Economic changes in Lithuania after re-establishment of independence in 1990: the case of a double transition

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The outline:

• The context;
• The main legal and political steps;
• Re-regulation of relations with the former center;
• Political economy of sovereign policies;
• Institutional quality and economic growth;
• Concluding remarks.
Litva (Grand Duchy of Lithuania) – in “half-forgotten Europe”
Grand Duchy of Lithuania around 14th cent.
ELECTRICITY SYSTEM
The context:

• History of statehood, most recently interwar period (1918-1940);
• Geopolitical situation in mid-1980s in Europe, perestroika in the Soviet Union used as an opportunity for reforms;
• Movement for Reform established in June 1988 with growing popular support (i.e. “Baltic Chain” of 2 million people holding hands from Vilnius to Tallinn on August 1989; rock marches, basketball games);
• The initial objective of sovereignty “within the Soviet Union” was in 1989-1990 modified to the goal of complete sovereignty
• In 1989, around 80 percent of population were Lithuanians, only 12 percent were Russians and around 7 percent Polish.
Legal and political steps (I):

• In February 1990, first free elections to the Supreme Council took place were Independence Movement and Lithuanian Communist Party had their candidates with the former winning absolute majority;
• Laws were adopted to drop SSR from LSSR, its state symbols (national flag, etc.) changed to restore prewar ones;
• In March 11, 1990, the act on re-establishing independence of Lithuania was adopted;
• The Constitution of 1938 was briefly adopted, very soon replaced by temporary Constitution to be replaced by a new one adopted by referendum in October 1992.
Legal and political steps (II):

• The Act adopted with the Constitution of 1992 states that Lithuania resolves “never to join in any form any new political, military, economic or other union or commonwealth of states formed on the basis of the former USSR”;
• After March 11, 1990, Lithuanian leaders attempted to get international recognition, but the first diplomatic recognition came only on February 1991 by;
• Majority of other countries started recognizing Lithuania only after August 1991, year and a half after declaration of independence.
Re-regulation of relations with the former center (I):

• In the Soviet Union, the Lithuanian economy was completely integrated into the centrally planned system run from Moscow;
• The Baltic States “were the best pupils of an admittedly very bad class” (Lainela, Sutela, 1994, p. 18);
• The concept of economic sovereignty adopted by a group of economists in summer of 1988 suggested sovereignty of most economic policies, but within the Union;
• As the concept was rejected by the Soviet authorities, the majority support shifted towards complete separation;
• After March 11, 1990, Lithuanian leaders suggested the Union leadership to start negotiations on settling issues arising from the act of independence.
Re-regulation of relations with the former center (II):

• Soviet Union authorities responded by imposing economic blockade;
• Although Lithuania declared 100 days moratorium on consequences arising from the Act of Independence, Soviet leaders refused to negotiate, on January 13, 1991, resorting to military action;
• During 1990 and 1991, Lithuanian institutions legislated new rules which have not been followed by many SOE and organizations like customs;
• Only after collapse of SU by the end of 1991, Lithuania took over control of its economic entities and settled relations with Russia on the basis of agreement signed in July 1991.
Re-regulation of relations with the former center (III):

• Initially in 1991-1992 relations with independent Russian Federation have been mutually supportive;
• The main issues to be solved included withdrawal of Soviet troops (done by September 1993), transit to/from Kaliningrad region (agreement on November 1993, together with agreement on trade and cooperation establishing MFN status to bilateral trade, renegotiated in 2002 as LT prepared to join the EU), border agreement (signed in 1997, LT ratified in 1999, RU ratified in 2003);
• Outstanding issues include treatment of the recent history of Soviet occupation, management of mutual economic relations, especially in energy field.
Political economy of sovereign policies (I):

- Soviet economic blockade and uncertainty about the authority and rule of law delayed economic reforms and prolonged period of price and wage regulation;
- The first governments and heads of institutions like the central bank changed frequently, contributing to instability of policies (currently, 16th government serving in 23 years);
- The parliamentary elections in 1992, brought back to power former communist nomenclature (every elections resulted in voter swings and emergence of some populist party);
- Although reforms were continued, the privatization, land reform and restitution of property rights, opening of economy was altered frequently.
Political economy of sovereign policies (II):

• Although Lithuania was the first to re-establish independence, it was the last among the Baltics to introduce national currency (in 1993), to open up economy for external trade and foreign investors, to join WTO;
• FTAs with Nordic, Baltic countries in 1992-1993 and EU in 1994 contributed significantly to “locking-in” and stabilizing open external economic environment;
• International norms and EU rules and institutions have been used (especially after EU accession in 2004) to deal with increasingly assertive Russia to solve bilateral issues and respond to unilateral actions like natural gas price increases, import restrictions or customs checks.
Political economy of sovereign policies (III):

- Lithuania experienced three crisis during two decades since 1990:
  - 1990-1995 (systemic transition);
  - 1998-1999 (effects of financial crisis in Russia);
  - 2008-2009 (effects of global financial crisis);
- The recent crisis has been managed by domestic adjustment measures (wage, price decreases) and the introduction of euro used as an exit from the crisis strategy:
  - Estonia introduced euro in 2011;
  - Latvia is planning to introduce euro in 2014;
  - Lithuania might introduce euro in 2015;
- The debate on joining the EMU is strongly influenced by geopolitical arguments.
Institutional quality and economic growth, or why Estonians are doing better?

• Lithuania had less political consensus on institutional reforms, more frequent changes to important economic reforms (property rights, privatization, opening economy);
• Lithuanian public, initially strongly supportive of independence, soon lost trust in its sovereign political institutions reflected in parliamentary voting and popular surveys.
The levels of trust (Eurobarometer 2008, 2009, 2010):

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“Baltic tigers” – alive again?
Strong convergence since 2000 till 2008, again after 2009:
Relative GDP per capita in PPS in 1997-2012

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Source: Eurostat, 2013
Convergence interrupted in 2008 by the global crisis and domestic factors with resulting swings in the key indicators
Rapid fall and rise in GDP

Source: European Commission  Spring 2013 Economic Forecasts

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Changes in unemployment

Source: European Commission Spring 2013 Economic Forecasts
Decrease of inflation

Source: European Commission  Spring 2013 Economic Forecasts

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... and state debts, % of GDP

Source: European Commission  Spring 2012 Economic Forecasts
The political economy of crisis management:

• The Baltic States responded to economic crisis in similar ways through internal adjustment of prices and wages, though influenced by domestic politics (elections in Lithuania in 2008 delayed the adjustment measures and made them more difficult due to pre-election spending promises);
• The outcomes of the adjustment were dependent on previous policies with Estonia being in the best fiscal situation allowing it to join the euro zone in 2011;
• While in Estonia government managed to maintain public trust during the crisis (“loyalty”), in Latvia and Lithuania crisis resulting in more people “exiting” (emigrating or withdrawing into shadow economy), while there has been very little response in the form of “voice” (demonstration and public protests).

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How Baltics are ranked compared to the Nordics and the rest of the world?
KOF Globalization index

2004  2005  2006  2007  2008  2009  2010  2011

0      5      10     15     20     25     30     35

Lithuania
Latvia
Estonia
Denmark
Sweden
Finland

Rank

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World Bank Ease of Doing Business Index

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- **Latvia**
- **Estonia**
- **Denmark**
- **Sweden**
- **Finland**

Rank

- 2006
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- 2009
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- 2011
- 2012
Heritage Foundation Economic Freedom Index

Lithuania
Latvia
Estonia
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Finland

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Concluding comments:

• Political consensus, consistency of policies and stability of legal framework (quality of governance) are crucial for the success of sovereign policies and popular support;

• Cooperation (or lack of it) with the previous center might impact significantly on the sovereign policies;

• Small countries can increase their bargaining power by relying on international norms and by uploading their concerns onto the EU agenda.
Thank You!

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