

August 31, 2010

## To the Swedish Friends

Latvia's hope in 1990 was that advice from Western Europe would be to help Latvia emulate its successful mixed economies and embark on the same path that had raised living standards and a balanced international trade and payments. And by opening the economy to Swedish and other Western European banks, the hope was that banks would help finance capital investment and rationalized industrialization and agriculture such as Sweden had enjoyed.

Instead, something quite different happened. The Neoliberal advice was not for a Swedish-type mixed economy, but a one-sided private economy. Most seriously, the Swedish banks indulged in a decade of irresponsible lending. Instead of lending productively – to provide the borrower with the resources to pay the loan with its interest, as in the West – Swedish banks simply lent against property already in place (mainly real estate), or construction loans for sale to foreigners (at prices that few Latvians could afford).

The result was that banks “helped” Latvia finance its trade dependency by foreign-currency loans to create a real estate bubble.

Despite having had a similar bubble-driven crisis in the early 1990s and dealt with it in a way that's widely regarded as a major success, the Swedish policy in Latvia has been diametrically opposite - by forcing the Latvian society to compensate the Swedish banks for their bad loans, all the while dooming thousands of households to debt peonage.

Latvia, which has had the deepest recession of all 27 European Union member states, contracted by 18 per cent in 2009. At more than 20 per cent Latvia's unemployment is the highest in the European Union. For several years now the number of emigrants has exceeded that of immigrants in Latvia. In the first ten months of 2009, the number of long-term emigrants was 18 per cent more than 2008. The trade deficit increased by 31 per cent in 2009 when compared to the previous year. None of this is stability. It is unsustainable as an entire economic and demographic model. The sooner this is realized, the sooner it can be changed.

If Swedish banks had made a similar loan philosophy on Sweden, that country would now be insolvent. **Latvia hopes that the Swedish people realize that the loans must now be written down to the ability to pay.** The alternative would be accelerated emigration of people and capital flight.

Unfortunately, Sweden's bank regulators were “asleep,” and after the election we will try to help them so that they don't make so many mistakes next time and risk 25 per cent of Sweden's GDP on irresponsible, bad loans that can only impoverish their country. We are considering opening a Latvian School of Economics in Stockholm to help avert future junk economics of this sort.

Latvia's bank regulator was warned that the Swedish banks in Latvia themselves admitted knowledge of creating a real estate asset bubble, but did not care (their words), given their bonuses were incentivized on making loans in Latvia.

Latvia of course welcomes tangible Swedish capital investment – the transfer of assets and technology – but instead, has only received a creation of debt without any comparable asset creation. If Swedish economists had known better, they would have realized that unproductive lending always goes bad in the end.

So Swedish voters no doubt can understand why Latvian voters are not about to continue to commit economic and demographic suicide. They are about to elect a government with a more balanced economic philosophy.

This economic philosophy is not hostile to Western Europe and the United States. It is precisely the policy that they themselves followed on their path to modernization and high living standards.

In the bilateral diplomatic context, Latvia has spent a great deal of effort this year in persuading the Swedish prime minister Fredrik Reinfeldt to visit Latvia and demonstrate Sweden's commitment to greater economic integration within the Baltic Sea region and to the revival of Latvian competitiveness through productive Swedish investments in the Latvian real economy and creating synergies between the Swedish industrial capital, technology, know-how and Latvia's workforce and geopolitical advantages. Mr Reinfeldt is not willing to do this on the election year i.e. any further association with Latvia beyond the financial straightjacket into which Sweden helped trap Latvia through IMF/EU austerity is deemed too risky by the right-wing Moderate Party.

In parallel, the Latvian foreign minister Aivis Ronis came up in July 2010 with a proposal that two inter-parliamentary investigative working groups be set up to 1) assess the performance of the Swedish and Latvian financial regulators prior to the crisis, and 2) seek ways to promote Swedish investment in Latvia and further regional economic integration. Unfortunately, the Swedish government has failed to dignify these very reasonable proposals with an official response.

To add insult to injury, just last week Carl Bildt was the only foreign minister that failed to attend the crucial Nordic-Baltic foreign ministers' summit in Riga dedicated to discussions of the future of the region's political and economic cooperation. His deputy did not hesitate to admit that Mr. Bildt did not attend due to the upcoming September 19 Swedish general elections. He did, however, hesitate to answer the questions about the above mentioned inter-parliamentary groups. This provides a dramatic contrast to Bildt's attitude when he was running for prime minister in 1991. The Yeltsin's Putsch took place a month before the Swedish 1991 elections, and the support for the Baltic States was one of Bildt's most important election platforms. After he got elected and Latvia regained independence, Bildt remained very visible on Baltic issues, not least as one of the most ardent supporters of the shock therapy.

Every democratic government is expected to act in the interest of its people. Latvia's population has seen that the neoliberal model it was given is not the model that Sweden, other Scandinavian and Western European countries have followed. The policies dictated to Latvia have made it dependent, and have treated Latvia as a financial and trade colony of Western Europe.

To complete the Swedish trio, the finance minister Anders Borg's actions during the past year deserve special attention. His most memorable episodes were: 1) rushing on a visit to Latvia in the spring of 2009 when Latvia's Peoples Party (then still part of the government coalition) reinvigorated the discussion on the lats devaluation, and 2) as the EU Presidency's finance minister in October 2009, publicly criticizing and humiliating Latvia on 'insufficient fiscal consolidation', having secretly warned Swedbank and SEB about Latvia's 'inevitable economic collapse'.

The Swedish people deserve to know that despite many episodes of interference in the Latvian domestic affairs in the recent past, the Swedish government has today wiped the Latvian issue under the carpet, while the Swedish people are being told that Latvia is actually on the road to a sustainable recovery. 2008 and 2009 the Swedish media consistently provided vivid accounts of the suffering and misery of the least protected groups within the Latvian society. Ironically, we see nothing like that in today's Swedish media.

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