

Bolz, Klaus; Polkowski, Andreas

**Article — Digitized Version**

## Trends, economic policies and systemic changes in the three Baltic states

Intereconomics

*Suggested Citation:* Bolz, Klaus; Polkowski, Andreas (1994) : Trends, economic policies and systemic changes in the three Baltic states, Intereconomics, ISSN 0020-5346, Nomos Verlagsgesellschaft, Baden-Baden, Vol. 29, Iss. 3, pp. 147-156, <https://doi.org/10.1007/BF02926352>

This Version is available at:

<https://hdl.handle.net/10419/140454>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*

Klaus Bolz and Andreas Polkowski\*

# Trends, Economic Policies and Systemic Changes in the Three Baltic States

*The almost total collapse of the old trade relationships with the other republics of the former Soviet Union has meant serious problems for the breakaway Baltic states of Estonia, Latvia and Lithuania. What progress have these countries been able to make so far on their way towards a market economy? Are the problems likely to get worse before they get better?*

During the period of their independence (1918-1940), Estonia, Latvia and Lithuania already had relatively well-functioning market economies with their own currencies and intensive economic relationships with western Europe. The three economies were largely agrarian, although in Estonia and Latvia industry was already well-developed and diversified; examples are photographic and radio technology, mechanical engineering, the textile, leather and foodstuffs industries, wood processing etc.

Their inclusion into the Soviet command economy put an abrupt end to the independent development of the Estonian, Latvian and Lithuanian economies. Taking hardly any account of this region's comparative advantages, Moscow realized diverse large projects; in the course of this, existing industrial plants were expanded and others were newly established. These industrial plants were largely dependent on supplies of raw materials and other inputs from other Soviet republics. The majority of the consumer and capital goods produced served the "planned" supply to the entire Soviet Union.

While the territories of Latvia and Lithuania were each only 0.3%, and that of Estonia 0.2%, of the entire USSR, and their populations 0.9%, 1.3% and 0.5% respectively, their shares of the produced national income of the Soviet Union were 1.2%, 1.3% and 0.8% respectively. The shares of the individual Baltic states of the USSR's industrial production were considerable: 1.2%, 1.5% and 0.7% respectively. For individual products the figures were

much higher. In Latvia, for example, 57% of all the mopeds made in the former Soviet Union were produced, 53% of the telephones, 31% of the railway passenger coaches, 20% of the small buses, 17% of the radios, 16% of the diesel engines and generators. A similar list could be presented for Estonia and Lithuania. The Baltic states obviously played an important role in the economy of the former Soviet Union.

Because of this high level of integration with the other Soviet republics, the breaking away of the three Baltic republics from the Soviet Union and the almost total collapse of the old trade relationships has meant serious problems for these countries on their way to the market economy and democracy.

## First Signs of a Recovery

Following the deep recession in 1991-1992, there are some first signs of a trend towards recovery in 1993 – at least generally speaking – in the economies of Estonia and Latvia, and possibly also Lithuania. The individual countries find themselves at varying distances from the end of the tunnel, however, as can be seen from several major indicators.

Similarly to other formerly socialist countries, *Latvia* suffered a strong decline in gross domestic product (GDP) and in industrial production at the beginning of the transformation process. There are already some signs, however, that the fall in GDP slowed down in 1993 and has meanwhile come to a standstill. Although GDP in 1993 still fell by 20% in real terms for the year as a whole, this is a relative improvement compared to 1992, which showed a decline of 34%. The trend towards stabilisation becomes clearer if GDP trends from quarter to quarter are examined. After GDP had fallen in the first quarter of 1993 by 18% compared to the last quarter of 1992, it grew

\* Hamburg Institute for Economic Research (HWWA), Germany. Unless otherwise specified in the text, the data mentioned in this paper are based on research which the HWWA Institute has conducted at regular intervals in the countries concerned in connection with reports produced for the Federal Economics Ministry. The sources range from official and internal bulletins, analyses, statements and discussions with the national statistical offices, ministries and central government bodies, and banks to current newspaper articles.

surprisingly in the second quarter of 1993 at about 8% in real terms and its volume then settled at almost that level in the third and fourth quarters. Actual GDP is possibly higher than that shown by the statistics, as the private sector is only partly included. Nevertheless, even if the economic situation as a whole has become more stable, economic policy-makers cannot be satisfied with this result, as real GDP in 1993 was still only half that of 1990.

Since industrial production, at a real growth rate of -36%, has declined much more strongly than GDP as a whole, while the decline in services and in agriculture and forestry has been below average, the relative weight of the different sectors within GDP has changed considerably. At 1993 prices the share of services rose to almost 54% (42% of GDP in real terms; the 1990 figure was 30%), while the share of manufacturing fell to about 22% and that of agriculture to 15%. These shifts can be explained in particular by the fact that the process of the restructuring of industry is only in its beginnings and the propensity to invest in this sector is still low. The fact that the services sector has made the greatest contribution to GDP is completely in line with the structural policy aims of the Latvian government, namely to give high priority to the development of trade, transport, telecommunications, tourism and banking and stock exchanges.

The second hopeful sign of the emerging change in Latvia is the moderate price trend. As a result of strict monetary and fiscal policy the rate of inflation in 1993 was reduced considerably compared to that of 1992, namely to about 35%. One year earlier the consumer price index showed a rate of over 1,000%. In the first nine months of 1993 the average monthly rate of inflation was only 1.5%. In the fourth quarter the average monthly rate increased to 6.2% due to extraordinary influencing factors. The newly

introduced turnover tax of 18% as of 1st November 1993 was partly responsible, as were certain cyclical demand and supply factors: the supply of agricultural goods became scarce in that period and in the second half of the year average wages grew faster than the rate of inflation. Latvia's result for the year as a whole is not at all bad compared to the other transforming countries of central and eastern Europe. Only the Czech Republic (18%) and Slovenia and Hungary (23%) had lower inflation rates. Latvia has a similar inflation rate to those of Estonia and Poland. Latvia's neighbours are struggling with much higher rates: Lithuania 188%, Russia just below 1,000% and Belarus about 1,700%.

The volume of Latvia's foreign trade increased by more than 20% in 1993 and reached a value of 1,349 m lat. Despite the high exchange rate of the lat an export surplus was achieved over the year as a whole. Countries from the CIS play a lesser role in trade than previously, but they are still important. Russia alone accounted for almost 30% of Latvia's total exports and 29% of its total imports. Trade relationships with the EU have grown closer: these achieved a share of almost 25% of exports and a good 17% of imports. Since exports and imports are both larger than 50% of GDP, foreign trade is of great importance for the development of the Latvian economy.

**Favourable Trends**

Although in the case of *Estonia* the calculation of GDP has continually run up against statistical problems, it is justified to state that the downward trend in the Estonian economy clearly eased off in the course of 1993. In the third quarter GDP grew by about 5% compared to the previous quarter. For 1993 as a whole the Economic Commission for Europe (ECE) names a decline of only 2%. For the current year a turn-around in the trend for the economy as a

Peter-Christian Müller-Graff (ed.)

**East Central European States and the European Communities:  
Legal Adaptation to the Market Economy**

The legal adaptation in East Central European states to the market economy of the European Communities is treated in four parts:

- Law as the basis of the market economy of the European Communities
- features and problems to the legal adaptation to market economy in Czechoslovakia, Hungary and Poland
- Common Market Law aspects for privatization and public enterprises, deregulation and the protection of public goods and interests, competition and industrial policy
- the cooperation between the European Communities and East Central European states.

The author analyses these different aspects and gives a well-based overview of these problems of adaptation.

1993, 235 p., paperback, 48.- DM, 338,50 öS, 43,50 sFr, ISBN 3-7890-3135-6

(ECSA-Series - European Community Studies Association - Europe / Association pour l'Étude des Communautés Européennes, Bd. 2)



NOMOS VERLAGSGESELLSCHAFT • Postfach 610 • 76484 Baden-Baden



whole is held to be possible and officially 2-4% growth is expected.

Real industrial production in 1993 was characterized by strong fluctuations. According to the recent ECE report industrial production for 1993 as a whole showed a decline of about 27% due to the slump in production in the second half of the year. While further structural adjustment will be necessary before a recovery in industry, or in the agricultural sector, takes place, positive growth rates were already achieved in 1993 in the services branches of tourism, trade and transport. Estonian forecasts assume that industry will also show positive growth figures in 1994.

As in Latvia, the rise in prices in Estonia was moderate in 1993; the average monthly rate of inflation until August was only a little over 2%. The price increases are due primarily to recent trends in the services sector. For the last four months of 1993 the average rate of inflation increased to 3.4%. For 1993 as a whole the inflation rate was about 35%.

Estonia's foreign trade has continued to show favourable trends. In 1993 exports were 10.6 bn EEK at current prices, and imports were 11.9 bn EEK. The import surplus of 1.3 bn EEK shows that the country's export industry is still competitive only to a limited extent and that domestic enterprises have large modernization requirements. The balance of trade deficit in the case of Estonia should not be seen negatively, however, particularly since the overall balance shows a positive picture due to the continuing surpluses on the services balance and to the capital balance. The trend towards a regional reorientation of both exports and imports away from the former Soviet Union is reflected in the changing shares of this trade. Russia's share of exports and imports today is only about 20% each.

### Improvement in Trends

*Lithuania's* government believed it was able to recognize the first signs of a stabilisation in economic trends in the autumn of 1993. In October it was assumed that a decline in GDP of 17% could be expected for 1993; that would be half the rate of decline in 1992. The ECE annual report also names -17% as the rate of growth realized by GDP in 1993 (1992: -39%). The in part rather optimistic forecast of a slight growth in GDP for 1994 (+ 1.5%) is based essentially on Statistical Office data on industrial production for January to August 1993. Taking into account that industrial production in 1993 as a whole fell by 46%, it is more likely that there will again be a certain decline in GDP in 1994.

The improvement in trends in the Lithuanian economy is also expressed in the inflation rate: while in 1992 prices

increased by 1,160%, the figure fell to only 188% in 1993. This inflation rate is still high enough, however, to impede a turn-around in trends in the economy. A further stabilisation of the price level is therefore imperative.

As in the cases of Latvia and Estonia, Lithuania's trade with western countries showed a positive trend in the first half of 1993 and achieved a surplus of almost US\$ 80 m. An almost equally large surplus of US\$ 70 m was achieved in trade with Latvia due to deliveries of crude oil. The fact that the total balance of trade surplus was only US\$ 23 m is due to the deficit of more than US\$ 140 m in trade with the CIS countries. In the first half of 1993 the CIS countries were Lithuania's most important trading partner. Russia alone accounted for 46% of imports and 24% of exports on the basis of 1993 as a whole.

The free trade agreement drawn up between the three Baltic states will facilitate bilateral trade considerably due to the definitive removal of trade barriers, but it will at first provide only moderate stimuli to the growth of the three economies; nevertheless, the increase in competition will be of benefit to the transformation of all three economies. Of greater importance is the agreement with the EU which is to be concluded in the course of 1994. The accession of their Scandinavian neighbours (Finland, Sweden and Norway) to the EU, scheduled for January 1995, will accelerate the conclusion of the free trade agreement between the EU and the Baltic states.

### National Currencies

Soon after gaining independence the Baltic states recognized that the stability of the value of money is an important precondition for economic growth and structural change. All three countries therefore worked out, with the help of the IMF, stabilisation programmes designed to suit the individual situation of each country. The instruments of monetary, exchange rate and fiscal policy were shaped differently from country to country. Since following independence in all three countries the Russian rouble continued to fulfil the function of money, although it was suffering from a rapid fall in value because the Russian central bank was issuing money in an uncontrolled fashion, the establishment of an independent monetary policy was regarded as the most urgent task; this meant breaking away from the Russian rouble.

In *Estonia* the break took place in the form of the introduction, without any intermediate steps, of the Estonian kroon (EEK) as the only legal tender. This was already done on 20th June 1992. Estonia's path to currency reform was unusual. In order to exclude from the beginning the danger of an uncontrolled money supply and to reinforce the confidence of economic agents in the

currency, several measures were taken: the EEK was coupled to the D-Mark at a fixed rate of 8:1. This exchange rate can only be changed with the consent of parliament. It is laid down in law that the central bank money supply must be covered to at least 100% by reserves of gold and foreign exchange. The Estonian central bank's room for manoeuvre is thus very limited. In the Estonian model changes in the supply of money are essentially linked to the balance of payments situation. Although the Estonian stabilisation policy has been successful until now, the question must already be put as to whether this system will be able to supply the adjusting and growing Estonian economy with the quantity of money it requires.

*Latvia* achieved its monetary policy independence by first of all replacing the Russian rouble with the Latvian rouble in May 1992 and then in a second step in March 1993 creating the lat as independent national currency. Latvia today is a country in which there are practically no limitations to the purchasing, ownership or selling of foreign currencies. Anyone can hold an account in Latvian or foreign currency and do as he/she sees fit with it. Latvian legislation and the policy of the Latvian central bank allow the free flow of capital. This means that foreign investors can transfer their profits to their home country in any currency they wish without limitations. In brief, the lat is convertible, stable and in the course of 1993 it was able to improve its rate of exchange with other convertible currencies by about 26%.

Because of the relatively low inflation rate, the high interest rates for deposits in lat and the stable monetary and banking system, as well as the liberal monetary policy and the positive development of the private sector of the economy, the flow of convertible currencies to Latvia has grown rapidly. The volume of foreign exchange bought by the Latvian National Bank increased heavily, especially in October and December 1993. In the course of their purchasing foreign currencies, Latvia's banks are closely involved in laundering money of doubtful origin. The "hardness" of the lat is meanwhile giving cause for concern as its negative consequences for Latvian exporters can no longer be ignored.

*Lithuania* attempted to achieve monetary independence by replacing the Russian rouble completely on 1st October 1992 by the talonas, a sort of substitute money. A too liberal monetary policy and a lack of confidence in the talonas led to a continuous devaluation of this auxiliary currency. It was not until 25th July 1993 that the step to a new national currency, the litas, was taken. Lithuania was altogether much more hesitant about the introduction of a national currency than the other two states. The discussion on the Latvian currency continued

after the litas had been introduced. As a result of this discussion, in the spring of 1994 Lithuania decided to introduce a currency board system – which Estonia had already done when it introduced the Estonian kroon – and tied the litas as of 1st April 1994 at a fixed rate of 4:1 to the US\$. The Lithuanian government and National Bank hope with this step to free themselves from the pressure to devalue which they had previously been experiencing. The currency board system will only be able to endure if Lithuania follows a strict monetary and fiscal policy which puts the Lithuanian economy on a stable course as soon as possible. The latter is also a precondition for the economy to be able, in the course of the adjustments it will be facing, to move into a phase of growth in the foreseeable future.

### Employment Trends and Problems

The three Baltic states were economically very closely interlinked with the other Soviet republics. The employment situation in these three countries is therefore particularly strongly affected by the loss of markets in the CIS states and of course, as is the case in all the reforming countries, by the process of adjustment necessitated by transformation. It is true for all three countries that the statistics presented can only give a limited picture of the real situation with regard to employment or to unemployment trends. Even if an increase in unemployment is reported for one country and a decline in unemployment for another, in reality trends in precisely the opposite direction can be taking place. It is extremely difficult to determine the real extent of unemployment in these countries because the figures do not reflect the vast amounts of hidden unemployment. Enterprises, which are still largely in the hands of the state, are usually hesitant to dismiss workers despite falls in production. Instead, they reduce wages, give the workers holidays without pay or offer them short-time employment for correspondingly lower wages. The management of these state-owned enterprises does not act in this way purely out of feelings of social responsibility, wishing to protect their employees from unemployment. They wish by this means to hold on to highly qualified workers for better times. Furthermore, dismissals mean high costs for the enterprises involved if, as in Latvia, the law defines that every dismissed worker has the right to compensation (until the end of 1993 this was three months' wages, but now it is only one month's). The enterprises do not have the necessary funds for this.

In *Latvia* there are plants which have been unable to pay their workers any wages for several months. In positive cases these workers are paid in kind, so that they can then sell the goods they receive. The figures on the situation on the Latvian labour market must therefore be adjusted quite considerably upwards if one wishes to have a picture of the

actual number of unemployed. At the beginning of 1993 there were officially 31,300 unemployed (2.1%). By the beginning of October 1993 this figure had more than doubled to reach 73,600. At the beginning of February 1994 more than 100,000 persons were already registered as seeking employment, of which 82,000 were recognized as unemployed (6.1%). Taking account of hidden unemployment, the Centre for Employment in Riga estimated the actual number of unemployed on 1st February 1994 at 113,000 (8.5%). Although it is difficult to forecast labour market perspectives in the general situation existing in Latvia, an unemployment rate of up to 15% is no longer regarded as unrealistic. The Latvian government is making an effort to counter this trend by trying to avoid too radical structural changes in certain sectors of the economy for a while and by not forcing privatisation on a grand scale too rapidly. In the medium term, however, even state enterprises will prove unable to avoid the pressure exercised by the market economy and the resulting efficiency constraints, and they will be forced to dismiss superfluous labour. The continuation of the strict monetary and fiscal policies will also increasingly force enterprises to dismiss workers, so that a very strained situation will develop on the labour market which will require appropriate efforts to expand and finance social security.

### Inadequate Statistics

The actual situation on the labour market in the case of the much smaller *Estonia* is also unclear because the employment offices only issue inadequate statistics. The following information was supplied by Estonia's statistical office: while only a few unemployed were registered until February 1992, the number rose rapidly from then until May 1993, reaching 22,309 by 1st May. Since May 1993 there has, surprisingly, been a decline in unemployment in Estonia and on 1st September 1993 there were only 16,151 registered unemployed. This is equivalent to an unemployment rate of 1.8%.

Economic estimates based on surveys assume that a large share of the unemployed do not register at the labour offices. They assume the actual rate of unemployment to be higher. For the first quarter of 1993 the unemployment rate is estimated at 9% and for the second quarter at 8.6%. The special regulations concerning the registration of the unemployed and the low incentives for workers to possess the status of a registered unemployed person are the main reasons why those looking for work often do not turn to their labour office. This is probably also the most important explanation for the fact that the statistics show a decline in unemployment since May 1993. The decrease in the unemployment figures in Estonia are certainly also an

expression of a seasonally higher requirement for labour in agriculture and in particular in the blossoming tourist industry. The hidden unemployment already mentioned above must be pointed out again here. In Estonia this takes the specific form of workers on short-time or on unpaid holiday. This is particularly the case in the industrial sector, in which in the first seven months of 1993 almost 27,000 workers were forced to take unpaid holidays. Official estimates in the autumn of 1993 forecast between 25,000 and 30,000 unemployed for the end of 1993. The forecast at that time for the end of 1994 was even 40,000 unemployed. The loss of jobs is taking place especially in heavy industry, since the enterprises in this sector still find themselves at the beginning of the adjustment process.

It remains to be said that the employment situation in the capital city of Tallinn, where more than one third of Estonia's labour force is employed, is relatively good. This is due to the fact that the establishment of new enterprises takes place mainly in the economic centre of Tallinn. With 771 unemployed at 1st September 1993 Tallinn had an unemployment rate of only 0.3%.

### Increasing Role of the Private Sector

In *Lithuania*, too, the labour market and employment situation is not completely clear. Up till October 1992 the number of those seeking work and the number of unemployed grew only slowly to reach 25,800 and 12,700 respectively. After that the number of those seeking work rose rapidly, reaching a peak at over 100,000 in April 1993, then fell again slowly to somewhat more than 70,000 in August 1993. Although the number of registered unemployed continued to rise, from March to August 1993 it remained at around only 30,000, thus staying relatively constant at a moderate level throughout the second quarter. At the beginning of December 1993 there were 30,800 registered unemployed. This is equivalent to a rate of 1.6%. The number of unemployed who found employment in 1993 showed a positive trend compared to 1992. While in 1992 on a monthly average between 2,000 and 2,500 persons found employment, the corresponding figures for April to August 1993 were between 3,300 and 4,300 persons. Of the 5,845 vacancies on 1st June 1993, almost 1,000 were in the services sector. The demand for bookkeepers, office workers, computer specialists and highly qualified construction workers is a sign that there have been certain successes in the restructuring of Lithuania's economy and that, in addition, the private sector is playing an increasing role as employer.

The increase until now in the number of those seeking work can be explained among other things by the reduction in employment in the state sector and by the ongoing

transformation of former state enterprises into joint-stock companies. The decline in the number of those seeking work in the summer of 1993 cannot be explained by the slight increase in the number of those for whom jobs were found. The explanation is to be found, rather, in the fact that unemployed persons increasingly seek employment in the private and informal sector, and partly in the fact that many people give up looking for employment.

All these figures do not show one thing, namely that Lithuania, too, is struggling with the problem of short-time working, especially in the state enterprises. Officially there were approx. 75,000 short-time workers in autumn 1993. It is assumed that at least 30% of all jobs in the state sector are in grave danger of being lost. There are also a large number of workers who have been given holidays without pay. In Lithuania, too, the phenomenon can be observed that many enterprises postpone dismissals in order to avoid compensation payments. On the other hand, the workers are also interested in at least formally remaining in employment in order to enjoy the benefits accruing to them in the course of privatisation, should this take place. As soon as privatisation in Lithuania is advanced and completed at a more rapid pace, however, and the harder the budget restrictions applied to enterprises, the greater will be the increase in unemployment. The same applies to Lithuania as basically to the other two Baltic states, namely that the altogether remarkably low rate of unemployment is not so much an expression of a successful transformation policy as of the fact that the inevitable structural changes in the economy have been begun hesitantly, or not at all, in many sectors.

### **Structural Policy**

As in other formerly planned economies, the transformation to the market economy in the Baltic states entails severe structural changes. Compared to Estonia, the former government in Latvia has exercised a somewhat stronger influence on the adjustment process. It has done this not least in order to prevent enterprises which are held to be capable of surviving being forced to give up too soon. Secondly, it has been the intention of the Latvian government (both before and after the election of June 1993) to allow the dismissal of workers to take place only in small steps in order not to put too much of a strain on the existing social system and to enable the dismissed workers to be transferred into the new structures which are gradually developing, particularly in the private sector.

The structural policy concepts developed by individual ministries and political parties in the course of 1993 have been combined into a programme by Birkavs' new government. This government programme is

characterised in particular by the concept of the most influential party, "The Latvian Way". The government sees the main objective of structural policy as being to ensure Latvia's competitiveness in the long run, particularly in the light of possible integration into the European Union.

The restructuring of the Latvian economy is intended furthermore to help overcome Latvia's one-sided political and economic dependence, above all on Russia. The government programme foresees support for the creation of a broader range of goods produced in Latvia, particularly research and technology intensive products. Further priorities are to lie in the development and safeguarding of the energy supply and in the expansion of infrastructure especially in the fields of communication, transport and tourism, as well as in the judicial and institutional transformation of the economy.

In the Cabinet's statement of its intentions with regard to the economy, the development of the agricultural sector is given a high priority as agriculture has traditionally been of great importance in Latvia. On the one hand Latvia wishes, at least in principle, to be able to produce largely enough foodstuffs to supply its own population. But it is also recognized that an increase in competition among agricultural goods will lead to the application of more effective methods in agriculture, which means that fewer people will be able to find employment in the agricultural sector. At the same time this means that attention must be paid to the creation of new branches of the economy in rural regions which can provide employment opportunities. In other words, regional policy plays an important role in the economic programme of the Latvian government and follows the goal of creating similar living conditions for the population everywhere by means of a balanced development in the various regions of Latvia.

### **Three Stages**

In the first stage of the realization of this structural programme the emphasis is on the utilization of existing strengths for the development of the economy and, by means of a rather cautious policy, to prevent enterprises which would be capable of surviving in the medium term and which are important for the economy from going bankrupt too soon. Also in this stage, trade, transport, telecommunications, tourism and the banking system are to be developed further. In the course of an accelerated small-scale privatisation a network of small and medium-sized enterprises is to be established as the foundation for the transformation to the market economy. Fundamental structural change in industry, agriculture and in the areas of the economy linked to agriculture is not intended during the first stage. Even large-scale privatisation is not to take

place too rashly, but successively under the increasingly improving conditions of a functioning market. One serious problem which must be solved quickly before privatisation takes place is the defaulted borrowings of many enterprises.

In the second stage the emphasis is to be on the development of those branches of industry in which Latvia has comparative advantages, e.g. the textiles and clothing industry, and selected areas of electronics. The development of these branches of industry, which are characterised by a relatively low consumption of energy and materials and which have highly trained workers at their disposal, is to take place in parallel to a re-orientation towards the markets of western, central and northern Europe. It is optimistically assumed that the Latvian textiles and clothing industry as well as some branches of electronics will indeed be able to compete successfully on these markets against products from the Middle East (Iran, Iraq, Turkey) and other developing countries (Egypt, India, Pakistan). It is hoped that it will prove possible to sell technically simple but qualitatively good Latvian mechanical engineering and metal-working products to the developing countries which are suffering from financial problems and cannot afford high technology from the West. Whether this will work out, will depend for one thing on the development of wage costs in Latvia and for another on the Latvian exporters' possibilities of granting credit. In this stage the economic relationships with the CIS states are to be "rationalized", i.e. energy and material intensive products are to be replaced by technology intensive ones and priority is to be given to trading partners in nearby regions and countries.

The third stage of the structural programme aims at modernizing the technology of productive capacity. Not until this stage are the enterprises to be exposed fully to competition and the bankruptcy laws to be fully applied. The state sees its task here as being above all the creation of a favourable general framework, and wishes to avoid violating the rules of the emerging market economy by direct intervention. In any case, the state budget deficit hardly leaves any room for expenditure on structural policy. These stages are not intended to be implemented in chronological order; rather, the implementation of the Birkavs government's economic programme will lead to a complex overlapping.

### **International Assistance**

The assistance granted to Latvia from abroad and the funds from international financial organizations largely fit into the structural policy of the Latvian government. This is obviously true of the loans from the World Bank. The first of

these, to the tune of US\$ 45 m for a period of 17 years will be used for the benefit of the development of the energy sector and the pharmaceutical industry (US\$ 15 m each), for agriculture (US\$ 14 m) and for the services sector (US\$1 m). In addition to aid from the World Bank, Latvia has also received a loan from the European Bank for Reconstruction and Development (EBRD) to the tune of US\$ 36.7 m for a period of 10 years for the development of the energy sector. Moreover, the EBRD is explicitly prepared to increase its involvement in Latvia even further. This is the case in particular with regard to further energy projects, the link to Eurovision and the expansion of Riga airport. At present in the examination/negotiation phase are participation in the planned Daugava Hotel and the renewal of the navigation equipment at Riga airport. The funding of the Via Baltica projects and participation in the capital stock of the Latvian Investment Bank can be regarded as certain. It can be seen from the involvement of the EBRD, as well as from Latvia's loan contracts with the European Investment Bank and with Japanese, Finnish and other commercial banks, that Latvia has achieved a good credit standing, probably due in particular to its strict monetary policy and to its successful cooperation with the IMF and the World Bank.

The governments of *Estonia* and *Lithuania* have of course also laid down their ideas concerning structural development in their economic programmes formulated with the assistance of the IMF. They have in common their recognition of the fact that many enterprises which today are still in the hands of the state will only have a chance of survival in the market economy if they succeed in changing the structures determined in the past by the plan and in directing them towards the requirements of domestic and foreign markets. In all three Baltic states the question is being discussed as to whether it should be the task of the state to determine future production structures by influencing them either directly, or indirectly by means of special support programmes. Structural policy is formulated correspondingly carefully. All three governments are endeavouring to create the best possible conditions in the newly emerging market economies for private, market-oriented decisions with regard to production. If the Baltic governments do argue in individual cases that the production of certain goods or services should be conducted by the state, or that it should be strongly influenced by means of various instruments, then they shall, as a rule, have to justify this with social, political, security, regional policy or other goals which are shared by society as a whole.

The structural policy in the Lithuanian government's programme of end-March 1993 is intended basically to create a general framework. The guidelines laid down for



structural policy are largely the same as those of the Latvian government, which are described in detail above. In addition to relatively general declarations of intent concerning structural change, the Lithuanian programme also contains specific projects, not the least important of which is that to secure energy supply.

#### Decentralised Privatisation

In the Baltic states, the transformation of the legal situation with regard to property rights is among the most important, and at the same time most delicate, questions in the transformation of the economic system. Basically, associated with privatisation are expectations that the economy will become more dynamic as a result of the increase in self-responsibility and individual effort.

Up until the present the process of privatisation has proved a difficult one, particularly in *Latvia*, because

interest groups continually attempt to influence the extent, speed and methods of privatisation. The decentralisation of privatisation, which is anchored in the present legislation (the ministries and the local administrations are responsible), led to a considerable bureaucratisation of the entire process and thus – at a low level – almost to a standstill. Each individual case of privatisation had to go through several stages and institutions. According to information from the Ministry of Economics, at the end of September 1993 there were 193 privatisation commissions in the areas of industry, transport and construction alone. Many of these commissions were characterised by a lack of adequate technical knowledge and a low level of commitment.

In the fields of industry, transport and construction only six enterprises were privatised by the end of 1992. A breakthrough was planned for last year: the government had put a total of 703 of the over 2,000 state enterprises on

Pedro T.B. Assunção/Harald Fuhr/Brigitte Späth

## Internationale Organisationen, Entwicklungsverwaltungen und Kleingewerbeförderung in der Dritten Welt

The success or failure of development projects depends to a large extent on the participating administrative units which shape the content of development policy and implement it in specific terms. This applies equally to both donors and recipients.

With the aid of examples of promotion of small-scale industry by the World Bank and UNIDO, this study shows that there are considerable differences as regards both the method of incorporating the promotion of small-scale industry in a specific performance range and as regards the relevant organizational arrangements under which the measures are to be implemented. Case studies from Ecuador, Peru, Zambia and Senegal make clear that little success has been achieved as regards promoting the small-industry sector on a wide and lasting basis by means of national economic policies and traditional administrative structures.

This comparative study indicates that the observable "inefficiencies" of development cooperation can be completely eliminated. However, policies can be effective only where, in addition to undertaking internal management reforms, both donors and recipients succeed in improving the efficiency of the administrative environment.

1993, 333 pp., paperback, 68,- DM, 479,50 öS, 62,- sFr, ISBN 3-7890-2829-0



NOMOS VERLAGSGESELLSCHAFT  
Postfach 610 • 76484 Baden-Baden



the privatisation list. But by mid-October 1993 only 19 of them had been privatised. According to more recent figures, by 1st January a total of 46 large enterprises in industry had been privatised, or 20% of those for which privatisation was intended. Half of them became limited companies and the other half joint-stock companies. Until now most of the enterprises released from state ownership have not even been sold, but leased – albeit with the concession of right of first refusal. It is not surprising that the greater part of industrial production, namely about 70%, continues to take place in state enterprises.

Privatisation in the field of agriculture includes both the transformation of property rights with regard to land and the selling of agricultural enterprises and processing plants to private owners. On the basis of the Law on the Privatisation of Real Estate in Rural Areas of 9. 7. 1992 the number of private farms and individual part-time farms has increased markedly and reached 53,800 and 106,200 respectively by 1. 9. 1993. By that date 54% of agricultural acreage had been transferred into private hands. Land was returned primarily to its previous owners or given to the workers of the dissolved communal farms, although in the latter case it was only leased. The purchase of land for agricultural purposes, although only by residents of Latvia (foreigners are temporarily excluded), was going to be introduced in 1993. Up until 31st December 1996 land can only be purchased with vouchers, from 1997 to 2000 with vouchers and money and after that only with money. The distribution of vouchers to the Latvian and non-Latvian population began in August 1993.

The privatisation by means of vouchers is intended, taking account of the weakness of domestic capital formation, firstly to create an artificial class of property owners, and secondly to reward the contribution of the residents of Latvia to the formation of national wealth in the past. The aim is also to involve broad layers of the population in the transformation process. First experience shows, however, that the government has not achieved these objectives. Slow and inconsistent privatisation contributed to the early owners of vouchers losing any hope of ever being able to purchase property, and they have parted with their vouchers. As a result the market price of a voucher (nominal value 28 lat) fell to 0.5 lat in only a few days. In September and October the price settled at one lat per voucher. The confidence of the population in the vouchers, and thus their market price, will only increase if the government lays down practicable and clearly defined purposes for which the vouchers can be used. At present there are still no regulations for the purchase of residential property or of land in urban areas, nor for the purchase of capital shares in state enterprises etc.

In order to accelerate the privatisation process in Latvia – which not a few believe to be a utopian idea due to the existing constellation of power – and to make it more effective in future, it should be reorganized from scratch. From decentralization to the centralisation of privatisation must be the motto. For this purpose the Privatisation Law of March 1994 has set up an almost 100 person strong privatisation agency in the form of a limited company under the Ministry of Economics. This agency should have started work by now.

### **Sale by Tender**

In *Estonia*, too, the privatisation process was characterized from the beginning by economic policy controversies, particularly regarding the question of the return of property. The first legal basis for the transformation of property relationships was established by the Law on Small-scale Privatisation of 13. 12. 1990. Legislation on large-scale privatisation was not passed until August 1992. Due to complex problems in the course of the privatisation process, in July 1993 the so-called Privatisation Law came into force, which foresaw a merger of the Estonian Privatisation Agency and the Estonian State Property Agency, which had operated in parallel until then, into a single privatisation agency. The tighter organisation of privatisation activities put an end to the institutionalized division of competences between the so-called small-scale privatisation for objects with a value of up to 600,000 EEK (Estonian State Property Agency) and large-scale privatisation (Estonian Privatization Agency). The sale by tender on the basis of the new law – the third sale by tender altogether – began at the end of October and includes for the first time a mixture of small and large enterprises. Within the frameworks of the first and second international sale by tender 45 enterprises were privatised by the end of December 1993. The small number of purchasers from western countries – only one German and one Finnish firm and two companies from Sweden obtained contracts – is possibly due to the fact that nationals operated as “frontmen” for the purchase of enterprises because they can obtain better payment conditions.

In 1993 small-scale privatisation has also made further progress; according to provisional data by the privatisation agency about 240 enterprises have been transferred to private hands. This means that about 80% of the privatisation in the trade and services sector has been completed. Of the smaller enterprises in the field of production about 60% are meanwhile counted as privatised. (Many of these privatisations are still afflicted with problems, however, as various laws have been infringed.)

Approximately 2,200 enterprises have emerged from the forced restructuring of large farms in April 1993 according to estimates by the Ministry of Agriculture in August 1993; the number of private farms has thus increased to over 10,000. (The question of property rights with regard to the land has still not been settled for most of these farms, however.)

Whereas it can be expected that the transformation of property rights in the services sector will continue to make rapid progress, a slowing down of the speed of privatisation for parts of small industry and some large enterprises is to be expected due to unsettled property rights. In order to increase the speed of privatisation it is also necessary to amend the law passed in summer 1993 and possibly to supplement the privatisation to date by means of large-scale sales by tender by new methods.

### Vouchers

In contrast to previous expectations that the *Lithuanian Democratic Labour Party*, which emerged from the former communist party, would put a brake on the transformation process, i.e. in particular on privatisation, following its coming to power in December 1992, the new government confirmed that it would rapidly speed up the privatisation of state enterprises and complete this task by July 1994. Large enterprises are to be privatised by means of vouchers. (In Lithuania every citizen over 18 years of age is to receive investment cheques to the value of 10,000 tallons = 100 litas.) Employees in the enterprises to be privatised will be given priority. Many managers do not expect the voucher method to do much for the development of their enterprises, since they bring neither new capital nor know-how.

At mid-1993 the state of privatisation was as follows: measured by the number of objects, 66% of enterprises were privatised; measured by the value of the enterprises to be privatised the figure was scarcely one third. The success of privatisation via purchases with hard currencies – a procedure which was intended from the beginning to be given a chance as a legal method of privatisation and which the new government intends to place more emphasis on than in the past – has until now remained slight; state enterprises to the value of only 15 m litas have been sold for hard currency, of which three properties went to foreigners.

At the present stage it is not to be expected that it will be possible to complete the privatisation process by July 1994, as the law foresees. Many of the privatisation cases to date have been take-overs of enterprises by their employees (to a maximum share of 51% of the capital stock), which may indeed have speeded up privatisation to

begin with, but on the other hand other buyers have thus been discouraged, and possibly are still being discouraged, from purchasing. It is also probable that the shadow economy or the mafia has its hand in not a few privatisations.

It is presently being discussed in Lithuania whether the process of privatisation should be extended by about 1 1/2 years beyond the period for which the present law is valid. Another possible solution to the problem would be to leave those state enterprises which have not been privatised by July 1994 (total value 230-250 m litas) in the hands of the state. The latter would mean that vouchers which have not yet been redeemed (after all, that is more than 50% of the number distributed to the population) would have to be converted into state bonds.

Privatisation in the fields of trade, services and small production seems to have been carried out successfully until now. The privatisation of agriculture is further advanced than in the other sectors of the economy; measured by value, on 1st July 1993 83% of the privatisation programme had been completed. It took place mainly through subscriptions to shares by means of vouchers and only to a small degree via the auctioning of agricultural enterprises or parts thereof. Approximately 20% of agricultural acreage was privatised by the return of the land to its previous owners or their heirs.

### Outlook

In the barely three years since achieving independence from Moscow, all three Baltic states have already succeeded in going quite some way along the path towards the market economy, i.e. they have, in particular, created the legal and institutional framework for a market economy. All three countries now face the task of making progress in the restructuring of their economies, which is essential for future growth, by accelerating privatisation, developing a capital market, ensuring competition, improving the fiscal system etc. Privatisation plays a key rôle among these tasks. In order for enterprises to be able to achieve the productivity necessary to survive, they must be granted more flexibility with regard to their labour force. The government's answer to the dismissals and job changes which can be expected to take place within the economy will have to be the expansion of its labour market policy instruments and of the social security system. In other words, the success of transformation and of the commencement of a phase of growth will depend in all three countries on the extent to which they succeed in coordinating national economic policy on the one hand with labour market policy, educational policy and social policy on the other.