3. In Focus

Bank of Latvia International Conference "Economic Adjustment under Sovereign Debt Crisis: Can Experience of the Baltics Be Applied to Others?"

The international conference organized by the Bank of Latvia brought together foreign and domestic economic policy makers, market players and scientists to discuss the experience of several countries which could help to overcome the current crisis.

The first part of the conference dealt with policy responses to the global economic crisis. The experience of Latvia, currently the fastest growing economy in the EU, was universally recognized as successful. Following the opening remarks of the Bank of Latvia Governor Ilmārs Rimšēvičs and the welcoming address by Latvia's Prime Minister Valdis Dombrovskis, Hans-Joachim Klöckers, Deputy Director General of DG Economics of the European Central Bank named the key features of the Baltic experience. First, significantly greater wage flexibility supported faster adjustments in competitiveness and was mirrored in price developments. Second, more prudent fiscal policies helped to stabilize debt earlier and to improve current account balance rapidly. He urged Latvia, among other things, to continue fiscal consolidation to meet the EDP commitments, strengthen the fiscal framework to avoid pro-cyclical policies as well as to pursue structural reforms to rebalance the economy towards the tradable sector and improve the functioning of the labour market. The Governor of the Bank of Finland Erkki Liikanen analyzed the European economic slowdown as a consequence of the previous misperceptions. PIMCO Managing Director Andrew Bosomworth emphasized the need of a democratic fiscal authority to complete the EMU while Latvia's Finance Minister Andris Vilks cautioned against populism and highlighted the advantages of public spending cuts as compared to tax rises within the framework of a frontloaded fiscal adjustment.

In the second part of the conference scientists analyzed and evaluated the experience of Ireland, Spain, Estonia and Latvia. The task of the panel discussion was to determine whether Latvia's experience in overcoming the crisis could be applied to other countries as well. Prof. Frank Barry of Trinity College Dublin analyzed the implementation and consequences of expansionary fiscal contraction in Ireland while Prof. Xavier Sala-i-Martin of Columbia University discussed the lack of thereof in Spain. Prof. Raul Eamets, Head of the Institute of Economics at the University of Tartu, introduced the Estonian experience: very strong political commitment, strong government, weak trade unions and flexible labour market. Prof. Anders Åslund of Peterson Institute for International Economics concluded with the lessons drawn from Latvia: credible action to restore the confidence, early fiscal adjustment relying primarily on spending cuts, structural reforms and sufficient international rescue financing.

Conference participants agreed that there was no universal solution for eliminating the consequences of the crisis that could be equally successfully applied in all countries. First, both Latvia and Estonia had a commitment to join the euro zone that strongly motivated the realization of the necessary reforms. However, the Southern European countries are already part of the euro zone and therefore lack this incentive. The second major issue is flexibility of both the labour market and wages. This flexibility is very large in Latvia and Estonia, but not so in the Southern European countries. Consequently, the lessons from the Baltics, although important and ultimately deserving a respective place in economic textbooks, are not fully applicable to the Southern European economies.