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

- Economic transition in the Baltic States: to break economic dependence on Soviet market, orientation towards the West

- General models of economic transition:
  - 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

• **Unregulated economy** and not transparent transition policies offered opportunities for frauds.

• **Transit** 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 unemployment and crime
- Falling living standard:
  - Transition pushed 1/3 of population below poverty line (Estonia 37% 1996, 2004 – 18%).
  - Especially hit rural districts, pensioners, certain regions
- Social stratification:
  - 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