Transition in the Baltic States: economical and political
Part I

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Objectives of the lecture

- To provide a general overview about the main features of transition in CEE and the Baltic States in the 1990’s
- To provide a more detailed overview about the the economical transition and the most important market reforms in the Baltic States in the I half of 1990’s
- Discuss the question, whether Baltic countries are the consolidated democracies today and why democratization was more successful in the Baltic States than in other parts of former Soviet Union
- To introduce some new concepts: shock therapy, gradual transition, consolidated democracy

Outcomes of the lecture

- The basic knowledge about the economical transition and market reforms in the Baltic States in the 1990's
- New concepts: shock therapy, gradual transition, consolidated democracy

Transition in CEE

- CEE region unique. Triple transition:
  - Democratization
  - Marketisation
  - State- and/or nation-building
- <u>Economic transition in the Baltic States</u>: to break economic dependence on Soviet market, orientation towards the West
- <u>General models of economic transition</u>:
  - Gradual (Lithuania)
  - Shock therapy (Estonia, Latvia).

Economic transition–general remarks

- Little knowledge about transition – IMF imposed a neo-liberal model
- Initial position of 3 Baltic States was quite similar (legacy of soviet time, size, geography)
- **Estonia** more successful:
  - more rapid recovery,
  - more foreign investments,
  - more rapid economic growth,
  - trade with EU and Scandinavia (Latvia, Lithuania – Russia)

Economic transition – structure of economy

- Agriculture and industry was declining and service sector was growing. Production in some sectors in agriculture fell more than 50%
- Service sector became more important: services, banking, etc.
- Soviet time industry collapsed.
  - Weak industrial policy
  - Rather low-skilled industries started to flourish in the 1990's (forestry) not knowledge-based branches

Shock therapy vs. gradual

- Main components:
  - Price liberalization:
    - Shock therapy: should be quick and radical to revitalize economy
    - Gradualist: should create social guarantees before
  - Privatization
    - Shock therapy: quick, because class of owners should be created.
    - Gradualist: large state companies remain in state hands
  - Tight fiscal policy –
    - Shock therapy: balanced budget.
    - Gradualist: deficit is accepted, otherwise a social catastrophe
  - International trade liberalization –
    - Shock therapy: all trade barriers should be removed.
    - Gradualists: should prepare the economy for free trade, it should be competitive enough.
  - Minimal state control. Gradualist – state is retreating later
- Which model was more successful: no clear answer

Shadows of transition - economy

- <u>Unregulated economy</u> and not transparent transition policies offered opportunities for frauds.
- <u>Transit</u> was rapidly growing and the main engine of the economy – often related to illegal activities
  - Metal trade from Russia to West. Russia forbade it – plundering of monuments and cables in the Baltic States
- Share of illegal economy I half of the 1990’s 20-30% (50% of Tallinn food trade illegal in 1994 – “booth economy”).
- High inflation

Shadows of transition - social costs

- Budget deficit in the 1990s was primarily covered by radical reduction of public expenditures
- Rapid growth of <u>unemployment</u> and <u>crime</u>
- <u>Falling living standard</u>:
  - Transition pushed 1/3 of population below poverty line (Estonia 37% 1996, 2004 – 18%).
  - Especially hit rural districts, pensioners, certain regions
- <u>Social stratification</u>:
  - Gini index was low in Soviet times,
  - Rapid growth of Gini in the I half of the 1990’s
  - Gini index was growing more than in Visegrad countries