Konrad-Adenauer-Stiftung e.V.

BRUSSELS

VALDIS DOMBROVSKIS

PRIME MINISTER OF THE REPUBLIC OF LATVIA

February 8, 2011

www.kas.de

Keynote Speech

EUROPEAN AND GLOBAL ECONOMIC GOVERNANCE AFTER THE FINANCIAL CRISIS

Konrad Adenauer lived through two world wars and the Great Depression, so he could say from experience 'history is the sum total of things that could have been avoided'. The current generation is still asking 'how did this global crisis happen, and how do we avoid a repeat?'

The global economic crisis is also making us ask: how competitive and sustainable is the European economic and social model? Or, rather, the variety of models. In Europe we find different approaches to the same goal – a balance between social equality and market efficiency. We find different models and patterns of development with different rates of success. Even states with similar income levels can have widely different records of macroeconomic performance – what matters is not so much the total amount of spending, but the best mix of payments and services, of policy measures and social investments.

The EU countries have recognized that European competitiveness can be advanced with stronger economic and social policy-making. The reform strategy 'Europe 2020' is a regular item on the agenda of the European Council, and European leaders are constantly looking for good ideas on tackling difficult social issues at home. For example, together with my fellow Nordic and Baltic colleagues I was invited by UK Prime Minister David Cameron to London last month for an 'Ideas Summit'. The concept was to share innovative approaches that generate not only higher GDP, but also greater 'general well-being'. We considered ideas such as more efficient spending of R&D finance, the question of work-life balance for families, and how to motivate the long-term unemployed. This was an excellent chance to compare policy on fundamental challenges.

Latvia was among the first countries in Europe to implement an ambitious austerity programme, several countries have now followed. When credibility in financial markets starts to crumble, it is not the cause of the crisis but the result of long-overlooked imbalances and overdue adjustments. In such a situation the country should show determination and concentrate on achievable results. Even though several observers were sceptical, Latvia has proved that internal devaluation can work. Austerity is rewarded not only by financial stabilization both in the short term and long term, but also by improved growth prospects and higher flexibility in public services.

The collective response in Europe is to take these lessons into account and improve the monitoring of imbalances as they occur – it is easier to cure the problems while they are small. The economic policy monitoring and co-ordination mechanism called the "European semester" is like a routine check at the doctor, where you receive prescriptions for a healthy economic lifestyle. As we know, a healthy lifestyle is not always pleasant and only few volunteer to follow it, but it is the best medicine against a sudden stroke. Therefore Europe is now working on a permanent crisis mechanism to strengthen the provisions on economic governance and keep the economy fit in any conditions.

In the Baltic countries for historical reasons the economic model is a mix of influences. In Latvia, we embraced US-inspired free market reforms in the early 90's, then adopted EU rules and regulations, but did not always have the political will to carry out structural reforms to make it all sustainable. The period before the crisis was characterised by massive capital inflows resulting in rapid but fragile economic growth

Konrad-Adenauer-Stiftung e.V.

BRUSSELS
VALDIS DOMBROVSKIS
PRIME MINISTER OF THE
REPUBLIC OF LATVIA

February 8, 2011

www.kas.de

accompanied by a property price bubble. Previous governments had postponed introduction of optimal property taxation and delayed structural reforms, demonstrated insufficient fiscal discipline and did little to address increasing social inequality. The so-called boom years continued, until suddenly the party was over and the lights came on – we were on the brink of collapse of our financial system. The global financial crisis caused the property price bubble to burst, followed by problems in the construction sector and banking, resulting ina rapid jump in the unemployment rate and a fall in government revenues. The attempts to contain the fiscal deficit reduced economic activity even more, resulting in GDP contracting by 18% in 2009 alone. Unemployment tripled, salaries were slashed by up to a third; government had to downsize the provision of public services, in some cases implementing an already prepared structural reform in health care or education, which previously could not gather sufficient political support.

To stabilize the situation, an international loan package was organized. The funds were provided not only by IMF, but also by European Union, as well as directly by several Nordic and East European neighbours. The size of the package at 37% of GDP seemed huge, but it lent credibility to the policy implemented by new government and soon helped to calm the markets. In spite of dramatic scale of recession, Latvia returned to growth by mid-2010. I would like to emphasize that regional support was of utmost importance for the success of this stabilization program. The countries in the region provided not only funds, but also credibility for the chosen stabilization path. This mutual trust creates a win-win situation where each country in the region is interested to protect its neighbours' well-being, thus maintaining the achieved openness in trade patterns and cross-border investment, in social and cultural co-operation. The regional aspect has been clearly demonstrated also when dealing with crises in Greece and Ireland – those countries with good working relationships during stable development periods are the ones that can provide valuable help during times of hardship.

Right now, my government's task is to achieve sustainability of an entire economic and demographic model, and these problems will not be solved by two or three years of austerity measures. Real changes, including structural reforms are needed to raise the long term growth potential of the country. To bring about difficult changes, continued dialogue and understanding from society is essential. I believe this helped us achieve re-election last October – despite the severe austerity measures, there have been no major social protests and my government was not 'punished' by voters. The budget cuts had been decided in close dialogue with our social partners – trade unions, pensioners' federations, employers' confederation, and others. As we face more budget consolidation this year, a lively debate continues in Latvia about long-term sustainability – with our ageing population and workforce emigration, we have to balance the needs of all generations, of the healthcare and education systems, of urban and rural populations. Further complicating our task are the constraints imposed by international lenders. The aims of my government in 2011 and 2011 are threefold: to boost competitiveness of Latvian enterprises, to better target social benefits and support, and to streamline public administration. Our exit strategy from the crisis is to join the euro by 2014, and to significantly boost FDI, especially in export-oriented and job creating projects.

Opinion polls and experience show that in reaction to the crisis, people in Latvia have become more self-reliant and expect less from the State. Unfortunately, with free movement of labour, the crisis has also pushed many working-age citizens to move abroad in search of work. But for those who choose to remain, new forms of economic activities emerge, self-help networks form, smaller schools double as community centres, volunteerism is up. The resilience and calm of Latvian society has been a key factor in surviving this crisis.

In comparison, other nations in Europe have shown far greater protest at austerity measures. The crisis has proved that what works in one country will not work in another. However, the crisis has also proved that European solidarity exists. A necessary package to strengthen economic governance in Europe is gradually taking shape. Last year the European Union introduced the European Financial Stability Facility (EFSF). Although from the simplified viewpoint of market analysts it is just a move to limit contagion in the eurozone, in fact it represents more. For sure, economic columnists are right that without dealing with the debt problems in one country, the interest rates in others will suffer as well, but that is not the entire picture. With closely interlinked economies, social and political structures, EU members recognize the need to help each other not only to limit their own economic risks, but to truly act for common good. This clearly has a moral aspect – being so close together, we cannot afford not to care for each other. And this is true not only for economics, but also for social justice and equality, migration, environmental protection and climate change.

Here in the Konrad Adenauer Stiftung, and in European social market economy tradition in general, the importance of common values has always been emphasised. We all know these – democracy and free market, individual responsibility and social support, inclusiveness and sustainability, solidarity and subsidiarity. The Guidelines for Prosperity, Social Justice and Sustainable Economic Activity published by the Stiftung is a concise yet comprehensive account of these principles.

Although the most inclusive international organization – the United Nations in its charter recognizes the dignity and worth of the human person, as well as several other common values – it is sad to acknowledge that in real life situations in some countries the self-interest of their leaders or some interest groups dominate over the nominally recognized values. Insufficient sharing of common values drives apart our ability to co-operate on a global scale. Without sufficient sharing of common values the international co-operation is oftentimes reduced to simple profit-seeking.

Taking this into account – I think we should pay more attention to the promotion of the good co-operation we have in the European Union, to spread the word on how we are working together – and through that to encourage others to engage in more fruitful co-operation. For someone outside the European Union the day-to-day operation of the block of 27 distinctive countries may seem extremely complicated. No doubt, the routines have evolved over time into a complex mechanism or rather a complex organism, yet they are based on good governance.

If one looks around to all the various economic crises and recoveries taking place all over the world these days – then governance, and especially the quality of governance, can be singled out as the key aspect which accounts for difference in outcomes. Good governance comes together with being prepared for rapid changes and unexpected events; it is a synonym for flexibility. Good governance is based on broad participation and open discussion, resulting in solutions with wide support. As the problems to be solved are increasingly of regional and global level, so should be the involvement, co-operation and co-ordination – a comprehensive approach for acting together for common good.

In summary, the turbulent economic environment of the recent few years clearly indicates that economic problems cannot be solved by financial means alone. Underlying effective economic assistance in Europe, whether loan packages or bail-outs, is good governance and shared values. When we offer the European model on a global level, through trade talks or development cooperation, we cannot impose, we can only show by good example. If Latvia overcomes the current crisis fully and creates a sustainable, competitive economy, I believe Europe has another good example to use globally.

I thank the Konrad Adenauer Stiftung for promoting this discussion, I thank you for inviting me, and I look forward to questions later.