

## Austerity: Latvia's Fake Economic Model

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Austerity's advocates are declaring victory with Latvia's battle against the European economic crisis and advocating it as the model for Greece & Spain to emulate. Curiously, Latvians have been declaring this "win" by exiting their country.

The "austerians" are celebrating Latvia as the plucky country that through hard work and discipline showed the way out of the financial crisis plaguing so many countries. For austerians, Latvia represents a veritable Protestant morality play demonstrating that austerity works. Indeed, they hope the Latvian example will retread Margaret Thatcher's "there is no alternative" tire for a European-wide scale austerity tour. Few writing on the subject unfortunately have the time on the ground to evaluate the economic and social costs of the Latvian model. While the Latvian government chose austerity, most of its people have not. Feeling there is no acceptable political alternative available, many elect to emigrate.

The European Commission and the IMF declared this victory with a public event in Riga on June 5th celebrating the Latvian model. The IMF head, Christine Lagarde, proclaimed Latvia "could serve as an inspiration for European leaders grappling with the euro crisis <http://www.businessweek.com/ap/2012-06/D9V743LO1.htm> ." The IMF's chief economist, Olivier Blanchard, followed with a *mea culpa* admitting initially he thought the Latvian peg and internal devaluation program a "disaster," but now sees success. To better appreciate Blanchard's remarks one must bear in mind Latvia is one of the few countries following the 2008 crisis that actually attacked the IMF from the right on economic and social policy. In effect, Blanchard and the IMF are declaring, "our policies were too cautious on austerity, long live austerity!" For the IMF it reprises a familiar chorus harkening back to their greatest hits of the 1980's and 1990's glory days of structural adjustment.

A seat at the table of power routinely flatters pundits invited to these affairs. They dutifully report, rather than investigate, what they are told. On Latvia, *The Economist*, to paraphrase Paul Krugman's characterization of US Congressman Paul Ryan, increasingly "looks like *stupid person's* idea of what a smart *magazine* looks like." It provides its customary breezy reporting that gets anything of importance wrong. Meanwhile, big names (one is reluctant to say heavyweights) on the circuit, such as Chrystia Freeland of *Reuters*, embarrassingly, for anyone that might have bothered to query the hotel bartender or taxi driver of their views on Latvia, allege, "the harsh Latvian plan worked because the whole country was committed to it." This reminds one of the Red Cross inspections of the *Theresienstadt* showcase concentration camp, who shown orchestras and clean conditions announced, "everything in order here!" Of course, Latvia is no concentration camp and its people not fascists. Indeed, Riga, its capital, is among Europe's most beautiful, and if you have a bit of money, livable, cities. Meanwhile, others report the country feels like a prison. The reality is that there are several *realities* depending on one's social class and income. To declare

the “whole country” is “committed” to anything in this society deeply divided by class and ethnicity is lazy reporting at best.

In short, Latvia is not a model for austerity in Greece or anywhere else. The impression that neoliberal policy has been a success is debatable, and the claim that Latvians have voted to support it, false. Latvia’s solid economic growth since its economy plunged by 25 per cent in 2008-10 is billed as a success. Its unemployment during the crisis soared above 20 per cent as the shutdown of foreign capital inflows (mainly Swedish mortgage loans to inflate its real estate bubble) left Latvia with deep current-account deficits. It had to choose between devaluation and maintaining the euro peg. There are inherent problems with either choice, but the theological manner in which the choices have been made has been disturbing.

Latvia’s government chose internal devaluation in order to proceed towards euro accession; and indeed this goal is more popular with Latvians given the people have lost their savings multiple times to devaluations and banking crises since the collapse of the USSR. To meet the eurozone criteria on inflation and deficits it cut public sector wages by 30 per cent, driving down consumption to match its low labor productivity.

What enabled Latvia to survive the crisis were EU and IMF bailouts (a “credit card” which for whom the Latvians did not utilize the full credit line extended) – whose payments will soon fall due. Relatively low public sector debt (9 per cent of gross domestic product at the start of the crisis) also provided some protection from bond traders. Latvia’s problem was mostly private sector debt; especially mortgage debt, which is often secured not only by property but also by the personal liability of entire families as joint signatories. The banks insisted on this measure as it saw unaffordable housing prices being inflated by reckless bank lending. For this, the Swedes, have thanked Latvia for taking on a Stockholm Syndrome view of the crisis, thus having Latvia fall on the sword of austerity to protect Swedish Banks and the Swedish economy. To be fair, the Latvians expect this gratitude to be returned by both euro accession in 2014 and continued Swedish liquidity supplied to the Latvian economy. Whether either of these is good for Latvia is contestable.

Yet, what of the contention that Latvia’s people supported austerity as distasteful, yet necessary? Latvia’s parliament often polls approval ratings in the single and low double-digits. Yet the government has survived two elections. How is one to read this? Chiefly by ethnic politics. Harmony Center was the biggest party opposing the austerity model—albeit often without *consistently* voicing any program. Moreover, the party (as with most in Latvia) contains its quota of grabbers and neoliberals as most of Latvia’s parties do. They largely represent ethnic Russians and had no chance of winning given its focus on rights for Russian speakers. Other previously powerful parties were run by post-Soviet oligarchs. They were rightly seen as being in league with Russian interests and are widely resented for fiscal imprudence during the boom years, when they were part of the governing coalition. So the only political force left was the austerians. While most voters dislike their economic policy, a majority is convinced that they are best able to resist Russia’s embrace. All other issues come a distant second for Latvian voters.

That said, Latvians strongly protested austerity. On January 13, 2009, in the dead of winter, 10,000 in Riga protested against austerity and corruption. Teachers, nurses and farmers held demonstrations in the months following. The national police were called to suppress protests over the closure of a hospital in Bauska; fearing local police might not do what was “required.” Police detained one economist for two days for his remarks on the economy,

meanwhile there is evidence a foreign economist in Riga critical of Latvian economic policy had his phone tapped. Latvia is by no means a police state, but neither is it innocent in matters of controlling public opinion either.

Latvia's policymakers in the main are neither saints nor sadists. Indeed, some genuinely care about the country's future. Their Prime Minister leading the austerity charge is by all accounts a paragon of integrity. Unfortunately, he has come under the policy counsel of Anders Aslund, now seeking to salvage his place in history given he was one of the chief proponents of the failed shock therapy in 1990's Russia.

Too many in Latvia, however, take a view of the poor and of the country's speculators that would comfortably fit in the pages of Ayn Rand's *Atlas Shrugged*. This is especially true of Central Bank, which has dominated economic policy since Latvia's independence in 1991. For Latvia's elite, the internal devaluation and austerity program have become something of a vanity project. Coming of age during the 1980s when the USSR was crumbling and the US neoliberal model ascendant, they fully internalized market fundamentalism as a rigid dogma to advance liberation from the Soviet occupation. The chief criterion for its selection seems to be it was the model that looked most different from Soviet policy. To see their austerity model heralded by the IMF and ECB today is seen as vindication of their worldview, and repudiation of the putdowns heaped on them by chauvinistic occupiers in the past.

Elites aside, many emigrated. After these protests subsided, Latvians resigned themselves to the situation and left. Demographers estimate that 200,000 have departed the past decade - roughly 10 per cent of the population - at an accelerating rate that reflects the austerity being inflicted. Latvian demographers estimate that at least 200,000 have left Latvia the past decade, Moreover, birth rates declined from already low numbers. If a similar percent left the US, some 30 million would exit. Where would they go? Mexico? Surely, this model cannot be reproduced in any sizeable country.

Why have so many left Latvia if it is such an economic success as the advocates claim? Latvia experienced the full effects of austerity and neoliberalism. Birth rates fell during the crisis - as is the case almost everywhere austerity programs are imposed. It continues having among Europe's highest rates of suicide and of road deaths caused by drunk driving. Violent crime is high, arguably, because of prolonged unemployment and police budget cuts. Moreover, a soaring brain drain moves in tandem with blue-collar emigration.

The moral for Europeans is that a Latvian economic and political model can work only temporarily, and only in a country with a population small enough (a few million) for other nations to absorb émigrés seeking employment abroad. Such a country should be willing to have its population decline, especially its prime working-age cohort. In Greece, this could only worsen an already serious demographic challenge.

Politically, it helps to be a post-Soviet economy with a fully flexible, poorly unionized labor force. Above all, its cultural and policy elite needs to put an almost blind faith in "free market" central planners. Ethnic divisions can distract voters from complaints against austerity. Only under these political conditions can austerity be considered a "success."

On balance, the Latvian model has done much harm. Demographically, in terms of its future, one can even argue that the country is being euthanized. The fact that the point is even debatable hints at the huge costs and risks the country has undertaken with its neoliberal program since 1991 and austerity following 2008. To be fair, one must also give

the Latvian government their due. After the calamitous crash following 2008, their economy is now growing again. While much Latvian growth is linked to unsustainable clear-cutting of timber to satisfy West European demand (though Latvia has plenty of forest for managed logging), other sectors are growing too, such as food exports, along with some rebound of its small manufacturing sector. Transit and the emergence of a new Silk Road is yet another growth area.

One must also note that Latvia's options are circumscribed by the limitations imposed by Article 123 of the EU treaty. This removes currency autonomy and domestic credit creation for national development. The treaty locks countries like Latvia into an embrace of private credit markets that forces governments to pay rents to bankers rather than financing their own development where possible. What additionally holds production back more than anything are regressive tax policies that place Latvia's tax burden on labor. Thus, this makes labor expensive, preventing advantages that could accrue from lower labor costs. Meanwhile, speculators get a free ride on taxes.

Latvia's growth, however, is tenuous. It is exceptionally dependent on a rogue financial offshore industry that destroys wealth in other countries. Production is also disproportionately geared to exports, even for a small country. Yet, even if growth continues it will be years before they reach pre-crisis level of GDP. Thus, victory laps on recovery, let alone advocacy for others to follow the Latvian path, is premature at best, and reckless at worst.

Latvia has many strengths: an impressive reservoir of human talent; a highly developed aesthetic and design sense rivaling the Scandinavians; an embrace of innovation and approach to tasks with a perfectionist sensibility; and geography facilitating trade. Yet, its government's advocacy of austerity is decidedly not among those assets.

While the Latvian model is not exportable, might it deliver economic recovery in the highly specific conditions of that country? Too early to tell. What is possible, however, is that even if it does, the price paid for it might be too few people to sustain the country into the future. Europeans should reject Latvia as a model to emulate. Instead, they should engage a wholesale reorganization of European Union rules facilitating national development to liberate its member states from usurious ties to European banks currently delivering its people into penury.

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Both have advised members of Latvia's government on alternatives to austerity.

They are also contributors to the forthcoming book by Routledge Press: *The Contradictions of Austerity: The Socio-Economic Costs of the Neoliberal Baltic Model*.

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