ECONOMIC AND FINANCIAL DEVELOPMENTS IN LATVIA (1920–1940)

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World War I ravaged the greater part of the territory of Latvia. The War of Independence from 1918 to 1920 and the war against the Russian adventurer Bermon from October 1919 to January 1920 hindered economic recovery and development. The Peace Treaty between Latvia and Soviet Russia was signed on 11 August 1920. Industry was destroyed, and industrial equipment had been evacuated to Russia already in the early years of World War I. Also, the population had significantly decreased. Only after 1920 was it possible for the state and the nation to begin the renewal of the economy and the restoration of a normal rhythm of life.

The Latvian State was established without its own national currency. During this time, several means of payment were in circulation - German marks, estri marki, 25 and 50 lats rubles, the money of Duma, Keresmys rubles or “kerenkas”, etc. On 27 March 1919, the Latvian Provisional government published a decree on exchange rates, which was signed by Prime Minister Kārlis Ulmanis on 26 March, stating that the Latvian lats was equal to 1 estri, 2 German marks and 1.5 tsar rubles.

The main source of revenue for the government was the issuing of paper money, which covered the costs of the War of Independence, the maintenance of the state apparatus and the minimum requirements of the economy. From November 1918 to 1 April 1920, paper money was issued in the amount of 37.9 million lats, which corresponded to 58.3% of state income and from the 1929/1930 budget year, this monopoly operated at a loss.4 On the other hand, from 1922 to 1930, the spirits monopoly ensured from 12.7% to 18.4% of state revenue.5 Of the state-owned enterprises, the Bank of Latvia, the State Railways and the Post and Telegraph Offices provided most of the revenue.

In 1914, the territory of the population of Latvia was 252.0 thousand, at the beginning of 1920, there were only 1,596.1 thousand inhabitants.6 The loss of nearly 1 million inhabitants was the largest economic loss caused by Latvia to World War I. For example, in 1914, the population of Riga was 520.0 thousand inhabitants, but in December 1920, it was only 225.0 thousand inhabitants.7 This is due to the evacuation of workers and officials, which began in 1915, and many families becoming refugees. Their return began as early as 1919, and by 1925, about 220 thousand soldiers, refugees, prisoners of war, and those opting for the Latvian citizenship (persons with dual citizenship) had returned home.8

Due to the changes imposed by the war, the agrarian nature of the Latvian economy became more pronounced (see Table 1). In 1897, 744.8 thousand people (39% of total population) actively participated in the economic life of the country, while from 1923 to 1933 their number was some 1.1–1.2 million people (more than 60% of total population in 1933).9 The growth in the share of economically active population can be explained by the active participation of women in the economic life of the country. Table 1 indicates that employment growth in the industrial, trade, transport and other areas was at the expense of agriculture, which in combination with forestry and fishing continued to be the main employment areas of population. Before World War I, in the then Tsarist Russian Baltic provinces, 53.5% of the land was owned by less than 2% of landowners. In Latgale, large estates held 38% of land.10 Therefore, one of the most far-reaching changes in the economic life was the agrarian reform, which radically transformed both the legal and economic foundations of the country.

In accordance with Part 1 of the Agrarian Reform Law of 16 September 1920 adopted by the Constitutional Assembly, a special State Land Fund was established, into which 61% of all Latvian land, including 45% of agricultural land, was transferred.11

Previous large landowners were left only a small part of inalienable land (about 50 ha). This evolution is reflected in Table 1. Of total state land (forests), 30.6% was allocated to farms, 4.7% to private farms, 35.6% to forests, and 6.1% to other properties. However, 12.5% of the land is state-owned by the state and the local government authorities.

The main state monopolies were the flax monopoly (established on 27 March 1919) and the spirits monopoly (established on 30 April 1920). During the first years of independence, the most important was the flax monopoly, but gradually its share

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Table 1: EMPLOYMENT OF THE LATVIAN POPULATION (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>1913</th>
<th>1920</th>
<th>1925</th>
<th>1930</th>
<th>1935</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large landowners</td>
<td>3 016</td>
<td>48</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Small landowners</td>
<td>628</td>
<td>10</td>
<td>1 861</td>
<td>30</td>
<td>1 746</td>
</tr>
<tr>
<td>Old-farmer land</td>
<td>2 667</td>
<td>30</td>
<td>7 172</td>
<td>45</td>
<td>2 816</td>
</tr>
<tr>
<td>State Land Fund allocated for farms</td>
<td>1 423</td>
<td>23</td>
<td>1 750</td>
<td>25</td>
<td>–</td>
</tr>
<tr>
<td>Other properties</td>
<td>156</td>
<td>3</td>
<td>136</td>
<td>2</td>
<td>130</td>
</tr>
<tr>
<td>Total</td>
<td>6 267</td>
<td>100</td>
<td>6 912</td>
<td>100</td>
<td>6 246</td>
</tr>
</tbody>
</table>

in Zemgale (16.0 ha). The largest average size of new farms taken by counties was in Valga (19.6 ha), Valmiera (19.2 ha), Aukstaita (18.6 ha), and Ventspils (16.6 ha) counties. 48 The agrarian reform transformed Latgale, and with the division of vil-

gage-controlled land into single-owner farms, Latgale became more similar to the rest of Latvia.

Agricultural development was one of the national priorities. A stunning block was the losses caused by war (contracting of the workforce; destruction of 25 thousand farms, 70 thousand horses, 170 thousand cattle, 28 thousand work carts, 4 thousand grain harvesters and 76 thousand buildings, 122 thousand part-

dly destroyed buildings). 49 During the war, the area of arable land was reduced by 27%. 50

It was necessary to import not only many industrial products but also food and cereals, as in the first post-war years crop yields were small, the grain was of uneven quality; and the pro-
duction costs were too high in Latvia. 51 Due to the small size of the new farmers’ land plots, they were more suitable for inten-
sive farming than grain production for the market. In addition, grain prices in the world market began to decline in 1921, and by 1927, for example, price decreases had been slightly more than 30%, while at the same time butter prices had risen by about 50%. 52

Agricultural cooperative societies began to be formed, espe-
cially in the dairy farming. Before World War I, there were 88 dairy producer societies, but by 1929, 430 dairy producer societies had already been formed. 53

As the Latvian market could absorb only a small part of pro-
duced butter, bacon, eggs and other products of the new farms, the development of this sector was almost entirely based on ex-

ports. In particular, rapid growth was observed in butter pro-
duction for exporting. Butter became one of the most impor-
tant export products and up to 1932 accounted for almost a third of total exports.

Latvia is a land richly endowed with forests, and the utilisa-
tion of great economic importance. 80% of all forests belonged to the state, where about 6–7 million m² of timber were cut annually. 55 This quantity of raw materials and the geographical location favourable for the timber industry (the rivers flow in the westerly direction, as well as favourable port sites) meant that the latter could grow rapidly. 56

Flax production also played a significant role in the Latvian economy. During the early years of national statehood, flax was one of the most important raw materials and a source of foreign currency. The British pounds sterling paid for Latvian flax laid the foundation for a stable and secure financial system. The amount of exported flax slowly declined in the course of 10

years due to high wages and unfavourable purchase prices. The state flax monopoly profits were very high while based on low purchase prices; they thus contributed to reduced areas of flax sown and even to flax smuggling to Estonia, where there was no flax monopoly. 57

Before 1914, industry in Latvia was well-developed, and about 80% of its output went to the Russian market. The main industrial sectors were the metal industry, including machine building (also railway carriage production), and the chemical industry. 58 To recover the industrial technical equipment brought out of the country during World War I, the Peace Trea-

ties of 1919 with Germany and Austria included a provision that, along with other property taken away, industrial machinery and equipment would also be returned. Soviet Russia failed to fulfil this provi-
sion of the Treaty.

When the Ministry of Trade and Industry was established, it took care of the restoration of industry. After World War I, Lat-

vian industry worked mostly to satisfy the domestic needs. In 1920, 1,430 industrial enterprises with 21.2 thousand workers were registered (23% of the number of registered workforce in 1910).

Industrial growth was hampered by a lack of capital, and the price increases reduced the possibility of utilising the needed bank credits. Therefore, the government started crediting in-
dustrial companies. Up to 1 November 1923, the state had issued 22.7 million lats in loans; moreover, most loans were is-
sued in the 1921/1922 budget year. 59 State-owned banks played a major role in the issuing loans to industry: first, it was the Bank of Latvia, from whose total loans about 40% were loans to industry by the end of 1924, later it was the Latvian Mortgage

Bank, which issued long-term loans necessary for industrial
development, thus at the end of 1932, the Bank of Latvia’s short-
term loans to Latvia industry accounted for only about one fifth of total credits issued. 60 Industrial development was also hampered by the lack of cheap machinery and fuel shortages.

Foreign capital played a fairly large role in the renewal of Lat-

vian agricultural industry because of foreign companies. It was in-

vested in state-owned enterprises (production of machines and timber industry as a whole) and many private companies (for its growth in joint-stock companies, see Table 3).

Up to 1928, foreign capital was mainly invested in joint-stock companies of chemical industry; textile industry; transportation sector and banks. Latvia’s renewed industry tried to export sur-
plus production. Industries such as timber, paper, cardboard, rubber and linseed, chemical, leather processing and food were working mainly for exports. Up to 1927, more than 60% of all Latvian bank capital was owned by foreigners. 61 Moreover, foreign businesses owned 27.8% of the total equity capital of all joint-stock companies in the insurance sector, 33.9% in the commercial sector, 63.1% in the transport sector, and about 50% in industry.

Many foreign countries tried to establish trade relations with Latvia to sell their products and to win a starting point for the large market of Soviet Russia. Nevertheless, Latvia’s for-

eign trade was very limited at the beginning. On 4 July 1919, exports of goods to foreign countries were completely banned. In addition, permits were issued only for imports of essential goods. 62 The ministries prevented exports of Latvian goods, encumbering them with various formalities which were often changed in accordance with Soviet Russia’s requirements.

For example, the Ministry of Finance regulations adopted on 5 January 1920 on exports of timber stipulated that the exporter had to transfer a large part of the income earned in foreign cur-
rency to the Ministry of Finance, in some cases even up to 75% of the value of exported timber (this was determined by the Ministry of Agriculture), in exchange for Latvian rubles. 63 Whereas the 14 January 1920 Ministry of Trade and Industry decree stated that all export packages should be appropriately marked, and export permits should indicate the contents of each labelled package. All previously issued export permits were considered invalid. 64 Such a foreign trade policy hindered Latvian exports and, at the same time, contributed to a rise in prices; it likewise hindered imports of those goods the lack of which in Latvia was very strongly felt, thus pushing up the prices sharply.

In Latvia, like in most countries in Europe at the end of World

War I, there existed many trade prohibitions. Because of food shortages, as early as 4 December 1918, the Latvian Provisional government issued regulations, which prohibited exports of food products without an express permission. Later, the govern-

ment created a restrictive licensing system, which had been gradually phased out by 1921. The customs tariffs, which were introduced in 1919, were basically very low because of the ab-

sence of protected industries and the lack of a wide range of production of foreign capital. As a result, the trade policy remained very similar to the pre-war period, when the golds Kalnings was the Minister for Finance. On 28 June 1921, the government issued a decree that allowed eggs, butter, cheese, ham, poultry and fruit exports. However, a real export growth was observed in the second half of 1921 with the entry into force of new export tariffs. In 1921, a new customs tariff law was adopted, which was essentially meant to stabilise the new currency. In the 1921/1922 budget year, customs duties al-
ready amounted to more than 20% of the value of imported goods. 65 Whereas raw materials and agricultural and industrial machinery and equipment could be imported free of customs duties up to 1926. On 16 April 1928, a new tariff law, which met all international standards, was implemented; it was harmo-

nised with the Latvian foreign trade agreement framework and introduced a system of maximum and minimum tariffs de-

pending on whether or not an international trade agreement had been entered into.

Latvian foreign trade was largely based on trade agreements. Up to 1929, Latvia had signed trade agreements with all major trading partners. 66 The trade policy principles included in trade agreements remained unchanged: an unlimited Most Favoured Nation Principle (reserving the right to grant special privileges to Finland, Estonia, Lithuania and Russia) and freedom of currency transfer (entry and exit) for citizens. 67

The exception was the Latvian and Estonian effort to con-
clude a customs union. On 1 November 1923, the ‘Intern Agreement on Economic and Customs Union between Latvia and Estonia’ was signed. Since the parties’ views on the con-

tent of the agreement differed considerably, it was never en-
tered into. Beginning with 25 March 1928, a number of tempo-
rary agreements were signed, which regulated Latvian and Es-
tonian foreign trade. 68

For Latvian industrial development, a 5-year trade agreement between Latvia and the Soviet Union was signed on 2 June 1927, ratified on 27 October by the Saeima (Parliament). The agreement included a special customs convention with signifi-
cantly reduced rates of customs duty for many goods of both countries. The USSR promised to place orders for Latvian in-

dustrial goods worth 40 million lats annually. Exports to the

Soviet Union, not Latvia. Moreover, the Soviet Union did not

Table 3. FOREIGN CAPITAL IN LATVIAN JOINT-STOCK COMPANIES (1920–1929)

<table>
<thead>
<tr>
<th>Year</th>
<th>Million of lats</th>
<th>% of equity capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>1924</td>
<td>56.8</td>
<td>50.0</td>
</tr>
<tr>
<td>1925</td>
<td>74.0</td>
<td>52.7</td>
</tr>
<tr>
<td>1926</td>
<td>85.4</td>
<td>54.0</td>
</tr>
<tr>
<td>1927</td>
<td>94.9</td>
<td>54.0</td>
</tr>
<tr>
<td>1928</td>
<td>93.5</td>
<td>55.5</td>
</tr>
<tr>
<td>1929</td>
<td>102.2</td>
<td>53.9</td>
</tr>
</tbody>
</table>

The global economic crisis, which began in the fourth quarter of 1929, i.e. later in part because of the operation of the Latvian–USSR Trade Agreement of 1927, replaced the economic boom period in Latvia. The crisis opened with a fall in wholesale prices in the internal market and a price decrease for Latvian exports abroad as well as a decrease in the country’s gold and foreign exchange reserves. Latvia, like other European countries, did everything to reduce imports and the associated foreign exchange outflows, including the establishment of an Exchange Commission limiting the exchange of lats for foreign currencies, establishing a contingent (quota) system, drafting import rules, increasing import duties and promoting import substitution.

In the overall context of national policy, on 20 December 1930, the Bank of Latvia decided to restrict credit, a resolution in effect as of 1 January 1931. The worsening economic situation had the effect of increasing enterprise bankruptcies (see Table 4). Their numbers peaked in 1932, while the number of forced auctions, mostly in the countryside, continued to grow.

The banks were first and hardest hit by the crisis. As a rule, this was partly inevitable because the big banks did not own real estate, machinery, and other material assets but possessed only the means of payment and claims that in a crisis situation are exposed to problems first. In July 1931, the German banks, with which the activities of the Bank of Liepāja and the Riga Interna
tional Bank were closely linked, incurred certain difficulties. Depositors demanded to be paid their deposits, but the banks did not have sufficient liquidity and closed their cash offices. Therefore, depositors tried to withdraw deposits from other Latvian banks (e.g. 5 million lats were withdrawn on 15 July).

On 21 July 1931, the Saeima retroactively adopted a special law, which stated that private banks could pay out to each depositor not more than 5% of their deposit value per week, and this restr
iction was abolished only on 1 September 1933.

When on 21 September 1931 the UK abolished the pegging of the British pound sterling to gold and its devaluation to a new parity, the Saeima decided to withdraw its pegging to gold, and on 24 September the British pound was devalued. The Latvian krona was pegged to the British pound until 15 November, when it was devalued by 10%.

The sudden devaluation of the British pound sterling resulted in a loss for the Bank of Latvia of 2.1 million lats. Latvia, however, did not abandon the gold standard, but adopted a number of restrictive measures regarding free trade and capital flows. With the adoption on 8 October 1931 of the ‘Regulations on Foreign Currency Transactions’, Latvia switched to a managed currency exchange rate, keeping the former lats exchange rate but ending its unlimited exchange for gold or foreign currency. The regulations stated that foreign exchange operations can be executed only by the Bank of Latvia, and an Exchange Commis
sion, which examined the demand for foreign currency, was estab
lished. In the same year, a number of regulations were adopt
ed that restricted the volume of imports or banned imports of certain goods altogether. Over time, regulations regarding for
eign exchange were amended and supplemented, and other laws and regulations were issued in growing numbers.

The customs tariff was amended six times in 1931 and 1932 and 10 times in 1933. Nevertheless, the state budget during the crisis years was with deficit, including the largest deficit in the 1931/1932 budget year (24.2 million lats). The largest de
cline was recorded for tax revenues and those from state forest management and profits of state-owned enterprises and credit institu
tions.

In the wake of the global economic crisis, the Latvian export policy also changed. In order to find markets and facilitate set
tlements, inter-state clearing contracts and agreements were concluded. For Latvia, the first such agreement was drawn with France and came into force on 26 March 1932. For settlements with Germany, an agreement between the Bank of Latvia and the Reichsbank (its functions were later taken over by Deutsche Verrechnungskasse) was reached. It came into force on 8 July 1932 and stipulated that in their mutual trade both countries should settle payments for imports of goods in the local cur
rency. The intention was to avoid difficulties that impede restric
tions and exchange restrictions created for settlements. Clear
ing agreements emerged due to the world economic crisis, not to cease transactions, for example, in 1933 Latvia signed clearing agreements with Sweden, Lithuania and Estonia.

The UK began to increase exports already in 1933, forcing Latvia to buy products and raw materials in certain amounts as well as to lower import duty on imported British goods.

The diversity of goods Latvia could offer in foreign trade was significantly affected by international cartels and syndicates, which, merging businesses within Europe or globally, bought up the existing Latvian companies and, after some time, closed them down for the purpose of centralisation of production or

Chart 2. MOST IMPORTANT LATVIAN FOREIGN TRADE PARTNERS (1921–1930, annual averages % of total)

Table 4. TOTAL NUMBER OF BANKRUPTCIES AND FORCED AUCTIONS IN LATVIA (1917–1939)
On 17 July 1934, following the Scandinavian model, Latvia signed a trade agreement also with the UK. The agreement was no longer based on the MFN principle, but on a reciprocity (mutual obligations, compliance) principle. The agreement spelled out Latvia's obligation to import various commodities (iron, steel, automobiles, machine tools and equipment for wood and paper industries, coal tar, textiles, herrings, etc.) from the UK, because the British objective was to improve the negative trade balance with Latvia. Under the agreement, Latvia had the right to export all the goods to the UK, which still was Latvia's most important export market (for example, up to 1938, the UK received almost 100% of Latvian bacon).

Already in 1927, the global agricultural prices had begun to fall, with the world economic crisis accelerating this process, especially for the most important Latvian exports, such as flax, butter, bacon and timber. In the 1931/1932 budget year, the prices for wheat, rye, barley, oats, butter, bacon and flax fell sharply (by 30%–50%). The government tried to reduce the impact of the crisis by increasing exports and reducing imports. On 7 May 1931, a law was adopted on increasing agricultural stimulation, stipulating that from the 1931/1932 budget year up to 1 million lats from the state budget will be spent for this purpose each year for a period of five years. In 1932, Latvia (the only time until 1936) had a positive foreign trade balance. State monopolies were established for the sugar industry and bacon production.

Food products that after World War I formed a large proportion of Latvian imports were almost no longer imported. Grain imports in particular were among those that could be substituted most easily by domestic producers. After 1933, rye was not imported at all, and wheat was imported only in the 1937/1938 budget year, as the summer in 1937 was very dry. In 1934, sugar imports were also suspended. In the second half of 1930, Latvia was self-sufficient in terms of almost all agricultural products and focused on importing food products other than those that could be obtained in Latvia, e.g. herrings. However, due to the crisis, even herring imports were limited, and never again reached the volumes of 1929 (for the dynamics of Latvian foreign trade during the economic crisis see Table 5).

Table 5. Latvian IMPORTS AND EXPORTS (1929–1933; millions of lats)

<table>
<thead>
<tr>
<th>Year</th>
<th>1929</th>
<th>1930</th>
<th>1931</th>
<th>1932</th>
<th>1933</th>
</tr>
</thead>
<tbody>
<tr>
<td>Imports</td>
<td>362.1</td>
<td>296.3</td>
<td>377.1</td>
<td>446.6</td>
<td>491.2</td>
</tr>
<tr>
<td>Exports</td>
<td>273.9</td>
<td>247.0</td>
<td>365.8</td>
<td>293.5</td>
<td>395.2</td>
</tr>
<tr>
<td>Balance</td>
<td>–88.2</td>
<td>–49.3</td>
<td>–13.3</td>
<td>12.0</td>
<td>–9.7</td>
</tr>
</tbody>
</table>

On 15 May 1934, the then Prime Minister Kārlis Ulmanis, the Minister of War Rainis Balodis, and the home guard and army leaders carried out a coup d'état. The reasons for the coup d'état were more political than economic in nature. Nevertheless, the authoritarian regime actively influenced the economic life of the country. In place of the Parliament, a Supreme Council was appointed which regulated the economic system. In the economic field, there were four chambers: the Chamber of Trade and Industry was established in 1934, the Chamber of Agriculture and the Chamber of Artisans both were formed in 1935, and the Chamber of Labour came into being in 1936. Chamber members were appointed by the regime, which also controlled their activities as each chamber was subordinated to a relevant ministry.

The important issue of farm debt was resolved. The forced auction of farms was postponed for a specified period; the Bank of Latvia lowered interest rates on their debt and extended the loan repayment terms. The farmers' access to credit was also made easier. In order to promote mechanisation of agriculture, agricultural machinery and equipment were exempt from import duties. The Chamber of Agriculture established agricultural schools and overseas the development of pedigree livestock and crop selection in state breeding stations and model farms. On 29 May 1934, the ‘Regulations on Limitations on the Activities of Co-operative Societies and Their Associations’ were adopted. These regulations gave the Co-operative Audit Board or the Minister for Justice the right to dismiss the elected members of the Board of Directors, the Governing Council and the Auditors. The Board had the right to appoint representatives of the authorities of other co-operative societies, to whom these societies had to pay salaries and who were charged with strong powers. In this way, the co-operative society movement, particularly with respect to societies producing for exports, was subordinated to the government. For example, the dairy co-operatives were consolidated into the Latvian Central Union of Dairy Farmers.

The regime tried to implement an economic programme aimed at the role of foreign capital in industry and trade, and, instead, strengthen the state-owned enterprises and increase the role of state monopolies and joint-stock companies. On 9 April 1935, a new commercial bank, the Credit Bank of Latvia, was established with the task of reorganising credit institutions. The bank was in fact state-owned enterprise with an established state monopoly. The bank was responsible not only for the reorganisation of all credit institutions, but also for regulating the foreign trade. The initial capital of the bank was made up of credits granted by the government, and it was to ensure the flow of foreign capital in the country was reduced. By March 1939, the number of state-owned joint-stock companies had reached 31.

In industry, the consequences of the economic crisis were finally overcome. The number of employees increased from 84.7 thousand in 1934 to 71.7 thousand in 1939. In the industrial sector, metal, machinery, textiles, wood and food industries were the most significant. Of particular importance were the state-owned enterprises, e.g. the State Electrotechnical Plant (VEF), which also manufactured radios, aircraft and Minore cameras.

The share of foreign capital in Latvian joint-stock companies declined from 50.4% in 1934 to 25.4% in 1939. This decline was particularly significant, for example, in metal industry and banks. However, Swedish investment in the 1930s increased as the project of the Kegums hydroelectric power station (1936–1939; designed capacity of 70 thousand kWh, largest in the Baltic States; see the box) was developed; it was managed by Swedish companies, which in accordance with the provisions of Article 17 of the agreement entered into with the government ensured an 11 million SEK loan for its implementation (about 8.9 million lats according to the exchange rate of the Swedish krona against the lats at the time of entering into the agreement, or approximately 14.4 million lats according to the exchange rate after the pegging of the lats to the devalued British pound sterling). The repayment of this loan was the responsibility of a partnership organization, which also had access to other resources (according to estimates, 52 million lats was needed) in the form of both domestic loans and bank funds.

The government also developed a wide range of building programmes, which included monumental structures (such as the Palace of Justice, the Ministry of Finance building, and the Freedom Monument), railway station buildings, schools, cultural centres and sanatoriums. After a coup d'état of 15 May 1934, the people were promised that the lats gold parity would continue, and following the Italian and German models, the regime tried to introduce autarchic (a country’s economic isolation) principles in order to stabilise the foreign trade balance.

To regulate foreign trade, a number of new measures were implemented. On 8 June 1934, a new law ‘On Foreign Exchange and Foreign Trade’ was adopted, which replaced the old law of 1927 regulating the import of goods. Already on 7 March 1935, this law was replaced by another law, which prescribed in more detail the work and mandate of the Exchange Commission, and continued to restrict imports.
In order for Latvia, which has no oil or coal, to provide energy resources for growing industrial and agricultural use, and to avoid import growth of these resources, the government drew up, in October 1932, and the US firm The Foundation Company entered into an agreement regarding the preparation of a project for the use of the force of the Daugava River waters and the construction and financing of the first hydropower plant. A study of possible power station building sites had to be completed within a period of three months. Taking into account the results of research conducted on the Plaviņas, Mucukrogs, Lejas Mēnēni and Ķegums sites, the government decided in the middle of 1933 to build a power plant at the Ķegums site, because the most suitable geological conditions were there, and it was not far from the main consumer – the city of Riga. The agreement with The Foundation Company was terminated because it had not procured the specified credit.

In 1934, the Latvian Maritime Department on behalf of the new regime started negotiations with Swedish entrepreneurs. On 30 July 1936, the Cabinet approved the project submitted by Svenska Entreprenad A. B. (abbreviated SENTAB) for the central hydro construction on the River Daugava near Ķegums. On 1 August 1936, the Latvian government entered into a contract for the construction of Ķegums power station with SENTAB and A. B. Electro Invest, Västerås, but, on 4 August 1936, the Cabinet adopted and, on 6 August, the President promulgated The Law on the Construction of Ķegums Power Station. It increased the powers of the Ministry of Finance to raise funds utilising domestic and foreign credit. Such a construction, on a scale unprecedented in Latvian history, was immortalised for the future. The photographer and cameraman Edvards Rihrs Kraucs recorded in 2 409 photographs the technical advance of the construction from August 1936 to 25 July 1940. These materials are stored in Ķegums at the Daugava Power Station Museum.

On 22 May 1937, for the laying and consecration of the foundation-stone came the President and Prime Minister Kārlis Ulmanis, the Archbishop of the Latvian Evangelical Lutheran Church Teodors Grīnbergs, Ministers and guests, who, in accordance with the report in the newspaper Jaunākās Zīnās, travelled from Riga to Ķegums by special train. Kārlis Ulmanis signed a message for future generations, which was placed in a silver capsule designed by the artist Arvīds Dzērītis, and sealed into the foundations of the power station. At the celebratory feast afterwards, together with guests, were more than 1 500 workers. It was intended that foreign capital would be used to import the main machinery (in accordance with Article 17 of the contract entered into by the Latvian government, SENTAB was to provide a loan in the amount of 11 million Swedish kronor),
but the construction work itself would be carried out by Latvian labour and capital. Of 52 million lats necessary for the construction of the Ķegums hydroelectric power station, the government allocated 4 million lats, the Bank of Latvia invested 10 million lats and another 34 million lats in 5% credit notes obtained from the Ministry of Finance for domestic distribution.

In February 1938, the Bank of Latvia published a prospectus with photographs showing the construction work already done on the Ķegums hydroelectric power station site and calling upon the general public to subscribe to the credit note issue from 15 February to 1 March, to act patriotically and to receive interest payments.

"Construction of the power station near Ķegums will be the largest construction work carried out so far in Latvia, which will continue to serve many generations to come. (...) In order that the entire nation may participate in the facilitation of the construction of Ķegums power station, the Ministry of Finance has issued state credit notes for a total of 34 million lats, which the Bank of Latvia will realise at the nominal value thereof. Credit notes are available for each person’s ability to pay, starting with 25 lats and ending with 100 000 lats each. (...) The credit notes will pay 5% interest per year and the interest will be paid out by the Bank of Latvia twice a year, i.e. on 2 January and 1 July. The credit notes will be redeemed by the state 4 years after issue for circulation, paying out the full value shown on the credit note. Acquired credit notes may be sold or pledged at will prior to maturity, and they will be accepted at the full value as collateral by all public works and suppliers. The name of the owners of the credit notes will not be mentioned, and they will be quoted on the Riga Stock Exchange."

It was expected that the credit notes would be issued in four series (A and B series on 1 March and 1 July 1938 respectively; and C and D series on 2 January and 1 July 1939 respectively). Credit notes of A series, already in the subscription period, for payment were issued by the Bank of Latvia and its branches, and the Postal Savings Bank and its branches. It is true, however, that although the prospectus said that "the invested capital is completely safe and provides income for holders of credit notes", this was in effect only so long as there was an independent Latvian state. According to news reports in the press, the response was overwhelming: already by 16 February 1938, for the planned 34 million lats the inhabitants had subscribed to credit notes worth 36 million lats. Although the acquisition of credit notes was not as smooth as the subscription to them (in 1940, in the portfolio of the Bank of Latvia there was still 13.3 million lats worth of Ķegums hydroelectric power station credit notes), the construction work continued.

Latvia’s inhabitants wanted to see the construction work with their own eyes, therefore, in accordance with the construction site visiting regulations, from special observation sites on the right bank of Daugava it was permitted to watch the construction work. Varied and popular were postcards with views of the Ķegums hydroelectric power station construction work with additional stories and text, but the most popular caption was: "Ķegums produces electricity, two hearts produce love!".

On 15 October 1939 at 23:05, the first turbine of the power station was set going. The work was led by Swedish engineers, but from 4 December 1939, power station operation was taken over by a 25-man Latvian team (led by Pāvils Krasovskis, his deputy Edgars Kelders).

On 2 August 1934, a law was adopted on import trade, which prescribed that in the future imports of goods for domestic consumption and processing would be allowed only to those traders and companies that had received permits to engage in import trade in the respective calendar year from the Ministry of Finance and had paid a fee (1,000 lats) for the right to import goods. On 15 December 1936, this law was replaced by a law on import trade and representation of foreign merchants. The second part of this law provided that also foreign merchants in Latvia could operate only after receiving a permit from the Ministry of Finance.[189] The tasks of the Chamber of Trade and Industry for representation and promotion of trade in Latvia as laid down by the law were to limit unfair competition, to hold product fairs and other similar events, to ensure economic cooperation, to organise information and legal services.[190] In order to promote exports, the government continued to enter into the so-called compensation or clearing agreements with a number of countries. These clearing agreements were of little importance and often forced the making of uneconomic transactions, especially with Germany. The Exchange Commission began using the so-called export clause that allowed importers to buy necessary foreign currency from exporters at a premium. Therefore, when importing, one had to pay 30%–40% above the official exchange rate.[191] The law adopted on 24 September 1935 restricted flax and timber exports.

Comparing the data in Charts 2 and 3, one can see that average annual exports in the period increased slightly (from 164.1 million lats in 1929 to 165.9 million lats), but average annual imports decreased (from 218.4 million lats to 151.3 million lats). In the 1930s, almost 70% of Latvian exports and 53% of imports were ensured by the UK and Germany (by 42% and 54% respectively in the 1920s). Latvia managed to achieve greater diversity in purchasing import goods than in finding markets for its exports. This export concentration and dependence upon two countries was the result of the 1934 reciprocal trade agreement concluded with the UK and the 1932 clearing agreement entered into with Germany. Given the relatively high proportion of local resources in Latvian exports (a large part consisting of agricultural products and timber) and the significant volume of exports to the countries which had already abandoned the gold standard, the pegging of the lats to the British pound sterling in 1936 implemented by Ulmanis regime, which meant a de facto devaluation of the lats, and the simultaneous recovery of world trade from the economic crisis facilitated Latvia’s foreign trade. This step also implied the abandonment of the idea of autarchy. After currency depreciations by a number of major trade partners, Latvia’s ability to compete in export markets, particularly in the UK market, became weaker. However, it was only on 26 September 1936 after the announcement of devaluation and the currency reform of the Bank of Latvia that the Finance Minister L. Ėkis informed that “consultations were held with the State President and Prime Minister, and after assessment of the whole situation, we acknowledged that we should follow the French example and ensure the necessary reforms also in our country.”[192]

With the 28 September 1936 amendments to the Credit Regulation, the lats was pegged to the British pound sterling (the lats was pegged to the British pound sterling or one British pound sterling or one British pound sterling corresponded to 25.22 lats). This was the exchange rate which existed up to 29 September 1931, when the British pound sterling abolished the gold standard. Thus, “in terms of the value of gold at the London Stock Exchange, the outcome is that the value of the lats in gold is now 39% less.”[193] The exchange rate quoted by the Riga Stock Exchange for the purchase of the British pound sterling was 15.43 lats on 28 September, but on 29 September it already rose to 25.18 lats[194], from 7 October 1936 up to 8 September 1939 standing at 25.16 lats. Consequently, the value of the British pound sterling in lats had increased by 63.1%.

Along with its positive impact on foreign trade, devaluation of the lats had a negative impact on the Latvian economy. This significant rise in prices caused by devaluation was partly offset through substantial tariff changes. Import tariffs were reduced for many consumer goods[195] and a variety of textile, metal and tobacco products. However, in order to prevent the timber exporters from making unreasonably high profit, the export duty on timber was increased.[196]

According to the data of the State Statistical Office, retail prices rose after devaluation, by, for example, 24% for men’s wool suits, 4% for white bread, 33% for fresh pork, and 20% for kerosene.[197] In relation to foreign trade, wholesale prices were the most important indicator.

In the first year after devaluation, the largest increase (60 points) was recorded for the export price index. This meant that exporters received 68.2% more lats for their export goods than before devaluation. However, despite the significant changes in customs tariffs, the import price index also increased by 24 points.[198] Thus, importers had to pay in lats 29.3% more than before devaluation.

One of the main reasons for devaluation of the lats was the improvement of foreign trade balance. After devaluation, total Latvian exports rose sharply, while imports expanded less fast, so the foreign trade balance surplus reached its highest levels in the 1930s. This was due to the fact that the only restrictions on exports were export duties and timber export licensing, while on imports there remained a number of constraints, including currency restrictions and quotas as well as importers’ licensing. The devaluation also brought about a more balanced structure of the trade balance and even its elimination in 1936. In that year, both imports and exports had a tendency to expand (already at the end of September, the trade balance improved), and the devaluation only strengthened this trend (compared with September, October exports in lats grew by 52.8%, while imports increased only by 14.2%). In 1937, Latvia’s foreign trade balance surplus reached its historical high of the 20th century due to a very strong export growth mainly observed in previous years by import licensing or foreign exchange restrictions. In 1938, two new customs tariffs were adopted (in force as of 1 January 1938).[199]

During the authoritarian regime, national income gradually increased from 857.6 million lats in 1933 (444 lats per capita) to 1 256.0 million lats in 1938 (637 lats per capita).[200] Thus, the 1929 level was reached only in 1938.

Latvian economic development was interrupted by the Molo- tov–Ribbentrop Pact signed on 23 August 1939 and the beginning of World War II. At the start of the war, Latvia, and other Baltic States had declared complete neutrality. The circumstances of the war led to economic difficulties in Latvia, and the Ulmanis regime in economic as well as political terms. Latvia had to make several important decisions to minimise the effects of the war on the Latvian economy. Already on 3 September 1939, strict controls over the Latvian economy were introduced regarding the acquisition, processing and sale of key raw materials along with a ban on transferring Latvian ships to foreign flags and leasing them abroad. On 12 September, the lats was uncoupled from the British pound sterling, and the Bank of Latvia was given the task to “maintain the lats for the needs of the Latvian economy at an appropriate stable level using as a basis the value of gold or some other stable currency.”[201]

In the secret protocol of the Molotov–Ribbentrop Pact, it was fixed that the Baltic States were included in the USSR sphere of influence. After grabbing Eastern Poland in September 1939, the USSR began to strengthen its influence in the Baltic States and Finland. Their representatives were summoned to Moscow and forcibly invited to sign a mutual assistance treaty with the USSR. On 5 October 1939, Latvia signed “Mutual Assistance Pact between Latvia and the Union of Soviet Socialist Republics” with a confidential protocol, which provided for the establishment of Soviet military bases with 25 thousand soldiers in Latvia.[202] Ulmanis declared: “This pact with our big neighbour, which was entered into in mutual trust, confidence and a spirit of good faith, brings us security, as well as distancing from the danger of war.”[203]

The beginning of the war hit Latvia, for which the majority (about 90%)[204] of foreign trade was provided by, particularly, Norway. Hardly had closed the access to the Baltic Sea, prevent- ing trade with the UK, which was Latvia’s second largest trad- ing partner. The attempts to maintain trade with the UK through Scandinavia were unsuccessful.[205] For example, imports from Britain fell from 19.8% of total imports in the first three months of 1939 to 2.6% in the first three months of 1940, while exports fell from 40.8% of total exports contracted to 0.1% respectively.[206] There were two options left – the USSR and Germany.

On 18 October 1939, in Moscow, “Agreement on Trade Turn- over between the Latvian Republic and the Soviet Union” was signed. The agreement was seen as advantageous to Latvia in the circumstances of war when export options were severely limited.[207] Latvia exported raw agricultural produce, including live pigs, butter, meat, and cheese as well as railway wagons, but imported from the USSR mainly oil products, cot- ton, chemical products, agricultural machinery, salt and sug- ar.[208] In January–May 1940, Latvian exports to and imports
from the USSR were six and five times higher respectively than from the USA. The other potential market in the circumstances of war was Germany. The mutual aid agreement could not replace the peace-time foreign trade. The reduction of foreign trade had a negative effect on the Latvian economy, causing an increase in the cost of living, shortage of goods, a fall in industrial production, and unemployment. The wholesale price index rose from 113 in 1938 to 140 in June 1940; the cost of living index went up from 90 in 1938 to 272 in May 1940. The especially cold winter of 1940 also made an impact. In March 1940, the sugar rationing began. Problems resulted from a shortage of labour in rural areas, because guest workers from Poland could not enter Latvia. On 28 May 1940, a law had to be adopted regarding the formal admission of Latvia to the Soviet Union on 5 June 1940. The formal admission of Latvia to the Soviet Union on 5 August 1940 ended the Latvian State and its economic inde- pendence.

SUMMARY

Latvia's first 10 years were characterised by economic growth and a foreign trade boom. Overcoming enormous material dif- ficulties, the country was able to restore the economy and even to ensure some growth compared with the period before World War I. The establishment of the Bank of Latvia and the implementa- tion of national currency based on the gold standard stabilised the banking and financial systems and ensured the engagement of foreign capital.

Agriculture developed particularly buoyantly, and the agrar- ization reform played an important role, contributing to the transit- ion to intensive agriculture. The Latvian industry primarily adapted to domestic needs. The 1927–1938 ‘Latvia–USSR Trade Agreement’ was intended to develop in- dustry, promoting the production for exports and reducing im- ports of manufactured goods. Latvia wanted to develop transit, and the Latvian Shipping Company played a small but growing role in ensuring transport transport, as well as imports and exports. Up to 1929, Latvian foreign trade was mainly represented by imports of manufactured products and exports of agricultural products and timber. During 1922–1929, butter exports in- creased notably, becoming a significant part of foreign trade. Although during this period the trade balance was negative, both imports and exports steadily grew, and export and import terms of trade were relatively stable.

Up to 1929, the fiscal policy was focused on a balanced bud- get or building a surplus budget, which the country managed to implement from the 1922/1923 budget year up to the 1929/1930 budget year. The budget surplus was used to build up a reserve fund, and the state funds were used mainly to restore the infra- structure and to return to growth. Due to the global economic crisis, prices also fell in Latvia, both in the domestic market and for its export products abroad. Around 1931, due to the declining purchasing power of the population, there was a sharp drop in demand. The reduction in production caused bankruptcies of enterprises, and the number of unemployed increased. The standard of living deteriorated. Latvia did not devalue the lats but in 1931 moved to a managed currency exchange rate maintaining the former lats exchange rate and stopped the guaranteed exchange of the lats for gold and foreign currencies. The decision not to devalue the Latvian lats simultaneously with devaluation in the UK, Latvia's largest ex- port partner, meant that Latvian exports became more expen- sive and the trade deficit increased. To cover this deficit, previ- ously reserved reserve fund was utilised, and, therefore, the crisis in Latvia was not as severe as in other European countries. At the end of 1933 and the beginning of 1934, the Latvian econo- my had started to recover.

After the coup d'état, the intervention of the state in the eco- nomy intensified, utilising the Credit Bank of Latvia for the pur- pose of creating state-owned companies on the basis of private enterprises. The system of chambers was established, of which four were related to the economy. Agriculture was still the main sector of the national economy. The regime restructured co- operatives as well as centralised and controlled their activities. The main export goods still were butter, bacon and timber. In industry, state joint-stock companies were established. New in- dustrial sectors like the production of radios, airplanes and tele- phone apparatus, developed, and the Kegums hydroelectric power station was built. The fiscal policy was again directed towards a balanced bud- get or building a surplus budget. Subsidies for agriculture were introduced. In banks, the share of foreign capital decreased. In 1936, the lats was devalued via abandoning the gold standard. At the same time, there was a retreat from autarchy, especially in industry. Devaluation of the lats lowered export prices, al- lowing the country to overcome the negative trade balance already in 1936. However, Latvia's foreign debt increased and imports became more expensive, raising costs for Latvian pro- ducers. The effects of devaluation were corrected by the state control over foreign trade and domestic price levels. In the years before World War II, foreign trade developed rapidly, and the engagement of foreign investment was enhanced.

ENDNOTES

3 Latvia’s foreign debt increased and imports became more expensive, raising costs for Latvian pro- ducers. The effects of devaluation were corrected by the state control over foreign trade and domestic price levels. In the years before World War II, foreign trade developed rapidly, and the engagement of foreign investment was enhanced.