The Architects of Economic Collapse: The Case of Latvia

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Anders Åslund and other austerity cheerleaders tout Latvia as a poster child for huge cuts. Nothing could be further from the truth

This past month's economic data reveals the global economic crisis continues to worsen, and by its duration and severity threatens to become known as the Great Depression II. Yet, even though it is evident to most that our problems arose from finance run wild, several media commentators claim the fault lies with its victim, the public. Instead of curbing finance, they advise governments impose radical austerity measures, which, in this economy, is tantamount to throwing the drowning victims an anchor, while tossing the perpetrators a life-preserver in the form of cash.

From Robert Samuelson at the Washington Post, the declared answer to the world's crisis, mystifyingly (until one asks "cui bono?"), is to be found in one of the European Union's smallest (and poorest) nations, Latvia; a country that has imposed one of the world's most brutal austerity regimes on its people and whose policies have pushed it to near demographic collapse. Latvia has a highly literate people and is proximate to the world's richest Scandinavia countries. It is also blessed with world-class transit ports. But Latvia has the per capita purchasing power parity (PPP) of only half that of Greece and only marginally ahead of landlocked and politically isolated Belarus.

Yet, this is the model bankers and their proxies in government and policy-making circles want other countries to emulate. Commentators advancing the Latvian solution, however, neither understand (or choose to misunderstand) the country, nor the outcome of its austerity policies. Not only do they insist that Latvia's austerity was necessary, but that it was the first place in which austerity policies were supported by a nation's people. The presumption, therefore, is that electorates can be "mature" and "wise", thus politicians need not fear imposing austerity on a properly "educated" public. These assertions are both dangerous and false, yet they're gaining currency.

The reality in Latvia is that after experiencing the world's greatest economic contraction from the 2008 crisis, it has now observed a modest bounce of the dead cat after its freefall finally ended with it hitting the pavement. **The modest uptick in growth is primarily a consequence of Swedish demand for Latvian timber**. Long-term economic prospects in the country, however, remain grim.

Moreover, the airbrushing of Latvia's recent history by Samuelson and other pundits claiming the population has supported austerity is contradicted by the massive protests early on in its crisis. When these protests failed to bring about change, the public's response was to vote with their feet and exit the country. Indeed, when combined with its low-birth rate, this emigration from Latvia is creating a kind of demographic euthanasia that risks the very disappearance of this nation. Furthermore, the political party that advanced the austerity programme is now polling a distant third place in the national elections slated for 17 September. Given this cascading set of failures for Latvia's austerity regimen, one has to ask, where did the perception of its economic success and public support of its policies arise?

Every crisis attracts carpetbaggers and every personal failure pines for Scott Fitzgerald's "second act". With Latvia's economic crisis, both have been found in the name of the banking industry-funded travelling economic policy consultant, Anders Åslund. Latvia experienced the world's greatest binge credit-fuelled boom in the run up to the Great Depression II – and has experienced the crisis's greatest fall, as well. The 2008 crisis hit hardest those countries that followed Åslund's neoliberal brand of economic policies, which he trafficked in the post-Soviet bloc during the 1990s. The 2008 crisis in Latvia, however, provided the opportunity for Åslund to retread his reputation as a policy analyst and consultant, while simultaneously finding "doctors" in the country's central bank and government willing to administer his toxic austerity medicine to address the economic crisis.

Åslund's narrative depicts austerity as a success story – enough of one to provide a model for the rest of Europe and the Unites States to follow. It has also introduced into the economics lexicon the term **"internal devaluation". This policy is being presented to others in the euro zone as a way to keep the euro, and to prospective joiners as a means to reject depreciating their currencies toward future inclusion in the euro zone. Its advocates counsel driving down labor's wages and non-wage benefits, thus shrinking public spending. This programme maintains public and private debt overhead in place so that bankers do not have to suffer "haircuts" – another neologism coined by the bank lobby**.

In short, the bankers get paid, while the public pays the bill. This would seem a tidy solution to the problem for finance – make the public pay off the massive debt overhang on the economy through reducing their consumption. Unfortunately, while this serves the banking sector, it kills the real economy through reducing demand, thus returning Latvians to a kind of debt serfdom – a condition Latvians thought they had escaped in the early 19th century.

Remarkably, Åslund is taking his victory lap as the architect of this terrible plan. His "success" has taken the form of a new book *How Latvia Came Through the Political Crisis*, published by the banking industry-funded Petersen Institute (pdf), and co-authored with Latvia's austerity prime minister, Valdis Dombrovskis. Åslund declares the long winter of economic crisis presided over by the Pigs (Greece, et al) is at an end for Europe's troubled economies. The Bells (Latvia, et al), according to Åslund and Dombrovskis, have rung in a new season of hope, showing the way out of economic crisis for Europe's troubled economies.

Thus, the book has become a style manual of sorts for neoliberal economists trying to demonstrate that austerity works. To Åslund and Samuelson, and other neoliberal sectarians, countries should emulate the Latvian and Irish payments of debts to banks at the cost of seeing their economies stagnate and social structures collapse.

Meanwhile, others, such as Icelandic voters, have rejected neoliberalism and find that membership of the eurozone has lost its bloom, while Greeks are mounting general strike urging withdrawal from the euro if that is the price that must be paid for avoiding debt servitude, austerity and forced privatisation sell-offs to pay foreign bankers who have made what look like bad loans.

So, let's interrogate **what Latvia's "success" means? First, the banks are being paid. There has been no debt write-down. That would be an answer to the question previously raised of cui bono. Latvians are paying their private debts (largely to the Swedes, Aslund's home country, helping to ensure that Sweden has faced no economic crisis). The cost, however, came at 25% GDP contraction of Latvia's economy and public-sector salaries to driven down 30%, with unemployment from public spending cutbacks driving down private sector salaries**. Meanwhile, the Latvian public will have to bear the cost of this programme through the future debt payments required on the more than €4.4bn borrowed from the EU and IMF, which was required to keep its government running on life support during the crisis.

The Latvian solution's defenders, however, argued that the economic contraction has ended and that modest growth has returned, with **unemployment finally below 15%. But emigration has been part of the reason for the fall in unemployment, while investment in manufacturing and savings are far too low to return the country to robust growth**. Unlike, say, Argentina, which rejected austerity, and saw its economy grow at 6% annually for six of the seven years following its crisis, Latvia shows no signs of posting such numbers.

Second, there is Åslund's claim that Latvians have supported austerity and will re-elect austerity governments – as evidenced by the return of the austerity party, Vienotiba, to power in the October 2010 elections. Anyone familiar with Latvian politics sees nothing of the sort. Latvia's 2010 election came down to chauvinism and nationalism, pure and simple. That election season had a promising start: the sometimes centre-left Harmony Centre party put forward a Keynesian plan to rebuild the economy and unite ethnic Latvians and ethnic Russians. In the end, however, manipulation of fears over links to the Kremlin by the austerity party led to an election that predictably split along ethnic lines. Since last year, however, Latvia's largely pro-austerity parliament has seen public approval ratings of roughly 5-15%. Hardly a ringing endorsement.

In short, Latvia's people and long-term prospects have been greatly harmed by these austerity policies. Thus, the claim that Latvia's public supported these policies is bunk.

So, is Latvia on the way to recovery? Only time will tell, but the initial signs look very bad. Demographically, the country's very survival looks in doubt. Economically, according the internal devaluation proponents, the country will have to export its way back to health. Yet, as the economist Edward Hugh has shown, **only 10% of Latvia's economy is from manufacturing, as opposed to roughly 40% for an industrialised economy like Germany's. The very structural underdevelopment that Åslund's policies have advocated from the start (no industrial policy, flat taxes, relying on foreign direct investment) have now left Latvia bereft of the economic base from which a recovery could be staged**.

The good news is that Latvians have begun again to protest the rule of oligarchs and look for alternatives to austerity. If only they could get sound economic policy reflecting the people's will, perhaps they might just achieve the aspirations for which they so bravely struggled during the Soviet occupation in the late 1980s.

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