

The Baltic economic model: some results of the 1990-2015 transformations

Mezhevich, Nikolai M.

Veröffentlichungsversion / Published Version

Zeitschriftenartikel / journal article

Empfohlene Zitierung / Suggested Citation:

Mezhevich, N. M. (2015). The Baltic economic model: some results of the 1990-2015 transformations. *Baltic Region*, 4, 20-37. <https://doi.org/10.5922/2079-8555-2015-4-2>

Nutzungsbedingungen:

Dieser Text wird unter einer Free Digital Peer Publishing Licence zur Verfügung gestellt. Nähere Auskünfte zu den DiPP-Lizenzen finden Sie hier:

<http://www.dipp.nrw.de/lizenzen/dppl/service/dppl/>

Terms of use:

This document is made available under a Free Digital Peer Publishing Licence. For more information see:

<http://www.dipp.nrw.de/lizenzen/dppl/service/dppl/>

**THE BALTIC
ECONOMIC MODEL:
SOME RESULTS
OF THE 1990—2015
TRANSFORMATIONS**

N. Mezhevich*



During the last 25 years, the economy of the Baltic States has been developing in the conditions of sovereignty, both de facto and de jure. This period has been sufficient to identify regular patterns in the national economic models. Studies into the nature of the economic development of the Baltic States have a considerable practical and scientific significance. On the one hand, the three Baltic States are a part of the post-Soviet space. The nature, success or failures of their economies contribute to a more accurate assessment of Russia's development. On the other hand, it is the second decade of the Baltic States'

EU membership, and the countries' experience is very relevant. The article identifies and analyses key characteristics of the Baltic States' economic model. The author puts forward a hypothesis on two stages of the economic transformation undergone by the Baltic States. The first stage is characterised by a combination of transformation and modernisation whereas the second — by transformation accompanied by a number of destructive trends in the economy. The current economic model demonstrates limited stability, partly due to deliberately severed economic ties with Russia.

Key words: transformation, modernisation, the Baltics, economic models, political limits to economic development

The transition of Eastern Europe and the former USSR republics to a new path of economic development resulted from a combination of external and internal development factors. The only debatable issues were development rates, priorities, and strategic goals. An increase in the standards of living based on sustainable economic growth was declared the key economic goal. This goal was to be achieved through attaining the following objectives:

* Saint Petersburg State University
7—9 Universitetskaya nab.,
Saint Petersburg, 199034, Russia.

Submitted on September 10, 2015.

doi: 10.5922/2079-8555-2015-4-2

© Mezhevich N., 2015



1. Overcoming the crisis that became more pronounced after the society had entered the phase of a transitional economy;
2. Development of market relations and infrastructure, including stock, currency, and commodity exchange; deregulation of the market;
3. Financial and economic stabilisation, achieved, as a rule, through pursuing a strict monetary policy aimed at curbing inflation;
4. Using the state as a mechanism to protect the developing market economy;
5. Reforms in ownership relations as a basis of the economic system, including restitution and land reform.

A transformational, or transitional, economy is a special state of an economic system, functioning during the period of the society's transition from one established model (system) to another. The central characteristic of this system is stable interconnections between elements and subsystems, whose composition can change without unbalancing the system.

A period of transformation is an interval during which a society completes a radical economic transformation, and the country's economy reaches a qualitatively new state as a result of fundamental reforms in the economic system. Transformational economy has features distinguishing it from other established systems. From our point of view, the current condition of the Baltic States' economy makes it possible to speak of a completed fundamental transformation. In our opinion, the transformation of the political system had been concluded much earlier. However, the transformation of the political system is beyond the scope of this article.

Another crucial issue is the correlation between transformation and modernisation. In our opinion, any modernisation is a transformation, but not vice versa. When a transformation is successful and it contributes to social and economic progress, then it is modernisation. However, transformations can also result in the degradation of the economic system, which was the case in some post-Soviet countries.

As to the economic systems of the Baltic States, they do not only developed under the slogans of transformation and modernisation, but also aspired for the so-called Westernisation. The denial of national historical and economic experience in the republics (states) of the Baltics can be explained by the victory of propaganda used by scholars and politicians arguing that prosperity could never be attained without complete Westernisation. Authoritarianism and totalitarianism, ideologies and practices of communism and Nazism are considered as tragic deviations from the bright way to civilisation achieved through Westernisation. Denying Westernisation took a lot of forms, including euroscepticism and was generally frowned upon. Only in 2015, a landmark event took place: the introduction of migration quotas by Brussels provoked a large-scale discussion about rights and obligations in the European Union.

* * *

Versions of modernisation theories used in the Baltic States suggested a rapid and effective breakthrough to a Euro-Atlantic economic system based on the concepts of Postmodernism and Neoliberalism. However,

‘neither the postmodernist, nor neomodernist (including ethnicity-based neomodernism) theories explain complications associated with and distinctive features of the objectives faced by these countries. They do not take into account the countries’ specific features when describing their prospects. Nor do they make it possible to manage changes in these countries’ [1, p. 13]. The Baltics’ political elites are still developing. The thesis ‘there is only one way to manage a contemporary economy’ [2, p. 118] was most actively promoted in Eastern Europe, especially in the Baltics. That is how the era of transformations began. At the same time, Estonia, Latvia, and Lithuania ignored a well-known fact: modernisation projects can entail degradation of traditional institutions and traditional national values. The situation started to change after 2009, whereas debates as to whether eurointegration is an unquestionable good began much later — in 2015 [3; 4].

In the Baltic States, the idea of a breakthrough towards the global and European economy developed in the conditions, when the society was split along ethnic and political lines. Extremely isolated elites strived to remain in power without offering an economic action plan. On the other hand, the Soviet regime paradoxically contributed to the formation of both a new elite and national economic interests in the Baltics. Without focusing on the Baltic problem, Mancur Olson writes that conquerors¹ tend to sweep away accumulated narrow interests, leaving the field free for encompassing interests, i. e. there are ‘superencompassing interests that do not comprise the whole society ... that would lose from redistributing income from the minority to themselves’ [5, p. 22]. According to the declared ideology, the Soviet party elite became representatives of ‘superencompassing interests’ through regulating production and consumption and ensuring economic and social stability. There is also the aspect of economic psychology. The ‘demonstration effect’ of Western standards of living substantially exceeding those of Eastern Europe, was evident. It is also worth noting that, 25 years ago, a significant part of the Baltic societies was ready to pay the economic price for independence. This was one of the key features of the regional transformational model.

When analysing Russian and European approaches to the problem of transformational development, one cannot but admit that most works of Russian political scientists dedicated to post-Soviet transformations of political regimes have an apparent ideological anchor. Political priorities are also of great importance in discussing transformation processes in the Baltics. However, we believe that the transformational economy in the Baltics had a number of major characteristics, which will be considered in detail below.

¹ The author would like to ask the reader not to consider this quotation as agreement with the concept of ‘occupation’ underlying the political and economic model of the Baltic States. In our opinion, it is more correct to speak of Sovietisation in the case of the Soviet Baltic republics.

1. The influence of the historical background

It is important to address the key features of the Baltics' current economic model. One should identify the basic factors affecting the development of Latvian, Lithuanian, and Estonian economies in the past and present. The Baltics' development is affected by the experience of certain historical periods. Their economy still shows traces of the agricultural model of imperial periods and the large infrastructure projects implemented in the Soviet times.

Their socioeconomic development in the 1920—1920s and over the past 25 years followed several different scenarios. Despite all the problems, in the beginning of the XX century, the development was multidirectional and oriented to both western and eastern markets. A unidirectional model of Western integration is being implemented today.

In the early 1990s, the Baltic States demonstrated very similar models of economic development. In the Baltic Soviet republics, the vision of forthcoming reforms was based on nostalgic — and thus not always accurate — memories of the 'first republics' and the concepts of regional economic accounting.

The mythological perception of economic history became an important component of denying the present.

On the verge of Perestroika in 1986, the fixed assets value rate was 5,875 roubles per capita in the USSR. This rate differed significantly between republics — from 8,007 roubles in Estonia, 6,923 in Latvia, and 6,111 in Lithuania to 5,500 in Belarus, 4,500 in Moldova, 3,823 in Azerbaijan, and 2,291 in Tajikistan.

The growing differences in salaries were even more conspicuous. In 1940, the difference in the salaries of civil servants and workers was 10 roubles, in 1960—21 roubles, in 1960—33, and in 1988—78. In agriculture, the contrast was rather striking — 74 roubles in 1970 and 159 roubles in 1989 [6, p. 39]. It is not hard to guess that the Lithuanian, Latvian, and Estonian SSRs ranked top. Moreover, Soviet Estonia outperformed Latvia and Lithuania in these and other indicators. In 2015, the situation remained the same.

Reconstruction and industrial development were high on the Soviet priority list in the Baltic States for a number of economic and political reasons. From a pragmatic viewpoint, Latvia and Estonia represented a skilled-labour reserve unlike any other republic in the Soviet Union. They also had a very substantial infrastructure, which had not been destroyed during the war [7, p. 104].

By the 1990s, the Baltic States' proportion of population with an income of over 300 roubles was the highest in the USSR. If the Union-average proportion was 8.8%, it was 19.8% in Estonia, 14.5% in Latvia, and 13.8% in Lithuania. The poverty rate was the lowest in the Baltic republics. The proportion of population with an income below 75 roubles did not exceed 1% in Estonia and Latvia, and 1.2% in Lithuania. Republics with the highest poverty rate in the USSR showed the highest level of autocracy in the post-Soviet period [8].

Receiving the highest return on investment, the federal authorities decided to build new production facilities in the Baltics. The republics developed production faster than other regions. The proportion of fixed assets in the Baltics was above the Union-average and the equipment was more modern and less depreciated. This also held true for the agricultural industry. Latvian, Lithuanian, and Estonian kolkhozes and sovkhoses enjoyed privileges when distributing fertilisers, equipment, fodder, cattle breeds purchased abroad, etc.

Annual subsidies to agriculture reached tens of billions of dollars, received from oil exports from the USSR. For instance, milk was bought from kolkhozes and individual farmers for 55 kopeks per litre and sold for 22 kopeks per litre in shops. The same held true for meat and other agricultural produce. It is easy to imagine the scale of this public subsidy. The independent Latvian state did not have a comparable financial source [9].

It is evident that the initial economic achievements of the Baltics were to a great degree — but not completely — accounted for by the ‘Soviet heritage’, i. e. infrastructural and industrial potential and the quality of human capital.

The thesis about the significance of the Soviet heritage for the economic development was formulated as early as 1991 [10]. It was developed in a series of works [11; 12]. Let us quote a team of authors led by L. M. Grigoryev:

The Baltics had the best initial conditions among ex-Soviet republics for building a market economy. They had developed a significant innovative potential. In the Soviet period, the region served as a ‘laboratory’ for improving economic mechanisms. The Baltics always enjoyed a special status in the USSR, which suggested significant investment in the region’s development. In the 1970—80s, the republics boasted the highest investment per capita rate.

In effect, Estonia ranked first in the USSR as to this indicator outperforming the Union-average by 6—8%. Technically, the leader was the RSFSR (Russian Soviet Federative Socialist Republic), but the republic accounted for most of investment in defence and security, without which Estonia exceeded the Union-average by 15%). Investment in Lithuania was traditionally high, whereas that in the Lithuanian economy increased in the late 1980s [13, p. 55].

In the Baltic States, the formation of market economy was affected by a number of factors: foundations of market economy that existed before the transition to the administrative command economy, economic and historical ties with Western Europe, a relatively balanced structure of the national economy, and a consensus over the need for a market transition.

In Latvia, Lithuania, and Estonia, numerous reforms were launched in 1991—1992. As early as in 1989—1990, there was an understanding of the necessity and inevitability of reforms, which became a consolidating factor for the society. The general nature of reforms was apparent — the denationalisation of the economy in accordance with the new territorial framework. A number of major reforms — monetary, housing and utility, medical, and municipal — were promptly carried out. They were put in place or

launched until 1993. The entrepreneurial skills of the Baltic population and assistance from the West contributed to a swift overcoming of the crisis caused by the severance of economic ties within the so-called national economic complex of the USSR. It is only logical that it was decided to reorient the economy to the West. However, at first, leaders of the Baltic Soviet republics and, later, independent Baltic State were very cautious when discussing the prospects of economic development and stressed the need to retain economic ties with Russia.

The understanding of limitations associated with the countries' orientation to the West will come later. In the early 1990s, the major Baltic facilities were purchased by Western partners at knockdown prices. The situation of the 1920s repeated itself, when Scandinavian and later German bankers started buying up Baltic assets. In both the 1920s and 1990s, the Baltics' authorities did not realise the actual cost of the property sold and destroyed. The understanding came much later, when there was nothing left to redistribute.

It took the first decade of the Baltics' second independence to realise the actual cost of their national treasures. Matti Maasikas, Estonia's Deputy Minister of Foreign Affairs, gave the following assessment of the Soviet legacy:

We chose the most radical of the possible variants of economic reforms. The political forces that came to power in 1992 campaigned under the slogan 'clean house'. They believed that the Soviet economy did not leave Estonia anything worth using. Everything has to be reconstructed or built anew, and everything has to be done rapidly and decisively [14, p. 15].

However, only transit, transportation, and trade with Russia accounted for almost half of GDP. Today, the assessments of the economic potential of the Soviet republics have changed. However, this discussion still remains purely academic.

2. Volatility of key economic processes

Most economists coming from different schools of thought stress that rapid growth is an equally reliable indicator of serious structural and financial disproportions in national economies as is rapid decline. This thesis does not hold true for the initial period of reforms and transformations in national economies. The economic decline in the Baltics was very dramatic: -35% in Estonia, -49% in Lithuania, and -52% in Latvia. This situation was observed everywhere from Kazakhstan to the Czech Republic. It was also predictable that Estonia would be the first country to overcome the crisis. In 2001, it reached the pre-crisis 1989 level. At the beginning of 2008, the country's GDP constituted 158% of that level. The economic achievements of Latvia and Lithuania are much more modest — 115 and 111% respectively [13, p. 53]. However, the 2008 crisis led to a new phase of destabilisation. In 2007—2009, the 10% GDP growth was replaced by a 19% decline. Until today, the economy remains unpredictable and economic forecasts highly volatile [15]. In this context, the 2008 forecast of a 5.6% growth in the Estonian economy in 2009 seems to be extremely politicised and unscientific.

Let us consider GDP per capita in the Baltics in 2006 and 2007. In Latvia, it increased by over 33 %. How did it happen? ‘After ten years of prosperity brought by the construction boom, cheap production, and Russian transit, today, Lithuania needs new sources of income’ [16]. Similar ideas are promoted in Estonia. The analysis of the largest Scandinavian financial groups — *Skandinaviska Enskilda Banken (SEB)* — Ruta Arumäe interprets the economic decline as a large-scale phenomenon. Therefore, its adverse effect on consumers is just a question of time. The situation could be remedied by the acceleration of external demand. Yet, there are no signs of such acceleration [17].

All factors contributing to a large-scale crisis can be divided into two groups. The first group is external factors — the balance of payment deficit, uncontrolled capital inflow, disregard of exchange risks, and real estate ‘bubbles’. Although these factors are rather important, they do not exhaust the list, otherwise the economic decline would be at the level of other countries (the decline in the region under consideration is rather dramatic).

The second group brings together national practices. Trying to clear the way for private enterprises, the Estonian government opted for maximum liberalisation — absolute deregulation, abolition of subsidies to any companies that proved to be inefficient in 1991, and rejection of the progressive tax rate. As a result, the emerging private sector was booming. 15,000 new companies were registered each year (and a comparable number of corporate entities went bankrupt).

The macro-target was eurointegration at any cost, accompanied by unidirectional foreign economic orientation of the Baltics to EU partners and ignoring the economic opportunities associated with east European partners. Eurointegration was also connected with political deindustrialisation, deagrarianisation of the economy, and transferring the control over funding to Scandinavian banks.

In the first decade, such policy brought positive results. However, international — including Russian — experts have stressed an increase in the crisis trends at least since mid-2007. In the late 2007, the instability in global financial markets grew, the banking sector was experiencing problems, and specialists spoke of a possible deceleration of global economic growth. These processes developed in the conditions of globalisation, when changes observed in periphery markets could undermine global stability. That is why dealing with negative trends and their consequences in such major sectors of economy of developed countries as stock markets and banking required coordinated actions of their ‘monetary’ authorities. In the post-Soviet space, the crisis first affected Latvia, Estonia, and Lithuania (in this very order). The accelerated integration, which was not based on actual economic achievements, could not last forever.

Even the complete failure of this policy did not lead to a revision of practices in 1991—2008. Instead, another book ignoring the economic reality was published [18]. During the crisis, the economy of the Baltic region fell by 20 %. However, in 2011, the Baltic States showed the highest growth rate of 6.3 %.

The decline in all economic indicators necessitated a revision of economic forecasts for the Baltics. *Danske Bank* expected the economy of Estonia to increase by 1.5% in 2014 and 1.8% in 2015, the economy of Estonia — by 3.7% in 2014 and 2.6% in 2015, and that of Lithuania — by 2.4 and 2.7% respectively [19].

Let us consider the case of Latvia. The 2015 budget was drafted based on the assumption that next year GDP would increase by 2.8% and the inflation rate of 2.4% [20]. However, the stability programme for 2015—2018 adopted by the Latvian government expected a 2.1% increase in the Latvian economy in 2015. According to Brussels, the country's GDP had to increase by only 2.6% (2014). At the end of April 2015, the Bank of Latvia predicted a 2% GDP growth [21]. Moreover, the European Commission also revised its forecast for Latvia's economic development. In spring, Brussels predicted a 3.8% economic growth. And in six months, the economic forecast for Latvia was even less optimistic — a 1.5 times decrease in the country's economic growth. The European Commission believes that the state was too susceptible to external risks [22]. Moreover, Mārtiņš Zemītis, an economic expert of the European Commission Representation in Latvia, stressed in May 2015 that, in 2016, the country had to undertake fiscal consolidation of 0.3% of GDP. In his opinion, the European Commission did not object to Latvia's plans to increase defence spending and carry out reforms in healthcare. The country should not have spent more than it could afford. 'The European Commission is not sure that Latvia has enough money to cover all these sectors' [23].

What were the causes of the 2009 dramatic decline? In our opinion, it is a consequence of the hypertrophied development of several sectors of the economy — the financial sector, real estate, and trade. Economists are familiar with the phenomenon of speculative economic growth, which is not backed by the development of real economy.

Today, the banking sector of Latvia, Lithuania, and Estonia is dominated by Nordic transnational financial corporations. This structure of the banking sector is a trendsetter in the Baltic economies. The identification of priority areas for lending makes it possible to stimulate industries that do not compete with the parent organisation's capital.

Experts are becoming increasingly aware of a disruption of the normal course of the Baltics' economic development. If earlier we spoke about a dialectical interaction between the economy and politics, today the economy has become subordinate to politics. The golden age of European economy (the 1950s — the first seven years of the XXI century) came to its end. Europe will not grow at a rate of 3—5% per year for many years to come until the paradigm of political and economic development changes. This means that, regardless of the forms of support for the economies of Estonia, Latvia, and Lithuania, the European Union will not and cannot ensure economic development and can only secure the already achieved level.

3. Industrial and innovation policy

Today, it is difficult to imagine that Riga was one of the largest industrial centres of the European part of the Russian Empire alongside Warsaw, Kyiv, and Kharkov. Riga specialised in high-tech industries. It had a significant proportion of companies with foreign capital, surpassed only by the capital of the empire. During the interbellum, mechanical engineering was not rapidly developing in Latvia. Yet, it did not disappear. K. Ulmanis's authoritarian regime maintained the industrial achievements and contributed to the development of the transport and energy sectors. At the same time, industrial production almost disappeared in Estonia and did not exist in Lithuania at all. As it was mentioned above, the USSR launched modern industrial production in the Baltics based on economic considerations — to cut costs.

Former industrial giants of the Latvian SSR — Riga factories RAF, VEF, Radiotehnika, Alfa, Daugavpils chemical fibre plant — were privatised and driven to bankruptcy in the 1990s. The Riga railroad-car, Liepaja metallurgical, and Daugavpils locomotive maintenance factories were more successful. However, the new vector of industrial politics did not leave much room for further development. In 1990, Riga railroad car factory was labelled an unnecessary appendage to the Soviet economy. Therefore, bankruptcy conditions were created for the factory in 2013. An attempt to find an effective investor failed in 2015. The debate taking place in the expert community showed that the investor is interested in potential markets of at least Russian scale. The Russo-Balt car manufacturer was supported by foreign capital. However, it assembled cars for the whole market of Russia. The Riga railroad car factory cannot be attractive for investors as a company of the Latvian or even European market. The brand of the Latvian Republic, the only large industrial company that does not show any signs of a systemic crisis is *Latvijas balzams*. It employs 600 people, being one of the largest Latvian exporters, whose produce is sold in over 30 countries of the world and this figure grows every year [24].

The results of deindustrialisation are evident. Therefore, let us consider its causes. Firstly, a post-industrial (postmodern) society using knowledge and global electronic technologies as the main development resource can emerge only in a modern developed economy. Germany followed this path. Moreover, a certain controlled reduction in industrial production in favour of services is a sign of the approaching 'new economy'. A vivid example is controlled deindustrialisation in the USA.

Secondly, 'what the Nordic economies were extremely good at during the post-war period, and still are, was hedging or socializing risks for long-term R&D, innovation and industrial upgrading while the Baltic economies of the 1990s and 2000s hedged or socialized risks for short-term consumption and asset booms. The former learned to manage financial fragility and long-term growth; the latter have no options left to manage enormous fragility brought into the system by short-term rapid growth' [25].

Thirdly, the emphasis on deindustrialisation had a double political subtext. As a rule, workers at large and medium companies of the Baltics did not belong to the Baltic nations. They were organised on the social and industrial basis. Therefore, destruction of industrial production was not an economic, but a political objective. Further, the liberal project would inevitably encounter resistance from supporters of the concept of social state popular in Germany and the Nordic countries. Violent suppression of trade unions used by Latin American right-wing dictatorship was not acceptable, whereas liberalisation accompanied by the gradual closing of Eastern markets yielded the desired political effect.

Today, having faced the mentioned phenomenon, regional societies and states are looking for new, non-standard ways for the Baltics' participation in the international division of labour [26; 27]. Regardless of the results, it is evident that, having destroyed industrial production (and agriculture), Estonia, Latvia, and Lithuania have not become contemporary post-industrial countries. Industrial civilisation will exist even when the utopic experiment of self-regulating market becomes a scary memory [28]. The positioning of the Baltics in this civilisation is questionable.

4. Foreign economic aspect of the post-Soviet transformation in the Baltic States

As it was mentioned above, in the beginning, the leaders of Soviet Baltic republics and, later, independent Baltic States were very cautious when speaking of the prospects of economic development; they stressed the need to retain economic ties with Russia. The objective of transit potential development was set. And until 2004—2007, it was more or less successfully implemented. 'The transit potential of a country is a total of external and internal factors shaping a country's opportunities for handling international cargo and passenger transit without applying the measures of state economic policy to transport objects' [29, p. 94]. The academician of the Estonian Academy of Sciences, Prof. M. L. Bronstein wrote, 'Transit, being the most rapidly developing industry, accounted for 10—12% of Estonia's GDP in the 1990s, this figure increasing when financial and logistic services are taken into account'.

The significance of transit for the Baltic States' economy has always been widely debated. However, it is a solid fact that, in the late 1990s — early 2000s, this and the associated industries accounted for 20% of GDP [30]. This figure does not take into account the transport sector proper. Otherwise, it would be higher. The Baltic States' accession to the EU could have contributed to the development of trade and transit. However, the supposition that 'the accession of Latvia, Lithuania, and Estonia to the European Union has provided fertile ground for further development of trade and economic relations' [31, p. 122], as expected, proved to be unreasonable. In the 21st century, the concept of transit policy is impossible without assessing the political climate. A sign of the political component in action is that the Baltic ports handled 53,239 million tons of cargo in 2015, which is 3,638 tons (6.4%) below the 2014 level [32].

According to *Bloomberg*, in 2015, Russian exports to the Baltic States decreased by approximately one fifth due to the sanctions. *Danske Bank* predicted an 18–25% reduction in exports, which would entail 690 million losses for Latvia, Lithuania, and Estonia; exports to Russia account for 6.3% of all exports in Latvia, 4.4% in Lithuania, and 5.5% in Estonia. A reduction in exports is caused by the plummeting rouble and recession in Russia. *Bloomberg's* experts predicted the development of the Baltics' economies at a rate of 1.3–1.7% in 2015, which is lower than expected earlier [33].

Another important aspect is re-export. In 2014, total Lithuanian exports to Russia accounted for 2.5 billion litas, whereas the cost of goods re-exported from other countries was six times this level, exceeding 14 billion litas [34].

The objective of strengthening economic ties with other countries has been declared by the President of Latvia [35]. However, Adviser to the President of the Republic of Latvia on European and Economic Affairs disavowed the position of the President, who was about to leave the office, stressed that the idea of a 'bridge' between the West and the East had to be abandoned [36]. The implementation of this idea will affect the general stability of the Baltics' economy.

Of course, it will also have a certain effect on Russia. Another important factor is the disconnection of the Baltics' energy system from Russia. This means that Russia will have to launch additional generating capacities in some of its western regions. Since power transmission lines ran through the Baltics to certain Russian regions and vice versa and they will be reoriented to Europe, Russia will have to build new electricity lines to ensure power transmission. This will cost approximately 2–2.5 billion euros [37]. However, the cost to the Baltics (more precisely, the European Union) will be much higher. It is worth stressing that Finland does not only buy power from Russia, but also sells it to Russia for mutual benefit [38].

In the context of foreign economic ties and their role in the economy, it is important to consider the role of tourism. The Baltics and Transcaucasian countries top the list of the most affordable tourist destinations for Russians. However, the tourist flow from Russia to Estonia reduced almost twofold [39].

Based on the above and the ambitious project of the Baltics in the fields of transport and energy [40], it can be concluded that Estonia, Latvia, and Lithuania will take every effort to undermine the remainder of their economic sovereignty.

It is also worth stressing that one of the key problems of the Baltics is the lack of a development strategy for the period after 2004. Strategic targets were lost after the accession to the EU, which was considered the ultimate goal.

5. Financial and economic relations with the European Union

When considering the economic prospects of the Baltic States, it can be argued that these countries have fully benefitted from the European integration.

A comparison of the transfers from the Baltics to the EU budget and vice versa in 2000—2011 shows that the funds were managed most successfully by Lithuania, even if the EU support for the closing of the Ignalina NPP is not taken into account. Lithuanians receive 4.4 euros, Latvians — 3.7 euros, and Estonians — 3.4 euros for each euro transferred to the EU budget. However, as to EU support per capita, Estonia ranks first with 2.72 euros per person, followed by Lithuania — 2.68 euros, and Latvia — 2.17 euros [41].

There is, however, a risk that the inflow of external funds will turn out to be a Pyrrhic victory... Often investment decisions are made according to “opportunities” offered by the various EU programmes, rather than according to the “needs” of society in general. With the contractor, not having to pay the full cost from his or her own budget, there is a clear incentive to overinvestment. There are multiple examples of large construction works undertaken without paying due regard to the actual needs of the beneficiaries or even the ability to pay for the running cost in the long term [42, p. 13].

Over the recent years, the Baltics’ governments have formulated three priorities during their negotiations over subsidies to their national budgets:

- 1) a stronger support from the Cohesion Fund;
- 2) an increase in subsidies to farmers within the Common Agricultural Policy;
- 3) financing of the Rail Baltica project within the Connecting Europe Facility [43].

Counting on the EU assistance is a key factor behind the current policies of the Baltics. However, the economic prospects of the EU in general are also unclear. Today, the EU-Baltic infrastructural projects require expenditure comparable to that provided for in the 1950—1980s by the Soviet Union. The difference is that, in that period, return on investment was ensured by the three-hundred-million Soviet market. Today, the EU does not have an opportunity to finance such projects, nor does it have the desire to inform Tallinn, Riga, and Vilnius about it.

EU subsidies account for 75—90% of investment in the public sector. If we assume that Estonia’s national budget equals 100 units, 76 units (pensions, benefits, etc.) will be regulated by laws. The remaining 24 units are the part of budget that can be discussed by the Parliament. Over the recent years, the EU has accounted for 16—18% of Estonia’s budget [44]. The Baltic economic model survives and will survive with the support from the EU. The system does not generate a steady inflow of funds on its own.

6. Economic framework for social policy

The Baltics’ social policy is based on abandoning the concept of *social state* suggesting a contract between the state and the civil society, in particular, between the state, employers, trade unions, associations, and NGOs. In practice, this means a change and a dramatic reduction in the initially developed system of social security and social guarantees and healthcare commercialisation.

Changes in the economic structure did not increase productivity at the expected rate; they curb opportunities for solving the country's social problems. Estonia's social security spending per capita accounts for 40% of the EU's average. The social alienation rate has not decreased in Estonia over the past decade. Every fourth Estonian is in the at-risk group [45].

Swedbank has analysed the expenditure of residents of Tallinn, Riga, and Vilnius on food and housing. The analysis shows that in Riga, a family of four living in their own 70 m² flat spends 44% of the family's income on food, housing, and transport, in Vilnius — 41.5%, and 25.5% in Tallinn. A family consisting of two adults and two children spends 591 euros a month on food, housing, and public transportation in Riga, in Vilnius — 513 euros, and 499 euros in Tallinn [46]. *LETA*, referring to the data of Latvia's Central Statistical Bureau, stresses that, in the first quarter of 2015, Estonians received the highest (1010 euros) and Lithuanians the lowest (700 euros) salary across the Baltics. In Latvia, gross salary reached 786 euros in that period. As compared to the first quarter of 2014, the highest increase rate was observed in Latvia with 6.1%. In Estonia and Latvia, salaries increased at the rates of 4.5% and 4.3% respectively. However, after taxation, Latvian salaries are lower than those in the neighbouring countries. An average net salary in Latvia accounted for 74% of gross salary, in Lithuania — 78%, and in Estonia — 81% [47].

7. Political obstacles to economic transformations and modernisation

Extreme politicisation of economic development — which is more pronounced in the Baltic States than anywhere across the post-Soviet space — is a characteristic feature of the countries' economic regime. In Estonia and Latvia, the economic mythology has become part of politics, a standard of public administration. Complicated economic processes are explained through simple political slogans and criticism of earlier economic practices. The 'reserves' of economic politicisation were sufficient for almost twenty years. However, 'at the moment, an increasing number of people pay attention to concrete results of a policy rather than its ideological bases' [48, p. 211]. Society demands Western standards of living, which are not observed in the Baltics.

David Woodruff, an associate professor of political science in the Massachusetts Institute of Technology, argues with the authoritative economist Mancur Olson:

Is it too much to speculate that democracy's success has been that it aids in the design of locally appropriate policies, the policies that take for granted that dynamiting inherited industries is unlikely to be the best course, and grapple with such unobvious issues as how best to promote the adaptation of socialist enterprises to market conditions? [49, c. 216].

Only 25% of Latvians, 25% of Lithuanians, and 22% of Estonians 'partly agree' that their voice is heard in the EU (as compare to the EU average of 33%). At the same time, 32% of Latvians, 16% of Lithuanians, and 53% of Estonians 'partly agree' that their voice is heard in the own states (the EU average is 52%) [50].

* * *

It can be concluded that the Baltic States have undergone two stages of transformation. The first one took place in 1990—2004, when the objectives of the key structural reforms were achieved. The accession of the Baltic States to the EU confirmed this thesis. With certain reservations, this period can be interpreted as a part of the modernisation project. However, the basis for the development of the economic model, functioning as a privileged periphery of the EU, was established at the time.

At the second stage, the Baltics unsuccessfully tried to overcome their periphery position following the catch-up development pattern. Yet, despite all efforts, they remain a periphery zone of the decelerating modernisation process, whose centre is located in Western Europe. Of course, the functioning of the centre would be impossible without periphery, thus the centre created periphery in the course of its evolution.

A vast array of empirical data, a creative generalisation of Russian and international economic theories, and Russian experience make it possible for economic and political scientists to develop concepts based on a new model of studying transformation in the Baltics. Firstly, it uses comparative methods of transitology. Secondly, the model acknowledges the fact that the period, when Russian science used primarily linear-progressive concepts of post-Soviet transformations, has ended. Relatively market-oriented and relatively democratic political systems have developed in Estonia, Latvia, and Lithuania. These stages of transformation were almost identical in the Baltics and in Central and Eastern Europe. However, the year of 2004 saw the beginning of a new stage of post-Soviet transformations, whose results are not yet known and, in many cases, are difficult to predict.

There is another important aspect. Despite ritual incantations of eurointegration, it turned out to be very different from basic European values and priorities having evolved within the paradigm created by Anglo-Saxon neoconservatives in the 1980s. The very foundations of European economic policy suggest close regulation associated with the idea of a welfare state. Current orientation to the tertiary sector requires centuries of industrial development and protectionism towards national industrial production. In Europe, a successful economic policy suggests political pluralism and peaceful transfer of power, which is not the case in the Baltics. For instance, right-wing parties have been in power in Estonia for a decade and a half, whereas the opposition is formed not by leftists (the part of political spectrum is absent in the country) but by centrists led by Edgar Savisaar — the ‘father’ of Estonian economic reforms.

It can be concluded that the post-Soviet transformation in the Baltic States has been finished. The current economic model can be described as liberal Anglo-Saxon. However, the classical liberal economic model suggests freedom of markets in all geographical and economic directions, which is not the case in the Baltics.

References

1. Fedotova, V. G. 1997, *Modernizacija «drugoj» Evropy* [Modernization of the "other" Europe], Moscow, 255 p.
2. White, S. 2014, *Evropejskij Sojuz, Vostochnaja Evropa i «imperializm cenostej»* [European Union, Eastern Europe and the "imperialism of values"], *Vestnik MGIMO-Universiteta* [Vestnik MGIMO-University], no.4 (37), p. 116—124.
3. Sokol, Ju. 2015, Rumm H: Argument o sovetskih migrantah v spore o kvotah na Evrokommisiju ne dejstvuuet [Rumm H: The argument of Soviet immigrants in the debate about quotas for the European Commission does not act], *Eesti Rahvusringhääling*, available at: <http://rus.err.ee/v/estonia/5c909cfb-3d92-4fa5-822e-8580d742d7bc> (accessed 03.06.2015).
4. Sokol, Ju. 2015, Kristina Kallas: ne sleduet putat' bezhencev s immigrantami [Christina Kallas: refugees should not be confused with migrants], *Eesti Rahvusringhääling*, available at: <http://rus.err.ee/v/estonia/6cad0dc5-6e23-4df9-b9fe-3ed443853042> (accessed 05.06.2015).
5. Olson, M. 2012, *Vlast' i procvetanie: Pererastaja kommunisticheskie i kapitalisticheskie diktatury* [The power and prosperity: outgrowing communist and capitalist dictatorship], Moscow, 201 p.
6. Agafonov, N.T., Litovka, O.P., Islyae, R. A. 1998, *Gosudarstvennaja strategija regional'nogo razvitija Rossii: smena paradigmy territorial'noj organizacii obshhestva* [State Strategy of the Regional Development of Russia: the paradigm shift in the territorial organization of society], St. Petersburg, 52 p.
7. Misiunas, R. Taagepera, R. 1983, *The Baltic States: Year of dependence 1940—1980*, Berkeley.
8. Gareeva, N. E., Shkel, S. N. 2011, *Teorija modernizacii i social'no-jekonomicheskie faktory demokratizacii v kontekste politicheskikh transformacij na postsovetskom prostranstve* [The theory of modernization and socio-economic factors of democratization in the context of political transformations on the post-Soviet space], available at: <http://gisap.eu/ru/teoriya-modernizatsii-i-sotsialno-ekonomicheskie-faktory-demokratizatsii-v-kontekste-politicheskikh> (accessed 26.04.2015).
9. Mediņa, I. 2015, Gatis Krūmiņš: PSRS Latviju patēreja..., *SIA "Mediju nams"*, available at: <http://nra.lv/latvija/138988-gatis-krumins-psrs-latviju-patereja.htm> (accessed 26.04.2015).
10. Mezhevich, N. M. 1991, Geopoliticheskoe polozhenie Jestsnojskij SSR: mify i real'nost' [The geopolitical position of the Estonian SSR: Myths and Reality]. In: *Politicheskaja geografija i sovremennost'. Regional'nye i prikladnye aspekty* [Political geography and modernity. Regional and applied aspects], Leningrad.
11. Samonis, V. 1995, *Transformacija litovskoj jekonomiki: ot Moskvj k Vil'nyusu i ot plana k rynku* [The transformation of the Lithuanian economy from Moscow to Vilnius and from plan to market], Warsaw.
12. Grigoryev, L. M. 2005, *Konkurencija i sotrudnichestvo: jekonomicheskie perspektivy Vostochnoj Baltiki* [Competition and cooperation: economic prospects of Eastern Baltic], Moscow.
13. Grigoryev, L. M., Ivashchenko, A. S. (eds.), 2012, *Aktual'nye voprosy mirovoj jekonomiki: 2010—2012* [Topical issues of the world economy: 2010—2012], *Baltijskij forum* [Baltic Forum], Kaliningrad, available at: http://www.balticforum.org/files_uploads/files/book_2012_grigorjev.pdf (accessed 05.05.2015).
14. Klyamkin, I. M., Shevtsova, L. F. (eds.), 2008, *Put' v Evropu* [Way in Europe], Moscow.

15. Ral'f-Martin Soje 2009 god: jekonomicheskij rost 5,6% [Ralph Martin Soe 2009: growth of 5.6%], 2013, *Delovye vedomosti* [Business News], available at: <http://dv.ee/Default2.aspx?ArticleID=d329f296—517d-452b-8fef-70a83e1d52cb&open=fou> (accessed 14.07.2008).
16. Economist: Latvija smogla dostich' nevozmozhnogo [Economist: Latvia managed to achieve the impossible], 2010, *DELFI — Vadošais ziņu portāls Latvijā*, available at: <http://rus.delfi.lv/news/daily/business/economist-latviya-smogla-dostich-nevozmozhnogo.d?id=30262511> (accessed 01.03.2010).
17. Pylendik, K. 2014, 6 prichin, pochemu jekonomicheskij spad prodolzhtsja [6 reasons why the economic downturn continues], *Delovye vedomosti* [Business News], available at: <http://www.dv.ee/article/2014/6/16/6-prichin-pochemu-jekonomicheskij-spad-ne-zakonchitsja> (accessed 16.06.2014).
18. Åslund, A., Dombrovskis, V. 2011, *How Latvia Came Through the Financial Crisis*, Peterson Institute.
19. Bank: jekonomika JeR v grjadushhem godu vyrastet na 1,8% [Bank: Economy of Estonia in the coming year will increase by 1.8%], 2014, *Gazeta «Stolica»* [Newspaper "Metropolis"], available at: <http://stolitsa.ee/77375> (accessed 25.08.2014).
20. Knyazeva, O. 2013, Chto podpisal prezident: desjat' glavnyh faktov o bjudzhet-2015 [What the president has signed: ten key facts about the budget-2015], *Gazeta «Biznes&Baltija»* [The newspaper "Biznes & Baltija"], available at: <http://bb.lv/finansi/item/9160906-chto-podpisal-prezident-desyat-glavnykh-faktov-o-byudzhet-2015> (accessed 31.12.2014).
21. Dombrovskis: prognoz prirosta latvijskogo VVP, vozmozhno, pridetsja snizit' [Dombrovskis: Latvia's GDP growth forecast may need to reduce], 2015, *Rus. lsm. lv*, available at: <http://rus.db.lv/ekonomika/makroekonomika/dombrovskis-prognoz-prirosta-latvijskogo-vvp-vozmozhno-pridetsja-snizit-65892> (accessed 2.04.2015).
22. V 2015 godu jekonomiku Latvii zhdet stagnacija [In 2015, the Latvian economy is waiting for stagnation], 2014, *Gazeta «Biznes&Baltija»* [The newspaper "Biznes & Baltija"], available at: <http://bb.lv/rinki-i-kompanii/item/9160837-v-2015-godu-ekonomiku-latvii-zhdet-stagnatsiya> (accessed 27.12.2014).
23. Evrokommisija: Latvii predstoit bjudzhetnaja konsolidacija v razmere 0.3% ot VVP [European Commission: Latvia should fiscal consolidation of 0.3% of GDP], 2015, *LETA*, available at: <http://rus.db.lv/ekonomika/makroekonomika/evrokommisija-latvii-predstoit-bjudzhetnaja-konsolidacija-v-razmere-0-3-proc-ot-vvp-66196> (accessed 14.05.2015).
24. *Oficial'nyj sajt AO «Rizhskij bal'zam»* [Official site of JSC "Riga Black Balsam"], 2015, available at: <http://www.lb.lv/ru/predpriyatie/obshchaya-informatsiya/> (accessed 11.05.2015).
25. Kattel' Rajner Vzlet i padenie Baltijskih gosudarstv [Rainer Kattel The Rise and Fall of the Baltic States], 2015, *Europeandcis*, available at: <http://europeandcis.undp.org/data/show/6D3DABEF-F203-1EE9-B76AC2297A6967A> (accessed 06.06.2009).
26. Ministr jekonomiki: kosmicheskaja industrija — horoshij biznes dlja Latvii [Economy Minister: space industry — good business for Latvia], 2015, *Mix Media Group*, available at: <http://www.mixnews.lv/ru/economics/news/2015-05-02/175319> (accessed 02.05.2015).
27. Biznes po vyrashhivaniju ulitok v Latvii poterpel krah [Business on cultivation of snails in Latvia crashed], 2015, *DELFI*, available at: <http://www.gorod.lv/novosti/256056-biznes-po-vyrashchivaniu-ulitok-v-latvii-poterpel-krah> (accessed 29.05.2015).

28. Polanyi, K. 2002, *Velikaja transformacija. Politicheskie i jekonomicheskie istoki nashego vremeni* [The Great Transformation. Political and Economic Origins of Our Time], St. Petersburg, p. 270.
29. Kudryashov, N., Nechay, A. 2012, Tranzitnyj potencial: sushhnost', faktory realizacii, podhod k ocenke [Transit potential: essence, factors implementation approach to assessing], *Zhurnal mezhdunarodnogo prava i mezhdunarodnyh otnoshenij* [Journal of International Law and International Relations], no. 3.
30. Bronstein, M. 2007, Latyshi okazalis' mudree nas [Latvians have proved wiser], *Biznes & Baltija* [Business & Baltics], no. 113 (3236), June 15th.
31. Kozlov, O. 2014, Osobennosti vneshnetorgovyh svyazej stran Baltii i Rossii (1991—2012 gg.) [Features of foreign trade relations of the Baltic States and Russia (1991—2012)], *Vlast'* [Power], no. 3.
32. Chetyrehmesjachnyj gruzooborot portov stran Baltii umen'shilsja na 6,4% [The four turnover of Baltic ports decreased by 6.4%], 2015, *Buhgalterskie novosti* [Accounting news], available at: <http://rup.ee/rus/novosti/ekonomika-i-biznes/chetyrehmesjachnyi-gruzooborot-portov-stran-baltii-umenshilsia-na-6-4> (accessed 09.06.2015).
33. «Bloomberg»: jeksport stran Baltii v Rossiju umen'shitsja v jetom godu na 18—25% [«Bloomberg»: Baltic States exports to Russia will decrease this year by 18—25%], 2015, *Freecity.lv*, available at: <http://www.freecity.lv/biznes/19629/> (accessed 23.02.2015).
34. Jeksport litovskih produktov v RF sostavljal pochti 2 mlrd. litov [Exports of Lithuanian products in Russia amounted to almost 2 billion. Litas], 2014, *RU. DELFI*, available at: <http://ru.delfi.lt/news/economy/eksport-litovskih-produktov-v-rf-sostavljal-pochti-2-mlrd-litov.d?id=65501216#ixzz3c6CElsoC> (accessed 07.08.2014).
35. Berzin'sh: bez stremitel'nogo razvitija Latviju ozhidaet mrachnoe budushhee [Berzins: without rapid development of Latvia is waiting for a bleak future], 2015, *LETA*, available at: <http://rus.db.lv/nachalo/politika/berzin-sh-bez-stremitel-no-razvitija-latviju-ozhidaet-mrachnoe-budushee-66231> (accessed 15.05.2015).
36. Piebalgs: ot idej mosta mezhdru zapadom i vostokom nado otkazat'sja [Piebalgs: the idea of a bridge between East and West must abandon], 2015, *RU. DELFI*, available at: <http://rus.delfi.lv/news/daily/latvia/piebalgs-ot-idei-mosta-mezhdru-zapadom-i-vostokom-nado-otkazatsya.d?id=45839323> (accessed 19.04.2015).
37. Putin, V. V. 2015, *Il Corriere della Sera*, available at: <http://kremlin.ru/events/president/news/49629> (accessed 06.06.2015).
38. Prokhorov, P. 2015, Rossija v pervye v istorii kupila jelektrichestvo u Finlandii [Russia for the first time in the history of buys electricity from Finland], *the RBC*, available at: http://top.rbc.ru/spb_sz/08/06/2015/973655.shtml (accessed 01.06.2015).
39. Turpotok iz Rossii v Jestoniju sokratilsja za god pochti vdvoe [Arrivals from Russia to Estonia decreased by almost half], 2015, *Buhgalterskie novosti* [Accounting news], available at <http://rup.ee/rus/novosti/obshchestvo/turpotok-iz-rossii-v-estoniiu-sokratilsia-za-god-pochti-vdvoe> (accessed 10.04.2015).
40. Mezhevich, N. M. 2014, Major infrastructure projects and the foreign policy of the Baltic states in 2010—2014, *Balt. Reg.*, no. 1, p. 4—20. DOI: 10.5922/2079-8555-2014-1-1.
41. Jekspert: sredi stran Baltii net absoljutnogo lidera po osvoeniju evrofondov [Expert: the Baltic States there is no absolute leader in the development of EU funds], 2013, *BNN-NEWS*, available at: <http://bnn-news.ru/ekspert-sredi-stran-baltii-net-absoljutnogo-lidera-po-osvoeniyu-evrofondov-84672> (accessed 03.06.2015).

42. Holmgard, R. A. 2013, Estonia, *Bulletin on European and CIS Studies EU Budget 2014—2020: Views from across Europe after 7—8 February 2013*, Moscow, p. 13.

43. Estonian Government press release ‘Peaminister Ansip osaleb Euroopa Ülemkogu kohtumisel’, 2012, *Valitsus. ee*, available at: <http://valitsus.ee/et/uudised/74044/peaminister-ansip-osaleb-euroopa-%C3%BClemkogu-kohtumisel> (accessed 01.06.2015).

44. Argo, I. 2013, Varblane: dlja nas gosudarstvo — klub milliarderov [Varblane: for our state — the club of billionaires], *RUS. POSTIMEES. EE*, available at: <http://rus.postimees.ee/1173604/varblane-dlja-nas-gosudarstvo-klub-milliarderov> (accessed 19.03.2013).

45. Otchet o chelovecheskom razvitii Jestionii ukazal na obilie ierarhicheskikh lovushek [The Human Development Report of Estonia have the abundance of hierarchical traps], 2015, *Buhgalterskie novosti* [Accounting news], available at: <http://rup.ee/rus/novosti/obshchestvo/otchet-o-chelovecheskom-razvitii-estonii-ukazal-na-obilie-ierarkhicheskikh-lovushek> (accessed 29.05.2015).

46. Chtoby zhit' v Tallinne, nuzhno minimum 500 evro v mesjac [To live in Tallinn, you need a minimum of 500 euros per month], 2015, *Delovye vedomosti* [Business News], available at: <http://dv.ee/novosti/2015/04/27/chtoby-zhit-v-tallinne-nuzhno-minimum-500-evro-v-mesjac> (accessed 27.04.2015).

47. Sredi stran Baltii samaja vysokaja brutto-zarplata v Jestionii, samaja nizkaja — v Litve [Among the Baltic States the highest gross wages in Estonia, the lowest — in Lithuania], 2015, *DELFI. LV*, available at: <http://www.delfi.lv/biznes/bnews/sredi-stran-baltii-samaya-vysokaya-brutto-zarplata-v-estonii-samaya-nizkaya-v-litve.d?id=46029481> (accessed 28.05.2015).

48. Gechev, R. 2008, Institucional'nye ramki ustojchivogo razvitija v Vostochnoj Evrope [Institutional framework for sustainable development in Eastern Europe]. In: Oleinik, A., Gaman-Golutvina, O. *Administrativnye reformy v kontekste vlastnyh otnoshenij* [Administrative reforms in the context of power relations], Moscow.

49. Woodruff, D. M. 2001, Vlast' i procvetanie: pererastanie kommunisticheskikh i kapitalisticheskikh diktatur [Power and Prosperity: escalating communist and capitalist dictatorships], *Konstitucionnoe pravo: Vostochnoevropejskoe obozrenie* [Constitutional law: the East Europe review], no. 2 (35), p. 216.

50. Future of Europe, 2012, *Special Eurobarometer*, Report, no. 379, April, available at: http://ec.europa.eu/public_opinion/archives/ebs/ebs_379_en.pdf p. 23—25 (accessed 05.06.2015).

About the author

Prof. Nikolai Mezhevich, School of International Relations, Saint Petersburg State University, Russia.

E-mail: mez13@mail.ru