



ESTONIA

Fast growth continues

The recovery of the Estonian economy is well under way. In the first half of 2000, GDP grew 6.4 % from the same period a year earlier. Manufacturing recorded the biggest increase in the second quarter, 21 %, while wholesale and retail trade grew 12 % and construction 10 % y-o-y. In January-October, industrial sales increased 11 % y-o-y.

Export demand remains the most important factor behind production expansion. In January-September, the value of Estonian exports increased an impressive 31 % y-o-y. The growth in imports was 23 %. After a 29 % fall in 1999, investments experienced 14 % growth in the first half of 2000.

Despite the robust economic growth, Estonia has managed to keep its current account deficit under control during 2000. The deficit, which according to revised data was 6.5 % of GDP in the first quarter, declined to 4.5 % of GDP in the second quarter. The public sector deficit has also remained within the planned limit.

Inflation accelerating

Inflation has accelerated during the current year, reflecting higher energy prices and weakening of the kroon, which is pegged to the euro. In October, the 12-month consumer price inflation was 5.4 %.

Unemployment has apparently peaked. The unemployment rate, calculated according to the International Labour Organisation's (ILO) methodology, hit a high of 14.8 % in the first quarter of this year. In the second quarter, it declined to 13.2 % and in the third quarter further to 12.8 %. The third quarter figure was still, however, slightly higher than a year earlier.

High scores from Commission

In early November, the European Commission published its regular report on applicant countries' progress in meeting EU membership criteria. The report puts Estonia, Hungary and Poland in the first category among transition economies with regard to fulfilment of the economic criteria of membership. All three countries have functioning market economies, and they should be able to cope with competitive pressure in the common market in the near term as long as they continue their present reform policies. Last year's progress report stated that the three countries would reach competitiveness in the medium term.

SIDOTTAVA KPL

As to economic policy and macroeconomic development, the Commission commended Estonia for its strengthening macroeconomic stability and restructuring of its enterprise and financial sectors, as well as utilities and energy sectors. The Commission stressed the importance of containing government sector expenditure. It further noted that reforms in the oil-shale sector and land ownership need to be completed.

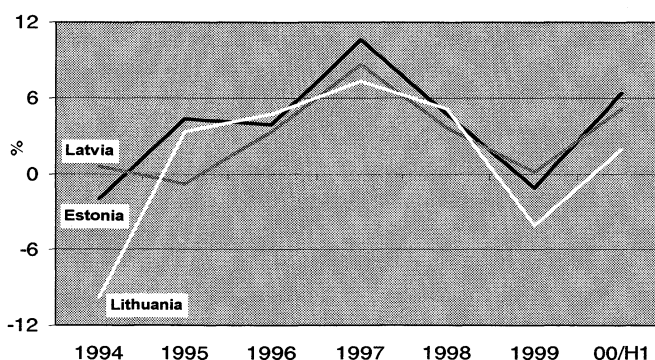
A most demanding part of the accession process is the adoption and enforcement in applicant countries of EU rules and legislation, the so-called *acquis*. On the whole, Estonia has proceeded well in most areas of the *acquis*. Estonia's legislation regarding free movement of capital, provision of financial services and company law are largely in conformity with the *acquis*.

In the field of customs operations, the report called attention to Estonia's limited progress during the past year. Due to its liberal foreign trade system with practically no import or export duties, Estonia now has to create from scratch customs legislation and set up bodies to enforce it. The Commission urges Estonia to enhance efforts to implement tariffs and related measures so that it can comply with the EU foreign trade system.

The Commission notes that in several areas of the *acquis*, Estonia's administrative capacity to enforce legislation is weak. In some cases, necessary institutions are still absent. This problem is common for all applicant countries, and the Commission has raised this issue in all its country reports.

As of mid-November, Estonia had provisionally closed negotiations on 15 of the 31 *acquis* negotiation chapters. In this respect Estonia is the leader among transition economies.

On-year change in Baltic GDP



ESTONIA	1994	1995	1996	1997	1998	1999	2000,	as of
GDP, %-growth	-2.0	4.3	3.9	10.6	4.7	-1.1	6.4	H1
Industrial sales, %-growth	-3.0	1.9	2.9	14.6	4.1	-3.9	11.4	1-10
Inflation, %-growth, end-year	41.7	28.9	14.8	12.5	6.5	3.9	5.4	10
General government budget balance, % GDP	1.3	-1.3	-1.9	2.2	-0.3	-4.7	-1.7	H1
Average gross wage, USD, period average	134	208	248	256	283	337	286	1-9
Unemployment, % (end of period, registered)	5.1	5.0	5.5	4.6	5.1	6.5	6.7	10
Exports, USD million	1211	1660	1764	2275	2674	2437	2352	1-9
Imports, USD million	1557	2398	2876	3516	3928	3430	2997	1-9
Current account, % GDP	-7.2	-4.4	-9.2	-12.1	-9.2	-5.8	-5.4	H1

Sources: Statistical Office of Estonia, Bank of Estonia, EBRD, IMF

LATVIA

Growth continues

The Latvian economy grew at a brisk 5.1 % in the first half of this year as compared to the same period a year earlier. Forestry exhibited the fastest increase, 31 % y-o-y. Manufacturing grew 5 %, wholesale and retail trade 6 % and construction 4 %.

Investment in fixed assets recovered from last year's contraction and increased 22 % y-o-y in the first half of 2000. Private consumption also has risen at an accelerating pace during the current year, as is reflected by retail sales. In the third quarter, retail sales were 12 % higher than a year earlier.

Latvia's current account deficit, which in the first half of 2000 equalled 5.6 % of GDP, has come down significantly from the 10.2 % recorded for the whole of 1999. In the second half of this year, the deficit has, however, been rising again. In January-September, both exports and imports grew at a year-on-year pace of 12 %.

Latvian inflation has remained relatively low – under 3 % per annum since June. Unemployment (according to registration data) peaked in the spring of 1999, and has declined ever since. The unemployment rate according to labour force surveys based on ILO methodology was 14.4 % in May 2000.

Fiscal deficit targets missed

In early November, the Latvian parliament adopted amendments to this year's budget, increasing the general government budget deficit to 3.6 % of GDP. This well exceeds the deficit limit of 2 % of GDP, which the Latvian government agreed to in its economic memorandum concluded with the IMF. The increase of the deficit was due to overly optimistic tax revenue forecasts and new expenditure items in the supplementary budget.

The government is also boosting next year's budget deficit above the limit of 1 % of GDP set in the IMF-supported economic memorandum. The draft budget, which is under discussion in the parliament, assumes a deficit of 1.7 % of GDP.

The IMF has been critical about Latvia's recent relaxation of fiscal policy and warned of the country's need to prepare for higher budgetary expenditures related to the EU accession process.

EU accession proceeds

The European Commission's regular report placed Latvia together with Lithuania and Slovakia in the third category of transition economies as regards fulfilling the economic criteria of accession. These countries are somewhat behind the first-tier applicants Estonia, Poland and Hungary, as well as the second tier, which consists of the Czech Republic and Slovenia.

The Commission said it considers Latvia to have a functioning market economy. Provided that Latvia completes its current reforms and continues its reform policies, the Commission expected the country would be able to cope with the competitive pressures of EU markets in the medium term. In these respects, Latvia's assessment has not changed from last year.

Latvia got good marks for reforms in its public administration, improvement of its judicial system and measures against corruption. Nevertheless, the report said it was necessary to continue reforms in all these sectors.

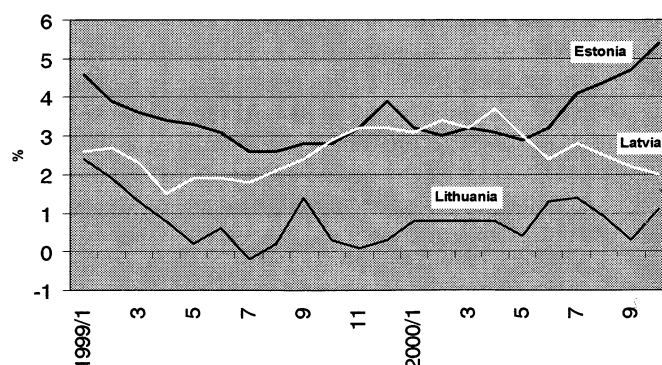
Latvia was commended for preserving macroeconomic stability, but admonished that efforts must be made to keep fiscal and current account deficits under control. Privatisation of remaining large-scale enterprises still lies ahead. The Commission noted that the country's financial sector functions well.

Latvia made steady progress last year in the adoption of the *acquis*. Legal reforms have advanced, particularly with regard to the environment, consumer protection and transport. In agriculture, where reforms have been slow, significant efforts are still needed to make the system compatible with EU rules. Other areas where reform process needs to be enhanced include social policy and regional policy.

As elsewhere, enforcement of the *acquis* was seen as one of the biggest problems in EU accession. This will require further institution building and training of specialists. Latvia's administrative capacity needs improvement, especially in the fields of agriculture, environment, justice, and regional policy.

As of mid-November, Latvia had provisionally closed eight negotiation chapters. Latvia began membership negotiations in early 2000 in the second wave of applicant countries. Within this group, Slovakia has provisionally concluded the most chapters, i.e. ten.

Baltic 12-month inflation



LATVIA	1994	1995	1996	1997	1998	1999	2000,	as of
GDP, % growth	0.6	-0.8	3.3	8.6	3.9	0.1	5.1	H1
Industrial production, % growth	-9.5	-6.3	1.4	6.1	2.0	-8.8	1.5	Q3
Inflation, % growth, end-year	26.3	23.1	13.1	7.0	2.8	3.2	2.0	10
General government budget balance, % GDP	-4.0	-3.9	-1.7	0.1	-0.8	-4.0	-3.2	H1
Average gross wage, USD, period average	128	170	179	207	226	241	245	1-9
Unemployment, % (end of period, registered)	6.5	6.6	7.2	7.0	9.2	9.1	7.8	10
Exports, USD million	1020	1367	1488	1839	2012	1729	1399	1-9
Imports, USD million	1321	1947	2286	2689	3138	2957	2311	1-9
Current account, % GDP	-0.2	-3.6	-4.2	-6.1	-10.6	-10.2	-5.6	H1

Sources: Central Statistical Bureau of Latvia, Bank of Latvia, EBRD, IMF

LITHUANIA

Production growth slow

Lithuania's GDP growth has been rather uneven during the current year. In the first quarter, year-on-year growth was 4.2 %, in Q2 GDP remained flat, and in Q3 the growth amounted to 2.6 % according to Statistics Department's preliminary calculations. Altogether in the first nine months of 2000, GDP increased 2.2 %. During the same period, retail sales grew 11 %.

Twelve-month consumer price inflation has been very slow during the past year, mostly below 1 %. In October 2000, it was 1.1 %. The relatively sluggish recovery of domestic demand has been one factor contributing to moderate inflation. Furthermore, because the Lithuanian litas is pegged to the US dollar, the litas has strengthened significantly vis-à-vis the euro, which in turn has acted as a buffer against import price inflation.

Even with the strengthening of the litas, Lithuania's exports to the EU expanded 22 % y-o-y in January-September, and total exports grew as much as 28 %. The respective increases in imports were 6 % and 12 %. Lithuania's current account deficit declined to 4.3 % of GDP in the first half of 2000.

Unemployment, that started to grow again after the Russian crisis, remains high. Biannual labour force surveys (LFS) show that the highest unemployment rate, 15.3 %, was recorded in May 1999. In May 2000, the rate was still 14.7 %.

New government takes power

After the October parliamentary elections, Lithuania installed a centrist coalition government, which is backed by 67 of the parliament's 141 deputies. In addition to the political centre, the new government comprises parties both to the left and right of centre.

Prime minister Rolandas Paksas pledged that the new government would continue the former conservative government's policies of approaching the EU and NATO and reforming economic structures. The new government also will seek to reduce next year's general government budget deficit to 1.4 % of GDP as was agreed by the previous government in its IMF-supported economic policy memorandum. The IMF approved in September the former government's appeal to increase the deficit limit from 2.8 % to 3.3 % this year, due to the slow recovery of the economy.

EU accession efforts bear fruit

Lithuania has improved its performance during the past year, as was witnessed by the Commission's progress report in early November. The report noted that Lithuania has now advanced roughly as far as Latvia and Slovakia in meeting the economic membership criteria of the Union. Lithuania can also be re-

garded as a functioning market economy, and should be able to cope with competitive pressure in the common market in the medium term as long as current reforms continue and new reforms are launched as planned. In last year's assessment, Lithuania had yet to fulfil the criteria for a market economy and facing the competition of the EU market.

Lithuania has progressed during the past year in reforming its public administration. Development of the legal system has been furthered by the adoption of the Civil and Criminal Codes. Nevertheless, much remains to be done in both areas. The fight against corruption, although improved, also needs to be stepped up.

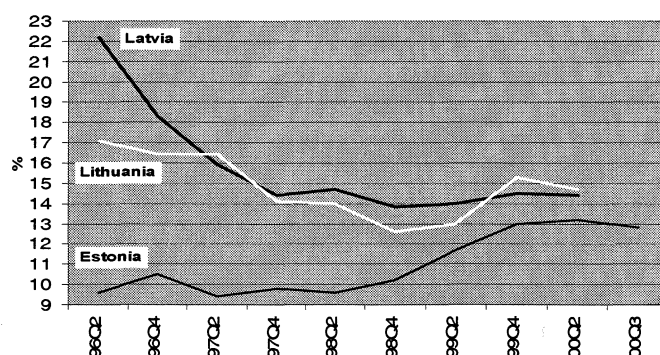
The Commission's report makes a positive note of several specific structural reforms launched in Lithuania during the past year. These include banking sector privatisation, energy sector restructuring and reduced state interference in the enterprise sector.

The Commission observed many problems still need to be tackled, including improving bankruptcy procedures and bolstering the financial sector. It further urged Lithuania to start implementation of its planned pension reform. Concerning macroeconomic policy, Lithuania was reminded of the need to keep its current account deficit under control.

The report found that during the past year Lithuania has made significant progress in the adoption of the EU *acquis*. The implementation of the new laws and regulations, however, has proceeded slowly. Legislative progress was noted in such areas as the free movement of goods, customs operations and energy. Much remains to be done, however, especially in the field of Common Agricultural Policy, taxation and regional policy.

By mid-November, Lithuania had provisionally completed negotiations on seven chapters of the EU *acquis*. Lithuania entered into membership negotiations with the EU in early 2000.

Baltic unemployment rates according to LFS



LITHUANIA	1994	1995	1996	1997	1998	1999	2000,	as of
GDP, % growth	-9.8	3.3	4.7	7.3	5.1	-4.2	2.2	1-9
Industrial production, % growth	-26.6	5.3	5.0	3.3	7.0	-9.9	2.6	1-10
Inflation, % growth, end-year	45.1	35.7	13.1	8.4	2.4	0.3	1.1	10
General government budget balance, % GDP	-5.5	-4.5	-4.5	-1.8	-5.8	-8.2	-3.9	H1
Average gross wage, USD, period average	81	120	155	195	232	253	271	1-10
Unemployment, % (end of period, registered)	4.5	7.3	6.2	6.7	6.9	10.0	11.7	10
Exports, USD million	2020	2706	3413	4192	3962	2996	2621	1-9
Imports, USD million	2220	3404	4309	5340	5480	4791	3719	1-9
Current account, % GDP	-2.1	-10.2	-11.4	-10.2	-12.1	-10.8	-4.3	H1

Sources: Lithuanian Department of Statistics, Bank of Lithuania, EBRD, IMF

Winners and losers, Latvia during the transition

by Franziska Gassmann*

A decade ago the world was confronted with the phenomenon of the collapsing communist system in the Soviet Union and other Central and Eastern European countries. Now, ten years later, the question arises as to what happened to people during these years of transition. Who are the winners, and who are the losers? Although poverty has been studied extensively in countries in transition since the beginning of the 1990s, the dynamics in the living standards have scarcely been investigated. A survey among 3,200 households in Latvia in 1998 shed some light on the perception of the households and the effects of transition.¹

The majority of the respondents (62 %) thought they were much worse off in 1998 compared to 1991. Another 14 % thought they consumed a bit less, while 12 % said they consume at about the same level in 1998 as in 1991. Only 9 % said their consumption was higher than in the past. While these figures obviously only reflect respondent opinions, correlation of the households' welfare level with their perception indicates that most respondents have a fairly good understanding of their own place in the income distribution.

One important result of the survey was that both improvement and deterioration are closely related to employment and employment possibilities. Individuals currently employed tend to live in households that said they consume more or the same. The opposite is the case for the unemployed, of which 80 % live in households that consume far less today than in 1991. Households with a main income earner with a non-agricultural job are generally better off than those with income from employment in agriculture or from social transfers. The households that felt that they can consume more today are, on average, larger, have more children, more prime-age adults and fewer elderly. The fact that households with children experience themselves as better off actually contradicts results from other poverty assessments in Latvia as well as experience from other countries. Moreover, households with seniors (over 60 years of age) feel to be relatively worse off, even though they are not among the losers in transition in most other countries. Neither do they belong to the most vulnerable groups in Latvia.

Interestingly, the gender of the breadwinner is a significant determinant of a household's perception. Male-headed households have a more positive view on their possibilities than female-headed households. Ethnicity is also decisive. Russian and other non-Latvian households had more negative perceptions.

Overall, people tended to be more pessimistic when asked the question about improvements in general, than when asked whether things improved or at least did not get worse with respect to a specific item (food, clothing, equipment, etc.). However, it is important to note that the vast majority of people think that in general life in Latvia has become more

difficult: gains in terms of consumption possibilities are the privilege of the upper-income minority. For most people, consumption possibilities have declined, particularly with respect to specific items.

When asked to qualify whether children nowadays have more possibilities compared to the situation before 1991, only households that said their consumption declined substantially, tended to express the view that children have fewer possibilities today. It seems that pessimism has installed itself in these households.

The overall conclusion on the dynamics of gaining and losing during Latvia's transition should be that more than 75 % of the population feels to be among the losers. Although the great majority express loss, some groups are less pessimistic than others. The current perception of the past and its changes depends on where one stood before the transition. In general, those that had much to lose felt they had lost relatively more than those who did not have as much to lose. For example, pensioners tended to be rather pessimistic in their judgements on the outcomes of the transition. This argument is supported by the equally pessimistic feelings of those that had a well-paid job in 1991. Such factors clearly influence the results of a survey, because the responses are closely related to the person's perception of reality.

Younger generations and families with children tended to be more positive, although they have been identified as highly vulnerable groups both in the poverty profile for Latvia and in the respective literature on other CEE and FSU countries. These persons are more likely focused on the future and expect their situation to improve. It could be an expression of their hopes that the current low living standards are only transitory.

Nevertheless, the fact that most Latvians feel they have lost and are worse off than ten years ago should cause concern. A main conclusion from the survey is that life in Latvia has become more difficult and insecure, and the future is uncertain. In other words, people didn't just get poorer, they became more pessimistic. This political reality cannot be ignored even when economic growth rates seem to have recovered.

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¹ The survey was part of a UNDP Latvia financed project 'Support to the Development of a National Poverty Strategy.'