UK (0.750). There are differences in approach to competition violations. The second index shows that Estonia has a more rigid *per se* approach as opposed to Latvia who scores high with a more case-by case approach (0.233 Estonia; 0.785 Latvia). The third indicators – *de iure* independence of the Competition Council is also very similar (0.650 Estonia; 0.577 Latvia). *De facto* independence of Council is slightly higher in Latvia than in Estonia (0.500 Estonia; 0.636 Latvia). However, both of the latter two indexes that pertain to the political independence and discretion of Competition Council are much lower than in e.g. German, Netherlands and UK. Thus there is possibility of political influence of instructions from executive branches of government in both Latvia and Estonia.

¹⁶¹ M. P. Schnikel and J. Thielert, “Estonia’s Competition Policy: A Critical Evaluation towards EU Accession.” In *European Competition Law Review*, (online, 2003) 24(4) Available at: <http://ideas.repec.org/p/dgr/umamet/2002021.html> (cited April 20, 2007)

rule adoption and highly asymmetrical gains from domestic deregulation clearly favoring more competitive EU-based firms¹⁶².

To sum up, it is possible to conclude that the ideas and political consensus of the early stages of transition in Estonia produced spill-over effects to policy-making sphere as well. As a result of this spill-over, the policies of economic restructuring were framed within the basic premise of market-liberalism – free competition. This claim can be confirmed as the task of Competition policy implementation was described as rather automatic and self-evident by Peeter Taamistu, the Head of Estonian Competition Council in an e-mail interview. He stated that: “In early 1990ies Estonia had decided to change its economy to market economy. This meant that the state administration of prices was finished, which created the need to set up an effective competition regulation and also consumer protection regulation.”¹⁶³ The value-added of rule adoption was not questioned.

Explanation III Estonian competitiveness as a social construction

Morten Hansen argued in the interview for this thesis that: “Estonian rankings look conspicuously good some times. A colleague of mine has written an article where he argues that part of the good ranking for Estonia is an Estonian perception that they are really good!”¹⁶⁴ Various cultural references illustrate that Estonian economic competitiveness can also be conceived as a social construction. For example, Estonia is referred to as the most competitive new EU state, the 9th economically freest country in the world¹⁶⁵, a country where 90% of banking transactions are made using the Internet, or where citizens can use electronic ID cards to vote in elections. Even the domestic strategy for attaining goals of the Lisbon Agenda is called “Success Estonia 2014”.¹⁶⁶

These cultural references have contributed to the external marketing activities of the Estonian state institutions and attempts to build an enterprise culture and “bring out” the domestic “entrepreneurial spirit”. In 2006, Mart Laar was awarded the Milton Friedman

¹⁶² Saul Estrin and Peter Holmes, *Competition and Economic Integration in Europe*, (UK, USA: Edward Elgar Publ., 1998): 6-8

¹⁶³ E-mail interview with Peeter Tammistu, Director General of Estonian Competition Board (conducted on May 25th, 2007). Answers provided by his representative Lea Tõntson.

¹⁶⁴ E-mail interview with Morten Hansen, Head of Economics Department, Stockholm School of Economics in Riga (conducted on May 25th, 2007)

¹⁶⁵ Marian L. Tupy, „A champion of liberty” In *Tesdaily.com*, (April 20th, 2006)

¹⁶⁶ Signe Ratso, “Miracle of Estonia: Entrepreneurship and Competitiveness policy in Estonia,” prepared for the for the Trade, Industry and Enterprise development Week, UNCE 2005 (available at <http://gwww.unece.org/ie/wp8/documents/maufor/Signe%20Ratso.pdf>): 5

Prize for Advancing liberty and an article appeared in *tesdaily.com* stating that the presence of market-liberal Estonia in the EU will lead EU away from her socialist policies.¹⁶⁷

The role of the “Finnish factor” in the Estonian economy is widely shared also in Latvia. Thus, for example, Arlita Sedmale mentioned in the interview that “Estonians are very close to Finland, and they have managed to adopt Finnish practices in the right time. Many countries should learn from the Finnish skills of economic management, they are very effective.”¹⁶⁸

Thus the economic indicators and cultural inferences have to be evaluated carefully, because the expectation and public image of a country may contribute to a socially constructed impression of competitiveness.

¹⁶⁷ Marian L. Tupy, „A champion of liberty” In *Tesdaily.com*, (April 20th, 2006)

¹⁶⁸ Interview with Arlita Sedmale, Executive Director of the Latvian Federation of Food Enterprises (conducted on May 23, 2007)

Conclusions

The conclusion is that identity of the “economic self” in Latvia is still disputed and divided. The two conceptions - *a national economy based on national identity aspects* and the *alternative conception based on international norms and practices* are in a constant dialectic interaction in the public discourse. The case studies from Latvia show that the dialectic interaction between the two competing conceptions can be interpreted as an intersubjective process, through which actors are trying to make sense of the competition rules and their impact on the social context. The experience of Estonia shows that competitiveness is can also be conceived as a socially constructed notion that reinforces formal economic indexes.

This general conclusion can be laid out in more detail:

First, in Latvia there is a strong influence of cultural, social and economic aspects of national identity in the political process and public discourse. The implication is that certain groups can access political decision-making and “penetrate” public discourse relatively easy. The Food Producers’ lobbying is an example *par excellence* that shared national values in the economy can help actors to further their interests in state institutions and public space.

Second, in Latvia rule adoption in Competition policy has been a rather technical matter and the level of socialization of market participants and economic elite is rather low. The lack of understanding and identification with EU’s Competition policy may explain why the disputes emerged. However, the cases also showed that the brakemen are not completely unaware of this normative context, and it could be argue that their identity is close to that of *weakly socialized agents*. Although the preferences of food producers and the traffic officials were essentially pragmatic and material, the normative context shaped the behavior and choice of strategies. The food producers had to justify their claims vis-à-vis the norms of free competition in market economy and the EU’s internal market. The Minister of Traffic sued the Competition Board in court thus appealing to democratic norms.

Third, in the context of the research agenda this observation leads to an important conclusion – although the in brakemen represented the international capital, and formally this should give them legitimate claims in political institutions and public discourse, nevertheless, due to the *powerful impact of national identity-related understanding of the*

economy the large international retailers were pressed to stay silent and hope that the EU would intervene and solve the issue. Nevertheless, this view about the omnipresent power of the EU obviously turned out to be a myth, as in fact, the Commission was sending mixed signals about the correct interpretation of Article 82. The Commission was also not intervening directly in the tax policy case, although the behavior of national government was clearly against EU laws. Thus one can conclude that Latvia's political entrepreneurs were testing how far they can go against the EU norms, and *where is the line at which their claims and behavior are indeed illegitimate*. This finding can be excelled as one of the central contribution of this study to the understanding of Europeanization as a discursive process and the EU as a normative regime, rather than just a rigid system of automatic laws and hierarchies. A lot depends on the particular situation, actors, ideational and ideological aspects.

Forth, Schimmelfennig's model of rhetorical action fulfilled the initial expectations in terms of its analytical value. It helped to show that the normative context significantly shaped the Competition policy-related disputes in Latvia, actor strategies and outcomes. In the dispute between local food producers and international retail chains, the initial bargaining power of brakemen was stronger as the state institutions were among the brakemen coalition, too. However, intervention of drivers that used EU's normative context significantly constrained the brakemen. The rhetorical action of drivers severely constrained the argumentative space of brakemen thus showing that alternative norms - national values in economic policy and law-making – are no longer unconstrained and the EU context and Europeanization pressures have the effect of disempowering local patriots. This can also be interpreted as a certain Europeanization conflict dimension, however, the local patriots are not fundamentally opposed to EU norms, and in fact, their identity is closer to *weakly socialized agents*. Otherwise the drivers would not have been successful with rhetorically entrapping the brakemen. Thus it can be argued that the presence of two competing conceptions of the national economy, as integral parts of the "economic self", initiated rhetorical action in Latvia. The dialectic of ideas this turns out as a central aspect of "misfit" between Europeanization pressures and domestic social context.

Fifth, in the airport tax-policy case the role of a domestic intervening variable - *Realpolitik* practice of high profile political entrepreneurs emerged as a crucial for outcomes and served as constraining factors for drivers. As a result, the driver - the Competition Council could not use EU-norm-based arguments in rhetorical action.

Sixth, the explanatory variable – the “fit” between Europeanization pressures and domestic social context in Estonia – explains the initial puzzle. The Estonian variable showed that early socialization and social learning conditioned a more coherent identity of domestic elites with regard to the values and principles of national economy. The spill-over effects of these shared understandings were less evident in practical terms. That is – rule adoption in Competition policy area does not vary significantly between Latvia and Estonia. Although the approach to competition policy violations in Estonia is more rigid as compared to an economic approach, this aspect has a rather low explanatory value. The generally more effective market structures and governance may have a stronger impact on “fit” vis-à-vis the role of a single institution (Competition Council). Nevertheless, the spill-over of earlier identity formation can be observed in a socially constructed image of a competitive market economy in Estonia that resonates both with international observers and social actors in Latvia. The general intersubjective perception that Estonia is a more competitive economy could contribute to the view that Estonian Competition Council is more effective and legitimate.

Thus it is possible to confirm the hypothesis that misfit between Europeanization pressures and domestic social context trigger rhetorical action. As it was noted, misfit can have economic, sociological and cultural aspects related to variation in identity.

Finally, although initially it was presumed that Latvia and Estonia are structurally very similar, the case studies and explanations showed that actors perceive them as very different – early exposure to Finnish capitalism and greater risk-taking in economic policies have shaped the image that Estonia is “on the road to success”, while Latvia still lingers in uncertainty. The image of a more competitive Estonia has wide resonance. It is difficult to disentangle the economic or institutional aspects from sociological aspects in this image; however, the case analysis and interviews showed that actors perceive these variables as mutually related. The exact direction of causality has been acknowledged as a rather disputed methodological issue in social sciences, and this analysis shows that ultimate explanations are not possible.

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Appendix 1

Interview with Ieva Jaunzeme, Chairperson of the Competition Council of the Republic of Latvia (conducted on May 22nd, 2007)

- 1) **Free competition is the cornerstone of liberal market economy. According to this theory, the role of state should be minimal in the economy, because market forces such as the „invisible hand” and the Law of Demand provide the most optimal price, quantity and quality of products. What is your general attitude towards such assumptions, or, to put it differently - laissez-faire in the economy?**

I. Jaunzeme: “Competition jurisprudence emerged at the end of 19th century in the United States (US). Historically it has been one of the most liberal economies in the world. The basis of Competition rights was created there, even if the conviction was that the state should regulate as little as possible. Of course, American rights in this field are somewhat different from European approaches, even today. Nevertheless, it means that liberalism in a certain period is not possible without minimal intervention and regulation.

In Europe Competition rights were introduced much later than in the US. We do not have to look far in the history – even in the middle of the 20th century in some European states a cartel were considered to be a normal form of economic activity. The Dutch say that until the 1980ies Holland was the “cartel paradise”. Thus I think that there is no direct correlation between the understanding of competition rights and liberal economy, because the goal of competition rights is to provide that every one has equal opportunities to develop. In other words the aim is to provide that the economy works in the interests of society.

One could say that there is a contradiction between regulated or social economy and capitalism. However, in industrialized countries we can see that the goal of capitalism is to serve the interests of the society and to promote its welfare. Society’s development comes to a standstill if the “invisible hand” is allowed to rule over the economy - if there is no intervention, monopolies and cartels can not be restricted.

What does the society want? They want cheaper and varied goods. This is the essence of consumer society and society in general. Thus I think there is really no contradiction

here, because the economy is not an end in itself. Economy means relationships that are oriented towards a certain goal.”

2) In the field of Competition rights, there are two methods for dealing with actors that violate rules – the economic and legal approach. From the position of different socialization effects, which method is more appropriate in the particular context of Latvia?

I. Jaunzeme: “Economic approach is very new in Competition rights. As an economist I could say that this approach could be rather likeable. At the same time, it has to be noted that the lawyers have built the foundations of these rights. The judicial thinking has a great role in the EU and also in the US. I do not want to offend lawyers, but usually they are not very flexible. Already for the second year there is a discussion at the EU level about this new approach and the way it could be introduced. The opinion of Commissioner Kroes (*Neelie Kroes, European Commissioner for Competition*) is that maximum effort should be devoted to socialization and informing entrepreneurs. Judicial norms should be brought nearer to economic reality. Currently this discussion has led to a realization that the legal basis what was created over the years, as well as the public opinion is not ready to move completely to the economic approach. Lawyers still remain the central propellants of Competition rights.

There is a big difference between competition as an economic category and Competition rights as a judicial concept. In an economic sense, we can speak about competitiveness that entails mainly microeconomics, but also a part of macroeconomics in the sense of macro-economic stability. Competitiveness is a very broad concept and almost anything can be included. However, if we speak about competition in the judicial sense, the meaning is much narrower and norms have formed historically.

Although I think that it is important to speak more about competition in the economic sense, not only about “the letter of the law”, we have discussed in our family of European Competition institutions that the most problematic thing is transition period from legal to economic approach. What would be the duration? European Court of Justice has developed case law that is based on the violation of norms and emphasizes consumer interests. What would happen if suddenly we would say that the law is not important any more and we have to evaluate? How will we evaluate then? One day an enterprise is doing great, but next day things can change. This would create legal instability and could

create devastating economic consequences. No one will be sure about what is allowed and what is not.

The law is the law – if one must not violate it, then this is how it should be. If I start to evaluate whether the expenses are economically justified, or they were not, whether they were discriminating or not, let's say in the period 1995-2007, in this moment we create judicial instability. This can be very traumatic for enterprises. As a result the discussion at the EU level has come to a point where we say yes, we have to evaluate consequences, but the application of the Article 82 should be brought nearer to the practice in dealing with cartels.

There is no discussion about cartels – it is forbidden and we do not have to prove economic effects. According to the definition, cartels are evil. It is not so straight-forward with Article 82 that pertains to dominant position in market. The opinion is that the methods of investigation and argumentation have to approximate to the practice in cartels and mergers. At the same time economic effects have to be considered as well. However, knowing who leads these processes – the lawyers, we can not refrain completely from a legal approach. We can not create judicial instability.”

3) The Competition Council in its decision about tax-relief policy in Riga's airport appealed to the common practice and understanding of Competition rights in the EU. However, it did not have the expected effect on the political elite that refused to change the policy. What could be the reasons for that?

I. Jaunzeme: “In this case I could speak from the categories of *Realpolitik* and these categories are very simple. We have a coalition government, and, although I am not a political scientist, but my experience in state administration is quite long, I can say that this result is the optimal model in the context of current events. In order to maintain the coalition government, there is a need to make all kinds of compromises. Of course, I do not know who is behind this. It is not due to lack of common sense, or lack of understanding about EU norms that nothing has been changed. It is simply because of *Realpolitik* and we have to take it into consideration. This decision is probably a compromise.

I really hope that Latvia will not have to face great financial costs in future lawsuits. But we have to understand; we went through legal norms to see how it should be; but the situation is the way it is. I can say that we are not the only ones with such problems. My colleagues have told that in their countries ministers have the right to annul the decisions of

Competition Council. For example, Competition Council forbids a merger, but a minister annuls this decision and allows the merger.

The issue with tax relief policy will be discussed in court, but it will take place only in September, 2008. All water will change until that time. We support the initiative of European Commission to come up with a new directive about tax policy in Airports. I know that the opinion of Ministry of Traffic is not supportive towards this directive. There are many violations in this sphere in almost in every member state, the DG of Transport has informed about this. There is a need to create some order and so that this discrimination would finally end. We could bang our heads against the wall, but currently we can not change *Realpolitik*. But there will be a day, when things will change.”

4) What is the goal of this new directive?

I. Jaunzeme: “It will regulate tax policy in Airports. It has been the project of DG Transport already since January 2004. The discussion has already started at the EU, and will start at one point in Latvia as well. Most probably our opinion and the opinion of Ministry of Traffic will not match. They think that everything is fine and there is no need to regulate.”

5) The government plans to amend the Law on Concessions to take out norms that hitherto precluded the privatization of strategic state enterprises. Riga’s Airport is one of them. Can this be related to information in the media that SAS plans to buy Air Baltic – the major economic beneficiary of the current tax-policy?

I. Jaunzeme. “I think this idea is no longer on the agenda. Although, there are examples in other EU countries that state cooperates with private sector in public-private partnership agreements. I have not heard about such plans in Latvia. In fact, the last time I heard about Riga’s airport was a few months ago. There was a discussion between airport officials and banks about a loan of 30 million lats that would be necessary for further development of the airport. Lately everything has calmed down – no one mentions the 30 millions, nor development plans.

In any case, SAS has already bought Air Baltic. This deal was made in 2002, when the bonds were emitted. It means that *de facto* the state no longer owns Air Baltic. Representatives of SAS were here in the Competition Council; we talked and told them to submit an official merger application. Since then they have not yet implemented their

right. They can convert their obligations in 10 years time. In December 2006 they announced that plans to finally do it. However, nothing has happened yet and they have not secured their rights *de iure*. They have this right and no one can take it away. After the merger, the structure will change – SAS will own 51% and the state – 49%. There will be some minor shareholders as well.

This deal, the privatization of Air Baltic, has already happened, but we have to be realistic – SAS does not have the money to invest in Riga's airport. In January there was a change in SAS management, and they planned to announce in May this year what will be their future plans in Riga. I have not noticed any announcements yet. Anyway, SAS does not have enough money for that. I have not heard anything lately about the grandiose airport development plans.”

6) What factors motivated Competition Council to get involved in the dispute between Latvian food producers and the international retail chains?

I. Jaunzeme. “This dispute started in 2005 when the first publications appeared in the media. It was mainly about the drastic terms of contract that the retailers imposed upon producers. This started when the Commission allowed a merger between IKA and KESKO that previously had two separate retail chains in Latvia – RIMI and CITYMARKET. In November 2004 this merger was allowed on the basis of very optimistic terms – that there will be development, new market entries.

Unfortunately, none of these optimistic prognoses have come true. Since 2004 only RIMI and MAXIMA have experienced considerable development. There is also the local chain ELVI. In total eight retail chains can be mentioned, the rest are not relatively competitive. If we look at the contracts that supermarkets enforce upon suppliers, the terms are drastic. In my practice I have not encountered such contracts – they are beneficial only for one side. Of course, if you are not a supplier of exclusive products. But even for them the situation is problematic – top ten Latvian food brands have said that at least once they have been thrown out of the supermarket. Then there was the Law on Trade Organization, where the attempt was to restrict this situation. At one point there was nothing left of this law and the norms were transplanted to Competition Law.

In general, this problem is not local; it is international – in EU member states and also other countries, for example in Australia, the US. This is a conflict between farmers and supermarkets. This problem exists everywhere and what we have to talk about is the balance of power in terms of purchasing power. If we look at the experience of Norway,

they used to have a few very powerful food producers and very many, small and fragmented retailers. As a result, producers could dictate their power. At one point there was equilibrium and then everything turned upside down. Retailers turned in to a bottleneck as they are the only link between producers and consumers”

7) When looking at the exchange of opinions in the media, it seems that retailers and producers have different perceptions about competition norms. In part this can be understood as a strategy, however, have you tried to create a dialogue and explain your understanding of competition norms to both sides?

I. Jaunzeme: “I have to say that when we meet, everyone expresses their opinion and then we go home. On human level, I completely understand entrepreneurs, as I have worked with them previously. I would do the same in their position. Why allow someone to regulate, if everything is fine and there is good profit? Although they say that their costs exceed profit, I do not know such business, where one opens new stores with a failing business. I do not know, although from time to time they try to convince me.

I do not think that this is panacea and that these amendments to Competition Law could change something. Until the last moment I thought that good will could solve this situation. But it did not work. We looked at various models in Europe, and there are no more than three. We are somewhere at the middle with this Law. Prohibition of dumping prices is banned everywhere as it harms the interests of consumers. This law says clearly what they can not do, and it is perfectly understood. If they will do it any way, they will not be able to reach their profit targets and everyone will suffer.

I understand them as the goal of business is to earn money, but at the same time consumers not deserved such an attitude. Only in half a year prices rose for 10% without any reason.”

8) As I am comparing Latvia and Estonia, there has been significant difference in trade policies in the field agriculture. Latvia maintained high protective tariffs over the 1990ies while Estonia pursued a unilateral liberal trade policy. Has this policy created expectations and a tradition among Latvian food producers to ask the state for help to defend their interests?

I. Jaunzeme: “I have met with farmers in many different forums, associations etc. My impression is that they have found a way out of the situation. Previously producers in the milk and grain sectors were really subject to the interests of the processing industry. At

one point they found a rescue in Lithuania. It is completely normal; this is how market economy works. They get their price.

Now we read about EU subsidies and that we do not get enough. I have to say that before that the prices corresponded with real costs. Now we have European prices for milk, and European prices for grain. The prices are the same. However, income in other sectors is not in the same level with EU. Irrespective of the tariffs, whether we had “pork wars” or we did not, the EU spoils everything, it deforms the price. I understand that everywhere there are subsidies, but they make the system ineffective. There is no need to think. Farmers would not agree with me, but I think that previously when the prices were locally set, once orientate in the market more easily. Now the price is deformed, free competition has been distorted.

During the “pork wars” - the short-term protective measures to safeguard local industry I expressed an unpopular opinion that tariffs make the entrepreneur inert. He does not think, or look in the future. Currently many enterprises work for the local market and think that this is enough, to compete about the local market. But how big is it? Lithuanians are more aggressive and enter new markets and take their share”

9) By violating Competition rules.

No, no I do not think that buying milk from Latvia is a violation. I also do not speak about Maxima as a retail enterprise. I am referring to their products that are not only sold to Maxima, but also exported. I do not know why, but their products are cheaper, our producers should find out how they manage it.

Last year we commissioned a study about food industry in Latvia and it turns out the meat processing sector has experienced growth very recently, after opening the borders of EU. Before that there were not enough meat suppliers, but currently food processing in Latvia is one of the sectors that is growing. New opportunities for development have opened up. All other traditional sectors have declined, but food processing has increased turn-over substantially just because there is enough supplies, due to free trade.

If our entrepreneurs would work more actively towards Western market, it would be better for all of us. Why not work with Lithuania? Businessmen often say that it is difficult, but why is it not difficult for the Lithuanian?”

10) Perhaps there are some national differences?

I. Jaunzeme: “Yes, but then there is no ground for claims that Lithuanians are bad, because they buy out all our milk. Then they tell me - we tried, but something does not work. But why does it work in Lithuania? Thus it is much easier to come to me and say that we have to prohibit everything. A small open economy remains a small open economy, we can not prohibit anything and all doors are open. But please tell me, what did you find in Estonia?”

11) The Competition Board was set up in Estonia 5 years earlier, and their initial policy was to educate market participants. There are many cases when enterprises naively admitted participation in cartels and concerted action without knowing that it is not allowed. Initially the Council did not punish such actions; their approach had a strong socialization dimension.

I. Jaunzeme: “I think that in the last 10 years many things have been neglected in Latvia. During the time of the previous directors, the attitude was – the less we speak, the better. I used to work in the Confederation of Employers and I do not remember hearing about Competition Council at all. The society was not informed.

We also have to consider that those institutions that were set up in the beginning of independence, had very small budgets and could not do anything. The indexation of their salaries and budgets has been very minimal. On the other hand, effectiveness of institutions depends very much on the personality of their leader. The head of the Veterinary Inspection Vinets Veldre has been the forth most popular person in the country for many years. We could not work with the Work Inspection Office, but cooperation has resumed after the change of management.

The history of Competition Council is similar. Problems had accumulated, there was a scandal and the previous director was released. When I started to work, the budget was almost doubled.”

Appendix 2

Interview with Arlita Sedmale, Executive Director of the Latvian Federation of Food Enterprises (conducted on May 23, 2007)

- 1) **There are many views on how market economy should function. One theory is Adam Smith's „invisible hand” – the market forces regulate themselves, and the state should intervene as little as possible. What is your general attitude towards *laissez-faire* in the economy? Is it good for the consumer and society?**

A. Sedmale: “It is definitely good for the consumer. My thinking in this respect is oriented towards food industry. Every sector of the economy has its twists and turns, and this applies to us, the food producers as well. We work for the consumer who wants to have sufficient variety and quality of goods for a reasonable price. From the positions of consumer, in free market economy the supply of goods increases. I am referring to the Single Market of EU, and bilateral agreements with third-countries. On the one hand, this possibility to purchase freely goods and sell them is good.

However, on the other hand the situation in food product sector is not so straightforward. The amount was higher previously, but currently 80% out of domestic food consumption is made up from goods that are produced in Latvia, and only 20% originate from abroad. I mean – products produced by Latvia's companies, despite the fact that they might have outsourced production elsewhere. This ratio is similar in other countries, in some it is around 70%. We have to understand that the 20% “travel”. This is one point.

For the consumer it is good to purchase fruits and vegetables around the whole year. Seasonality of these goods is not that explicit anymore. The impact for local producers can not be measured as only positive or only negative. Competitive conditions require thinking - how to work better, how to raise productivity? On the other hand it is not so good, as this limits distribution channels for goods.

I will mention an example Imported strawberries cost 2 Lats per kilogram in supermarkets. Usually the first strawberries appeared in stores at the beginning of June and cost around 4 Lats per kilo, everyone bought at least a few grams and felt happy. I am not sure whether local strawberry producers will be able to sell strawberries for 4 lats per

kilo anymore, in June there will be the Polish and Lithuanian strawberries as well. For the consumer this is good news. However, in order to grow certain amount of strawberries in Latvia much more labor is required than for example in Poland or Spain. The crops are smaller here, too. As a result strawberry cultivation has substantially shrunk and those who produce will have to position these products as very exclusive.

The consumer no longer has the same attitude towards the product. They ask the producer - why are you cheating? Previously they could buy Latvian strawberries, and they taste better, too, but now they choose imported products due to the lower the price. The same problem applies to tomatoes and other food products.

The value of the product is lost, and this is what concerns me. Of course one can say that we should perhaps not talk about this, I do not know. Personally I choose Latvian strawberries, because of the taste and other things. Speaking about other products, there are traditional flavors, for example very explicitly for local bread. Our bread is different than in Europe.

The consumer thinks that bread was tastier 10 years ago. But we can not think this way, technologies and the general economic situation have changed. The consumer still feels that they are being deceived, or forced to do something that they do not want. I do not know whether this happens only in Latvia, but there are positive and negative effects of free market economy.

If we look from the perspective of health, such products as vegetables, the most beneficial milk and bread for consumers of a country or region are those, which have been grown in the same locally. In the level of assumptions we could argue that nature in a certain region provides food products that have all the necessary ingredients, taste and nutrition value for people living in this region. No one has proved that salad that was raised in my garden is better than salad from Estonia. At the same time, I think that still there is a certain correlation.

Local products have shorter realization periods than imported goods. It does not mean that imported goods are worse than local, because there are technologies that help to extend realization periods without adding preservatives. However, if we consider the realization period together with price, there is a reason to be concerned about the amount of preservatives. Many preservatives are allowed, but there is another aspect here. The retailers constantly pressure producers to extend realization periods for products. One can achieve this with better technology and I personally know one producer that uses a modern production system to suck out all air from the product in order to extend to

realization period. Theoretically he could extend the realization period, but he thinks that the consumer will not understand and get the impression that he has added preservatives.

Open economy offers new export opportunities. But it is not so simple and those who are new in the business think that our products are so good that everyone is waiting to buy them. If we look at supermarkets in Europe, perhaps less so in developing countries or Africa, it is not so that something is missing in the shelves. In fact there is an oversupply of goods and an increasing amount of goods are simply thrown away.

Squatters in London can get very good products from Mark's and Spencer almost every day. I think that this is a compliment to food producers that even if the realization term has ended or will terminate in a few days, the product is still good. I know that producers always set the realization term with a certain margin. The technologies have considerably upgraded the quality of food products in the last ten years and the example of these squatters show that one can eat the food even a week after the end of realization period."

2) How did the opening-up towards European market in 2004 affect local food industry? Which sectors are the winners and the losers?

A. Sedmale: "My personal opinion is that the impact is actually not so great. If we look at statistics, our exports are growing. However, the information from the last year completely destroys credibility of statistical data. In 2005 there was 75% increase of exports. This number is not characteristic to real processes, because a large amount of these exports were "*raw materials*" such as milk and grain, exported to Lithuania in large amounts.

A new trend is cooperation among large companies in the Baltic and Finnish region, for example such bakeries as Hanza and Fazer. They used to have one producer in each country; they have made great investments in Estonia and set up modern production equipment to produce, for example, toaster bread. As a result, a substantial part of bread products that used to be produced in Lithuania or Latvia are made in one concentrated production facility in Estonia. The products are then distributed to the all three markets. Export/import balance does not reveal the real situation. Of course there are goods which are similarly produced in Latvia and then distributed to Estonia.

This is how I understand globalization. The logo and brand is Latvian, but production is outsourced in another country. Many businessmen have told me that after accession to

EU they no longer produce the same products in each country, but try to concentrate production of a certain product in one place.

The other thing that has changed is the price of raw supplies – the prices have increased. Some raw products are even more expensive than in the EU, for example milk.

Everyone is talking about inflation, but prices for food products are still lower than in the EU. There are product groups that still have the possibility to grow. For example, the prices of bread are much lower in Latvia. The producer can not increase the price, because the purchasing power of our people is not so great.

All costs have increased for the producer – gas, electricity and, of course, labor costs. The lack of labor is the most painful problem. After accession to the EU there has been a considerable out-migration of labor force.

In order to be competitive, there is a need to invest in production. Many producers have not understood the market economy. At one point they will have to decide what to do. We are in Europe for three years, but still we compete with the same kind of products. Of course some enterprises have developed specialized products, but this is certainly not a general tendency. They still compete in the same market with the same kind of goods. The result is a price war.

Increased competition is certainly good, because sooner or later food producers will have to decide what to do and find ways to restructure. However, this transition period has been too slow. Restructuring is not easy even for those enterprises that know what they are doing. You can not just go to your competitor and tell him to stop producing packed milk, because you can do it more effectively. Overall the food market is currently overheated and a lot of energy is wasted for unproductive purposes.”

3) On a comparative level, Latvia has had a protective regime in the field of agriculture and there were high tariffs in the 1990ies. In contrast, Estonians never introduced protection in the food product market. Has this tradition of protectionism affected the late socialization of market participants in Latvia and as a result there is a higher chance of a destabilizing shock?

A. Sedmale: “I completely agree. Why should one worry about the future, if I am protected today? This kind of thinking is very explicit in Latvia. We still hear that in many enterprises salaries are paid in envelopes. Why do employees agree with such practice? They do not think what will happen if they will need to go on sick-leave. The important thing is that they have a little bit more money today.

The same is happening in milk sectors – local producers choose to sell milk to Lithuania although the price difference is 1 or 2 santims. They know that this is hurting the milk processing industry. Today the income margin from one ton of milk is slightly greater, but they do not think whether it will be possible to sell in Lithuania after a few months. The local processing industry is suffering from this process, and the producers could suffer at one point as well, because the Lithuanian can say one day that he does not need our milk anymore. To whom will they sell the milk, if the local industry will be destroyed?

We can be patriots of our country to a certain extent. The milk processing industry has its limits in this respect and many enterprises are being restructured to other businesses.

The level of agriculture subsidies varies across EU member states. But I do not think that subsidies always have a positive effect. Subsidies are calculated according to the size of agriculture land, or the number of cow horns. No one evaluates the quality of production. I have heard that new quality requirements will be introduced in the milk industry.

The productivity is extremely low in the cattle-breeding sector. The statistical data inform that one average a person rears three cows per year. It means that there are also people who rear only one cow per year. The quality of such production is not stable and certainly much better in larger farms. The big farmers with hundred or thousand hectares of land have great profits. Those who have three hectares are in an agony. But this is how market economy works. Agricultural subsidies are being used mainly for solving social problems in the countryside.

If we speak about Estonia, they were much more relaxed about many sectors. For example, they have never grown sugar-beets, thus their sugar production industry was more competitive than in Latvia after accession to the EU. Estonian sugar has been two times cheaper than Latvian.

Estonians are very close to Finland, and they have managed to adopt Finnish practices in the right time. Many countries should learn from the Finnish skills of economic management, they are very effective.”

4) How did you come to the decision to ask Ministry of Economics to help the food industry and create amendments to Competition Law?

A. Sedmale: “This is a difficult question and I would be happy if this was finally over. This question is disturbing me even in dreams when I try to sleep.

Here we have to talk about the relationship between producers and large retail chains. This question is very sensitive in every EU member state. I know this because the national federations of food producers have meetings three times a year in the level of directors. The last meeting we had in February and the question about retailers was among top three issues in each of the participating countries.

It is so because the purchasing power is completely concentrated in the hands of retailers. Of course, producers have this power vis-à-vis supplier of raw materials, and so on down the chain. This is nothing surprising. But there is a Latvian saying that “the appetite incurs while eating”. The requirements are increasing all the time. Everyone understands that you have the right to refuse signing the contract, and if you are a large enterprise with a well-known brand you can bargain. Currently even the largest local enterprises are facing an increase of all kinds of payments that the supermarkets require. As a result, your products can be thrown out of the supermarket at any moment. There is no protection – they can send some mystical bills.

The expansion of retail chains has been grandiose in Latvia – I do not know a single city where you could not find a store from the chain of Rimi or VP Market. All these Supernetto, Saulite and what have you. If the producer thinks about ways how to provide consumers with his product, he has no other option than to cooperate somehow with these two supermarket chains.

Sometimes I look at the prices in supermarkets and I do not understand – how can you produce something for this price? I never go to Supernetto or Saulite to avoid feeling upset. But I have been told that they sell pasta for 3 santims per half a kilo. I understand that they can have their special offers, but the consumer goes to another store next day and asks – why do you ask 30 santims for pasta here if they can produce the same thing for 3 santims? The consumer is not so smart to evaluate these details.

This problem in Latvia has to do with the small size of our market. The largest players in the retail market will not come here. Thus these two chains – Lithuanian VP Market and Norwegian Rimi have very equal power as each of them has a market share of 23%. They fight for life and death, and the weapons in this war are the producers. If you have your products in stores of both of the competitors, you are under constant risk of being thrown out from the shop. There are cases when the owner of a food producing company has said something in a marketing leaflet of one chain and was immediately expelled from the other store.

We had to think about a ways out of this situation. Why Ministry of Economics? First of all, they are in charge of matters that relate to the regulation of internal market. Actually they were the first who talked to use during the time when the Law on Trade Organization was prepared. We had to express our opinion about a draft of this law and then we realized that this could be the right place where to restrict, or to put it differently – to specify the things that the supermarkets can not do. We included such points that the retailer can not ask the producer to finance the building of a new store. If I would build a house it would not make sense to ask someone else to pay for it. The same problem applies to marketing activities. The amount of money they ask is not great, but even that could be important for the producer as all costs are increasing.

We managed successfully to include in the draft of this law a few things that are obvious. Then there was a change in government and Mr. Stokenbergs (*Minister of Economics after the change of government*) said that he will not support this law. We had a meeting and told him that we really do not care in which law it would be more appropriate to regulate this situation. The Ministry knows better these specific procedural aspects.

We formulated three general points: first of all, the business of producers ends at the point when the goods are delivered to the retailer. At this moment the producer should receive the money. In reality, the producer's loader is responsible for unloading the products in the supermarket, assembling and putting them on the shelves. Producers told me that their representatives have official permits in Rimi, they go inside and organize the products in the shelves. What is the business of producer and where the responsibility of the retailer starts?

The second point pertains to payments. They should be equal for all. One of the leading enterprises in food product sector, with a great share in the Baltic markets told me that he can not get his products in VP Market stores. They could not agree, because the retailer set the price lower than the product cost. In this case it does not make sense to produce anything as you will loose at the end. Next day this entrepreneur went to a store of VP Market and saw that the shelves are full with Lithuanian products. The question is – did they have the same terms of contrast as our producers? Perhaps there are some political rather than economic reasons for this. We can not stop this, but the Competition Council can. I think that our claims are justified. This is not just one case – it happens systematically. One does not know whether the winner had the same terms as the losers.

The third requirement was to regulate the limit of payment days. There are cases when the credit days reach 180. Thus you basically credit the retailer's business with your money. You supply the good, but the money is there only after 180 days. The optimal duration would be 40 days. But for example the realization period for milk is three days, but the payment period is 40 days. I think this is not normal. One large enterprise told me that they take loans in order to cover up lack of money supply and support further production. They can not wait for the credit days to expire and they need extra finances all the time.

The Ministry proposed to include these norms in the amendments to the Competition Law. I understand that this will not solve everything. We refused to take part in this seminar of lawyers, because it was not objective. They admitted frankly that this is organized in favor of certain interests – the Foreign Investors Council in Latvia and Statoil. In their press realize they write that our Federation supports amendments to Competition Law as the only solution. This is not completely correct, because these amendments help only theoretically. They would give the feeling that the interests of the producers are taken into account. In practice, there will not be immediate benefits; the effect is more on the level of public relations.

Even without these amendments, it is possible to start a lawsuit. We had a meeting with the Head of Competition Board Ieva Jaunzeme and she told me that the Civil Law already provides such rights. However, there are no precedents, because the producers know that they depend upon the retailers. They do not want to put their profit and turnover at stake and go to court. Thus basically I am the spokesperson who represents the general interests of the industry in order to avoid direct sanctions.

The new amendments prescribe that the producer can address the Competition Council if there is unfair treatment. The Council would start a case and investigation could last even for two or three years. Thus I do not think that this law will solve everything.

I have seen these contracts and it is obvious that the terms are unfair. The retailers argue that it is the task of lawyers to evaluate contracts, but these are standard contracts. Their arguments are simply no sense; they want to stop this law at any cost.

What has been achieved with this initiative? From our positions, there has been a public discussion about this issue and food producers are already very satisfied. The relationships have improved; at least the retailers are now talking to them. I have personally met with the directors of both retail chains. Of course I did not feel

comfortable, but with one of the two retail chains we at least had a constructive conversation. Subsequently we could not develop effective cooperation, as other questions emerged. However, with the second retail chain, I had a meeting with the head of board and during this conversation I was thinking that I should just stand up and walk out of the room. It was humiliating to continue sitting in this meeting. I completely understand the producers – they are like little rabbits that meet with the big wolf. If this is not the case anymore, if the attitude has changed, this is already a good accomplishment.

The retailers have actually produced an effect that contradicts their initial interests. Mr. Danusevics (*The Head of Retailer Association*) is very interesting and when he speaks many people have negative emotional reaction. He insults people, and then we receive mystical letters from him. The current version of the Law is more precise, initially the protection of small and medium enterprises was not mentioned at all. Our opinion was that competition is what it is, but due their activities the draft law currently applies exactly to retail business. They showed publicly how concerned and scared they really are.

Currently I can not say how to solve this situation, what other solutions could be developed. One way would be a new regulation at the EU level. The last time we met with Head of the Competition Board she informed that such a regulation could be introduced. The discussion about this has started in EU, but currently it is more behind the scenes. The whole food industry of the EU is concerned with this issue, there is a common position.

I have heard that United Kingdom, certainly a strong state, is working on an explicit proposal for this new directive. It will not be easy, it will take at least two or three years to discuss and agree.

There was information in the media that the EU does not allow us to have this law. Personally I have not seen this letter. I received some kind of a letter, but I do not know whether it is the one, it is really difficult to tell whether the sender was Internal Market DG. Very mysterious. I asked Ieva Jaunzeme – what does this letter say, but she had not seen it either. She said that this letter is the internal correspondence between Ministry of Economics and the EU and formally it can not be distributed to other persons. The question is - how could this leak of information occur and for what interests?

Later I contacted Ieva and she had received this letter. Basically the EU opinion was neither yes nor no. They said that in five member states such norms are already introduced. Thus we are not inventing anything, the norms are very similar.

Another solution could be this Code of Good Conduct. Ethical Code has been put in effect already for six years in England, and they have realized that it is not enough. Their initiative in the EU level could come from this experience. They have a Code of Good Will, signed by producers and retailers, and the English Competition Council as the third party. It is basically a form of self-regulation and no one can go to court. There are no sanctions, and it does not work. As a result the English are promoting this initiative of a new directive with explicit sanctions.

I think that we will not be able to agree about these amendments. As Prime Minister Mr. Kalvitis said in the third time we discussed this issue in the government: “Please do not come to me before you have not reached a compromise”. I can say immediately that we will not have a compromise.

We could consider this idea about the Code of Good conduct, and come up with norms and ideas from our positions. The retailers already came out with their version, but we were not invited to participate in the drafting process. They had sent it to the Ministry of Economics without consultations. The Ministry asked me whether I have seen this document, and honestly I had not. They told retailers that we can not speak about this until they would not have consulted with producers. But nothing happened.

Mr. Danusevics said that he had sent the draft Code to 70 food enterprises and no one had any objections. I think that no one had any clue what this paper is about. I asked 20 largest enterprises and they had not even received this document. I think this was simply bluffing.

A week ago I heard that Mr. Danusevics had wanted to contact me and solve this issue together, but did not have the possibility. This is really interesting, because we always have someone at the office here, there is e-mail, and he has my mobile phone number. At the same time he claims that we do not want to cooperate.

Our position is that yes, we could talk about the Code of Good Conduct, but only together with the draft amendments to Competition Law. It would be silly to rely just on goodwill as we have not managed to cooperate all this time.

Of course one could say that if food industry will cease to exist in Latvia, we could just import Lithuanian products. However, we all and the government have to understand that food industry is the greatest sectors of national economy. Perhaps to a certain extent this is a legacy of Soviet times. According to statistic, we are still the largest sectors, although machine building will surpass us very soon. They work for exports and their position is very good. But our sector still employs 35 000 people.

We fight for the existence of this industry. When I talk to entrepreneurs, about any question, there is a point when they say – we do not care about anything else, all we need is markets for sales. You can tell them about innovations, technologies or what have you. But if your direct responsibility is to find markets for products and your immediate problem is that you do not know, where to realize the production, everything else loses meaning. This is a very fundamental struggle for us.”