Munich Economic Summit

Friday, 30 April 2010

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Ladies and Gentlemen,

Let me begin by saying that I am very honored to speak in front of this distinguished audience, and to take part in a discussion on such a topical theme – 'managing the crisis: the way forward'. In fact, one could say this theme has been the motto or leit-motiv of my term as Prime Minister.

In my remarks this morning I will look back at the roots of the crisis in Latvia and highlight the features specific to our situation. I will also explain how we are emerging from the crisis, and what lessons can be drawn.

After joining the EU in 2004, until 2007, Latvia enjoyed a period of strong double digit economic growth. Cheap credit was available on international financial markets, which most of our commercial banks used to fund a generous crediting policy. Easily available credits fuelled domestic demand, which led to the economic boom.

The Latvian government during those years adopted loose fiscal policies, despite repeated strong warning signals about overheating from the European Commission and IMF. Nevertheless, Latvia neglected these warnings. On the contrary, certain politicians called for 'full-speed ahead', 'pedal to metal' and so on.

As a result, during the boom years Latvia built up large economic imbalances. Capital inflows in the non-tradable sector caused the real estate bubble to balloon and accelerated inflation. Meanwhile, strong wage growth undermined the competitiveness of Latvian producers and stalled export growth. As a result, the current account reached a record deficit of 22.5% in 2007. Regrettably, no thought was given to building up reserves during the boom years.

And then the crisis hit. The global financial crisis at the end of 2008 amplified Latvia's domestic imbalances, causing sharp economic contraction. GDP fell by 4.6% in 2008, after 10% growth in the previous year. GDP in 2009 was 22% down from 2007. Employment in 2009 was 12% down from the previous year.

***Parex* case (2008-2009)**

Although Latvia's situation looked similar to many others in 2009, there was one significant local factor – the run on Latvia's second-largest bank, PAREX.

Due to both the global financial crisis and mismanagement by its owners, PAREX experienced large deposit withdrawals at the end of 2008, prompting government intervention to stabilise the whole financial system in Latvia. PAREX was a systemic bank and its failure could trigger an overall collapse of Latvia's economy. The government took over an 84.3% stake in PAREX and deposited funds to regain liquidity and pay back the first part of a syndicated loan in 2009. By the end of 2009, the government's deposit in PAREX amounted to 622 million lats, or 4,7% of GDP. In addition, the government issued guarantees to PAREX for a total amount of 381million lats or 2,9% of GDP. In summary, when situation in the State treasury was already critical, we had to find one billion lats (1,3 billion euro) to rescue PAREX.

request international financial aid. €7.5 billion was provided by the EU, IMF and our regional neighbours. In order to bring the economy back on a sound and sustainable footing, it was crucial to implement a national programme, first, to withstand short-term liquidity pressures, second, to improve competitiveness, and third, to support an orderly correction of imbalances in the medium term.

Up until now Latvia has taken all necessary consolidation measures, predefined in the programme, by carrying out structural reforms and stabilising the situation in the financial sector.

So, before looking at the remedies, let's summarize the diagnosis. As a small, open economy, Latvia was badly hit by a combination of three factors: first, the global financial crisis, second, irresponsible fiscal and macroeconomic policies, and third, a run on PAREX Bank. Latvia plunged into the deepest recession ever experienced by an EU member.

Serious problems need painful remedies.

Structural Reforms. The international bail-out package came with strong conditionality, asking the Latvian government to commit itself to decisive structural reforms. As the saying goes, reforms begin where the money ends.

My government took office in March 2009 after the failure of the previous government to make the necessary amendments to the State budget. From the beginning, we have been committed to major economic and social reforms.

Regaining national competitiveness was set as the over-arching priority. Here, we had a double objective. Short-term competiveness meant improving ratings by the largest international rating agencies as soon as possible. In parallel, we had to restructure from an inward looking economy, based on real estate and local services, towards an export-oriented economy able to compete on the European and global stage.

To boost national competitiveness, we have chosen structural reforms based on three pillars - economy, social system and public sector.

Economic reform is happening mainly through EU Structural Funds, as no other financing was available for stimulating growth. The aim of our activities is to support enterprises in increasing the value added of their production, as well as their ability to export. To achieve this objective, we have put in place programs promoting innovative products and services as well as the export credit guarantee schemes. On a more macroeconomic policy level, although the margin of manoeuvre is rather limited due to our commitments towards international lenders, we are looking at reshaping our tax system in the medium term.

One of the features of the Latvian **social system** was poor accessibility and inefficient targeting of social benefits. My government has put in place an Emergency safety net, keeping a focus on active labour market programs and reviewing the benefit system.

In the health sector, the main features are quality and accessibility of health services, reorganisation of healthcare institutions, and reform of the network of in-patient service providers.

In education we are focusing on improving efficiency and eliminating the overcapacity (too many teachers per one student). Another feature is introduction of per-student financing or the principle “ money follows the student”.

Finally, concerning the **public sector** our goal is to establish a small, efficient, client–oriented, professional and transparent public administration. The emphasis is on assessing which functions and programmes should continue to be financed by the State budget, which can be reduced and which can be delegated to NGO's, the private sector or simply eliminated. The same goes for state-owned enterprises.

On top of these measures, we have carried out a territorial reform, reducing the number of municipalities from around 500 to 109.

Current economic situation and forecasts (2010-2012)

In 2009 Latvia's GDP contracted by 18%, which was exactly as expected. A further 3.5% contraction is expected in 2010.

In the medium term we expect that actual GDP growth will recover and reach a long term potential level. At present, according to Ministry of Finance forecasts, we expect a GDP growth of 3.3 % in 2011 and 4.0 % in 2012.

Exports grew year-on-year by 18.2% in February 2010, while imports contracted by 2.6% in the same period. Steady export growth is expected to continue in 2010.

Registered unemployment rose to 17.3% in March of 2010 and will remain significantly above the pre-crisis level in the medium term.

Latvia is experiencing a quick correction of external imbalances. 2009 saw a surplus in the current account balance in the amount of 9.4% of GDP, compared to a 13% deficit in 2008. The surplus was mainly caused by a deficit reduction in the trade balance of goods, as imports contracted faster than exports.

High inflation in the boom years has been replaced by strong deflation that reached 4.2% in February of 2010.

During 2009, the average wage decreased. The public sector led the way with a 23.7% reduction, while wages in the private sector have fallen by 5%. A further wage reduction is expected later this year.

In recent months, stabilisation and improvement is already visible in manufacturing, with year on year growth since January 2010 (5.6% in January and 4.0% in February).