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BACK TO THE WEST

**The reintegration of the Baltic countries
to the European Union and other Western structures**

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EXECUTIVE SUMMARY

The collapse of communism ten years ago, which led to the disintegration of the Soviet Union, Czechoslovakia and Yugoslavia, resulted in a large number of countries, which began their post-socialist transition towards a market economy and Western democracy. The former Socialist countries(FSCs) have reintegrated themselves to the West with hugely varying success. None of them has yet completed the reintegration process.

The aim of this research is to study the factors affecting and determining the reintegration processes of the three Baltic countries, Estonia, Latvia and Lithuania. These three countries constitute an intermediate group between former Socialist countries and former Soviet republics, as the Baltics came under Socialist rule only in 1940 after a 20 years long period of independence. The main emphasis of the reintegration process of the Baltics is in their accession process to the European Union.

Basically, the following questions are set, to which answers are sought through this study:

- *How the initial position of the Baltics has affected their reintegration?*
- *Which domestic factors have contributed to the success of Baltic countries in joining Western organisations?*
- *Which internal factors explain failures or slow progress?*
- *How much has international politics affected reintegration processes?*
- *To what extent do the differences between Western organisations explain the varying paces of the FSCs to reintegrate to the West?*

To find out correlations between the reintegration record of the six regional FSC groups defined by EBRD (European Bank for Reconstruction and Development) and various explanatory factors regression analysis is used. As to the differences between the Baltics, conclusions are drawn based on a rough qualitative comparison.

FIRST PART: TRANSITION, REINTEGRATION AND ACCESSION TO THE EU

In the first part of this study, the Baltics are located in the current post-socialist transition process, as well as their relative success in joining Western organisations. The records of the FSCs in various areas of transition are compared by dividing the FSCs into six groups: higher and lower advanced, higher and lower intermediate and higher and lower slow-progress countries.

Post-socialist transition

During the ten years of post-socialist transition, two patterns of transition have emerged: a group of countries with overall progress in reform and another group with persistent problems in reforming markets and institutions. The description of

transition includes a discussion on initial conditions, various elements of transition, and a regional comparison.

- **Initial conditions**

Two separate indexes of initial conditions initial position were calculated by the EBRD. The first common factor is based on the initial level of GDP, distance to the EU, employment distortions, duration of socialist rule and macroeconomic imbalance; the second common factor on dependence on intra-socialist trade, private sector share of GDP, employment in agriculture and level of urbanisation.

The first common factor gave the Central and Eastern European countries and the Balkan states clearly the most advantageous initial position, followed at a distance by the Baltics and the Central CIS (Commonwealth of Independent States) countries. The least favourable initial position is in the Caucasian and Central Asian republics. Nevertheless, when measured according to the second factor, the position is almost contrary to that given by the first common factor, a result that can be argued.

- **Transition processes**

Post-socialist transition is defined in this study to include three broad areas of transition:

- 1) *economic transition*
 - *market reform*
 - *legal transition*
 - *infrastructure transition*
- 2) *macroeconomic performance*
 - *GDP recovery*
 - *Foreign direct investments*
- 3) *democracy and governance*
 - *political competition*
 - *political and civil liberties*
 - *quality of government*

One of the most striking phenomena in the transition process has been the relatively rapid pace of liberalisation and privatisation and the relatively slow progress in building institutions supporting market and private enterprise. Another main dividing factor in transition has been the overall approach: “a shock therapy”, which calls for a rapid establishment of markets and a forceful adjustment of enterprises with the risk of creating major imbalances, and “a gradualist approach“, where the private sector grows and the state sector diminish approximately at the same pace, with a risk of stopping halfway in reforms.

*Within **economic transition**, the legal transition has been the easiest area of the economic transition, followed by market reform while infrastructure has been obviously the most difficult*

transition area. There are vast differences in the **macroeconomic performance** between the most advanced and the least advanced FSCs. As to **democracy and governance**, the political competition variable shows a fairly positive picture. The picture is worse when it comes to political and civil liberties. The results of the EBRD study on the quality of governance inquiry are somewhat confusing.

In regional comparison, two regions, the CEE and the Baltics, are superior to others in all three dimensions. The Central and Eastern European region has a very even record, but the Baltic countries' weak spot is macroeconomic performance. The Balkan countries constitute an intermediate region with a fairly good economic transition record but a quite low economic performance. The former Soviet republics are the last ones with the Central Asian countries having the poorest regional transition record. It is somewhat surprising that the Baltics, carrying the burden of half a century as Soviet republics, have progressed as well as the most developed FSCs, the Central and Eastern European countries.

Based on the EBRD first common factor, the correlation between initial position and advancement in post-socialist transition is notable (0.56), but when both the first and the second common factors are used, the correlation is quite weak (0.44). The Baltics have progressed much better than their initial position leaves to expect.

Reintegration processes

None of the FSCs has yet completed its reintegration process. As a whole, the 27 former Socialist countries have proceeded quite slowly towards membership in the seven Western organisations.

- **Organisations and memberships**

There are basically three different accession policies found among the Western organisations studied:

- 1) very restrictive organisations with accession criteria that are either complex, politically determined or demanding high level of development (EU, NATO and OECD),
- 2) organisations which will in principle accept any country fulfilling their accession criteria (European Council and GATT/WTO) and
- 3) organisations which strive for global or pan-European membership and have very simple admission criteria (CSCE/OSCE and IMF).

Respectively, the most exclusive organisations are NATO (3 members), OECD (4 members) and the EU (5+5 candidates). On the other hand, CSCE and IMF have accepted all 27 FSCs, and the Council of Europe (16 members) and GATT/WTO (12 members) are in the middle field. Seen from another angle, majority of the FSCs (17 countries) has not attained more than two or three memberships in Western organisations. Also the top, countries with six or seven memberships (incl. EU candidature) is very sharp (4 countries of 27).

- **Explanatory factors**

Reintegration is studied as a function of several factors, namely initial position, economic transition, macroeconomic performance, democracy and governance and, concluding, as a function of overall post-socialist transition.

*The **initial position** is measured both by using the first common factor and the weighted averages of both factors. In the first analysis, the correlation between initial position and reintegration is strong (0.70), but it is somewhat weaker in the second (0.58). The correlation is strong enough to allow a conclusion that the initial position of the FSCs has a strong relation to their success in reintegration to the west. The Baltic countries have achieved the second highest reintegration level after the CEE, although their initial position is only slightly better than that of the CIS states.*

*Correlation between **economic transition** and reintegration is clear, but not very strong (0.60). The Baltics have reintegrated less than their economic transition success would indicate.. The correlation of **macroeconomic performance** and reintegration is very strong (0.92). The Baltics' relatively poor real GDP index brings their macroeconomic performance down in spite of their good record in receiving direct foreign investments, and, hence, their macroeconomic performance level correlates very strongly with their reintegration record. The correlation between **democracy & governance** and reintegration is clear, but not very strong (0.59). The fact that the Baltics have the best record of all regional groups does not correspond to their achievement in reintegration.*

*The correlation between **overall post-socialist transition** and reintegration is high (0.83), clearly higher than that of initial position (0.70). It may be concluded that what has taken place since the end of socialist era has been more important to reintegration success than which kind of initial position the countries had. However, the correlation in both cases is strong, and thus both initial position and post-socialist transition are substantive explanatory factors to reintegration.*

The Baltics have a post-socialist transition record matching that of the CEE countries, but they have not been as successful as the CEE in reintegration for external political reasons (NATO-Russia relations) and because of their relatively poor economic position, which will postpone their membership in the OECD with several years.

Accession to the European Union

At the Luxembourg summit in December 1997 it was agreed that the accession process will be started with all applicants, but negotiations only with the six most advanced countries (Czech Republic, Estonia, Hungary, Poland and Slovenia with Cyprus). The remaining FSC applicant countries (Bulgaria, Latvia, Lithuania, Romania and Slovak Republic) together with Malta and Turkey were given a candidate country status at the Helsinki summit in December 1999.

Although the new candidates were accepted in two groups, they are not expected to join collectively but all countries will join by their own merits ("regatta" principle) and, hence,

later starters can potentially reach earlier beginners of membership negotiations (“catch-up” principle). Recent evaluations assume that the negotiations with the most advanced applicants to be concluded by the end of 2002, and the first new members might enter the Union in 2004.

- **Membership negotiations**

The negotiations with the first group of candidates were opened on March 31, 1998 and with the second on February 15, 2000. At the Luxembourg Group, all 29 chapters of the acquis (EU legislation) have been opened and by the end of March 2001, 15 to 18 chapters have been provisionally closed. Respectively, in the Helsinki Group, 10 to 23 chapters have been opened and 6 to 13 chapters have been provisionally closed.

The Helsinki group has not been able to catch up the Luxembourg group, but the difference has diminished. The Baltic countries have proceeded well. Estonia tops the Luxembourg group in the number of closed chapters (18) together with Cyprus and Slovenia, while Latvia has been able to open the highest number of chapters (24) in the Helsinki group, and Lithuania shares the first position in number of closed chapters (13) with Malta.

PART II: THE REINTEGRATION OF THE BALTICS TO THE WEST

The three Baltic countries, Estonia, Latvia and Lithuania, however small they may be, have a surprising amount of differences. History, language, religion, ethnic composition, outward orientation: the Baltics are very different from each other. But when it comes to modern history, their fate has been uniform. All three gained independence from Russia after World War I, but were annexed to the Soviet Union in the spring of 1940 and regained their independence in 1991.

The policies of transition of the Baltics have differed, which in turn has been reflected in the macroeconomic performance of these states. The Baltics adopted quite similar courses in their macroeconomic stabilisation policies as well as in liberalisation, but differed considerably in restructuring the banking sector, in privatisation and enterprise reform.

The newly independent states had, at least in theory, various options regarding their future international status: neutrality, non-alignment, Nordic orientation, Baltic community, orientation to Atlantic community and USA, NATO-membership, EU-membership. What were left were basically memberships in NATO and the European Union. At first, the Baltics considered NATO membership as the only way to secure their independence and integrity, but the reluctance of NATO to invite the Baltics as members became soon apparent. Hence, the Baltics began to lean more towards EU membership, as Russia declared its strong opposition against the NATO membership of the Baltics while being positive toward their EU membership.

In the initial phase of independence (1991-92), the Baltics gained memberships in the CSCE and the IMF, like all other FSCs. Estonia and Lithuania were accepted as members in the Council of Europe in 1993, but Latvia, because of its minority problems, followed them only in 1996. Estonia and Latvia became members of the WTO in 1999, and Lithuania has already

concluded the final phase of membership negotiations and is expected to become member in 2001.

Estonia was given a candidate country status of the European Union in the Luxembourg summit of 1997 and Latvia and Lithuania followed at the Helsinki summit of 1999.

All three countries have applied for NATO membership. They got a political recognition to their candidacy at NATO summit in 1998, but have not been invited as members by the alliance. A membership in the OECD is not yet attained by any of the Baltic states, and applications may still take some years to materialise.

Accession to the European Union

All Baltic states continue to fulfil the Copenhagen political criteria. It is obvious that the main problem within the political criteria, the position of Russian and other Slavic minorities in Estonia and Latvia, has now largely been overcome, at least in the legislative niveau. The public administration, because of its poor experience and efficiency, seems to be one of the main obstacles in accession preparations, especially in adoption and implementation of the acquis.

All Baltics are considered functioning market economies and fairly capable to cope with the competition and market forces within the Union. However, the latter condition is expected to be fulfilled by Estonia already in near term, but in the case of Latvia and Lithuania, only in the medium term.

The Baltics opened negotiations on the membership in March 1998 (Estonia) and in February 2000 (Latvia, Lithuania). Having an earlier start, Estonia has advanced more than Latvia and Lithuania. By the end of March 2001, in the Estonian membership negotiations all 29 chapters have been opened and so far 18 have been closed. In the case of Latvia, 24 chapters have been opened and 11 have been closed. Lithuania has opened 22 chapters and been able to close 13 chapters. During the ongoing Swedish presidency, the progress of Latvia and Lithuania has been rapid.

Conclusions and comparisons

In the conclusions on which factors have affected reintegration, a division to three categories is made: initial positions, internal factors and external factors.

Factors affecting the initial positions

*There are no significant differences between the Baltics in their **historical experience**.*

*Estonia has the best **geographical location** of the Baltics, having easy access to both Finland and Sweden. Latvia follows with close proximity to Sweden, but Lithuania is relatively isolated.*

As to the **historical orientation** of the Baltics, Lithuania's position, because of its Poland-orientation, is somewhat worse than that of Estonia and Latvia, whose historical orientation could be determined almost equally advantageous.

Estonia has in its **lingual proximity** a clear asset, which Latvia and Lithuania, constituting their own group among the Indo-European languages, do not have. This has contributed to Estonia's transition, and, consequently, to Estonia's lead in reintegration compared with the other two Baltics. In addition, the northern half of Estonia was within the reach of Finnish television, which played a significant role in transmitting Western news and information as well as teaching the Finnish language.

Lithuania, having the smallest **ethnic diversity**, has a slight advantage in the reintegration compared with Estonia and Latvia. However, the latter countries have been able to resolve the problems connected to the position of Russian minority and thus all but eliminated Lithuania's advantage as to the EU membership

As to the **economic position** of the Baltics after collapse of communism, Estonia had a small lead over Latvia, which had a slightly better economic position than Lithuania.

- **Internal explanatory factors**

As to **economic transition**, Estonia's lead over its Baltic neighbours is based on its better performance in market reform. Lithuania has overtaken Latvia in 2000. In legal transition, Latvia and Lithuania are lagging behind Estonia. As to infrastructure transition, Estonia fares better than the others. Latvia has proceeded somewhat better than Lithuania.

The Soviet legacy of the Baltics can be seen in their **macroeconomic performance**, especially their recovery of GDP: Estonia's real GDP in 2000 was 75 % of that of 1989, Latvia with 60 % is faring worst and Lithuania (70 %) is in the middle.

In the cumulative foreign direct investment (FDI) per capita in the years 1989-99, Estonia leads with USD 1115, followed by Latvia (USD 866) and Lithuania clearly behind (USD 545). Estonia is gaining from both its geographical and lingual proximity as well as from its historical orientation: Finland and Sweden together cover two thirds of its FDI. Latvia and Lithuania have received much less Nordic investment (30-40 %).

The reorientation of foreign trade from Russia-dominated to EU-dominated has been swift and profound, but also in this respect Estonia leads: the EU's share of both its exports and imports is almost three quarters (73 % in first half of 2000) compared with Latvia's 68/54 % and Lithuania's 50/47 %.

The Baltics' performance in both **democracy** factors is excellent: all countries reach the higher advanced category in political competition. As to political and civil rights, Estonia is in the higher advanced group. Latvia and Lithuania are both in lower advanced category. As to

quality of government, Estonia is the only Baltic country in the higher advanced group, Lithuania is in the higher intermediate category; as to Latvia, there is no information.

The latest **polls on popularity of the EU membership** in the Baltic countries are surprisingly low: the percentage of membership supporters is highest in Latvia, 47 % (1999). Lithuania with its 27 % support to membership shares the lowest popularity of the EU among the candidates with Estonia. However, the low support percentages for the EU membership in the Baltics must be put in proportion to both the high percentage of undecided (26-37 %) and low percentage of the negative (13-14 %).

- **External explanatory factors**

The Baltics are a special category within the FSCs: they were annexed to the Soviet Union after 20 years of independence and became Soviet republics, unlike the East European countries that remained independent states.). The West never recognised the annexation of the Baltics, and thus a special obligation towards the Baltics was established, and was well preserved by the Baltic communities in Western countries.

- **Factors advancing reintegration**

In the author's opinion, the **historical pledge** of the West towards the FSCs to let them become members of Western organisations is not only rhetoric but has contributed to the progress in the reintegration along the whole length of the front. To what extent the pledge will be fulfilled, is uncertain but there is still room to optimism. The two most important organisations, the EU has cleared major internal obstacles preventing the accession new members, including the Baltics, and NATO, after accepting three FSC members in 1998, will decide at its 2002 summit whether the alliance invites new members among the applicants.

The Baltics, seen from the **stability** point of view, are to some extent problematic. As tiny countries with good relations to neighbouring countries (except Russia) and hardly any military strength, they as such are no threat to stability in the region or even less in Europe. But all three are loudly speaking for NATO membership, as they fear to remain a "grey zone" between NATO and Russia.

The Baltics are, even together, a small **market**, not able to attract global or even all-European commercial attention. But their membership in the EU is strongly advocated by the Nordics as well as Germany, who see them as relatively well developed and rapidly growing markets within the Baltic Sea region. All of them are now trading mostly with Nordics and Germany, and receive most of their foreign investments from these countries. Their EU membership will make the Baltics even more attractive, also to Russia, to whom they with their "Euro-Russians" open a gateway to the EU market.

Public support to EU enlargement in the present member countries is slowly decreasing, the average support was 44 % in 1998 and 42 % in 1999 the strongest support comes from Northern Europe (60 % and 59 %). Although the support figures are relatively low to EU enlargement, they will probably play no significant role, when it comes to acceptance of new

members. No EU government is openly opposing enlargement, although certain opposition parties are against at least too hasty and too extensive enlargement.

- **Factors slowing reintegration**

NATO and its members have a dual attitude in their **Russian policy**: they are not anxious to endanger relations to Russia by a hasty and extensive NATO expansion, on the other hand they do not want to give Russia a practical veto in inclusion of new members in the alliance. Militarily, the Baltics are difficult to defend because of their small, flat area. Consequently, invitation of any Baltic state to NATO would deteriorate NATO-Russia relations and regional stability. The end result has been a careful, delayed, small-scale expansion with vague promises to the nine candidate countries. Both the fact that there are candidates that will not cause similar problems with Russia (Slovak Republic, Slovenia) and the up-coming membership in the EU of the Baltics are good excuses for NATO to keep the Baltics outside.

The Nice summit of December 2000 cleared the **structural obstacles of the EU** for inclusion of new members. At Nice, the future composition of the Commission, the numbers of votes at the Council of Ministers, number of members at the European Parliament were decided upon, as well as the principle of accepting deeper integration among some countries. All these decisions have “made the table ready” for all candidate countries.

However, there are still problems with some aspects of the accession conditions. The crucial question of agriculture is yet to be solved, and will not even be seriously discussed before the French and German elections in 2002. Another major question is the free movement of people, where the candidates are demanding the application of this freedom from the first day of membership. Existing members, fearful of an uncontrollable wave of immigrants, are proposing a lengthy transition period. Regional policy of the Union is the third major obstacle: the Southern flank of the EU (especially Spain) does not want to get its regional benefits cut because of the entry of new members.

The Baltics, with a combined population equal to that of Sweden and an economy less than half of that of Finland, are not especially difficult negotiation partners. As to agriculture, the Baltics no major producers in the vast EU agriculture and hence no substantial threat to CAP. The free movement of people is seen in the Baltics partially as a threat of losing their highly educated professionals to neighbouring EU countries. However, they demand free movement from the beginning of their membership, but might not be very unhappy with a short transition period.

The Baltics, however tiny they are, have also small **neighbouring countries**, to which their EU and/or NATO membership might be a real challenge, if not a threat. Especially Finland and Sweden, as former neutral states and with no imminent aspirations to join NATO, are favouring the EU membership over NATO as a realistic security arrangement for the Baltics.

The Nordic EU members are strong supporters of EU enlargement, but some worries of especially on the free movement of people have been expressed. The Baltic agricultural exports are not seen by neighbouring countries as major threat, due to the small size and relative inefficiency of the Baltic farming.

Comparisons

In overall comparison, Estonia has both a better initial position and post-socialist transition performance than the others, the differences being greater in transition factors than initial position factors. Latvia and Lithuania have an almost similar initial position, but Latvia is slightly better when it comes to transition performance.

The relative successes of the Baltics in reintegration are distinctive: Estonia has attained all memberships and a EU candidature as the first or as one of the first two, and Latvia has a slightly better record than Lithuania. The overall position of each country in respect to the explanatory factors correlates to its success in reintegration.

On the other hand, all the Baltic states have reached the same level of reintegration (or will reach, when Lithuania becomes a member of the WTO). Also in the EU membership negotiations, Latvia and Lithuania have progressed and diminished the gap between them and Estonia. The next big question will be the entry into European Union, where current thinking indicates a simultaneous membership of all the Baltic states, maybe in 2004. Of the remaining two organisations, OECD membership seems to be still several years ahead, probably in the latter half of present decade. Membership in NATO will obviously be the most difficult to achieve, as it is clearly dependant on external factors, mainly on NATO-Russia relations.

1. INTRODUCTION

The collapse of communism ten years ago, which led to the disintegration of the Soviet Union, Czechoslovakia and Yugoslavia, resulted in a large number of countries, which, having abandoned the socialist system, began their post-socialist transition process towards a market economy and Western democracy. Some of these countries had been independent before the World War Two and preserved their statehood after being forced to adopt socialism, some lost their independence by becoming Soviet republics through Soviet invasion, and some have been states within a socialist federation with very limited, if any, autonomy. These countries number altogether twenty-eight

In their transition, the former Socialist countries (FSCs) have sought membership in several Western organisations with various aims, such as increasing security, speeding adaptation to a market economy, seeking economic assistance and restructuring their administration. With the exception of the German Democratic Republic, which was immediately merged with the Federal Republic by the reunification of Germany, the former Socialist countries have reintegrated themselves to the West with hugely varying degrees of success. None of them has yet completed the reintegration process.

Similarly, the Western organisations concerned have had largely different accession policies towards former Socialist countries. Some of them, being global or pan-European by definition, accepted all applicants very soon after their independence. Others have certain admission criteria to be fulfilled, whereafter membership has been more or less a formality. A relatively large number, but not all FSCs have been able to gain membership to these organisations. Lastly, some organisations either have very strict and/or complex membership criteria or have to take into account the realities of world politics when accepting new members, or both. Only very few FSCs have become members of these organisations or, in the case of the EU, the ongoing accession processes of the candidate countries will still take a few years.

The aim of this research is to study the factors affecting and determining the reintegration processes of the three Baltic countries, Estonia, Latvia and Lithuania. These three countries constitute a kind of intermediate group between former Socialist countries and former Soviet republics, as the Baltics only came under Socialist rule in 1940. They can thus be compared with former independent socialist countries of Central and Eastern Europe when it comes to duration of Socialist rule. Historically, these states have been western-oriented, unlike most of the former Soviet republics. The Baltics, although being small and often misunderstood as constituting a homogenous group, differ from each other strongly as to their ethnic composition, religion, language and outwards orientation, which creates room for fruitful comparisons. Also their post-socialist transition history contains different approaches, policies and varying amount of success.

In the first part of this study, an attempt is made to fix the location of the Baltics in the ongoing post-socialist transition process, as well as their relative success in joining Western organisations. In this connection, a description of the post-socialist transition is given.

In the second part of the study, the transition and reintegration processes are described in detail. The main emphasis of the reintegration process of the Baltics is in their accession process to the

European Union. Here, too, differences can be found between the Baltics, and explanations to these differences are sought. In order to give a wider look on their reintegration, the Baltic countries' memberships in other Western organisations is given some consideration.

At the closing chapter, conclusions on the impact of various explanatory factors on reintegration are drawn and comparisons between the Baltic states are made.

2. AIM OF THE RESEARCH

Having had fairly similar positions after regaining their independence, Estonia, Latvia and Lithuania have gone through varying processes of integration to the West. The reintegration and transition process of each country is studied in order to find factors mostly affecting the reintegration and ultimately, their memberships in Western organisations. Basically, the following questions are set, to which answers are sought through this study:

- 1) How has the initial position of the Baltics affected their reintegration?
- 2) Which domestic factors have contributed to the success of Baltic countries in joining Western organisations?
- 3) Which internal factors explain failures or slow progress?
- 4) How much has international politics affected reintegration processes?
- 5) To what extent do the differences between Western organisations explain the varying paces of FSCs to reintegrate to the West?

It is assumed that the following factors, domestic and external, are of importance in determining the process of integration of a FSC to Western structures:

Initial positions:

- 1) Historical experience – years under Socialist rule
- 2) Geographic location – distance from the West
- 3) Historical orientation – to Western countries or to former Socialist countries
- 4) Economic position at the end of Socialist rule

Domestic needs:

- 1) Security – Russian threat based upon historical experience
- 2) Economic integration – new markets, investments from the West
- 3) Development – shift to market economy, assistance from the West
- 4) Socio-historical urges – popular desire to belong to the West again

Domestic abilities:

- 1) Government – stability, reformers vs. former communists, functioning of democracy
- 2) Administration – ability to adjust, perform, implement
- 3) Public opinion – amount of support for integration
- 4) Ethnic composition – minorities' attitudes vs. majority's views

External needs:

- 1) Obligation of the past – moral need to give access the FSCs to the West
- 2) Need to extend military alliance to the East
- 3) Entering to new markets through economic integration
- 4) Public opinion – support for enlargement (EU, NATO)

External hindrances:

- 1) Relations to Russia – preference for stable relations over military expansion
- 2) Will and ability to defend all NATO applicants, especially Russia's neighbours
- 3) Cost factor – can EU bear the cost of new members
- 4) Organisation – can EU organisational structure be adjusted to work with 20+ members
- 5) Opinions of existing members and public – support for enlargement declining

3. DEFINITIONS

3.1. Western structures

The Western structures are here understood as several organisations, both global and European, into which the former Socialist countries strive to join. As a truly global, not Western organisation, The United Nations has not been included. On the other hand, the CSCE/OSCE has been included as a European institution, although it was launched as an East-West structure, and as such is not a purely Western organisation.

In this study, Western structures are defined to include the following organisations:

- 1) European Community/European Union (EC, EU)
- 2) North Atlantic Treaty Organisation (NATO)
- 3) Organisation for Economic Co-operation and Development (OECD)
- 4) Council of Europe
- 5) Conference/Organisation on Security and Co-operation in Europe (CSCE, OSCE)
- 6) International Monetary Fund (IMF)
- 7) World Trade Organisation (WTO)

While the list of organisations is by no means exhaustive, it could be considered fairly representative both geographically and functionally. It contains both global (WTO, IMF, OECD), transatlantic (NATO) and European (EU, Council of Europe, CSCE/OSCE) organisations as well as political/security institutions (NATO, CSCE/OSCE), economic (WTO, OECD) and human rights organisations (Council of Europe) as well as the EU representing the most comprehensively integrated group of states in the world.

3.2. Former Socialist countries (FSCs)

The former Socialist countries in this study include only the European Socialist countries and the former Soviet republics, numbering 28 states (at present 27, after reunification of East and West Germany in 1990). There are still Socialist countries elsewhere in the world, some of which are changing their economic system toward market economy (China, Vietnam, Laos), while some still maintaining both the economic and political elements of socialism (Cuba, North Korea).

The former socialist countries (FSCs), that are the object of this study, can be divided according their origin, as follows:

- 1) former independent Socialist countries,
- 2) former Czechoslovakian,
- 3) former Soviet and
- 4) former Yugoslav republics

The previous groups consist of the following now independent states:

- 1) Albania, Bulgaria, Hungary, Poland, Romania, Russia, Yugoslavia
- 2) Czech Republic, Slovak Republic
- 3) Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia
Lithuania, Moldova, Tajikistan, Turkmenistan, Ukraine, Uzbekistan
- 4) Bosnia and Herzegovina, Croatia, Macedonia, Slovenia, Yugoslavia

Using the classification of EBRD, the European Bank for Reconstruction and Development), these countries could be divided into 6 groups:

- 1) Central and Eastern European (CEE) – Croatia, Czech Republic, Hungary, Poland, Slovak Republic
- 2) Baltics – Estonia, Latvia, Lithuania
- 3) Balkans – Albania, Bulgaria, Macedonia, Moldova, Romania
- 4) Central CIS – Belarus, Russia, Ukraine (CIS= Commonwealth of Independent States)
- 5) Caucasian CIS – Armenia, Azerbaijan, Georgia
- 6) Central Asian CIS – Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan

The EBRD has recently reduced the number of regional groups to three, indicating the diminishing differences between CEE countries and the Baltics as well as between the various CIS groups of countries, respectively:

- 1) CEE and Baltics
- 2) Balkans
- 3) CIS

In this study, however, the former six-group regional division of the EBRD is used.

PART I. TRANSITION, REINTEGRATION AND ACCESS TO THE EU

4. POST-SOCIALIST TRANSITION

The post-socialist transition has continued now for approximately ten years. During the 1990s, two patterns of transition have emerged: a group of countries with overall progress in reform and another group with persistent problems in reforming markets and institutions. However, the pace of transition has not been even, as a remarkable slowdown, if not a halt, took place in the last three years of the 1990s.

4.1. Initial conditions

Before studying the transition process, it is worth while looking at the initial conditions prevailing in the FSCs. The geographical location, or proximity to the West, as well as the number of years under socialism, are factors that clearly have an important effect on future prospects. There are also great differences between the initial economic and social conditions.

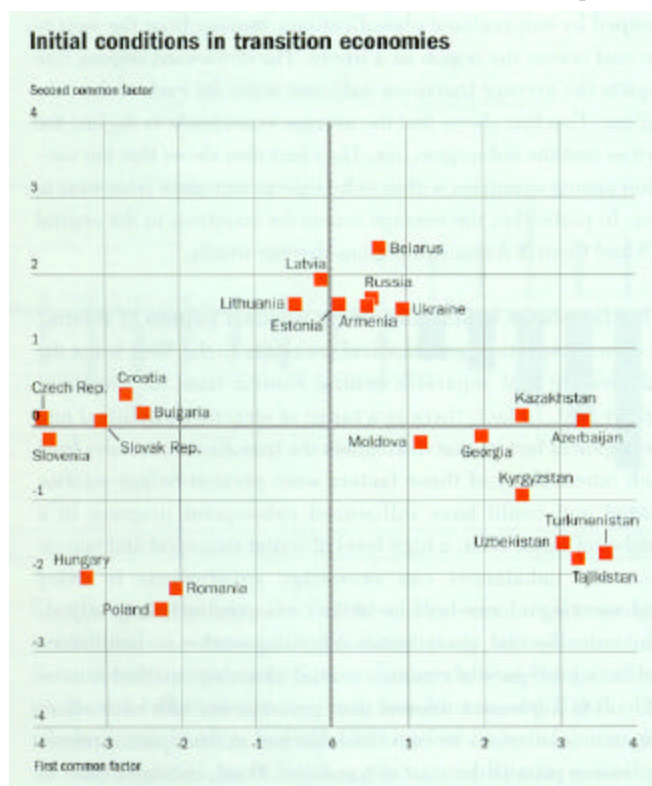
Central European states were the wealthiest, most industrialised and most urbanised of the FSCs, having substantial trade with the West and, in some countries, modest economic reforms had already been performed. Furthermore, they had been under socialist rule only for 45 years. On the other hand, the Caucasian and Central Asian former Soviet republics with 70 years of socialist history, were the poorest, most dependant on COMECON trade, the least urbanised, agriculture-dominated, with citizens that are still close being some nomadic. In the middle, there were the Balkan states and the Baltic republics (maintaining the highest standard of living within the USSR), both having 45-50 years of socialist rule behind them, and the Central CIS group (Russia, Ukraine and Belarus), with 70 years of socialism.

Two separate indexes of initial conditions (from -4 to + 4, with -4 indicating the most favourable initial position have been calculated by EBRD¹. The first common factor (horizontal axis in the chart) is based on the initial level of GDP, distance to EU, employment distortions, duration of socialist rule and macroeconomic imbalances. The second common factor (vertical axis) is based on dependence on intra-socialist trade, private sector share of GDP, employment in agriculture and level of urbanisation. The following chart shows the initial position of FSCs according to both common factors.

¹ EBRD, Transition Report 1999, pp. 28,30

Chart 1. Initial conditions in transition economies

Source: EBRD Transition Report 1999



When measured by the first common factor (horizontal axis), the initial positions are clear: the Central and Eastern European countries and the Balkan states have clearly the most advantageous initial position, followed at a distance by the Baltics and Central CIS countries. The least favourable initial position is in the Caucasian and Central Asian republics.

But when measured according to the second factor (vertical axis), the position is almost contrary to that given by the first common factor. The best initial positions are possessed by agriculture-dominated countries both from the CEE and the Balkans (Poland, Hungary, Romania) and the least developed Central Asian republics (Tajikistan, Turkmenistan, Uzbekistan). The rest of the CEE and Balkans have the next favourable initial position, and the worst positions are shared by the Baltics, Russia, Ukraine and Belarus.

The explanation for this contradiction is in the EBRD evaluation of high-level industrialisation and urbanisation as a liability to former Socialist countries. This is definitely true to some extent (e.g. in the case of the large defence industry in Russia), but may be less true somewhere else (e.g. the mostly light and not all-union bound industry in Estonia). However, the relative weight of the second common factor is low (0.19) compared to the first factor (0.49).

4.2. Post-socialist transition processes

In the following discussion, post-socialist transition is understood not only as reform of the economic structure of the FSCs, but includes macroeconomic performance and administrative and political restructuring. This section, and especially statistical data, is based on the Transition Reports of the EBRD. The author has attempted to further process the statistical data in order to achieve an overall picture of the transition.

One of the most striking phenomena in the transition process has been the relatively rapid pace of liberalisation and privatisation and the relatively slow progress in building institutions supporting markets and private enterprise. The former is relatively easy to accomplish, as it basically means reducing the role of the state in the economy, the latter is difficult, as the state has to build these institutions, get them working, and then get them publicly accepted.

Another main dividing factor in transition has been the overall approach. The “shock therapy”, calls for rapid establishment of markets and forceful adjustment of enterprises with the risk of creating major imbalances, while applying the “gradualist approach“, the private sector grows and the state sector diminishes approximately at the same pace, with the risk of stopping halfway through the reforms.

During the years 1994-99, when the EBRD conducted transition surveys, there was a clearly a trend towards more rapid transition in privatisation and liberalisation than in institutional reform. On the EBRD transition index scale of one to four (1 indicating “no transition” and 4 “full transition”), privatisation and liberalisation has reached level of 2.5 – 3.5, when institutional reform only proceeded to level 2.0-2.5.

In the following chapters, the individual performances of the FSCs are described using three broad areas of transition, which contain two or three variables:

- 1) economic transition
 - market reform (eight indicators)
 - legal transition (four indicators)
 - infrastructure transition (five indicators)
- 2) macroeconomic performance
 - GDP recovery
 - foreign direct investment
- 3) democracy & governance
 - political competition
 - political and civil liberties
 - quality of government

The indicators on which the economic transition variables are based are used individually only in part III, where comparisons between the Baltics are made.

Although the selection of indicators is somewhat arbitrary, their number is, in the author’s opinion, sufficient to give a rough idea of individual FSCs’ transition pace. As various kinds of

indexes were used in measuring elements of transition, in the following chapters the FSCs have been divided into three categories of transition progress: **advanced, intermediate, slow-progress**, and each category is split in two halves: **higher, lower**. To enable an overall comparison, categories have been given a numerical value from 6 to 1:

- higher advanced transition (6)
- lower advanced transition (5)
- higher intermediate transition (4)
- lower intermediate transition (3)
- higher slow-progress transition (2)
- lower slow-progress transition (1)

4.3. Economic transition

The EBRD uses an extensive market reform indicator, containing eight separate indicators (listed below). Another indicator is that of legal transition in commercial law and financial regulations.

a. Market reform indicators²:

- 1) large-scale privatisation
- 2) small-scale privatisation
- 3) governance and enterprise restructuring
- 4) price liberalisation
- 5) trade and foreign exchange system
- 6) competition policy
- 7) banking reform and interest rate liberalisation
- 8) securities market and non-bank financial institutions

b. Legal transition indicators³:

- 1) commercial law extensiveness,
- 2) commercial law effectiveness
- 3) financial regulations extensiveness
- 4) financial regulations effectiveness

c. Infrastructure transition indicators⁴:

- 1) telecommunications,
- 2) electric power
- 3) railways
- 4) roads
- 5) water and waste water

In composite indicators 1-3, the transition index at every indicator varies from 1.0 (no transition) to 4.3 (transition practically completed). For the purposes of this study, values of composite indicators have been calculated. (see Appendix 2)

² EBRD , pp. 24-25

³ EBRD, pp. 44-47

⁴ EBRD, pp. 50-51

The FSCs are divided below according to their performance in market reform, legal transition and infrastructure transition:

Table 1. FSCs' Progress in Economic Transition (Market Reform, Legal Transition and Infrastructure Transition), 1999

ADVANCED		INTERMEDIATE		SLOW-PROGRESS	
Higher (3.51-4.00)	Lower (3.01-3.50)	Higher (2.51-3.00)	Lower (2.01-2.50)	Higher (1.51-2.00)	Lower (1.00-1.50)
1. Market Reform					
Hungary	Croatia	Albania	Azerbaijan	Bosnia-Hertz.	Belarus
	Czech Rep.	Armenia	Russia	Tajikistan	Turkmenistan
	Estonia	Bulgaria	Ukraine		
	Latvia	Georgia	Uzbekistan		
	Lithuania	Kazakhstan			
	Poland	Kyrgyzstan			
	Slovak Rep.	Macedonia			
	Slovenia	Moldova			
		Romania			
2. Legal transition					
Estonia	Bulgaria	Armenia	Albania	Belarus	Bosnia-Hertz.
Hungary	Croatia	Czech Rep.	Azerbaijan	Ukraine	Georgia
Poland	Kazakhstan	Kyrgyzstan			Uzbekistan
Slovenia	Macedonia	Latvia			
	Moldova	Lithuania			
	Romania	Russia			
	Slovak Rep.				
3. Infrastructure transition					
Estonia	Poland	Bulgaria	Armenia	Albania	Belarus
Hungary	Romania	Czech Rep.	Croatia.	Azerbaijan	Tajikistan
		Latvia	Georgia	Bosnia-Hertz.	Turkmenistan
		Lithuania	Kazakhstan	Kyrgyzstan	Uzbekistan
		Slovenia	Moldova	Macedonia	
			Russia	Ukraine	
			Slovak Rep.		

The above chart indicates quite clearly that legal transition (commercial legislation and financial regulations) has been the easiest area of economic transition, followed by market reform while infrastructure has obviously been the most difficult area. These results reflect the general progress in transition: in those areas where immaterial actions are dominant, like adopting new legislation or regulations, it is relatively easy to attain a high level of transition, as opposed to areas where concrete actions are needed, requiring financial resources or difficult political decisions. Legal transition belongs to the first area, infrastructure transition to the second, and market reform contains activities in both areas: liberalisation of prices, currency or foreign trade is not very difficult politically and does not require economic resources but privatisation is a complex measure both politically and economically.

The Baltic countries are among those that have most progressed towards market reform, and they are all in the lower advanced category (only one country, Hungary, has yet attained the higher advanced category). In legal transition, Estonia has reached the topmost group, while Latvia and Lithuania are clearly behind Estonia, in the higher intermediate group. The same rankings prevail in infrastructure transition.

4.4. Macroeconomic performance

The macroeconomic performance of FSCs is demonstrated by using two variables. First is the real GDP index of 1998 (1989=100), which shows the overall performance of individual countries during the post-socialist transition years. The other indicator is the cumulative foreign direct investment per capita during the years 1989-98, expressed in US dollars.⁵

It could be said that the first variable gives an overall picture of the country's ability to recover from the economic decline that faced all FSCs soon after the end of socialist rule. The second variable is an indicator of the trust foreign investors have concerning the economic future, stability and credibility of the FSCs' transition.

In the following table, the FSCs are divided according to their real GDP indexes (varying from 30-45 % to 106-120 % of the 1989 GDP) and foreign direct investment per capita (varying from USD 0-150 to more than USD 751 per capita).

⁵ EBRD 1999, p. 79

Table 2. Macroeconomic Performance of the FSCs

ADVANCED		INTERMEDIATE		SLOW-PROGRESS	
Higher	Lower	Higher	Lower	Higher	Lower
1. Real GDP index, 1998 (1989 = 100)					
(106-120)	(91-105)	(76-90)	(61-75)	(46-60)	(30-45)
Poland.	Czech Rep.	Albania	Bulgaria	Latvia	Armenia
	Hungary	Belarus	Kazakhstan	Kyrgyzstan	Azerbaijan
	Slovak Rep.	Croatia.	Lithuania	Russia	Georgia
	Slovenia	Estonia	Macedonia		Moldova
		Romania			Tajikistan
		Uzbekistan			Turkmenistan
					Ukraine
2. Foreign Direct investment per capita in USD, cumulative investment 1989-98					
(751 >)	(601-750)	(451-600)	(301-450)	(151-300)	(0-150)
Czech Rep.	Latvia	Slovenia	Azerbaijan	Bulgaria	Albania
Estonia			Kazakhstan	Romania	Armenia
Hungary			Croatia	Turkmenistan	Belarus
			Lithuania		Georgia
			Poland		Kyrgystan
			Slovak Rep.		Macedonia
					Moldova
					Russia
					Tajikistan
					Ukraine
					Uzbekistan

The macroeconomic performance variables clearly show the vast differences between the most advanced and the least advanced FSCs. While the five Central European states have either reached the 1989 GDP level or are very close to it, most of the FSCs have only been able to recover to less than three quarters of the 1989 GDP level. The differences are even more striking in foreign investments, about 20 countries belong to the lower intermediate or slow-progress groups, while only five countries are in the upper half of the scale (higher intermediate and advanced groups).

The Baltic countries' macroeconomic performance is not at all as good as their record in economic reform. As for GDP index, Estonia is in the higher intermediate, Lithuania in the lower intermediate and Latvia in the higher slow-progress group. This reflects the very steep decline of the Baltic economies in the early years of transition (Latvia had the deepest decline of GDP of all FSCs). But the Baltics have been much more successful in receiving foreign investment: Estonia is in the top group, followed by Latvia in the lower advanced category. Only Lithuania has a relatively poor record in luring FDI (lower intermediate group). The trust of foreign investors toward the Baltics is obviously strong, at the same level as toward the CEE countries.

4.5. Democracy and governance

The level of democracy and the quality of governance is measured in the following table by using three variables. The first is political competition, which is defined by the average tenure of governments in months, and is based on the study of International Foundation of Electoral Systems, CIA World Fact Book⁶. Political and civil liberties are the second variable; the index used is the Freedom House political and civil liberties index 1998⁷. The quality of government index is based on the EBRD Business Environment and Enterprise Performance survey⁸.

Table 3. Democracy and Governance Transition in FSCs

ADVANCED		INTERMEDIATE		SLOW-PROGRESS	
Higher	Lower	Higher	Lower	Higher	Lower
1. Political Competition; Average Tenure of Governments (in months)					
(0-20)	(21-40)	(41-60)	(61-80)	(81-100)	(101-120)
Bulgaria	Albania	Armenia		Macedonia	Croatia
Estonia	Azerbaijan	Belarus			Kazakhstan
Latvia	Czech Rep.	Georgia			Russia
Lithuania	Hungary	Kyrgyzstan			Tajikistan
Poland	Moldova	Slovenia			Turkmenistan
		Romania	Ukraine		Uzbekistan
		Slovak Rep.			
2 Democracy; Freedom House Political and Civil Liberties Index 1998					
(8-9)	(7-8)	(6-7)	(5-6)	(4-5)	(3-4)
Czech Rep.	Latvia	Bulgaria	Albania	Azerbaijan	Belarus
Estonia	Lithuania	Moldova	Armenia	Kazakhstan	Turkmenistan
Hungary		Romania	Croatia	Tajikistan	Uzbekistan
Poland		Russia	Georgia		
Slovenia		Slovak Rep.	Kyrgyzstan		
			Macedonia		
			Ukraine		
3. Governance Transition; Quality of Government					
(1.9-2.1)	(1.7-1.9)	(1.5-1.7)	(1.3-1.5)	(1.1-1.3)	(0.7-1.1)
Estonia	Armenia	Azerbaijan	Bulgaria	Georgia	Kyrgyzstan
Hungary	Uzbekistan	Belarus	Croatia	Kazakhstan	Moldova
Slovenia		Czech Rep.		Russia	Romania
		Lithuania		Ukraine	
		Poland			
		Slovak Rep.			

The political competition variable shows a fairly positive picture on the functioning of democracy in the FSCs during the first ten years of transition. In ten countries, the average tenure of the government is less than 40 months, which is close to the usual period between parliamentary elections, and consequently indicates a working democracy. In seven more countries, the average tenure is still under 60 months or five years, which can be considered a fair result. Less than ten countries have either a one party rule or a straight dictatorship.

⁶ EBRD, p. 112

⁷ EBRD, p. 113

⁸ EBRD, p. 118

However, the picture is worse when it comes to political and civil liberties: the human rights situation is good only in half a dozen countries, it is to some extent unsatisfactory in a dozen countries and in half a dozen countries, it is quite bad.

The last variable, the quality of governance, was studied only in 20 countries, and the results of the EBRD inquiry are somewhat confusing: among the best-performing countries are Armenia, Uzbekistan (lower advanced) and Azerbaijan and Belarus (higher intermediate). Romania, on the other hand, is among the worst (lower slow-progress). The explanation may be in the nature of the study: it was addressed to local businessmen, which might have found the quality of governance in the above-mentioned countries rather satisfactory, as the system was basically still the old familiar socialist one. On the other hand, the new and unfamiliar governance systems in Central European and Balkan countries could have been seen still in state of turmoil and were, hence, given low grades.

The Baltics fare very well in political competition (all in the higher advanced group) and in political and civil rights (Estonia is in the higher advanced, Latvia and Lithuania are in the lower advanced category). Estonia also has an excellent record in quality of governance, but Lithuania is only in the higher intermediate group while Latvia's record is for some reason not presented

4.6. Overall Transition Record of FSCs

In this section, an overall transition performance categorisation, based on the EBRD data presented in previous section and calculated by the author, is presented. Furthermore, the ranking of FSCs in the UNDP Human Development Index (HDI) are also given to illustrate their progress in transition. At the end, the relation between the overall transition indexes and the FSCs' HDI rankings is studied.

The overall performance of individual FSCs in transition is categorised below in the six groups used in this study:

Table 4. The Average Overall Performance of FSCs

ADVANCED		INTERMEDIATE		SLOW-PROGRESS	
Higher	Lower	Higher	Lower	Higher	Lower
(5.20-6.03)	(4.36-5.19)	(3.52-4.35)	(2.68-3.51)	(1.84-2.67)	(1.00-1.83)
Estonia	Czech Rep.	Bulgaria	Albania	Belarus	Bosnia
Hungary	Latvia	Lithuania	Armenia	Georgia	Tajikistan
	Poland	Romania	Azerbaijan	Kyrgystan	Turkmenistan
	Slovenia	Slovak Rep.	Croatia	Russia	
			Kazakhstan	Ukraine	
			Macedonia	Uzbekistan	
			Moldova		

The above chart shows that almost two-thirds (16 of 26) of the FSCs belong still to the less progressed half of transition. Only ten countries belong to the more progressed half, all of them being CEE, Baltic or Balkan countries. The positions of the Baltics are different from each other:

Estonia is in the higher advanced group, Latvia is in the lower advanced and Lithuania is in the higher intermediate group.

4.7. Relation of overall transition record to the UNDP Human Development Index

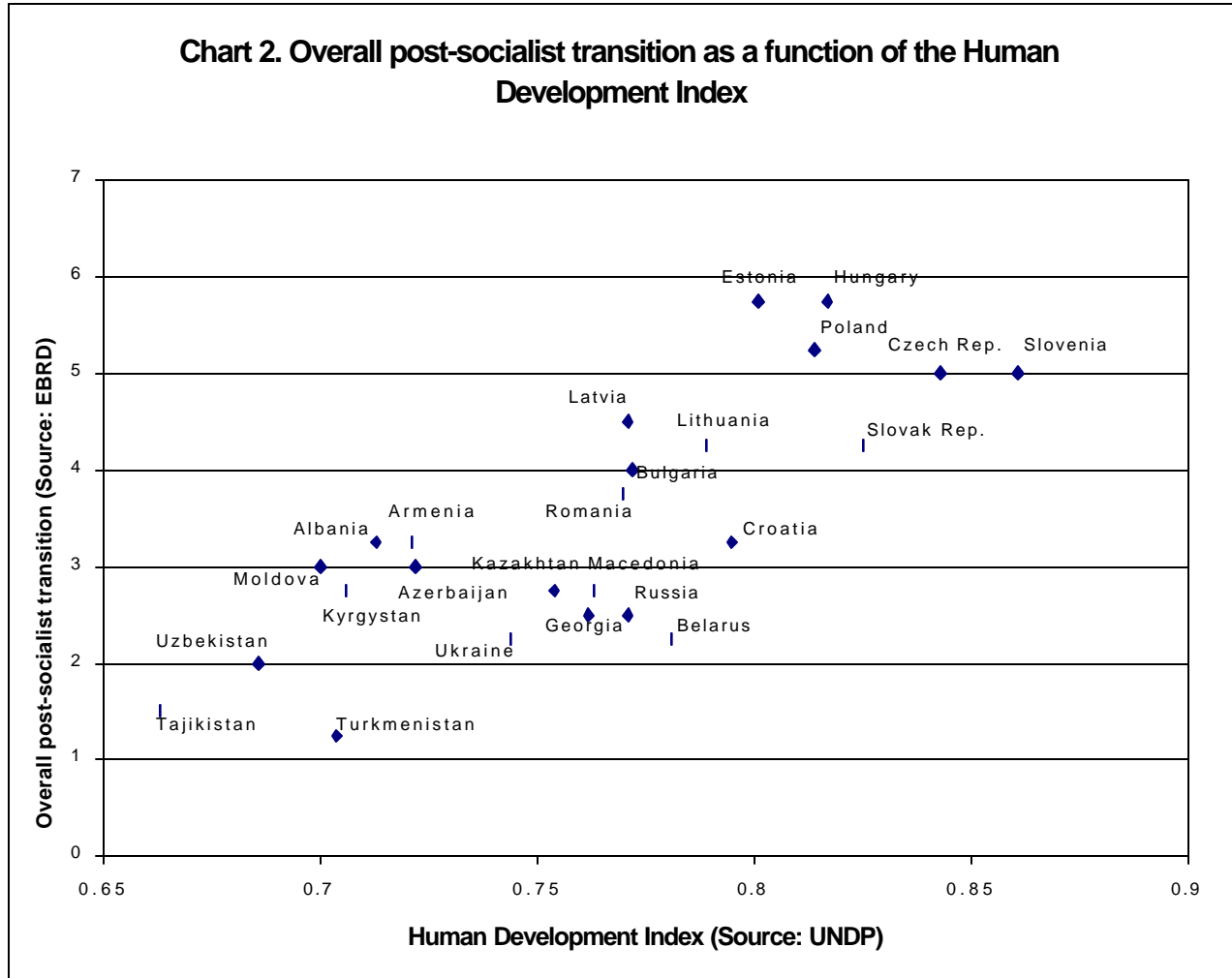
An interesting, but quite rough indicator of the present position of the FSCs is found through their ranking in the 1998 Human Development Index of the UNDP (based on life expectancy, education and GDP per capita according to purchasing power parity). Among the total of 174 countries the ranks and HDIs of former Socialist countries are as follows (the highest HDI was 0.935 and the lowest 0.252):

Table 5. The positions of the FSCs in the HDI Index

0.836-0.870 (Higher advanced):	Slovenia (29.), Czech Republic (34.)
0.801-0.835 (Lower advanced):	Slovak Republic (40.), Hungary (43.), Estonia (46.)
0.766-0.800 (Higher intermediate):	Croatia (49.), Lithuania (52.) Belarus (57.), Bulgaria (60.), Russia (62.), Latvia (63.), Romania (64.)
0.731-0.765 (Lower intermediate):	Macedonia (69.), Georgia (70.), Kazakhstan (73.), Ukraine (78.)
0.696-0.730 (Higher retarded):	Azerbaijan (90.), Armenia (93.), Albania (94.), Kyrgyzstan (98.), Turkmenistan (100.), Moldova (102.)
0.660-0.695 (Lower retarded):	Uzbekistan (106.), Tajikistan (110.)

In the following chart 2, the relation of the overall transition index and the HDI index of the FSCs is presented. It is clear that there is a strong correlation between these two indexes: the more advanced the country is in its post-socialist transition, the higher its HDI index and consequently the human development level.

The Baltic countries are well positioned, but their low GDP per compared with CEE countries prevents a top position. Estonia's ranking is 46, Latvia's is 52 and Lithuania's is 63.



4.8. Regional differences in transition

For the purposes of this study, a regional approach is useful: it reveals the differences between various regions and facilitates comparisons between them. Furthermore, the relative position of the Baltics compared to other groups can be defined accurately.

Regional differences in transition performance are rather significant, as described in the following table:

Table 6. Transition Performance of Regions⁹

Region	Economic Transition	Macroeconomic Performance	Democracy & Governance	Overall Transition
CEE	5-	4 ½	4 ½	5-
Baltics	5-	4-	5-	5-
Balkans	4	2+	3 ½	3+
Central CIS	2+	2-	3-	2 ½
Caucasian CIS	3	1 ½	3 ½	3-
Central Asian CIS	2+	2-	2-	2
Average	3 ½	3-	4-	3+

Two regions, the CEE and the Baltics, are superior in all three dimensions. The Central and Eastern European region has a very even record, but the Baltic countries' weak spot is macroeconomic performance. Balkan countries constitute an intermediate region with fairly good economic transition record but quite low economic performance. The former Soviet republics are the last ones, with Central Asian countries with the poorest regional transition record.

It is somewhat surprising that the Baltics, carrying the burden of half a century as Soviet republics, have progressed as well as the most developed FSCs, the Central and Eastern European countries. This can be explained to a certain degree by the inclusion of Croatia, with its relatively poor macroeconomic and democracy record, to the CEE. However, there is a substantial difference between the Baltic and the Balkan countries, to the benefit of the former, and even larger difference to the other former Soviet republics.

Another striking feature is the quite poor macroeconomic performance of all the regions except the CEE and the Baltics. Comparatively, the economic and democratic transition of the non-CEE/Baltic regions has been better than their economic performance, but it is still far below of that of CEE and Baltics. This clearly indicates a correlation between progress in transition and economic performance.

This correlation is studied in the two charts (3a and 3b) below, which demonstrate the relation between initial position and post-socialist transition. In the analysis, the FSCs are divided into the six regional groups mentioned in section 3.2. The method used is regression analysis, resulting in a set of correlation coefficients: value 0 represents no correlation whatsoever, values under 0.5 indicate either very weak or weak correlation, values above 0.5 indicate notable or strong correlation, while value 1 indicates a perfect correlation.

⁹ CEE = Croatia, Czech Republic, Hungary, Poland, Slovak Republic, Slovenia

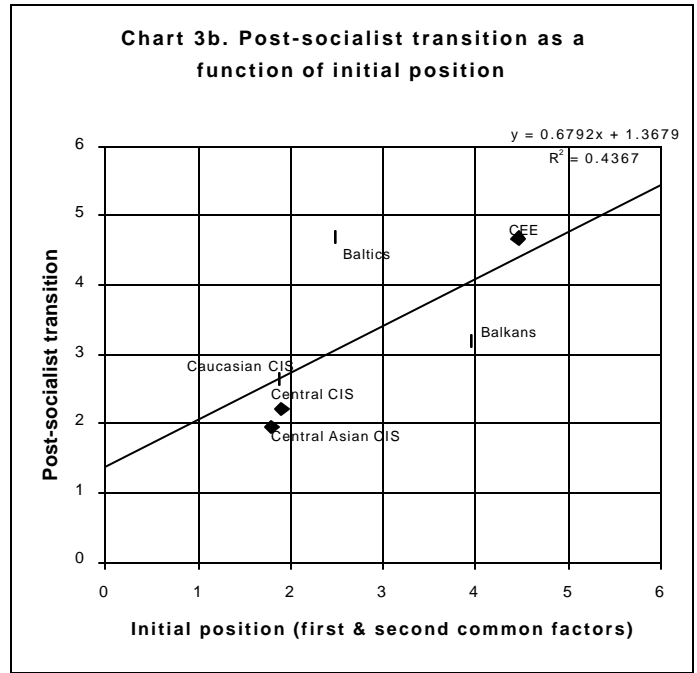
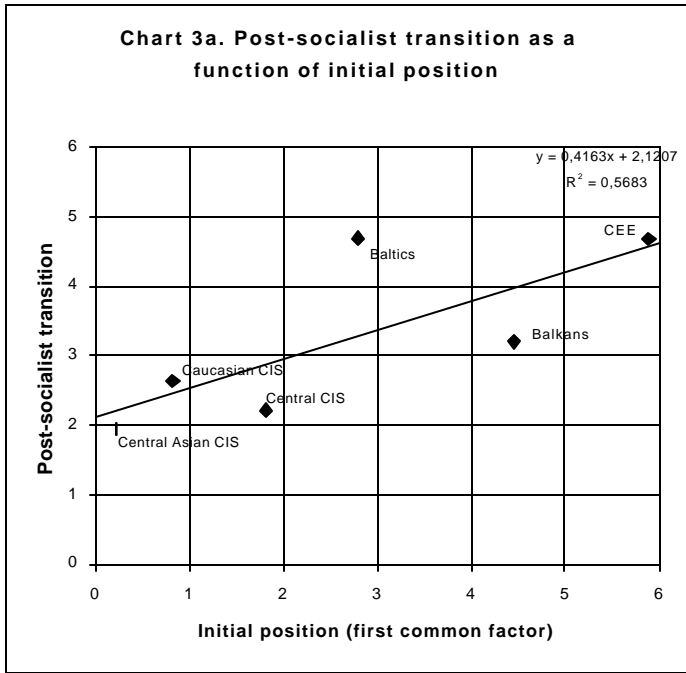
Baltics = Estonia, Latvia, Lithuania

Balkans = Albania, Bulgaria, Macedonia, Moldova, Romania

Central CIS = Belarus, Russia, Ukraine

Caucasian CIS = Armenia, Azerbaijan, Georgia

Central Asian CIS = Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan



In the first chart (3a) above, based on the first common factor (see section 4.1.), the correlation between initial position and advancement in post-socialist transition is notable (0.57), but in the second chart (3b), containing both first and second common factors, the correlation is clearly quite weak (0.44). In both charts, the CEE countries as well as all CIS groups have a strong correlation between their initial position and transition performance, but as to the Baltic and Balkan countries, the correlation is weak. The Baltics have progressed much better than their initial position would leave one expect. The contrary situation prevails in the Balkan countries.

5. REINTEGRATION PROCESS OF FSCs TO WESTERN ORGANIZATIONS

5.1. Typical reintegration process

Up to now, the integration process of a FSC has had typically the following steps, though not necessarily all of them and not necessarily in the order below followed:

- 1) **Trade and Co-operation Agreements with EU** (1988-90)
- 2) **Joining the OSCE** (1991-95):
former Soviet and Yugoslav republics
- 3) **Joining the IMF/World Bank** (1990-93):
All FSCs
- 4) **Joining the Council of Europe** (1990-96):
Albania, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Latvia, Lithuania, Moldova, Poland, Romania, Russia, Slovak Republic, Slovenia, Ukraine
- 5) **Joining the WTO** (1994-2000):
Bulgaria, Czech Republic, Estonia, Georgia, Hungary, Kyrgystan, Latvia, Poland, Romania, Slovak Republic, Slovenia, Yugoslavia
- 6) **Association Agreement with European Union** (Europe Agreement)
- 7) **Partnership of Peace agreement with NATO**
- 8) **Application to join NATO**:
Albania, Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Poland, Romania, Slovak Republic, Slovenia,
- 9) **Preparation of application to join EU**
- 10) **Joining the OECD** (1995-2000):
Czech Republic, Hungary, Poland, Slovak Republic
- 11) **EU candidacy decision at Luxembourg summit** (1997):
Czech Republic, Estonia, Hungary, Poland, Slovenia
- 12) **Launching of membership negotiations with Luxembourg group** (1998)
- 13) **NATO summit decision on new members** (1998):
Czech Republic, Hungary, Poland
- 14) **EU candidacy decision at Helsinki summit** (1999):
Bulgaria, Latvia, Lithuania, Romania, Slovakia
- 15) **Launching of membership negotiations with Helsinki group** (2000)
- 16) **NATO Summit decision on new members** (2002)
- 17) **EU ready to accept new members** (as of 2003)
- 18) **New members joining the OECD**

5.2. Accession policy of Western organisations

There are basically three different accession policies found among the Western organisations studied. Firstly, very restrictive organisations with accession criteria which are either complex, politically determined or demanding high level of development, secondly, organisations which will in principle accept any country fulfilling their accession criteria and thirdly, organisations which strive for global or pan-European membership and have very simple admission criteria.

Of the organisations at hand, the EU, NATO and OECD belong to the first category, the European Council and GATT/WTO to the second, and CSCE/OSCE and IMF to the third category.

There are great differences among the various organisations when compared with the number of FSC members accepted. The most exclusive are NATO (3 FSC members), OECD (4 members) and EU (5+5 candidates). On the other hand, CSCE and IMF have accepted all 27 FSCs, while the Council of Europe (16 members) and GATT/WTO (12 members) are in the middle field.

5.2.1. NATO

NATO is, in principle, open to any European democracy able to fulfill its membership criteria (working democracy, market economy, armed forces under civilian rule and capability of armed forces to participate in NATO) and its membership obligations (most important being the 2% of GDP share defence budget).

NATO's 1991 summit in Rome established the North Atlantic Cooperation Council, which constituted of NATO signatories, former Warsaw Pact members, former Soviet republics and neutral states of Europe.¹⁰ NACC was transformed in 1994 into the Partnership for Peace (PfP) program with FSCs, including Russia, and the non-aligned European countries. One of the aims of PfP is to encourage military-to-military collaboration among its members.¹¹

NATO's "open door" policy was reaffirmed at its Brussels summit in 1994. This policy was meant to assure the potential new members that PfP was not "a permanent waiting room of NATO". According to President Clinton, the question after the Brussels summit was "not if NATO would take new members but when and how"¹². This principle was repeated at the 1997 Madrid summit, when three FSCs were invited as members, implying that "no non-member of NATO will have a veto on new members".¹³

NATO has so far invited only three former socialist countries as members – after Madrid the summit decision of 1997, the Czech Republic, Hungary and Poland became members in 1998. There was also support in Madrid for the membership of Romania and Slovenia, but the necessary consensus was not reached.

It is by no means clear how NATO will proceed towards other applicant countries, the decisions are expected not earlier than at the NATO summit in Prague in the November 2002. Russia has opposed inclusion of former socialist countries into NATO, but was not able to prevent the Czech Republic, Hungary and Poland from joining. Stronger opposition can be expected from the new president, Vladimir Putin, than from his predecessor Boris Yeltsin. Membership of a former Soviet republic can also be assumed to raise stronger opposition than that of a former Warsaw Pact country. NATO has been careful not to anger Russia unnecessarily and has used

¹⁰ Grayson: *Strange Bedfellows*, NATO Marches East, p. 23. Lanham, Maryland, 1999.

¹¹ Grayson, p. 82

¹² Grayson, p. 86

¹³ Secretary Albright in Vilnius, Lithuania on July, 13, 1997. *US Policy Towards Northeastern Europe*, pp. 63,65. USA, 1999

PfP to strengthen NATO-Russia military ties and thus diminish Russia's suspicions. However, NATO's bottom line is not to give Russia a veto right when a former socialist country is joining it.

5.2.2. EU

EU membership is by far the most complex of all organisations at hand, covering altogether 31 different areas of economic, social, political and judicial life. Membership requires a profound change in the candidate country, and negotiations take usually several years. EU was unwilling to accept a great number of candidates before its internal structural reform was launched, and thus candidates were chosen in two groups: at the Luxembourg summit (1997) and at the Helsinki summit (1999). Both groups contain five FSCs and one or two other candidates. The groups are, however, not treated collectively but can proceed at any speed and membership can be reached at any time (the so-called regatta principle).

EU accession process is discussed in detail in chapter 7.

5.2.3. OECD

OECD is by definition a "club" of advanced Western industrial countries. Hence, it is not surprising that only four countries, the above-mentioned three NATO-members and the very recently joined Slovak republic have qualified as members.

The OECD's selective admission process centers around three key values: an open market economy, democratic pluralism, and respect for human rights. It is broadly based on the Convention of the organisation, which governs the aims and the responsibilities of its (possible) members.

"Article 1 of this Convention requires the Organisation to promote policies designed to achieve the highest sustainable economic growth and employment and a rising standard of living of the population. This must be achieved while maintaining financial stability inside the OECD area as well as on a world scale. The same article also requires that Member countries contribute to the expansion of world trade on a multilateral and non-discriminatory basis. Under the terms of Article 2 of the Convention, OECD countries undertake to ensure economic growth and external and internal stability, to reduce obstacles to trade in goods and services, to liberalise movements of capital, and to contribute to the economic development of all the world's countries. Members undertake to keep each other informed and to provide the Organisation with the information necessary for the accomplishment of its tasks, and to consult together, carry out studies and cooperate closely." ¹⁴

"All candidate countries agreed to participate in the exercise, unique to the OECD, called "peer review", which is based on transparency, explanation, and, when needed, self-criticism by the countries examined." ¹⁵

¹⁴ <http://www.oecd.org/about/general/member-countries.htm>

¹⁵ *ibid*

For most Central and Eastern European countries, OECD membership is therefore mostly contingent upon a strong stable economy. Economic stability combined with a (political) determination and willingness to liberalise all parts of the economy, from foreign direct investment and cross-border capital movements to service sector transaction, are therefore the two main criteria for OECD membership.

5.2.3. GATT/WTO

GATT/WTO already had Hungary, Poland, Romania and Yugoslavia as members before the collapse of communism. The eight new members are equally independent FSCs (Bulgaria, Czech Republic, Slovak Republic and Slovenia) and former Soviet republics (Estonia, Georgia, Kyrgystan and Latvia). The WTO rules of admission are clear-cut but rather tough for underdeveloped countries to fulfil

Because the brunt of the accession negotiations is concluded on bilateral level with current WTO members, it is difficult to point out specific criteria for accession. "Accession negotiations concern all aspects of the applicant's trade policies and practices, such as market access concessions and commitments on goods and services, legislation to enforce intellectual property rights, and all other measures which form a government's commercial policies. Applications for the WTO membership are the subject of individual working parties. Terms and conditions are related to market access (such as tariff levels and commercial presence for foreign service-suppliers) are the subject of bilateral negotiations."¹⁶

The rules of the WTO regarding trade cover most areas: agriculture, textiles and clothing, banking, telecommunications, government purchases, industrial standards, food sanitation regulations, intellectual property and much more. The WTO agreements regarding trade require members to abide by the principles of maintaining a freer, predictable and more competitive trading system without discrimination (most-favoured nation status for WTO members and national treatment of WTO members) and that provides increased benefits to less developed countries.

With the WTO's 139 members making up more than 90 % of world trade, there is increased pressure on the governments of non-members to join in. Despite the fact that the process has been slow to offer results, most FSCs (Armenia, Azerbaijan, Belarus, Bosnia-Herzegovina, Croatia, Macedonia, Kazakhstan, Lithuania, Moldova, Russia, Ukraine and Uzbekistan) are in the process of negotiations.

5.2.5. Council of Europe

"The Council of Europe is an intergovernmental organisation which aims: to protect human rights, pluralist democracy and the rule of law; to promote awareness and encourage the development of Europe's cultural identity and diversity; to seek solutions to problems facing European society to help consolidate democratic stability in Europe by backing political, legislative and constitutional reform."¹⁷

¹⁶ WTO Annual Report 2000

¹⁷ www.coe.int

The Council's most significant achievement is the European Convention on Human Rights, an international treaty of unprecedented scope, which came into force in 1953. The recently established European Court of Human Rights oversees the implementation of the rights and freedoms guaranteed under the Convention.

Any European state can become a member of the Council of Europe provided it accepts the principle of the rule of law and guarantees human rights and fundamental freedoms to everyone under its jurisdiction. The Council of Europe has accepted more than two thirds of FSCs as members. Those still outside are countries with difficult human rights problems, democracy deficit and/or government dominated judiciary. Almost all non-members (with the exception of Bosnia and Herzegovina, which has been given Special Guest to the Parliamentary Assembly status) are former Soviet republics.

5.2.6 IMF

The IMF is a global organisation established in 1946 to promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment

The IMF's membership now numbers 182 countries. Membership is open to every country that conducts its own foreign policy and is willing to adhere to the IMF charter of rights and obligations,(i.e. , avoidance of discriminatory currency practices, convertibility of foreign-held balances, furnishing of information, consultation between members regarding existing international agreements and obligation to collaborate regarding policies on reserve assets). All major countries are now members of the IMF and the formerly centrally planned economies of Eastern Europe and the former Soviet Union have become members.¹⁸

The IMF, like GATT, had some socialist member countries (Hungary, Poland and Romania). All FSCs joined IMF early, by 1993 at the latest. Most of them joined in 1992 and a very few before that (Albania, Bulgaria, Latvia). The IMF, as a global organisation, expanded its membership quickly to this new group of countries.

5.2.7. CSCE/OSCE

CSCE/OSCE (Conference/Organisation for Security and Co-operation in Europe), established in early 1970s, is by definition a pan-European organisation, and, like IMF, sought to achieve a rapid admission of FSCs. Most of them joined only one year after the break-up of Soviet Union (1992). The independent socialist countries of the cold-war era were original CSCE members (Bulgaria, Czechoslovakia, Hungary, Poland, Romania, Russia and Yugoslavia).

Originally set up as a conference (CSCE) aimed to overcome East-West differences in promoting pan-European security, the Organisation for Security and Co-operation in Europe (OSCE) is a security organisation whose 55 participating States span the geographical area from Vancouver

¹⁸ www.imf.org

to Vladivostok. The largest regional security organisation of its kind, it aims to be the primary instrument in its region for early warning, conflict prevention, crisis management and post-conflict rehabilitation. The OSCE approach to security is comprehensive and co-operative. It deals with a wide range of security issues, including arms control, preventive diplomacy, confidence- and security-building measures, human rights, election monitoring and economic and environmental security. Because decisions are made on the basis of consensus, all states participating in OSCE activities have an equal status. OSCE, formerly the CSCE, is based on the Helsinki Final Act (1975) and the Charter of Paris (1990).¹⁹

With the recent re-admittance of the Federal Republic of Yugoslavia, OSCE's membership now includes all former socialist countries.

5.3. Present situation of FSC reintegration process

None of the FSCs has yet completed its reintegration process. As a whole, the 27 former Socialist countries have proceeded quite slowly towards membership in the seven Western organisations.

Below in chart 4, FSCs are divided to groups according to number of memberships in western organisations (and candidatures to EU):

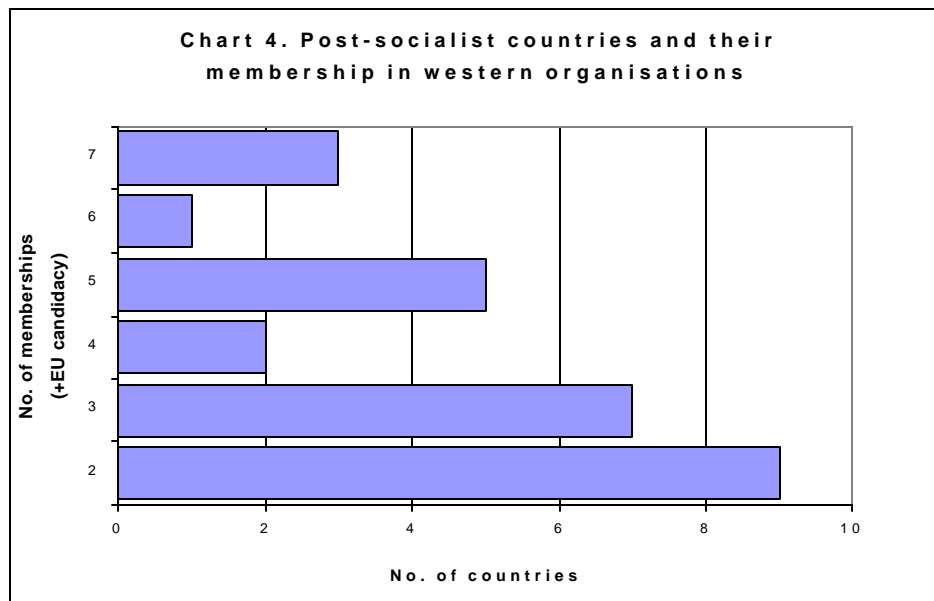


Chart 4. Clearly shows how the FSC reintegration has proceeded rather slowly: after almost twelve years since the collapse of communism and ten years after disintegration of the Soviet Union, the majority of FSCs (17 countries) has not attained more than two or three memberships in Western organisations. Respectively at the top, the number of countries with six or seven memberships (incl. EU candidature) is very low (4 countries of 27).

¹⁹ www.osce.org

In the following table 7., reintegration is displayed countrywise by organisation and by time of accession:

Table 7. FSCs memberships in Western organisations and their candidature of EU

Country	CSCE/ OSCE	IMF	CoE	GATT /WTO	OECD	NATO	EU cand.	TOTAL
Albania	91	91	95					3
Armenia	92	92	(96) ²⁰					2
Azerbaijan	92	92	(96) ²⁰					2
Belarus	92	92						2
Bosnia	92	92	(94) ²⁰					2
Bulgaria	75	90	94	96			99	5
Croatia	92	92	96					3
Czech Rep.	93 ²¹	93	94	94	96	98	97	7
Estonia	91	92	93	99			97	5
Georgia	92	92	99	00				4
Hungary	75	82	90	73	96	98	97	7
Kazakhstan	92	92						2
Kyrgyzstan	92	92		98				3
Latvia	91	92	93	99			99	5
Lithuania	92	92	93				99	4
Macedonia	95	92						2
Moldova	92	92	95					3
Poland	75	86	91	67	96	98	97	7
Romania	75	72	93	71			99	5
Russia	75	92	96					3
Slovak Rep.	93 ²³	93	93	95	00		99	6
Slovenia	92	92	93	94			97	5
Tajikistan	92	92						2
Turkmenistan	92	92						2
Ukraine	92	92	95					3
Uzbekistan	92	92						2
Yugoslavia	75	?		66				?

The use of only the number of memberships or EU candidature for measuring the achieved reintegration is, of course, quite rough, as 1) the relative importance of organisations to FSCs varies, 2) difficulty of access varies (as discussed in detail in previous chapter) and 3) the timing of EU candidature (1997/99) is a major indicator of the FSCs' reintegration success (also discussed in chapter 6.2.).

In charts below, where correlation between advancement in reintegration and economic performance is presented, the timing of EU candidature is taken into account as a relevant indicator of reintegration.

²⁰ Special guest to the Parliamentary Assembly to the Council of Europe

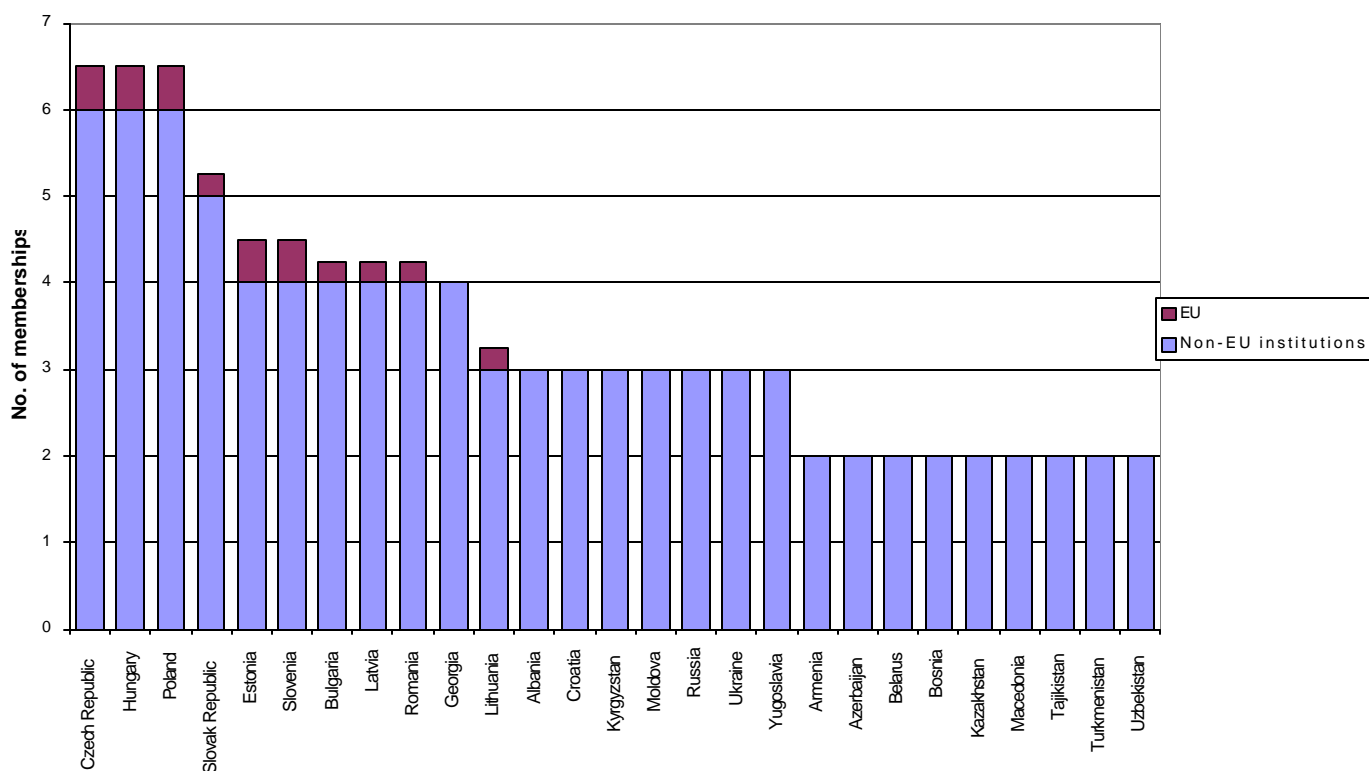
²¹ Czechoslovakia was original member of CSCE (1975), after separation Czech and Slovak Republics joined CSCE in 1993

In the following, , an EU candidacy in the earlier Luxembourg group is defined to equal to a ½ membership and a candidacy in the later Helsinki group is equal to a ¼ membership. This is a very artificial and by no means scientific division and used only to bring about the differences between candidate countries as to their entry to EU membership negotiations. The following division of FSCs results:

- 6 ½: Czech Republic, Hungary, Poland
- 5 ¼: Slovak Republic
- 4 ½: **Estonia**, Slovenia
- 4 ¼: Bulgaria, **Latvia**, **Lithuania**²², Romania
- 4: Georgia
- 3: Albania, Croatia, Kyrgystan, Moldova, Russia, Ukraine, Yugoslavia
- 2: Armenia, Azerbaijan, Belarus, Bosnia, Kazakhstan, Macedonia, Tajikistan, Turkmenistan, Uzbekistan

In the following chart 5, the reintegration of FSCs is presented according to the above numerical values:

Chart 5. Post-socialist countries and their membership in Western organisations



²² Lithuania is here assumed to have attained the WTO membership, which it will formally receive 30 days after the notification to WTO of the ratification of Lithuanian parliament of the WTO membership agreement. The ratification took place on April 26, 2001. (Source: www.urm.lt)

The higher advanced group ($> 5 \frac{1}{2}$) consists of the three existing NATO members, which also belong to the first EU candidacy (Luxembourg) group: Czech Republic, Hungary and Poland.

The lower advanced group ($5 - 5 \frac{1}{4}$) consists of Slovakia only, which reached this group due to its recent OECD membership.

The higher intermediate group ($4 \frac{1}{4} - 4 \frac{3}{4}$) contains the remaining EU candidate countries, of which Estonia and Slovenia belong to the Luxembourg group and Bulgaria, Latvia and Lithuania and Romania to the latter Helsinki group of candidates.

The lower intermediate group ($3 \frac{1}{4} - 4$) contains only Georgia. This country has been admitted both by the Council of Europe and by WTO. Georgia has progressed best of former Soviet republics..

The higher slow-progress group ($2 \frac{1}{4} - 3$) contains former mother countries of federations, Russia and Yugoslavia, and those FSCs, mostly formerly non-independent states, which have advanced at least to some extent: Albania, Croatia, Kyrgystan, Moldova, Ukraine.

The lower slow-progress group ($0-2$) includes those countries that have achieved only the readily available CSCE and IMF memberships. They are exclusively former Soviet or Yugoslav republics with serious political, human rights and/or democracy deficit problems.

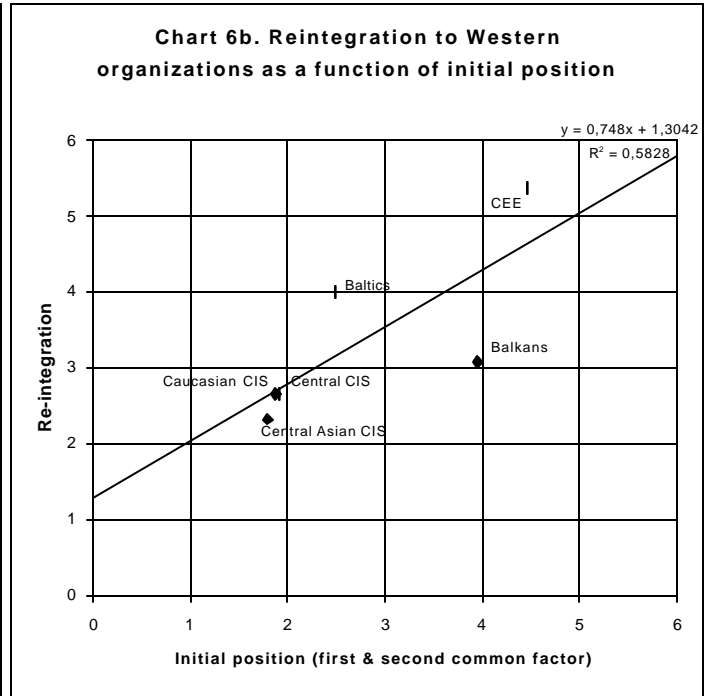
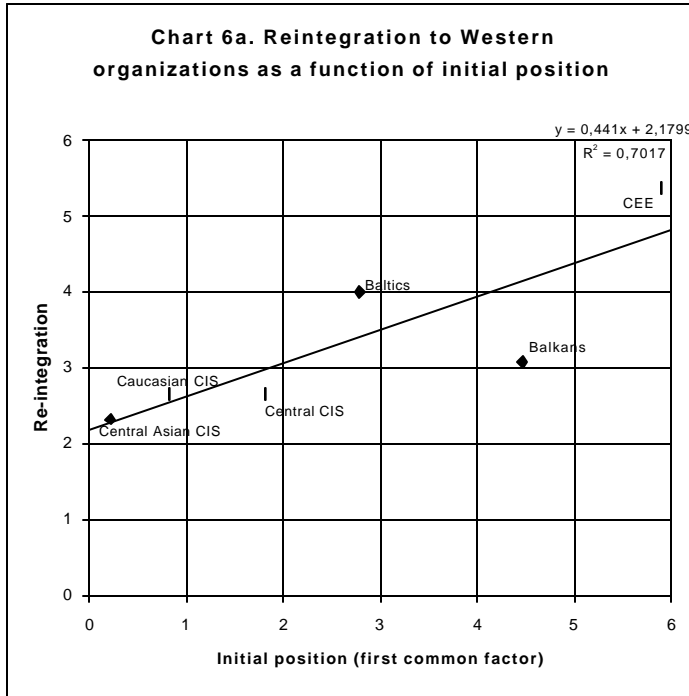
5.4. Correlation of reintegration to initial position and transition

In the following sections, reintegration is studied as a function of several factors; namely initial position, economic transition, macroeconomic performance, democracy and governance and, as a function of overall post-socialist transition. In the analysis, the FSCs are divided in the six regional groups mentioned in section 3.2. The method used is regression analysis, resulting in a set of correlation coefficients: (for details, see section 4.8).

5.4.1. Reintegration as a function of initial position

As explained in section 4.1., the EBRD analysis of initial positions of FSCs at the end of Socialist rule were based on two common factors, the first explaining about 50 % of the overall initial position, and the second approximately 20 %. It was also argued that the second common factor, taking industrialisation and urbanisation as liabilities, was somewhat distorted and gave unexpected results.

In the first chart presented below (6A), initial position is measured by the first common factor only, and in the second (6B) the weighted averages of both factors are used.



In the chart 6A, the correlation between initial position and reintegration is strong (0.70), but it is somewhat weaker in the second chart (0.58). This might be explained by the above-described controversy concerning the second common factor. However, the correlation is strong enough to allow a conclusion that the initial position of the FSCs has a strong relation to their success in reintegration to the West.

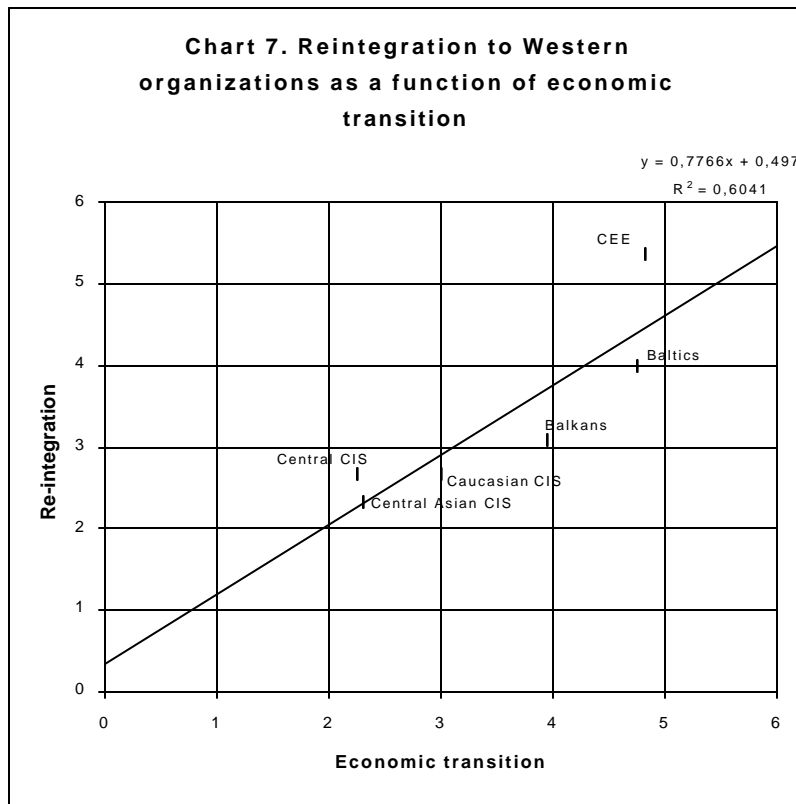
The Baltic countries have achieved the second highest reintegration level, in spite of their much worse initial position compared to the CEE and Balkan countries. This achievement is a clear result of their success in post-socialist transition compared to the Balkan countries, which in turn has brought the Baltics rapid reintegration into western organisations. The position of the Baltics as an intermediate group between the Central European FSCs and the CIS countries is clear. Their initial position is only slightly better than that of CIS states, but their success in reintegration clearly exceeds that of the Balkans and is not very far from that of the CEE countries.

5.4.2. Reintegration as a function of economic transition

As described in section 4.3., in this study economic transition contains three elements: market reform, legal transition and infrastructure transition. In the chart 7 below, correlation between economic transition and reintegration is clear, but not very strong (0.60). It seems that the correlation is much stronger in the CIS groups than in the other groups. The Balkans have less reintegration than their economic transition success would indicate, and the same is true with the Baltics. Their economic transition is at the same level as that of the CEE countries, though the latter has clearly achieved a higher level of reintegration.

There is reason to assume that the economic transition explains the success in reintegration to some extent, but the correlation is not among the strongest. An explanation to this might be in the fact that the content of economic transition is largely immaterial: adopting new commercial legislation and regulations, liberalisation of prices, currency and foreign trade and reorganising fiscal structures. The implementation of these relatively easy measures is often not effective, and from the Western point of view, formal reform is not seen sufficient but must be followed by real changes in practice. The results of poor implementation can be seen in macroeconomic performance.

The Baltics, having an excellent economic transition record, are lagging behind the CEE countries in reintegration. The reason must be found somewhere else than in the Baltics' successful economic transition and it can be found in the admission policies of NATO and OECD. The Baltics, as former Soviet republics and neighbours of Russia, have a too sensitive position for NATO membership. As to OECD, the Baltics are still recovering from their very deep GDP decline in the early 1990s and are not yet in a position to attain membership in this organisation, unlike the richer CEE members of the OECD.

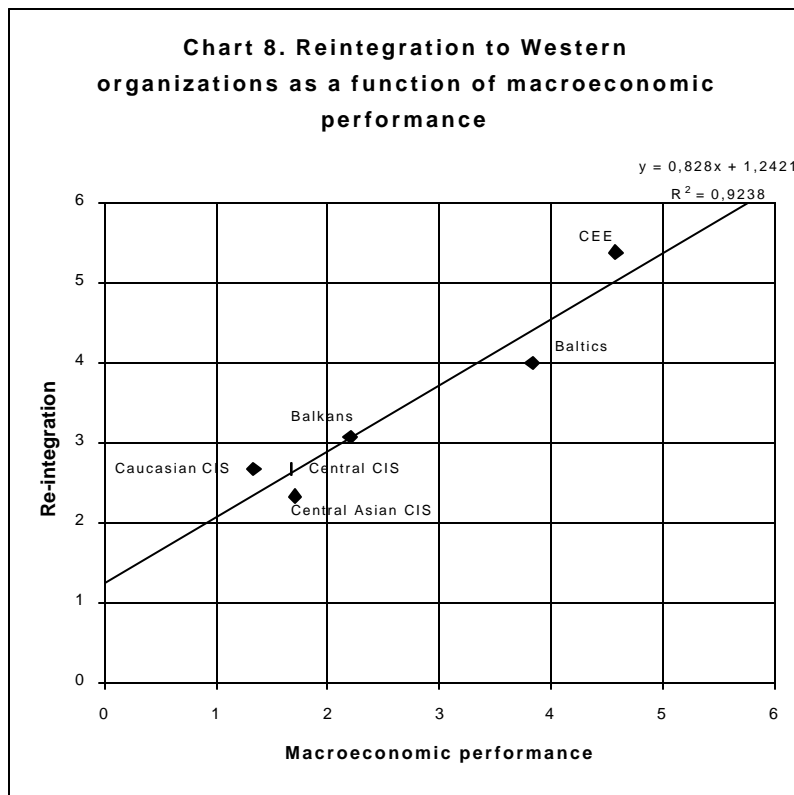


5.4.3. Reintegration as a function of macroeconomic performance

The FSCs' macroeconomic performance was measured by using two elements: the real GDP index of 1998 (year 1989 GDP=100), and the cumulative foreign direct investment per capita (see section 4.4.).

As seen in the chart 8 below, the correlation of macroeconomic performance with reintegration is very strong (0.92). There are no substantial differences among the groups, which gives reason to believe that macroeconomic performance explains success in reintegration better than any other variable. The Baltics and the Balkans, which had a quite weak correlation between their economic transition and reintegration, now have a very strong relation when it comes to macroeconomic performance.

The Baltics' relatively poor real GDP index brings their macroeconomic performance down, in spite of their good record in receiving direct foreign investments. Hence their macroeconomic performance level correlates very strongly with their reintegration record.



In his book *Transition and Economics*, Roland²³ divides former socialist countries into four categories according to their economic performance during the nine-year time span after liberalisation. While he excludes former Central Asian Soviet republics from his study, there are quite still clear similarities with the countries included in the groupings presented in chart 8 above:

1. Countries recovering after an initial output fall: Czech Republic, Croatia, **Estonia**, Hungary, Poland, Slovak Republic, Slovenia

²³ Roland, pp. 17-21

2. Countries experiencing an initial output fall and uncertain recovery: Bulgaria, Romania
3. Countries experiencing a very strong output fall and slow recovery: **Latvia, Lithuania**
4. Countries experiencing a continuous output fall: Belarus, Russia, Ukraine

When the countries included in Roland’s study are divided in four groups according to their level of reintegration and these groups are tabulated with his categories of economic performance, Table 8 emerges:

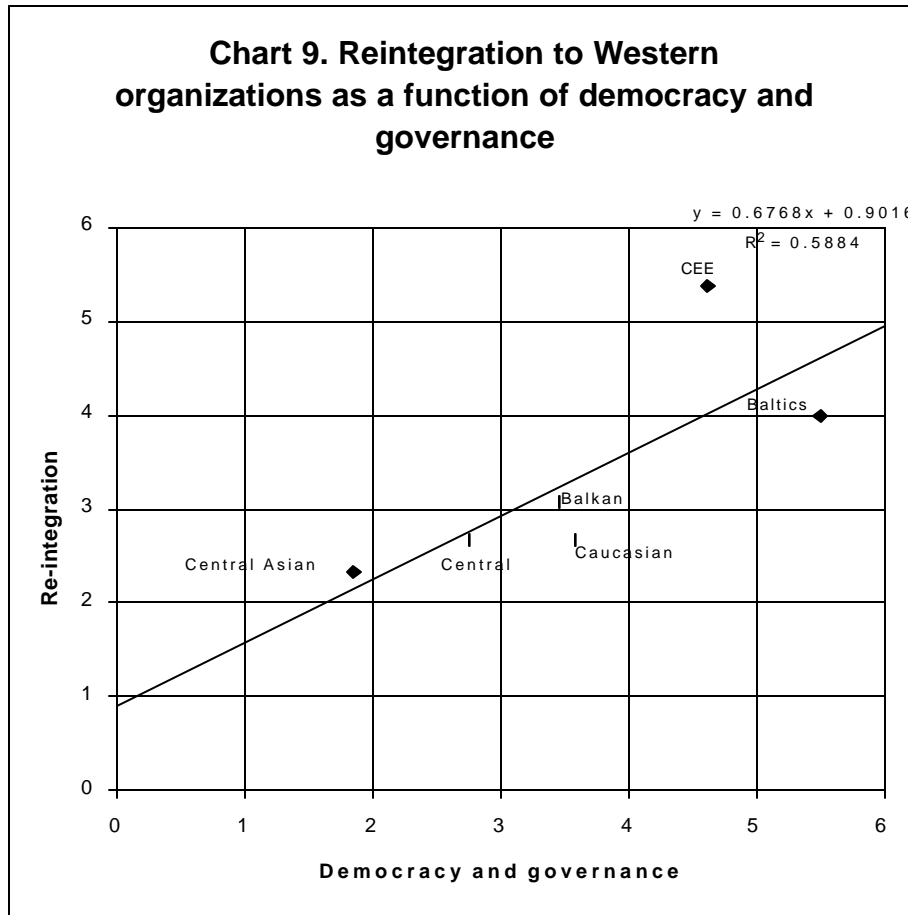
Table 8. FSCs’ phase of integration and post-socialist economic performance

Economic performance	Phase of reintegration			
	1. Most advanced	2. Less advanced	3. Intermediate	4. Least advanced
1. Recovering countries	<i>Czech Rep Hungary Poland Slovak Rep..</i>	<i>Estonia Slovenia</i>	<i>Croatia</i>	
2. Uncertain recovery		<i>Bulgaria Romania</i>		
3. Strong output fall, slow recovery		<i>Latvia</i>	<i>Lithuania</i>	
4. Continuous output fall				<i>Belarus Russia Ukraine</i>

In the above table 8, the relationship between these two factors is obvious. The Baltics’ positions here are similar to the previous results in this chapter.

5.4.4. Reintegration as a function of democracy and governance

The functioning of democracy and the quality of government was measured using three elements: political competition (tenure of governments in months), political and civil liberties (Freedom House indexes) and quality of governance based on an EBRD study. As presented in the chart 9 below, the correlation between democracy and governance and reintegration is clear, but not very strong (0.59). It may be true that this relatively weak relation is a result from the same phenomenon as that of economic transition: a formally working democracy might not be enough. Rapidly changing governments might indicate political instability, and good results in quality of government might also indicate that administrative structures remain more or less the same as during the Socialist era.



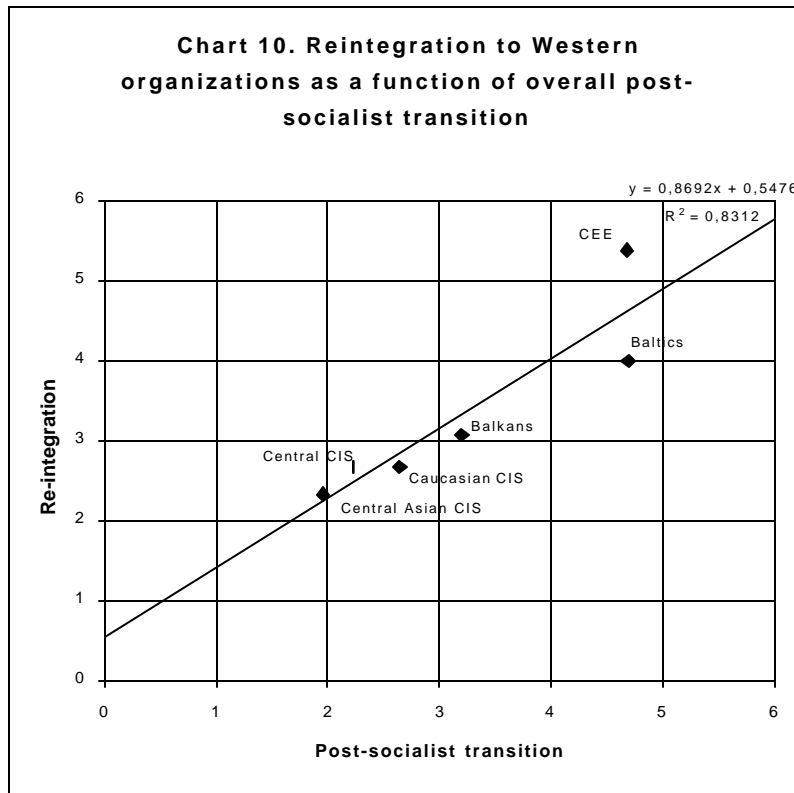
The fact that the Caucasian CIS countries have a better record in democracy and governance than the Balkans and that the Baltics have the best record of all regional groups is not followed by corresponding achievement in reintegration. It is obvious that the democracy and governance variable explains reintegration success much less than macroeconomic performance and initial position and has slightly less explanatory power than economic transition.

The Baltics have clearly the best record in democracy and governance, better than that of CEE, but it has not helped them to achieve the same level of reintegration as the CEE. The same reasons that explain the missing NATO and OECD memberships (see chapter 5.4.2 on economic transition) are probably also valid as to democracy and governance.

5.4.5. Relation of overall transition to reintegration

To sum up the previous chapters, the chart 10 below illustrates the correlation between overall post-socialist transition and reintegration. The correlation coefficient is high (0.83), clearly higher than that of initial position (0.70). It may be concluded that what has taken place since the end of the socialist era has been more important to reintegration success than the initial position

the countries had. However, the correlation in both cases is strong; both initial position and post-socialist transition are substantive explanatory factors for reintegration.



The Baltics have a post-socialist transition record matching that of the CEE countries, but they have not been as successful in reintegration for external political reasons (NATO-Russia relations) and because of their relatively poor economic position, which has postponed their membership in OECD with several years.

However, the transition performance of the Baltics has been remarkable. One major indication of their success is that the EBRD, in its annual transition report 2000, has merged the CEE and the Baltics into one group (CEE-Baltics). This underlines the fact that in almost all areas of transition, the Baltics are at same level as the CEE, if not higher.

6. ACCESSION TO EUROPEAN UNION

6.1. Enlargement process

The European Union's latest enlargements took place in 1986, when Portugal and Spain joined, and in 1995, when Austria, Finland and Sweden became members. In the case of Portugal and Spain, the negotiations took seven years, while those of the former European neutrals took three. Portugal and Spain were poorer than EU average when joining, but Austria, Finland and Sweden exceeded the EU wealth average.²⁴

The European Union committed itself to inclusion of European FSCs into the Union at the Copenhagen summit in 1993, where it promised that “the countries in Central and Eastern Europe that so desire shall become members of the Union. Accession will take place as soon as a country is able to assume the obligations of membership by satisfying the economic and political conditions”.²⁵ The criteria for membership were then defined and are referred to as the Copenhagen criteria.

At the Madrid summit of 1995, the European Commission was given the task of preparing a composite paper on enlargement, containing opinions on each applicant country's readiness for membership. The Commission presented its findings in the Agenda 2000 paper in 1997, and recommended opening negotiations with six countries: Cyprus, Czech Republic, Estonia, Hungary, Poland and Slovenia. The Commission further opined that the Union could not, because of its lacking internal structural reform, accept more than five new members, but some countries, like Sweden, Denmark and Italy, favoured opening negotiations with all applicants.

A compromise was reached at the Luxembourg summit in December 1997, when it was agreed that the accession process would be started with all applicants, but negotiations only with the above mentioned six countries.²⁶ The remaining FSC applicant countries (Bulgaria, Latvia, Lithuania, Romania and Slovak Republic) together with Malta and Turkey were given candidate country status at the Helsinki summit in December 1999.

Of the FSC applicants, the so-called Luxembourg group, is more below the EU wealth average than Portugal and Spain. This is even more true with the latter wave of candidate countries, the so-called Helsinki group.

The negotiations with the Luxembourg group started in March 1998, and have proceeded from easier questions to the tough ones, like agriculture and labour. The Helsinki group countries only commenced their negotiations with the EU in February 2000, with the exception of Turkey, which has to first get its human rights and minority record to correspond with the Copenhagen criteria.

At the Helsinki Summit in December 1999, the EU decided to reform its internal structures and decision-making to match the great number of future new members. The deadline set in Helsinki

²⁴ Barnard-Martin: EU enlargement, Europe, Issue 397/June 2000, Washington 2000

²⁵ EU Commission Enlargement Strategy Paper 2000, p.1

²⁶ Jopp & Arnswald 1998, p. 77-84

for implementation of the reform is the end of the year 2002, after which the EU is, in principle, ready to accept new members. The inter-governmental conference with this mission worked to produce proposals to be accepted at the Nice summit in December 2000.

The record-long Nice summit ended in a vague compromise on the structural reform of the EU, but from the point of view of candidate countries, the Nice outcome was positive: the obligations of the Helsinki summit were fulfilled and a major obstacle to their membership was removed.

Although new candidates were accepted in two groups, they are not expected to join collectively: all countries will join by their own merits (the “regatta” principle) Thus later starters can potentially pass earlier beginners of membership negotiations (“catch-up” principle).

Although the EU would be ready for new members in 2003, it was widely assumed that the first new members would join somewhat later, by 2005, when the mandate of present Commission expires²⁷ or 2006, when the EU is celebrating its fiftieth anniversary²⁸. Recently, more positive evaluations have been presented. The Commission expects the negotiations with most advanced applicants to be concluded by the end of 2002, and the European Parliament, in its resolution of October 2000, called for participation of the first new members in the next European Parliament elections in the spring of 2004.²⁹ The EU commissioner in charge of enlargement, Guenther Verhaugen, saw “a definite window for the first accessions” (2003-04), when evaluating the enlargement process after Nice.³⁰

6.2. Accession procedure for new members

The above-mentioned Copenhagen criteria of 1993 define the economic and political conditions for membership. Membership requires that each candidate country has achieved

- stability of institutions guaranteeing democracy, the rule of law, human respect for and protection of minorities;
- the existence of a functioning market economy as well as the capacity to withstand competitive pressure and market forces within the Union,
- ;
- the ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union

The pre-accession strategy of the European Union contains several elements that are aimed at facilitating the access of new members into the Union by assisting the candidates to fulfil the Copenhagen criteria. The Europe Agreements, which were concluded with applicant countries in 1994-95, aimed at transforming the applicant countries’ economic relations with the EU on the basis of free trade and reforming their internal markets and administrative and legal structures

²⁷ Guttman: European commissioner for enlargement Gunter Verheugen, Interview , Europe, Issue 397/June 2000, Washington 2000

²⁸ Bernard-Martin

²⁹ EU Enlargement Strategy Paper 2000, p. 35

³⁰ Verhaugen: “The Enlargement Process after Nice”, Brussels, January 16, 2001

already before membership negotiations actually began. In this work, EU offered assistance through its programs and agencies, especially through the PHARE program. During the actual negotiations, screening (analytical examination) of *acquis* (EU's existing legislation) and the Association Partnerships have been main elements³¹. Details of the pre-accession elements are presented below:

- 1) Trade and Co-operation Agreements³²
 - concluded in 1991-92, no option for accession
 - conditional, mutual obligation-based agreements
- 2) Free Trade Agreements³³
 - concluded in 1994, effective as of 1995
 - normal free trade agreements with transition periods
- 3) Europe Agreements³⁴
 - concluded at Corfu summit in June 1994 with all other applicants except the Baltics and Slovenia, whose agreements were accepted at the Essen Summit in December 1994
 - key element of pre-accession strategy
 - Association Councils, Committees examine implementation of priorities
- 4) Accession Partnerships³⁵
 - current partnerships adopted in 1999
 - sets out the key short-term and medium-term priorities to be met to prepare for membership in regular, annual reports
 - indicate the financial assistance available to support priorities and conditionality of assistance
 - national programmes for adoption of the *acquis* (NPAA) indicate the human and financial resources and the timetable to meet accession priorities
- 5) Participation in Community programmes and agencies³⁶
 - financial and expert assistance for aligning infrastructures to *acquis*
 - PHARE program: co-finances institution building and investment in *acquis* implementation
 - the pre-accession assistance amounts currently to over three billion Euro (\$ 3b)
- 6) Screening³⁷
 - analytical examination of *acquis* with FSCs (multilateral) launched in April 1998
 - goal to identify issues that may have to be taken up at negotiations
 - screening completed by the end of 1999

The progress of applicant countries was first analysed in the 1997 Opinions on Applications for Membership, which have been followed by Annual Reports (1998, 1999 and 2000). The reports assess the candidates' progress toward membership. The actual negotiations take place in accession conferences between Member States and each of the applicants, on the basis of the 31

³¹ EU Enlargement strategy paper 2000, pp. 9-15

³² Jopp & Arnswald, pp. 48-49

³³ *ibid.* 51-52

³⁴ EU enlargement strategy paper, p. 13

³⁵ *ibid.*, p.10

³⁶ *ibid.*, pp. 11-12

³⁷ *ibid.*, pp. 14-15

chapters covering all areas of *acquis*. Today, all chapters except the ones dealing with institutions and other matters, have been opened, totalling 29 chapters.³⁸

The accession progress is examined by the EU in three main areas: 1) political criteria, 2) economic criteria and 3) other requirements : *acquis* implementation, the European Monetary Union (EMU) and the Euro).

As to political criteria, the Commission states in its 2000 report that all candidates fulfil the Copenhagen criteria, but there are still problem areas, like public administration and judiciary, corruption, gender equality, minorities and the Roma (gypsies).³⁹

The Copenhagen economic criteria, a functioning market economy and capacity to withstand competitive pressure and market forces within the Union, are fulfilled by the candidates in a varying degrees: Estonia, Hungary and Poland are the leading group, followed by the Czech Republic and Slovenia, which both fulfill the first criteria and are expected to fulfil the second in near term. Latvia, Lithuania and Slovakia, fulfilling the first criteria, are expected to fulfill the second criteria in mid-term. Bulgaria, although not fulfilling either criteria, has made more significant progress than Romania.⁴⁰

The economic progress of candidates has improved in 2000 as GDP has grown 4-5 %. There are problems with inflation (Romania), the current account deficit (Baltics and Poland) and increasing unemployment in almost all countries. Trade with the EU has grown threefold between 1993-99.

In other requirements, the Commission notes that while adoption of *acquis* has progressed, the development in *acquis* implementation has been uneven. Good progress is reported in internal market, transportation, environment and common foreign and security policy, steady progress has been made in justice and home affairs and energy, but progress has been slow in agriculture, social policy and employment. As to the EMU and the Euro, the Commission emphasises obligatory participation in EMU, while inclusion into the eurozone is not expected at accession but later. Romania and the Slovak Republic need to improve their pre-EMU efforts.⁴¹

6.3. Progress in accession negotiations⁴²

The negotiations with the first group of candidates were opened on March 31, 1998 and with the second on February 15, 2000. At the Luxembourg Group, all 29 chapters have been opened and by the end of March 2001, 15 to 18 chapters have been provisionally closed. In the Helsinki Group, 10 to 23 chapters have been opened and 6 to 13 chapters have been provisionally closed.

By March 2001, the opening of chapters had proceeded as follows:

³⁸ *ibid*, p. 15

³⁹ Eu enlargement strategy paper 2000, pp. 16-18

⁴⁰ *ibid*, pp. 19-23

⁴¹ *ibid*, pp. 24-28

⁴² EU:n laajentuminen, Finnish Foreign Ministry background paper, 28.07.2000

1. Luxembourg group:

- November 1998: seven chapters opened
(science and research, education and training, small and medium-sized enterprises, culture and audiovisual policy, telecommunications, industrial policy, common foreign and security policy)
- First half of 1999: eight chapters opened
(company law, statistics, consumer and health protection, fisheries, competition policy, free movement of goods, customs union , external relations)
- Second half of 1999: eight chapters opened
(social policy, EMU, free movement of capital, energy, transport, taxation, freedom to provide services, environment)
- First half of 2000: seven chapters opened
(agriculture, regional policy, free movement of persons, justice and home affairs, financial control, financial and budgetary provisions, institutions⁴³)

2. Helsinki Group:

- in June 2000: 5-8 chapters opened by country of the following:
(competition, statistics, small and medium-sized enterprises, science and research, education and training, culture and audiovisual policy, external relations, common foreign and security policy, industry, telecommunication)
- second half of 2000: 4-9 chapters opened by country of the following:
(free movement of services, free movement of capital, company law, competition, fisheries, transport, EMU, social policy, industry, telecommunication, culture and audiovisual policy, environment, consumer and health protection, customs union)
- first half of 2001: 1-7 chapters opened by country of the following:
(free movement of services, company law, competition policy, fishery, social policy and employment, energy, telecommunication and information technologies, regional policy and structural instruments, environment, customs union, financial and budgetary provisions)

In the negotiation process with the Luxembourg group countries, an equitable policy was followed: the same number of identical chapters were opened at each of the four opening phases, and all but two chapters (institutions and other matters), totalling 29 chapters, have now been opened in this group. This policy was not followed with the Helsinki group, but different numbers of chapters per applicant country were opened both during the Portuguese (1st half of 2000), the French (2nd half of 2000) and the current Swedish presidency. The number of opened chapters varies from 10 to 24 (as of March 31, 2001).

There are considerable differences between the applicant countries as to the conditional closing of chapters. Not surprisingly, in both the Luxembourg and Helsinki groups, the most advanced country is the one not belonging to the FSCs, Cyprus in the Luxembourg group and Malta in the

⁴³ Will be considered only after the EU's institutional reform has taken place.

Helsinki group. In the following, the progress of candidate countries is studied by using the number of opened and closed chapters at the beginning of French presidency (July 2000) and in the middle of the Swedish presidency (March 2001).

The following statistics clarifies the accession situation:

Table 9: Candidate countries; number of opened and closed chapters in EU accession negotiations as of March 31, 2001

Country	Opened chapters		Closed chapters	
	July 2000	March 2001	July 2000	March 2001
LUXEMBOURG				
Cyprus	29	29	16	18
Czech Republic	29	29	13	15
Estonia	29	29	13	18
Slovenia	29	29	13	18
Hungary	29	29	11	17
Poland	29	29	11	15
HELSINKI				
Malta	17	21	7	13
Slovak Republic	16	23	6	12
Latvia	24	24	5	11
Lithuania	22	22	5	13
Bulgaria	11	14	4	8
Romania	9	10	5	6

The Baltic countries have proceeded well. Estonia tops the Luxembourg group in number of closed chapters (18) together with Cyprus and Slovenia. Latvia has been able to open the highest number of chapters (24) in the Helsinki group, and Lithuania, with Malta, shares the first position in the number of closed chapters (13). The Helsinki group has not been able to catch up the Luxembourg group, but the differences have diminished. Only the Balkan candidates, Bulgaria and Romania, have had clearly less progress than the others in the Helsinki group. The CEE countries Czech Republic and Poland have slowed down their pace, and are now somewhat behind the rest of the Luxembourg group.

6.4. Conclusion of the negotiations⁴⁴

The accession negotiations are based on the principle that candidates accept the *acquis* and apply it effectively upon accession. However, it is customary that both the candidates and the EU request for transitional measures in order to delay the application of a specific part of *acquis* for a limited period. So far, the Commission has received over 340 requests in the agricultural sector and more than 170 on other areas. In preparing the common positions towards the requests, the Commission will distinguish three categories of transitional measures: acceptable, negotiable and unacceptable. The Commission reserves the possibility of proposing transitional measures in the

⁴⁴ EU Enlargement Strategy paper 2000, pp. 29-38

interest of the Union, and has presented its proposal to the free movement of labour with lengthy transition periods in April 2001.

In order to advance the negotiations and, as far as possible, to conclude them before the end of 2002, the commission proposes a “roadmap” to be adopted in the form of a sequenced approach to remaining chapters. The Commission would leave only those chapters with greatest budgetary implications to be negotiated in 2002 and solve all others already this year. In detail, the Commission proposes that during the first and second half of 2001 and the first half of 2002, common positions including positions on transitional measures would be defined, as divided in the table 10 below, with the aim of closing the chapters concerned:

Table 10. Conclusion of the EU membership negotiations; timing of chapter closings

First half of 2001	Second half of 2001	First half of 2002
Free movement of goods	Competition policy	Agriculture (remaining)
Free movement of persons	Transport policy	Regional policy and structural instruments
Freedom to provide services	Energy	Financial and budgetary provisions
Free movement of capital	Taxation	Institutions
Company law	Customs union	Other matters
Culture and audio-visual policy	Agriculture	
Social policy and employment	Fisheries	
Environment	Justice and home affairs	
External Relations	Financial Control	

The Commission urges the Helsinki Group candidates to prepare their positions on the remaining chapters in order to begin negotiations on all chapters with the most advanced countries of this group as early in 2001 as possible. The Commission is prepared to present the common positions on transitional measures in all chapters requested by the most advanced candidates by July 2002.

The target set at the Helsinki 1999 summit “to welcome new member states from the end of 2002” will, according to Commission, be achieved with the most advanced candidate countries by following the above mentioned “roadmap”. Taking into account that the results of the accession negotiations must be ratified by national parliaments of the present members as well as the European Parliament, it would seem that year 2003 is the earliest possible date for the entry of new members. However, giving room for delays in negotiation and ratification processes, 2004 is a more probable year for the next enlargement of the EU.

PART II: REINTEGRATION OF THE BALTIC COUNTRIES TO THE WEST

7. INITIAL POSITION OF THE BALTICS

However small they may be, the three Baltic countries, Estonia, Latvia and Lithuania, encompass a surprising array of differences. History, language, religion, ethnic composition, outward orientation: the Baltics are very different from each other. But when it comes to modern history, their fate has been uniform. All three gained independence from Russia after World War I, but were annexed to the Soviet Union in the spring of 1940. They became involuntary Soviet republics and battle fields during the World War II, when invading German troops occupied them in 1941. When the Red Army defeated the Germans in the Baltic states in 1944, Estonia, Latvia and Lithuania were reannexed to the Soviet Union.

As Soviet republics, the three Baltics were the most weltoff republics within the Soviet Union. They became heavily industrialised, although Estonia and Latvia already maintained a quite developed industry before annexation. Lithuania, on the other hand, was a more agriculture-dominated economy. The rapid and large-scale industrialisation lead to substantial immigration of Russians and other Soviet nationals to the Baltics.

The Baltics constitute an interesting “intermediate” group of former Socialist countries: they were Soviet republics, but were under Socialist rule a considerably shorter period (50 years) than other republics (approx. 70 years). This fact, as well as their strong pre-war relations to the Western countries of the Baltic Sea area and their relatively developed market economy, has given the Baltics an advantageous initial position within the Soviet republics. However, when compared to Central and Eastern European FSCs, the Baltics have a major handicap in not having the government machinery of an independent state but being forced to devote lots of energy and work to create it. The status of Soviet republic also severed foreign trade: only 5 % of their trade went outside the Soviet Union and even that was mostly controlled by Moscow.

In the following sections, the initial position of each Baltic state is studied in more detail.

7.1.Estonia⁴⁵

With a land area of 45,125 sq. km and population of 1.44 million (January 2000 estimate), Estonia is the smallest of the three Baltic countries.

Estonia was under the Germanic knights of the Teutonic Order since the 13th century, but was annexed to Sweden in 1558. The Swedish rule was ended by Tsar Peter the Great in 1721, when Estonia became part of the Russian empire. Three years after the Bolshevik revolution of 1917, Estonia became independent under the Treaty of Tartu of 1920. After experiencing independence (1920-40) and then annexation to the Soviet Union, Estonia declared independence after 51 years of Soviet rule in August 1991.

Since that time Estonia has gone a significant way down the path towards democratisation and market liberalisation, creating the most open, free-market economy of all the former Soviet

⁴⁵ Estonia, EIU Country Profile 2000, Economist Intelligence Unit

Union countries. It was first governed by a semi-nationalist, somewhat rightist government, which was replaced in 1995 by a more centrist and left-leaning government after economic hardship persisted and a series of scandals. In March 1999, the right-of-centre parties managed to win 53 of the 101 seats in the Riigikogu (national parliament) and regain power.

Estonia's political system consists of a unicameral 101-seat parliament (the Riigikogu) and requires parties to gain at least 5% of the vote to enter the parliament. Its term is 4 years, with all citizens above the age of 18 being having the right to vote, even though the Citizenship law prohibits those who have not passed a citizenship test and exhibit competence in Estonian from voting. The president is a primarily ceremonial head of state, with some powers including the right to return legislation for reconsideration, appoint the prime minister and declare a state of emergency.

The executive power rests with the Council of Ministers, consisting of deputies from the governing parties. The judiciary is independent, with the National Court being the highest court in the country.

The two main goals of Estonian foreign policy are membership in NATO (the readiness for which Estonia has declared to meet by 2002) and in the EU (for which it was the only former Soviet Union country invited in the first group). It continues to have a strained relationship with Russia, mostly because of the position of the ethnic Russian minority within the country.

Estonia's armed forces number 3510, with a plan to increase defence spending to 2% GDP by 2001 in order to meet the minimum requirement for NATO membership. In addition, Estonia participates in various Balkan initiatives with the other two Balkan republics.

Estonia's population is made up of 65.2% native Estonians, 28.1% Russians and 2.5% Ukrainians. The highly contested citizenship legislation seems to have a part in determining the makeup of the population.

Estonia has a 99% literacy rate, with more than 95% of students continuing into secondary education and an increasing number continuing to higher education (an increase from 25,800 in 1991 to 30,070 in 1997).

The level of health has undergone dramatic changes during the transition, but seems to be on a more stabilising trend lately.

Estonia has very few natural resources, the most significant being oil shale, which accounts for 65% of Estonia's fuel supply. The mixed effect of the highly polluting oil shale production and the legacy of the Soviet era has, however, resulted in significant environmental problems and great potential clean-up costs for the future.

Estonia is the most "Nordic" of the Baltics, Estonians are Protestants, like the Nordics, their language is closely related to Finnish and Estonia has oriented herself to the Nordics in her external relations, mainly to Finland and Sweden.

Estonia was the wealthiest of the Baltics during the Soviet era, its net material product (NMP) was 22 % higher per capita than the average of Soviet Union (Latvia +16 %, Lithuania +6 %). Estonia's industrial structure was dominated by light industry and a relatively low share of all-union enterprises, which both were advantages in facilitating the building of industry of independent state. Estonia's main industrial problem is the shale oil, an environmentally difficult source of energy.⁴⁶

7.2. Latvia⁴⁷

With a land area of 64,589 sq. km and population of 2.42 million (January 2000 estimate), Latvia is the second largest of the Baltic republics.

Latvia's historical experience is similar to that of Estonia: Germanic rule from 13th century until 1591, when the Livonian state, established by Germans, was divided between Sweden and Polish-Lithuanian empire. In 1921, Russia added most of Latvia to its empire. After short-lived independence after 1922, Latvia became part of the USSR in 1940. It regained independence from the Soviet Union in September 1991 and is a unicameral parliamentary democracy.

Deputies are elected to the Saeima (parliament), under a system of proportional representation, which has brought a great number of political parties into the system, frequent government crises and relative uncertainty. A right-of-centre government won the first post-independence elections in 1993, but a shaky political horizon led to the general election of 1995 which led to a multiparty coalition government to prevent the ultranationalists from gaining access to power. The government was constantly on a shaky ground with the 1998 general elections not doing much to improve the situation. The president, Vaira Vike-Freiberga, is seen as standing above the party political fray.

Latvia's political system consists of a unicameral 100-seat parliament (the Saeima) and requires parties to gain at least 5% of the vote to enter the parliament. Only Latvian citizens and Latvian residents prior to 1940 have the right to vote. The president is a primarily ceremonial head of state, but may hold considerable political authority with respect to both foreign policy and domestic politics based on his/her personal authority.

The executive power rests with the Council of Ministers, headed by a prime minister chosen by the president and approved by the Saeima. The judiciary is independent, with the Supreme Court being the highest court in the country and the Constitutional Court overseeing the constitutionality of passed legislation.

The two main goals of Latvian foreign policy are membership in NATO and in the EU (which it plans to be ready to join in 2003). It continues to have a strained relationship with Russia, almost deteriorating to the brink of economic war in 1998 mostly because of the ethnic Russian minority in Latvia but hope can be seen in the more liberal 1999 version of the citizenship law.

⁴⁶ OECD Economic Survey: Baltic States, 2000, pp. 26-29

⁴⁷ Latvia, EIU Country Profile 2000, Economist Intelligence Unit

Latvia's armed forces number 8190, with one of the lowest defence spending in Europe (less than 1% in 1999) but Latvia plans to increase defence spending to 2% GDP by 2002 in order to meet the minimum requirement for NATO membership.

Latvia's population is made up of 55.7% native Latvians, 30.3% Russians, 4.3% Belorussian, 2.7% Ukrainian and 2.6% Polish. The contested citizenship law, despite being revised from its original version under international pressure, still requires a history and language test as a prerequisite to naturalisation.

In addition to its three strategic ice-free ports, Latvia's most important natural resource are its forests which cover about 45% of the land area. Latvia has insignificant energy sources and imports more than three fourths of its energy, most of it from Russia.

Latvia is a kind of "go-between" within the Baltics, as it is oriented to both the northern and southern countries of the Baltic Sea Rim. Being a mixture of Protestants and Roman Catholics and speaking an Indo-European language, the Latvians have maintained relations both with the Nordics (especially Sweden and Denmark) and with Germany and Poland in the south.

Latvia had its net material product per capita 16 % above the Soviet average, putting her in the middle of the Baltics as to per capita wealth. Latvia became the most industrialised of the Baltics, and especially machine industry was developed during the Soviet era, even to the amount of "over-industrialisation". Defence industry played a major role, employing 15 per cent of the total labour force. The share of all-union enterprises in Latvia rose to 35 %. Because of her advantageous geographical position, Latvia became a major transport hub within the Soviet Union.⁴⁸

7.3.Lithuania⁴⁹

Lithuania has a land are of 65,300 sq. km and a population of 3.7 million (January 2000, official est.).

Historically, Lithuania has also been a contested land with a more diverse history being the result of the 400-year Lithuanian-Polish Commonwealth, which ended in 1795 by Russia's annexation of Lithuania. After inter-war independence, Lithuania became part of the Soviet Union in 1940 and remained so (with the exception of the German invasion) until declaring independence in March 1990. The tense and somewhat bloody conflict with Moscow that ensued lasted for more than a year and ended after the Moscow coup in August 1991. In 1992, following economic hardships and a severe fuel shortage, the "reformed" communists returned to take power and held on to it until 1996 when a political crisis forced the prime minister to resign. The centre-right manage to retake power, but after the 1998 presidential election and the political tensions that followed, the Lithuanian political scene has seen its share of uncertainty.

⁴⁸ *ibid*

⁴⁹ Lithuania, EIU Country Profile 2000, Economist Intelligence Unit

Lithuania's political system consists of a unicameral 141-seat parliament (the Seimas) and requires parties to gain at least 5% of the vote to enter the parliament. Its term is 4 years, with all citizens above the age of 18 being having the right to vote. The executive power rests with the Council of Ministers, headed by a prime minister appointed by the president and approved by the Seimas. The president is the head of state and has a relatively broad set of powers, from appointment of ministers, subject to approval of the Seimas to foreign policy decisions and the right to return legislation for reconsideration. The highest court in the country is the Supreme Court, which oversees a tiered system of district and regional courts. The Constitutional court oversees the constitutionality of laws and has the right to impeach judges and the president.

The two main goals of Lithuanian foreign policy are membership in NATO (Lithuania was the first former Soviet republic to apply in 1994) and in the EU (for which it was invited in the second round of invitations). It continues to have a strained relationship with Russia, mostly because claims for compensation for Soviet occupation. Its relationship with Poland has improved in the later 1990's but it still has a strained relationship with Latvia (mostly because of competing economic interests).

Lithuania's armed forces number 12130, with its defence spending being higher than that of either Estonia or Latvia.

Lithuania's population is made up of 81.6% native Lithuanians, 8.2% Russians and 6.9% Poles, making it the most ethnically homogeneous of the Baltic republics. Unlike Latvia's and Estonia's citizenship law, Lithuania's granted naturalisation to all residents..

Lithuania has small offshore oil reserves in the Baltic Sea and some onshore reserves in western Lithuania, but most of Lithuania's oil and gas supplies are imported from Russia. Mazeikiu Nafta is the only refinery in the Baltic. 80% of Lithuania's energy needs are provided for by two Chernobyl-style RBMK nuclear reactors at Ignalina, with the rest being supplied by thermal and hydroelectric power plants.

Lithuanians, who like Latvians speak an Indo-European language (different from Latvian), are by far majority Roman Catholics and heavily oriented towards Poland and Germany.

In Lithuania, the NMP per capita was only 6 % higher than Soviet average. This was to some extent explained by the higher share of agriculture in Lithuanian economy than in Estonian and Latvian economies. Lithuanian industries, of which a hefty 40 % were all-union enterprises, were mainly labour-intensive light industries, with relatively advanced electronic industry. Lithuania was strong in energy production: she had the only oil refinery and nuclear power plant (Ingalina) within the Baltics.⁵⁰

⁵⁰:ibid

7.4. Comparison of initial positions of the Baltics⁵¹

Although the economies of Estonia and Latvia were more industrialised before annexation, the massive industrialisation typical of the Soviet Union resulted in three basically similar economies, where differences can be found but not very substantial ones.

Before the annexation, the standard of living of Estonia was comparable to that of Finland and was the highest among the Baltics. It seems that this difference persisted also during the Soviet era.

Some comparisons can be made on the basis of GDP composition, industrial structure, share of all-union industry, net material product per capita and ethnic composition:

Table 11. Initial position of the Baltic countries in comparison

	<u>Estonia</u>	<u>Latvia</u>	<u>Lithuania</u>
1. GDP structure, % (1989)			
industry + construction	44	45	45
Agriculture	20	19	27
Services	36	36	28
2. Industry structure, % (1989)			
Energy	7	2	9
Machinery	16	26	26
forest	9	6	5
textile, clothing, footwear	22	18	21
food processing	25	26	22
3. Share of all-union industry, %	13	35	40
4. NMP per capita relation to average Soviet NMP per capita, %	+22	+16	+6
5. Ethnic composition, % of population (before WWII/1989)			
Natives	88/62	77/52	69/80
Eastern Slavs	8/35	12/44	3/12
Poles	0/0	2/2	15/7
others	4/3	9/4	13/1

It seems that Estonia has the most advantageous initial position of the Baltics: she has the most advantageous industrial structure, with far less all-union enterprises, and a substantial light industry, which was mostly under Estonian rule. It also has the highest standard of living. On the other end, Lithuania has more agriculture-dominated economy and the largest share of all-union enterprises in industry as well as the lowest standard of living. Latvia is situated in between.

However Lithuania has ethnically the most homogenous population while in Latvia the Russians' share of the population was the largest and Estonia lies in the middle.

⁵¹ OECD Report on Baltic States 2000, pp. 24-29

In the EBRD study of the initial position of the FSC, the results differ to some extent. As described in detail in chapter 4.1., the EBRD study is based on two common factors, the values of which are located on a scale from -4 (best initial position) to +4 (worst initial position). On this scale, the Baltics are located as follows⁵²:

	First common factor	Second common factor
Estonia	0.40	1.72
Latvia	0.24	1.85
Lithuania	0.00	1.53

The results indicate that Lithuania has the best initial position among the Baltics, followed by Latvia and Estonia. In the author's opinion, this outcome may well be challenged with the support of OECD data. The more realistic order is just the opposite. However, the differences between the Baltics as to their initial position are not substantial.

⁵² Falcetti, Raiser & Sanfey, p. 20

8. TRANSITION POLICIES AND MACROECONOMIC DEVELOPMENT

8.1. Transition policies

Although the initial positions of the Baltics were roughly similar as described above, the policies of transition have differed, which in turn has been reflected in the macroeconomic performance of these states. The Baltics adopted quite similar courses in their macroeconomic stabilisation policies as well as in liberalisation, but differed considerably in restructuring the banking sector, in privatisation and in enterprise reform.

8.1.1. Macroeconomic stabilisation⁵³

Rapid and early price liberalisation, together with lack of control of monetary policy lead to hyperinflation, peaking over 1000 % in all Baltic countries by the end of 1992. This triggered a tight monetary policy (Estonia and Latvia in 1992, Lithuania in 1993) and launching of new national currencies (the kroon in Estonia, the lat in Latvia and the litas in Lithuania). Estonia adopted as the first of the Baltics a currency board by pegging the kroon to Deutschmark in 1992. Latvia and Lithuania followed in 1994, pegging the lat to SDR and the litas to USD, respectively.

The inflation rate decreased rapidly after the introduction of tight monetary policies with high real interest rates and supported by currency boards. Estonia and Latvia reached two-digit inflation (36/35 %) already next year in 1993 and Lithuania did so in 1994 (45%). In 1996, all Baltic countries' inflation was under 20 % and reached single-digit level in 1997 (Latvia, Lithuania) or 1998 (Estonia). Today, inflation is very low in Latvia and Lithuania (around 3 %) and low in Estonia (approx. 5 %).

In fiscal policies, the Baltics have followed similar policies of reducing deficits and even aiming at state budget surpluses until 1997. Lithuania was the only country to accumulate budget deficits through all these years, and in 1998 she eased up fiscal policy in order to stimulate her economy facing the August 1998 Russian economic crisis.

In macroeconomic stabilisation, Estonia and Latvia have preceded Lithuania, which has been the last to introduce stabilisation measures. The early currency board of Estonia – two years earlier than the others – has especially contributed to the credibility of Estonia's economy

8.1.2. Liberalisation⁵⁴

Price liberalisation was already launched in Estonia during Gorbachev era, in 1989, and in Latvia and Lithuania in 1991. In all three countries, price liberalisation was mostly completed by 1993, but in all countries significant sectors have remained outside: notably energy, heating, transportation and housing. The share of regulated prices exceeds 20 % of the consumer price index basket.

⁵³ OECD Report on Baltic States 2000, pp. 30-33

⁵⁴ *ibid*, pp. 30, 33, 35

Foreign trade was liberalised even more rapidly and extensively than prices. Estonia was the first to abolish duties by the end of 1993, while Latvia and Lithuania still maintained 15-30 % tariffs that year and entered free foreign trade only after concluding free trade agreements with the EU.. All Baltics adopted full current account convertibility in 1994. In 1995, they entered into free trade agreements with EU, Estonia without any adjustment periods, Latvia with a four-year and Lithuania with a six-year adjustment period. In 1999, Estonia and Latvia became members of WTO, and Lithuania, which is at the final stage of membership negotiations, is expected to join soon.

Liberalisation of foreign direct investments (FDI) was introduced through respective law in 1990 in Lithuania and in 1991 in Estonia and Latvia, which amended their legislation in 1993 and phased out tax benefits in 1995. Lithuania introduced a new FDI law only in 1999, when equal treatment of foreign investors was attained. Some restrictions still remain, most often concerning ownership of land, where liberalisation has proceeded slowly.

8.1.3. Banking sector reform⁵⁵

The Baltic countries have followed widely different policies in reforming the banking sector. Their policies have at least at the early phase of reform been affected by severe banking crises, which have had cleansing effects on the banking sector.

Estonia was the first Baltic state to face a banking crisis, which already occurred in 1992. The crisis led to elimination of about half of the 43 banks, and investors and depositors lost at least part of their deposits. Another crisis hit in 1994, but this time deposits were guaranteed by the state and bad loans were directed to a “trash” bank. The number of banks was reduced to 15, and has decreased steadily to six banks at present, among which two major banks cover 80-90 % of banking. This development has significantly strengthened the Estonian banking sector.

In Latvia, the number of banks increased very rapidly in the early 1990s and reached its peak, 63 banks in 1993. The very high number of banks and lack of risk management led to banking crisis in 1995, during which none of the 15 bankrupt banks was bailed out, many bad loans were eliminated and 40 % of deposits were lost. As a result of the crisis, banking sector control was strengthened and a higher capital requirement on banks was introduced. However, the Latvian banking sector remains fragmented with 25 banks still in operation.

Lithuanian approach to banking reform was characterised by reluctance to accept foreign capital and by delay of privatisation of banks. As a result, number of problem loans soared, and a banking crisis occurred in 1996. The government compensated the losses of depositors and, together with bank recapitalisation, a major burden (estimated at 3-4 % of GDP) was laid on state budget. Some progress has, however, been noted, especially the share of bad loans has decreased from 28 % in 1998 to 11 % in mid 1999. Unlike in Estonia and Latvia, almost half of the banking sector is controlled by two state-owned banks (expected to be privatised).

Estonian banking sector is now 60 % foreign owned (mainly Swedish), and numbers in Latvia and especially Lithuania are lower.

⁵⁵ OECD Report on Baltic States 2000, pp. 30, 35-36

8.1.4. Privatisation⁵⁶

Perhaps the strongest differences in transition approaches can be seen in privatisation, where basically two different policies existed: direct sales and voucher scheme. Estonia and Latvia (with delay) followed the policy of direct sales of state-owned companies, instead of the voucher scheme adopted by Lithuanian government.

Furthermore, Estonia set very few restrictions to foreign ownership of state-owned firms to be privatised, and did not favour insiders (former managers, who were mostly Russians) in sales of enterprises. In large-scale privatisations, the emphasis was in finding strong owners capable to run the enterprise successfully. The Estonian privatisation proceeded quickly, and by 1995 most of state-owned companies had been privatised. The process has been slower in latter half of 1990s when privatisation of major energy and infrastructure companies was faced.

Estonian privatisation was advanced by the country's tough bankruptcy law, which demanded either privatisation or elimination of the company concerned. Also the quickly developed banking sector offered private sector finance to potential buyers, and, as a result, hard budget constraints were established. Thus restructuring of state-owned companies by the government hardly took place.

In Latvia, the privatisation process has been largely similar to that of Estonia, but with delay. In 1994 only Latvia adopted the policy of direct sales, although a small-scale voucher scheme was implemented as well. Latvia is looking for strategic partners and wishes to sell controlling interests in enterprises. The Latvian Privatisation Agency still has some temporary control of privatised enterprises. The bankruptcy law of Latvia is not as effective as that of Estonia.

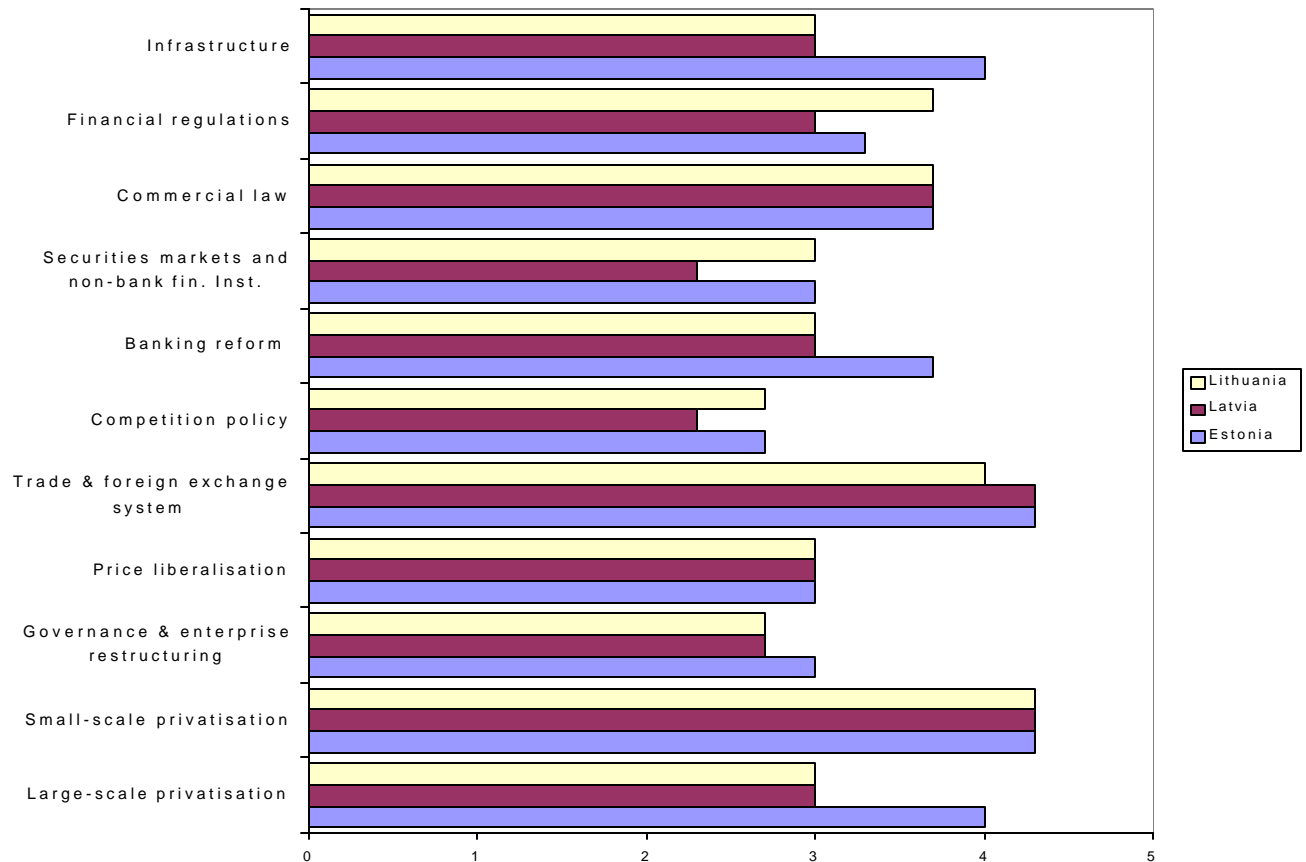
Lithuania followed the voucher scheme, gave property rights to insiders and was not willing to accept foreign investors. Also, even after privatisation the state remained as a major stakeholder in many cases. By end-1998, almost 3000 state-owned companies were not fully privatised and only 28 per cent of the enterprises were fully privatised. The Lithuanian government changed its policies in 1998, striving to sell control packages (51 % of shares). Lithuania has systematically tried to restructure state-owned companies, rather than letting them be liquidated, and the state still plays a role in bankruptcies, especially when large employers are concerned.

⁵⁶ OECD Report on Baltic States, pp. 30, 36-38

8.1.5. Comparison of overall transition

Chart 11 gives a breakdown of market reform: the Baltics' performance in the eight indicators of market reform is presented below, together with the two indicators of legal transition (commercial law and financial regulations) and the overall infrastructure performance:

Chart 11. Transition indicators in the Baltic countries



Estonia has best record of the Baltics in large-scale privatisation, governance & enterprise restructuring and banking reform, which all represent the hardest areas of market reform, the structural and institutional reforms. Latvia is lagging behind the other two in non-banking sector reform and competition policy, Lithuania in trade and foreign exchange liberalisation.

The differences in economic transition between the Baltics are presented below in Table 11:

Table 11. Economic transition record of the Baltics, 2000⁵⁷

Countries	Transition indicators			
	Market reform	Legal transition	Infrastructure transition	Average
Estonia	3 ½	3 ½	4	4 -
Latvia	3	3 +	3	3
Lithuania	3+	4 -	3	3 +

The differences are not great, but still clear: Estonia is slightly better in both in market reform and legal transition and significantly better in infrastructure transition. Lithuania has proceeded averagely somewhat better than Latvia, especially in legal transition.

In Table 12, the overall transition record of the Baltics is presented (economic transition, macroeconomic performance and democracy and governance combined):

Table 12. Overall transition record of the Baltics

	Economic transition	Macroeconomic performance	Democracy & governance	Overall average
ESTONIA	6 -	5	6	6 -
LATVIA	4 +	3 ½	5 ½⁵⁸	4 ½
LITHUANIA	4 +	3	5	4 +

Overall transition records show even more clearly the leading position of Estonia, whose record is at the very top of the FSCs. Latvia fares slightly better than Lithuania, due to its better macroeconomy (esp. FDI) and democracy record.

8.2. Macroeconomic performance of the Baltics

8.2.1. GDP decline and growth⁵⁹

Like all FSCs, the Baltics had a steep decline in gross national product after the collapse of the Socialist system. Actually, the Baltic three dived deeper than any other group among the FSCs, Central European countries, South-East European or Balkan countries and even the CIS (Commonwealth of Independent States) or other former Soviet Republics. At its lowest in the year 1994, the combined Baltic GDP was just above 50 % of the 1989 level. However, the Baltics have climbed ever since and have surpassed the ever-declining CIS countries and almost

⁵⁷ EBRD Transition Report 2000, pp. 14, 34, 36

⁵⁸ Democratic competition and civil & legal rights only, indicator of governance missing

⁵⁹ OECD Report on Baltic States, pp. 38-43

reached the stagnating Balkan countries and their GDP is now around 70 % of the 1989 level. In comparison, the Central European countries' GDP has already exceeded that of 1989.

The 50 years as Soviet republics explains to great extent the steeper decline and slower recovery of the Baltics compared with Central European countries and, in lesser extent, with the Balkan states.. It could also be claimed that the more rigid and extensive transition process of the Baltics has contributed to the levelling of the Baltics with the Balkans recently, and, besides more rapid transition, their shorter Soviet rule has played a role in surpassing the other former Soviet Republics.

As to individual GDP development, Estonia has had the lowest decline – to approx. 65 % of the 1989 level, from where she has climbed to 80 % level. Latvia had the steepest decline, down to 50 %, and she has now reached 60 % of 1989 GDP. Lithuania has fared slightly better, down to 55 % and from there to present 65 % level. After a steady growth since 1995, the Russian rouble crisis, which began in summer of 1998, brought the growth of Baltic economies to a standstill or even to negative figures in 1999. However, growth rates are again positive during the first half of 2000 (6 % in Estonia, 3-5 % in Latvia and 2 % in Lithuania). Prospects for 2001 are relatively good.

The year-to-year GDP growth of the three Baltic states is described below:

Table 12. % Real GDP growth in Baltic states, 1991-2000,

Country	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000*
Estonia	-13.6	-14.2	-9.0	-2.0	4.3	3.9	10.6	4.0	-1.1	5.0
Latvia	-10.4	-34.9	-14.9	0.6	-0.8	3.3	8.6	3.6	0.1	3-5
Lithuania	-5.7	-21.3	-16.2	-9.8	3.3	4.7	7.3	5.1	-4.1	2.0

* EBRD 2000, Est.

8.2.2. Current account, external trade⁶⁰ and investments

The external trade is “the most important factor in economic recovery” (OECD) in most FSCs. This is especially true in small, open economies like those of the Baltics. In Estonia, exports grew sevenfold between 1992 and 1998, in Latvia exports doubled and in Lithuania exports grew four-fold in the same time. Imports grew, however, in even more rapid pace and the Baltics have been running a current account deficit most of the time.

Actually, current account deficits in Baltic countries have been higher than in any other FSCs. Deficits emerged immediately, when Baltic GDPs started to grow in 1995 after steep decline. Current account deficits have been 4-12 % in Estonia, 4-11 % in Latvia and 10-12 % in Lithuania. In recent years, the deficit has been around 10 % in all three states. The Russian economic crisis curtailed exports to Russia considerably and deepened the deficit in Latvia and Lithuania. The net foreign debt emerging from current account deficit has reached 40 % of GDP in Estonia, about 20 % in Latvia and around 45 % in Lithuania. The OECD considers the net

⁶⁰ *ibid*, pp. 43-56, 186

debt of Estonia and Lithuania as such unsustainable. But when foreign direct investments (FDI) are taken into account as means of financing the deficit, a different picture of sustainability will emerge: in Estonia, the deficit is less than 10 %, in Latvia it disappears altogether and only in Lithuania it remains but at a lower, 25 % of GDP level. Thus FDI is very important in maintaining an external balance in Baltic states.

The different currency boards of Baltic states have recently caused problems. The Estonian kroon, pegged to Euro, has depreciated both to US dollar and other Baltic currencies, the lat, pegged to the SDR, has appreciated toward the Euro, and the litas, pegged to the USD, has appreciated toward both the Euro and other Baltic currencies. The Lithuanian government has, because of this development, decided to switch the peg of litas from the USD to the Euro as of latter half of 2001.

In foreign trade, the Baltics' starting point was less favourable: only 5 % of their "exports" was directed outside the Soviet Union, and even most of that took place under Moscow's control. With this background, the shift in foreign trade orientation has been remarkable. Already in 1995, when the Baltic economies started to grow, European Union covered 36-54 % of Baltic exports and 37-66 % of imports. In 1998, the European Union's share of Baltic exports was already 38-56%, from where it jumped to 50-64 % because of the Russian crisis. The share of CIS, mainly Russia, has remained remarkably high but was already in decline before the rouble crisis of August 1998. In 1995, CIS covered 25-42 % of Baltic exports and 19-42 % of imports. In 1998, the shares were 19-36 % in exports and 14-25 % in imports, whereupon a steep decline occurred to 11-19 % in exports, though imports were not affected.

The traditional external orientation of Baltics can be seen also in their foreign trade: Estonia's trade is oriented to Nordic countries, Latvia trades both with Nordics and Germany and Lithuania's main trading partner is Germany, while she remains most dependent on Russian trade.

Estonia's foreign trade and especially its foreign direct investments are strongly Nordic-dominated: its main trading partners are Finland (18 % of exports and 23 % of imports) and Sweden (19 % of exports and 10 % of imports). In investments, Sweden has a share of 37 % and Finland 30 %. Altogether, Nordic countries cover three quarters of FDI in Estonia. - Russia's share of Estonia's foreign trade has diminished to 10-15 %.

Latvia's foreign trade is dominated by Germany (17 % of exports and 16 % of imports) and Sweden (11 % of exports and 7 % of imports). In FDI, the USA is the leading country with a share of 13 %, followed by Denmark (12 %) and Germany (9 %.) The Nordics cover just 30 % of overall FDI. – Russia's share of Latvia's foreign trade is nowadays around 10 %.

In Lithuania, Germany is clearly the most important trading partner (exports share 16 % and that of imports 17 %). In FDI, Sweden (18 %) and USA (15 %) are most important investors. -Russia is more dominant in Lithuania than in other Baltics, its share is still around 20 %.

In overall foreign direct investments, all Baltics have succeeded well, they all are among the top seven recipients among the FSCs as to cumulative FDI in the years 1989-99. Estonia has the

third place (after Hungary and Czech Republic), Latvia ranks the fourth and Lithuania the seventh. The cumulative 1989-99 FDI in Estonia was USD 1604 million, equalling USD 1115 per capita. Latvia's corresponding figures were USD 2100 million and \$ 866, and those of Lithuania were USD 2012 million and USD 545. In 1998-99, the FDI's share of the Baltics' GDP have been averagely 5-6 per cent. The Baltics' share of the overall cumulative FDI to the FSCs has been 1.5-2.0 per cent per country, but they all are above the FSC per capita FDI average (USD 410).⁶¹

⁶¹ EBRD Transition Report 2000, p. 74

9. HISTORY OF REINTEGRATION⁶²

The Baltic countries gained their independence in August 1991, in connection with the failed coup d'état against President Gorbachev, which eventually led to dissolution of the Soviet Union. However, the Baltics had already launched their so-called "singing revolution" earlier, in 1989. In early 1990, the Baltics declared the restoration of sovereignty, which was followed by economic embargo of Soviet Union against Lithuania, and, in January 1991, by massacres of Vilnius and Riga, where 15 and 5 people respectively were killed by Soviet interior ministry troops (OMON). In their referendums of independence in the early spring of 1991, the Baltic nations accepted the restoration of independence. They gained their independence in 1990-91 (Lithuania in March 1990, Estonia and Latvia in August 1991).

These newly independent states had, at least in theory, various options regarding their future international status: neutrality, non-alignment, Nordic orientation, Baltic community, orientation to Atlantic community and USA, NATO-membership, EU-membership. Neutrality and non-alignment were abandoned at a very early phase: the bitter experiences of history as a whole and especially the last 50 years under Soviet rule called for some kind of alliance with the West. Nordic and Baltic alternatives were also rejected as insufficient security arrangements: the small countries, even together, would be no match to Russia's military might. Orientation towards Atlantic community, which would have meant trusting the USA for Baltics' security, was seen as an impractical and insecure solution.

What was left were basically memberships in NATO and the European Union. At first, the Baltics considered NATO membership as the only way to secure their independence and integrity, but the reluctance of NATO to invite the Baltics as members became apparent, and they began to lean more towards EU membership. This change of attitude was based on a realistic understanding of Russia's opinion on these alternatives: Russia declared its strong opposition against the NATO membership of the Baltics but it was positive on their EU membership.

The Baltics' membership processes towards Western organisations has been moderate among the FSCs, they have not fared as well as Central European FSCs but their success can be compared to Balkan countries and it has been better than that of other former Soviet republics.

In the initial phase of independence, the Baltics gained memberships in the CSCE and IMF, like all other FSCs. This took place in the years 1991-92, Lithuania becoming member of the CSCE in 1992 unlike Estonia and Latvia, which were accepted a year earlier.

The following year, 1993, Estonia and Lithuania were accepted as members in the Council of Europe, but Latvia followed them only in 1996.

Estonia and Latvia became members of WTO in 1999, and Lithuania has already concluded the final phase of membership negotiations.

⁶² This chapter is based on the home pages of the Foreign Ministries of the Baltics, international organisations and on the Country profiles of the Baltics published by the Economist Intelligence Unit

Estonia was given a candidate country status of European Union in the Luxembourg summit of 1997 and Latvia and Lithuania followed at the Helsinki summit of 1999.

All three countries have applied for NATO membership, and got a political recognition to their candidacy at NATO summit in 1998, but have not been invited as members by the alliance.

A membership in the OECD has not yet been attained by any of the Baltic states, and applications may still take some years to materialise.

9.1 Relations to Russia

The key challenge of all Baltic states after their independence was to normalise relations with Russia, which naturally was seen as a direct successor of the USSR, the former occupant of the Baltics. Not only was each Baltic state having sizeable Russian troops and important military bases on their soil, but Russians also constituted a major share of their population. The trade connections of the Baltics were almost completely to Russia or rather former Soviet Union.

The most urgent problem was that of Russian troops, whose existence on Baltic soil was in conflict with their newly gained status of independence. Negotiations on the withdrawal of Russian troops were launched almost immediately, but it took a few years to reach agreements. For instance, Estonia already demanded withdrawal in 1992, while Russia proposed the year 1997. Russia wanted long transition periods especially to withdrawals from crucial bases, like the huge Skundra radar station in Latvia (it remained in Russian possession for more than five years). To pressurise Russia, the Baltics appealed at various international forums, like the G 7, NATO and the 1992 summit of the CSCE for Russian withdrawal.

Negotiations proceeded slowly, but the support of Baltics to president Yeltsin in the coup attempt of October 1993 led to a better atmosphere, and in December 1993 a withdrawal agreement with Estonia was signed, giving Russian troops time to of August 31, 1994 to finalise their withdrawal. Similar agreement with Latvia was concluded in April 1994, but Lithuania managed to get Russian troops out of its soil already in 1993.

The position of the sizeable Russian and other ex-USSR minorities (Estonia 30 %, Latvia close to 40 %) was a major issue right from the beginning. Russia stressed the minorities' poor position and linked the withdrawal of Russian troops to securing of the position of Russian minority in Estonia and Latvia. Lithuania, having a far smaller Russian minority, did not face the same problems

The question culminated in the new citizenship legislation in Estonia and Latvia, where considerably stringent language requirements were set for Russians wishing to attain citizenship. Estonia requested an evaluation of the language law from both Council of Europe and the CSCE. The latter, as well as EU caused irritation within Estonian government with their critical statements on the contents of the law. The law has remained a major irritant in not only Estonian-Russian relations but also in Estonia's relations to EU, Council of Europe and especially the OSCE have suffered.

In Latvia, there was a genuine fear of Latvians becoming a minority in their own country, and hence, the requirements to attain Latvian citizenship were quite tight, causing conflicts with Russia as well as with the EU and other Western organisations. However, the EU candidate country position of Estonia and Latvia seems to have sped up necessary alterations in the language laws in both Estonia and Latvia, but the implementation of the laws remains still problematic.

The lengthy and very slow-moving negotiations on the border agreement between Estonia and Russia have not been concluded, it seems that Estonia has to accept de facto, but not de jure Russia's interpretation of the border. In Estonia's view, this means, a violation of the Tartu peace agreement of 1921 and a loss of approx. 2000 sq. kilometres of Estonian soil to Russia.

9.2 Strategies to join the West

The Baltic countries did not join the Russian-lead Commonwealth of Independent States (CIS), which was established to promote co-operation and economic integration among former Soviet republics. The Baltics, with their refusal to join CIS, demonstrated their special position as "occupied" countries, forcefully made to join the USSR. After a quick abandonment of the neutrality or non-alignment option, the Baltics chose integration to the West, especially to NATO and EU as their main policy as independent countries. However, Baltic and Nordic co-operation was a significant policy area, but by no means was considered an alternative to Western integration.

Estonia

In September 1992, Estonian Prime Minister Martin Laar defined integration into Europe as the main target of Estonian foreign policy. He set as individual goals integration Estonia to European security arrangements, co-operation with NATO, membership in Council of Europe as of 1993, an association agreement with EU also in 1993 and close relations to the Nordic countries. Foreign Minister Velliste confirmed Estonian targets next year, saying that Estonia belongs to the West and is a part of both the Nordic and Baltic regions.

During the early years of independence, membership in NATO was Estonia's first preference in her security policy, the EU was seen too weak to secure Estonia's position as Russia's neighbour. Estonia was afraid of becoming a part of a grey zone between Russia and an expanded NATO. This attitude was slowly modified, as Estonia proceeded in her basic agreements with the EU. At the same time, Estonia participated in NATO co-operation within the NACC and its Partnership for Peace program. Although far from membership, this cooperation calmed the Estonian government.

In January 1995, Foreign Minister Luik stated that Estonia strives for NATO membership, but not at short-term. He further opined that an EU-membership might open a way to NATO membership. Prime Minister Vähi in April 1995 declared that the EU membership is the first priority of Estonia's foreign policy, mentioning however also her strive for NATO membership.

In spite of this change of priorities, Estonia was irritated, when she was not included in the first expansion wave of NATO, but realism was gaining ground, even in the Parliament.

In January 1995 Estonia signed a free trade agreement with the EU and in June an Association Agreement with the EU (Europe Agreement) was signed. In November 1995 Estonia applied for the EU membership. Estonia was very optimistic about her readiness for membership, but also security concerns were behind Estonia's rush to arrange her relations to the EU.

Estonia continued to receive positive evaluations of her preparedness, for instance, in the Rand report she was the only Baltic country to be included in the first enlargement wave of both NATO and the EU. Estonia's position became, however, less secure when EU decided to restrict the number of new candidate countries to five (plus Cyprus), based on the lacking ability of the EU to accept a greater number of new members. Finally, Estonia was given candidate status as the only Baltic country at the Luxembourg summit of 1997.

Latvia

The very early short-term priority of Latvia's foreign policy was to achieve a working relationship with European Union, membership in NATO was seen as a medium-term goal. Like Estonia, Latvia did not see any value in neutrality, especially as her relations to Russia were perhaps the most strained among the Baltics, because of the high number of Russians in the country. Latvia was alarmed by the rise of Russian extreme nationalism (Zhirinovsky), leading to possible Russian expansionism.

Latvia was keen to join NATO, but was to some extent satisfied by visit of the US President Clinton in 1994: Latvia was assured that the Partnership for Peace program is in fact a gate to NATO membership. However, in 1995 Latvia proceeded on other fronts: she became member of Council of Europe and commenced Europe Agreement negotiations with the EU in January and applied for a EU membership in October. The Latvian Government defined the security concept of Latvia (without NATO membership) to include membership in European Council, Baltic co-operation, co-operation with the Nordics, NAACP membership, participation in PfP and agreements with and finally membership in the EU. According to the Government, Latvia's integration to Europe and strive for NATO membership serve the same purpose and are mutually reinforcing processes.

During the visit of Secretary General Solana of NATO in 1996, Latvia accepted that she will not be among the first FSC members of NATO. But as it became clear next year, that she will neither be among the first group of the EU candidates, Latvia was strongly disappointed and worked hard to get included in the forward group. Latvia claimed that the difference in membership negotiation readiness to Estonia was small and that all associated countries should have been accepted as candidates. However, by the time when the EU Luxembourg summit in December 1997 made the formal decision on six candidates, Latvia's attitude was quite moderate: "Estonia is a finalist, Latvia a semi-finalist.

One of the stumbling blocks of Latvia's candidacy was its citizenship and minority legislation, which in the spring of 1998 lead to a crisis with Russia. Latvia had no other alternative than to

accept the the CSCE recommendations on these issues, which took place in a referendum in October 1998. There was satisfaction in Latvia in the results of the EU 1998 accession report, in which Latvia was considered the most advanced among FSC associated countries. However, Latvia was disappointed of the EU's inability to begin membership negotiations.

In the NATO summit of April 1998, when the Czech Republic, Hungary and Poland became members, Latvia, to her satisfaction, gained a political recognition of her candidacy to NATO. Latvia committed herself to fulfil the membership criteria by 2002, when NATO would invite possible new members.

In the 1999 EU accession report, Latvia's advancement was noted and she was positioned clearly as number one of the associated countries, having distanced herself from Lithuania and Slovakia. At the Helsinki summit in December 1999, Latvia was given candidate country status.

Simultaneously, the new language law was enforced and received green light from both the EU, the Council of Europe and OSCE. However, the implementation of the legislation has been slow and thus the position of the Russian minority still remains a problem in Latvia's foreign relations.

Lithuania

Lithuania was the first of the Baltics to express her will to regain independence, she also suffered the heaviest casualties in the process toward independence. With this background it is logical that Lithuania has been perhaps the keenest of Baltics to attain NATO membership. Lithuania, with the smallest Russian population, benefitted from this fact in her relations to Russia and consequently gained a better position than Estonia and Latvia, whose NATO membership strive was burdened by minority problems.

Like Estonia and Latvia, Lithuania abandoned neutrality option and declared that she wants to become member in western organisations as early as possible. NATO became the main issue in security policy discussion in Lithuania, and two schools of thought emerged: proponents of immediate membership and supporters of step-by-step policy – the latter approach became the official policy. Lithuania was the second country to sign the PfP agreement, and already in 1994, the Lithuanian parliament accepted the request for membership, based on a collective initiative of nine parties.

On the other hand, Lithuania's integration with the EU was facing problems, mostly because of her slow post-socialist transition. When a free trade agreement with the EU was concluded in 1994, Lithuania was given considerably longer adjustment periods than Latvia or Estonia, the latter entering into straight free trade with the Union.

Lithuania shared Latvia's fate in 1997, when she was not included in the first EU candidate group. However, the reactions in Lithuania were milder than in Latvia, as it was understood that Lithuania was clearly lagging behind her northern neighbour in preparation for membership.

The NATO summit of 1998 recognition of Lithuania's candidacy was received with satisfaction and Lithuania considers itself the leading next member of NATO among the Baltics. This is based on Lithuania's relatively unstressed relations to Russia, although Lithuania is well aware of Russia's strongly negative attitude towards NATO's enlargement in former Soviet republics. Today, Lithuania concentrates in "keeping the NATO door really open"⁶³ and keeps up official optimism of a membership invitation in 2002.

Like Latvia, Lithuania achieved the EU candidate country status at the Helsinki summit in December 1999.

⁶³ Former Lithuanian President Landbergis in his speech at Harvard University, November 2000

10. ACCESSION TO THE EUROPEAN UNION

Since the publication of the Commission's opinion on applicant countries' accession to the EU in 1997, regular country-based reports have been issued in 1998, 1999 and 2000. The reports describe the relations between the candidate country and the EU (including bilateral trade), the fulfilment of the membership criteria (political, economic, ability to assume obligations of membership), assessment of Accession Partnership (short-term and medium-term priorities) and of National Programme for the Adoption of the *Acquis* (NPAA). In the following chapters, the progress made by the Baltic states is compared following the structure of the EU accession reports.

10.1 Relations to the EU⁶⁴

As to trade with the EU, there are considerable differences among the Baltics, strongly reflecting their dependence on Russian trade (see chapter 8.2.2), which is the largest in Lithuania and smallest in Estonia:

	Exports to EU	Imports from EU
Estonia ⁶⁵	73 %	73 %
Latvia ⁶⁶	68 %	54 %
Lithuania ⁶⁷	50 %	47 %

The EU community aid to assist the candidate countries in their pre-accession activities has been diversified last year to include special programs for agriculture and rural development (SAPARD) and for environment and transport (ISPA) besides the long-running PHARE program, which supports institution building, administration and investment in economic and social cohesion. The PHARE allocations to the Baltics have amounted to 190 million Euro to Estonia (1990-99), 248 million Euro to Latvia (1992-99) and 328 million Euro to Lithuania (1992-99). The 2000-02 programs have budgeted the following annual sums respectively to Estonia, Latvia and Lithuania (all sums in million Euro): PHARE 24/30/42, SAPARD 12/22/30 and ISPA 21-37/36-57/40-60.

The so-called twinnings, funded by PHARE, are bilateral projects between member states and candidate countries, aiming at strengthening the candidates' administrative capacity. Since 1998, the Baltics have benefited from twinning: Estonia has had 14 projects with eight more to come with eight member states (France, Germany, Finland, Sweden, Greece, Italy, Ireland and Denmark). Latvia has had eight projects and six more to come having six partners (Germany, France, Sweden, Denmark, UK, Finland) and Lithuania has 12 projects and six planned ones with five member countries (Denmark, Germany, Sweden, Italy, Finland).

⁶⁴ Estonia 2000 Regular Report, pp. 7-12, Latvia 2000 Regular Report, pp. 7-13, Lithuania 2000 Regular Report, pp. 7-14

⁶⁵ First half of 2000, Estonia 2000 Regular Report, p. 7

⁶⁶ First quarter of 2000, Latvia 2000 Regular Report, p. 7

⁶⁷ 1999, Lithuania 2000 Regular Report, p.7

10.2. Membership criteria

The membership criteria of the EU are included in the 1993 Copenhagen summit decisions (political and economic criteria) as well as those of the 1995 Madrid summit (adjustment of administrative structures) and the 2000 Feira summit (implementation of *acquis*). In the following, the progress of the Baltics is described on the basis of the 2000 Regular Reports, which compare the outcome of accession preparations in 2000 with previous year.

10.2.1. Political criteria⁶⁸

All Baltic states continue to fulfil the Copenhagen political criteria. According to Regular Reports, all of them “ have achieved stability of institutions guaranteeing democracy and the rule of law”. All countries “continue to respect human rights and freedoms”.

All countries have defects in their public administration and judicial systems. Latvia and Lithuania have to pay attention to corruption.

Estonia and Latvia have proceeded in the question of minorities (amendments in language laws and integration of non-citizens), but the implementation of minority legislation should be enhanced.

It is obvious that the main problem within the political criteria, the position of Russian and other Slavic minorities in Estonia and Latvia, has now largely been overcome, at least in the legislative niveau. The public administration, because of its poor experience and efficiency, seems to be one of the main obstacles in accession preparations, especially in adoption and implementation of the *acquis*.

As a whole, the Baltics have established themselves as democratic countries and have only minor problems in meeting the demands of the Copenhagen criteria. In their overall accession preparation, the Baltics have been most successful in the political area.

10.2.2. Economic criteria⁶⁹

The economic criteria of accession, as defined at the Copenhagen summit, are “existence of a functioning market economy” and “capacity to cope with competitive pressure and market forces within the Union”.

The 2000 Accession reports consider all the Baltics as functioning market economies and fairly capable to cope with competition and market forces within the Union. However, the latter condition is expected to be fulfilled by Estonia already in near term, but in the case of Latvia and Lithuania, only in the medium term, provided that the countries will continue their economic reforms at present pace.

⁶⁸ Regular Reports 2000: Estonia pp. 13-21, Latvia pp. 14-24, Lithuania pp. 15-21

⁶⁹ *ibid*: Estonia pp. 22-32, Latvia pp. 25-34, Lithuania pp. 22-32

All countries have preserved macroeconomic stability and have proceeded in structural reforms. The legal, institutional and regulatory frameworks are largely in place.

A common problem is found in the external balances: all countries are running a relatively high current account deficit (Estonia –5.8 %, Latvia –5.7 % and Lithuania –4.3 % of GDP). Also fiscal discipline remains weaker than the EU would desire.

Estonia is advised to complete its remaining structural reforms, primarily in oil-shale utilisation (main energy source) and land ownership. Latvia is urged to complete its enterprise privatisation concerning the last remaining big companies and to facilitate the entry into market of new companies as well as improve conditions for foreign investments. Lithuania is called to strengthen its bankruptcy legislation and develop its physical and human capital. Unlike in Estonia and Latvia, Lithuania's financial sector remains relatively weak and needs to be strengthened.

Estonia has advanced in its economic reform further than the two other Baltics, which was also confirmed in the EBRD study (see chapter 9.1.5, table 11)

10.2.3. Ability to assume the obligations of membership⁷⁰

The ability to assume the obligations of the membership is defined to include alignment of the *acquis*, secondary legislation and the policies of the Union. However, as defined in the Madrid and Feira summits, the new members have also to develop their administrative and legal capacity in order to be able to implement and enforce the *acquis*.

The Baltics opened negotiations on the membership in March 1998 (Estonia) and in February 2000 (Latvia, Lithuania). Naturally, Estonia has advanced more than Latvia and Lithuania, having two year's lead in the negotiations. By the end of March 2001, in the Estonian membership negotiations all 29 chapters have been opened and so far 18 have been closed. In the case of Latvia, 24 chapters have been opened and 11 have been closed. Lithuania has opened 22 chapters and been able to close 13 chapters. During the on-going Swedish presidency, the progress has been rapid with Latvia (7 chapters opened, 2 closed) and Lithuania (4 chapters opened, 6 closed) within three months.

The present outcome of the negotiations is given below in table 13:

⁷⁰ Regular Reports 2000: Estonia pp. 84-85, Latvia pp. 95-96, Lithuania pp. 95-96

Table 13. Negotiations of the Baltic states on *acquis*; opened and closed chapters, March 31, 2001

	ESTONIA	LATVIA	LITHUANIA
Ch. 1: <u>Free movement of goods</u>	CLOSED	CLOSED	Not opened
Ch. 2: <u>Free movement of persons</u>	Opened	Not opened	Not opened
Ch. 3: <u>Freedom to provide services</u>	CLOSED	Opened	Opened
Ch. 4: <u>Free movement of capital</u>	CLOSED	Opened	CLOSED
Ch. 5: <u>Company law</u>	CLOSED	Opened	Opened
Ch. 6: <u>Competition policy</u>	Opened	Opened	Opened
Ch. 7: <u>Agriculture</u>	Opened	Not opened	Not opened
Ch. 8: <u>Fisheries</u>	CLOSED	Opened	Opened
Ch. 9: <u>Transport policy</u>	Opened	Opened	Opened
Ch. 10: <u>Taxation</u>	Opened	Not opened	Not opened
Ch. 11: <u>Economic and monetary union</u>	CLOSED	CLOSED	CLOSED
Ch. 12: <u>Statistics</u>	CLOSED	CLOSED	CLOSED
Ch. 13: <u>Social policy and employment</u>	CLOSED	Opened	CLOSED
Ch. 14: <u>Energy</u>	Opened	Opened	Not opened
Ch. 15: <u>Industrial policy</u>	CLOSED	CLOSED	CLOSED
Ch. 16: <u>Small and medium enterprises</u>	CLOSED	CLOSED	CLOSED
Ch. 17: <u>Science and research</u>	CLOSED	CLOSED	CLOSED
Ch. 18: <u>Education and training</u>	CLOSED	CLOSED	CLOSED
Ch. 19: <u>Telecom. and inform. technologies</u>	CLOSED	Opened	CLOSED
Ch. 20: <u>Culture and audio-visual policy</u>	CLOSED	CLOSED	CLOSED
Ch. 21: <u>Regional policy & str. instruments</u>	Opened	Opened	Opened
Ch. 22: <u>Environment</u>	Opened	Opened	Opened
Ch. 23: <u>Consumers and health protection</u>	CLOSED	CLOSED	CLOSED
Ch. 24: <u>Justice and home affairs</u>	Opened	Not opened	Not opened
Ch. 25: <u>Customs union</u>	Opened	Opened	Opened
Ch. 26: <u>External relations</u>	CLOSED	CLOSED	CLOSED
Ch. 27: <u>Common foreign and sec. policy</u>	CLOSED	CLOSED	CLOSED
Ch. 28: <u>Financial control</u>	CLOSED	Not opened	Not opened
Ch. 29: <u>Financial and. budget. provisions</u>	Opened	Opened	Opened
Ch. 30: <u>Institutions</u>	Not opened	Not opened	Not opened
Ch. 31: <u>Other matters</u>	Not opened	Not opened	Not opened

In the EU's general evaluations on the Baltics' ability to assume membership obligations, "Estonia has continued alignment of legislation at good pace in most areas of the *acquis*. Although some steps have been taken in order to step up administrative structures in most chapters, Estonia still needs to make considerable efforts in this area."

As to Latvia, it "has continued to make steady progress in aligning its legislation to the *acquis* in most areas. While overall progress in terms of strengthening the administrative capacity has been more limited, Latvia nevertheless undertook efforts to re-structure and reinforce its institutions in several sectors, and decided to establish several new bodies in line with the provisions of the *acquis*."

In evaluating Lithuania, the Commission states that “Lithuania has made significant overall progress in terms of transposition and, to a lesser extent, implementation of the *acquis*. Additional progress is required notably in areas such as taxation, agriculture, regional policy and financial control. The strengthening of administrative capacity, which has, in part, been limited by the budgetary constraints, should be continued in a sustained and more coherent manner.”

10.3. Assessment of accession partnerships and NPAA⁷¹

The purpose of the Accession partnerships is to set out both short- and medium term priority areas for further work, besides the financial assistance available (see chapter 10.1). Furthermore, each candidate has been invited to adopt a National Program for the Adoption of the *Acquis* (NPAA) to define the means to deal with the Accession Partnership, to create a timetable and to indicate the human and financial resources needed. Both Accession Partnerships and NPAAs are revised on a regular basis.

The annexes of the 2000 Accession reports provide a detailed evaluation of the progress in meeting the short-term priorities, and mention those medium-term priorities, where some progress has been attained compared with the previous year.

According to overall evaluations on priorities, “Estonia has continued to address, although with some differences, aspects of all sectors indicated as short-term priorities. In particular, Estonia has met the priorities related to telecommunications, audiovisual, standardisation and conformity assessment, veterinary and phytosanitary sectors, transport, occupational health and safety, employment and employment services. Priorities related to public procurement, labour law, penal law, customs and market surveillance have not been met. Estonia has already started to address some of the medium term Accession Partnership priorities.”

“Latvia has started to address almost all of the relevant short-term priorities, and has already achieved a certain degree of success in most cases. This includes in particular the adoption of several pieces of key legislation in the Internal Market and of framework legislation in the environmental sector, as well as work on the modernisation of the tax and customs administrations, efforts related to maritime safety and upgrading border posts. Work should now continue on all short-term priorities in order to fulfil them as soon as possible. Those parts of the short-term priorities for which no visible progress has been made so far should be focused on as a matter of priority. Apart from a few specific cases of the Internal Market field, this, for example, includes priorities related to employment and social affairs, as well as to justice and home affairs.”

“Overall, Lithuania has made satisfactory progress in meeting the short term priorities of the Accession Partnership, especially as regards economic reform. However, in some areas such as agriculture, taxation, administrative capacity (including management and control of EU funds), further progress is still required. Lithuania has already started to address a number of medium-term priorities.”

⁷¹ Regular Reports 2000: Estonia pp. 89-92, Latvia pp. 100-105, Lithuania pp. 100-104

The overall results in meeting priorities are tabulated below:

**Table 14. Progress in meeting short-term and medium-term priorities;
Accession partnerships of the Baltics 2000**

	ESTONIA	LATVIA	LITHUANIA
Short-term priorities	met	met	met
Political criteria	to large extent	partially	-
Economic reform	partially	partially	largely
Internal market	partially	partially	largely
Agriculture	to limited extent	partially	partially
Transport	to large extent	partially	substantially
Energy	-	-	largely
Employment & social affairs	partially	partially	partially
Environment	partially	partially	largely
Justice & home affairs	to certain extent	partially	partially
Administrative and judicial capacity	partially	partially	partially
Medium-term priorities	addressed	addressed	addressed
	political criteria	economic criteria	fisheries
	economic criteria	internal market	adm. & judicial capacity
	Internal market	energy	capacity
	Justice & home affairs	transport	

The National Programmes for the Adoption of the *Acquis* for the Baltics (revised in 2000) have generally improved in quality, are well structured but lack a standard level of detail and accuracy. The uneven standards of the plans reflect to a great extent the need to strengthen the administrative capacity of the Baltics.

11. CONCLUSIONS AND COMPARISONS

In the following conclusions on which factors have affected reintegration, a division to three categories is made: initial positions, internal factors and external factors. There are several explaining factors within each category, some of them can be measured relatively accurately, some are not measurable in quantitative terms but in qualitative terms only. In the conclusions, the Baltics are compared not only to each other but also, as a group, to other groups of FSCs.

The relative weight of various factors cannot be determined due to the above-mentioned problems in measuring their effect. However, the relative importance to reintegration of measurable factors can be expressed, but it may well be that a non-measurable factor (like foreign policy realities) is in a particular case more dominant than those defined quantitatively. There, some evaluation of factors is given.

11.1. Factors explaining the initial position

The EBRD study on the initial positions of the FSCs gives a somewhat surprising picture of the Baltics. Although the differences are not very substantive, the study gives Lithuania the best initial position, followed by Latvia and Estonia having the least favourable initial positions. This result is in obvious contradiction to other data, like Estonia having the highest standard of living and GDP per capita among the Baltics.

The explanation for this contradiction might lie in the EBRD study method itself, as it uniformly considers industrialisation as a liability rather than an asset (the same applies to high urbanisation). In the following sections, various factors affecting the initial position of the Baltics are discussed without taking fully into account the EBRD study values.

11.1.1. Historical experience

Unlike other former Soviet republics, the Baltics had a short period of full independence between the world war; consequently, their period of Soviet rule was some 20 years shorter than that of the others, “only” about 50 years, or about two generations. This means that the legacy of independence and market economy was alive, although subdued, during the Soviet era, and could be transferred to younger generations.

The long-term historical perspective of the Baltics was also different from the other former Soviet republics: although they had been part of imperial Russia since early 18th century, before that they were under German and Swedish rule, which established a centuries-long relationship to Western Europe.

The Baltic communities in Western countries, immigrants and refugees, were a remarkable asset: supported by their host countries, which did not recognise the annexation of the Baltics to the USSR, they maintained a strong nationalism and patriotism among their communities. After independence, there has been a reimmigration to the Baltics, and the newly arrived westernised

countrymen have had quite important role in their respective states, including the President (Latvia).

It can be concluded that the historical experience of the Baltics, differing from other Soviet republics, explains to a relatively large extent the success of the Baltics in reintegration. Their initial position as to historical experience approaches that of non-Soviet FSCs, who like the Baltics were some 50 years under Socialist system. However, not having had a status of an independent country gives the Baltics a worse initial position compared to independent FSCs, which did not have to create the basic state institutions like the Baltics had to.

There are no significant differences in the historical experience between the Baltics, all were in turn under German, Swedish and Russian rule, gained independence in conjunction of the October revolution, were annexed to Soviet Union in 1940 and were occupied by Germany during World War II. They regained their independence almost simultaneously in 1992.

11.1.2. Geographical position

It may be claimed that geographical proximity to the West is a beneficial factor when it comes to reintegration. The contacts to neighbouring countries are easily and cheaply arranged, knowledge and information is conveyed through visitors at large scale and, during the Soviet era, proximity enabled them to monitor Western radio and/or TV programmes.

Although the Baltics are located at some distance from the core of Western Europe, they enjoy a close proximity to the Nordic countries, especially Finland and Sweden. Again, the Baltics can be compared to the Central and Eastern European countries (CEE), and in fact their position is better than that of the Balkan countries and far better than that of other former Soviet republics.

Although the geographical distances of the Baltics to nearest Nordic country do not vary much in kilometres, their locations are different: Estonia is separated from Finland by only 40 miles wide Gulf of Finland and is approximately as close to Sweden as Latvia. Lithuania's southern location gives it the longest distance to Sweden, and actually its neighbour in the EU, Germany, is separated from Lithuania by another FSC, Poland.

It can be claimed that Estonia has the best geographical location of the Baltics, having easy access to both Finland and Sweden. Latvia follows with close proximity to Sweden, but Lithuania is relatively isolated, having the longest distance to Sweden and having Poland between Germany and itself. The northern half of Estonia was within the reach of Finnish TV, which played a significant role in transmitting Western news and information (and teaching the Finnish language, see 11.1.4).

11.1.3. Historical orientation

The traditional historical orientation of the Baltics varies, but it is definitely to the West. These countries have been mostly oriented toward the other states around the Baltic Sea: the Nordics (Denmark, Finland, Sweden), Germany and Poland. There are, however, major differences between the Baltics.

Estonia is the most Nordic-oriented of the Baltics, its contacts have been mainly to Finland and Sweden. Finland is the closest and shares a very similar language with Estonia, Sweden was hosting a sizeable Estonian refugee community during the Soviet era. Latvia's orientation was divided between the Nordics (Denmark, Sweden) and Germany, but Lithuania's relations have been toward Central Europe, predominately to Poland and Germany.

It can be concluded that the historical orientation of the Baltics has not been quite as advantageous than that of CEE, but, again, better than that of the Balkans and CIS countries. Lithuania's position, because of its Poland-orientation, is somewhat worse than that of Estonia and Latvia, whose historical orientation could be determined almost equally advantageous.

11.1.4. Lingual proximity

Within the FSCs, lingual proximity to a Western country is rare: East Germany, of course, shared the same language with the Bundesrepublik, Romanian is a Latin language with a relatively vague relation to French and Estonian and Finnish are closely related Finno-Ugrian languages. It is natural that a close lingual proximity to a neighbouring Western country facilitates communication substantially and enables a direct submission of documents, information and experiences.

Estonians in the northern part of the country (including capital Tallinn) widely learnt Finnish by watching Finnish TV for decades, which has been a great advantage. Although Estonian and Finnish are closely related, they are separate languages, and, hence, the ability of Estonian politicians, civil servants, academicians, businessmen etc. to understand Finnish made the transmission of Western information and experience easy, which speeded up the post-socialist transition.

In conclusion, Estonia has in its lingual proximity a clear asset, which Latvia and Lithuania, constituting their own group among Indo-European languages, do not have. It is very difficult to estimate the effect of Estonia's lingual proximity to Finnish, but there can be little doubt that it has contributed to Estonia's transition, consequently, to Estonia's lead in reintegration compared with the other two Baltics.

11.1.5. Ethnic composition

One of the legacies of Soviet rule in the Baltics is the sizeable Russian (and other former Soviet) minority in each of these countries. The non-titular minority is the largest in Latvia (44 %), next largest in Estonia (35 %) and the smallest in Lithuania (8%). Most of the members of Slavic minorities are Russians, and thus the position of Russian minority has been a major issue in Estonia's and Latvia's relations to Russia, in Lithuania the small Russian minority has been fairly insignificant factor in relations to Russia.

Strongly diversified ethnic composition decreases national unity and easily causes problems with the mother country of the minority. In terms of reintegration, Estonia and Latvia have had difficulties in finding an approach to Russian minority acceptable to the EU and the OSCE. The

delay in EU membership process has, however, not been of decisive nature, and today this question has been solved, at least in principle. The implementation of the language and citizenship legislation might still cause minor problems.

The Russian minority is, according to polls, more eager to join the EU than the majority, and, consequently, the EU membership process has not been affected by ethnic diversity. On the other hand, the existence of a few million “Euro-Russians” after inclusion of the Baltics in the EU is seen favourably by Russia, which might to some extent explain Russia’s relatively positive view on the Baltic’s EU membership. At the same time, Russian minority might be a major obstacle to the Baltic’s NATO membership, giving a relative advantage to Lithuania.

It may be concluded that Lithuania, having the smallest ethnic diversity, has a slight advantage in reintegration compared with Estonia and Latvia. However, the latter countries have been able to resolve the problems connected to the position of the Russian minority and have thus all but eliminated Lithuania’s advantage as to EU membership. Lithuania may, however, be NATO’s choice of a Baltic member, if NATO decides to invite one Baltic country as member.

11.1.6. Economic position at the end of Soviet rule

As mentioned before (see chapter 4.1.), the EBRD sees industrialisation and urbanisation as liabilities. In the OECD study on Baltics, the Soviet type industry is seen more or less as a liability, but light industry and low share of all-union industry are seen as assets. A large agriculture is not seen as an asset.

Before World War II, Estonia enjoyed the highest standard of living among the Baltics, and this difference remained during the Soviet era. At independence, Estonia’s NMP (net material product) per capita was 22 % higher than the Soviet average, Latvia was second with +16 % and Lithuania third with + 6 %. Estonia and Latvia had the highest share of light industry, and Estonia had a very small amount of centrally managed all-union industries (sole producer for the whole USSR), unlike Latvia and Lithuania. As to agriculture, Lithuania was more strongly agriculture-dominated than Estonia and Lithuania.

Adding up the differences among the Baltics, Estonia has a small lead over Latvia, which has a slightly better economic position than Lithuania. The differences are small, but not insignificant; they build up explanation for the prevailing ranking in reintegration: Estonia-Latvia-Lithuania.

11.2. Internal explanatory factors

Internal explanatory factors are elements in post-Soviet development controlled solely or almost exclusively by the countries themselves. However, assistance in transition processes is largely given by international organisations, especially the EU, as well as neighbouring countries. Foreign direct investments, which naturally are decisions by foreign companies, are here defined as internal factor as a function of the ability of the country to attract FDI, which again is dependent of its stability, adoption of a market economy, legal framework and other domestically managed aspects. In the following, internal factors are divided in four categories:

economic transition, macroeconomic performance, democracy and governance and public opinion (on EU membership).

11.2.1. Economic transition

Success in economic transition from the Socialist system to market economy is a main explanatory factor in reintegration advancement (correlation coefficient 0.604), as success in economic transition lays the foundation for meeting membership requirements of many important Western organisations, like the WTO, OECD and the EU. In this presentation, the economic transition contains the following elements:

- a) structural reform: enterprise reform, competition policy
- b) liberalisation: prices, foreign trade and foreign investment
- c) banking sector reform: number of banks, bail-outs, foreign ownership
- d) privatisation: policy of direct sales or voucher schemes, foreign ownership
- e) legal transition: commercial laws and financial regulations
- f) infrastructure transition: telecommunications, electric power, railways, roads, water and waste water

Elements a-d) constitute what the EBRD calls market reform, and the overall economic transition contains also legal (setting legal framework of new market economy) and infrastructure transition.

As to market reform, all the Baltics are in the lower advanced category of the EBRD 2000 average index of market reform (3.01-3.50). Estonia's average index is 3.50, Latvia's 3.19 and Lithuania's 3.25. Estonia's lead over its Baltic neighbours is based on its better performance especially in large-scale privatisation and banking sector reform. Estonia has also a small lead in enterprise reform. Lithuania overtook Latvia in 2000 by advancing in competition policy and non-banking sector financial reform.

In legal transition (e): Estonia has reached the higher advanced category (3.58), while Latvia (2.92) and Lithuania (2.93) are in higher intermediate category. Latvia and Lithuania are lagging behind Estonia in establishing and implementing financial regulations, in commercial legislation the Baltics have progressed almost equally.

As to infrastructure transition (f): Estonia is, again, in the higher advanced group (3.75), Latvia (2.92) and Lithuania (2.64) only in the higher intermediate group. Estonia fares better than other Baltics in telecommunication, railways and waste management, Latvia has proceeded better than Lithuania especially in electricity and railways transition.

In regional comparison, the Baltics have almost reached the CEE (in the 1-6 scale, the Baltics' average economic transition index is 4.75 compared with CEE's 4.83). The Balkan region (3.95) is clearly behind in economic transition, and the CIS countries average index is under 3.

11.2.2. Macroeconomic performance

Macroeconomic performance is the strongest correlated explanatory factor of reintegration (correlation coefficient 0.92). It is obvious that macroeconomic performance represents the concrete results of post-socialist transition: contrary to market and legal reform, where reforms may be superficial because of lacking or inefficient implementation, economic indicators give clear-cut evidence of the success in transition, which, in turn, brings success in reintegration. In the following comparison, the following indicators have been used:

- a) GDP decline and growth: the initial GDP decline duration, GDP growth after that
- b) Foreign investments: relative success in obtaining foreign long-term investments
- c) External trade: reorientation from Russian-dominated foreign trade to EU orientation

The Soviet legacy of the Baltics can be seen in their GDP: Estonia is in the higher intermediate category (real GDP in 2000 75 % of that of 1989), Latvia (60 %) is in the lower slow-progress and Lithuania (70 %) is in the lower intermediate group. Estonia's better economic recovery is largely due to its early and rigorous reform measures in currency liberalisation, privatisation and banking reform. Latvia's third place is due to the deepest GDP decline among the Baltics, partially explained by its industrial structure (heavy, military, all-union).

In cumulative foreign direct investment per capita in the years 1989-99, Estonia is in higher advanced group (USD 1115) like Latvia (USD 866) while Lithuania is in higher intermediate category (USD 545). Here it may be claimed that Estonia is gaining from both its geographical and lingual proximity as well as from its historical orientation: Finland and Sweden together cover two thirds of FDI and all the Nordics about three quarters. Latvia and Lithuania have received much less Nordic investment (30-40 %) and investments from elsewhere, mainly from Germany and USA, have not been enough to bring these countries to the same level with Estonia. In Lithuania, its less advantageous geographical position has probably decreased FDI volume.

The reorientation of foreign trade from Russia-dominated to EU-dominated has been swift and profound, but also in this respect Estonia leads: EU's share of both its exports and imports is almost three quarters (73 % in first half of 2000) compared with Latvia's 68/54 % and Lithuania's 50/47 %. Before the Russian rouble crisis, which led to strong decrease in exports to Russia, Estonia exported to CIS countries 23 %, Latvia 25 % and Lithuania 42 % of their overall exports

Macroeconomic performance is the weakest area of the Baltics in their post-Soviet development. Especially the recovery of the GDP, after the steepest decline among the FSCs, has not brought the Baltics at the same level with the CEE countries (indexes 3.83 vs. 4.67). Again, Balkan countries and the CIS are clearly behind the Baltics.

11.2.3. Democracy and governance

Democracy and governance have a correlation coefficient of 0.588 to reintegration, which is the lowest among the three groups of explanatory factors. It seems that especially in the case of Baltics, the correlation is quite low, as the Baltics have the highest democracy and governance index (5.50) but a relatively low reintegration index. The CEE (4.67) has an almost opposite position, which also helps to explain the low correlation.

The democracy and governance group of factors contains the following explanatory factors:

- a) political competition: average tenure of governments
- b) political rights and civil liberties
- c) quality of government

The Baltics' performance in both democracy factors is excellent: all countries reach the higher advanced category in political competition. As to political and civil rights, only Estonia (6) is in the higher advanced group. Latvia (5 ½) and Lithuania (5 ½) are both in lower advanced category.

As to quality of government, Estonia (6) again is the only Baltic country in the higher advanced group, Lithuania (4) is in the higher intermediate category, Latvia: no information.

11.2.4. Public opinion (EU membership)⁷²

The latest polls on the popularity of EU membership in the Baltic countries give an impression of uncertain opinions: the number of undecided (26-37 %) is higher than anywhere else in the candidate countries. However, the low percentages for EU membership must be put in proportion to both the percentage of undecided and negative, the latter being very low (13-14 %).

The popularity of EU membership has decreased in both Estonia and Lithuania from the year 1998 to year 1999, but has risen in Latvia. The percentage of membership supporters is highest in Latvia, 40 % in 1998 and 47 % a year later. The next is Lithuania with 40 % support in 1998 and 27 % in 1999, and the lowest support is found in Estonia: 35 % in 1998 and 27 % in 1999.

It is quite surprising that the Baltic people support membership in the EU clearly less than people in other candidate countries do. In 1998 survey of the Commission, support for membership in the Baltics was 38 %, compared with 64 % in Balkans (Bulgaria, Romania) and 57 % in CEE candidates (Czech Republic, Hungary, Poland, Slovak Republic, Slovenia). On the other hand, the share of undecided was twice as high in the Baltics than in other candidate countries, which might indicate an insufficient level of knowledge of the Union.

It may also well be that Baltic citizens see European Union as another centrally managed system, where the independence of the nation is endangered. The fact that ethnic Russians were more in

⁷² Briefing No 41: Public opinion on enlargement in the EU member states and applicant countries, Europarlament 2000

favour of EU membership than the titular people, seems to support the concept of the EU among some the Baltics' citizens as some kind of Western equivalent of the USSR.

The EU and the Baltic governments are increasing efforts to inform the public more extensively of the EU membership. Although all parties in the Baltics support membership, the countries will hold referendum on the membership and do not want to risk a negative outcome.

The public opinion on EU membership has obviously not had any effect on the candidate status of the Baltics, the low figures have not prevented the Baltic governments to launch negotiations on membership, and the EU 15 has given candidate status to all Baltic countries. The real referendum is, however, a risky affair, if support for membership will not rise substantially during the next few years.

11.3. External explanatory factors

In this section, elements that are outside the control of the FSCs but affect their reintegration to the West are discussed. As there are element both favouring reintegration as well as hindering it, in the following first those elements advancing reintegration are discussed, followed by evaluation of those aspects slowing reintegration.

The reintegration of the FSCs is influenced by the Cold War era, during which the West pledged to take in the Socialist countries, as soon as they had been broken free from socialism and Soviet dominance. Now, 10 years after the collapse of the Soviet Union, this pledge has been honoured only partially, mostly because of political and economical reasons.

The actors in the area of reintegration are both organisations that the FSCs wish to join. and the member states of these organisations, mainly those of the EU and NATO. These organisations are, at least in principle, open to new members fulfilling membership criteria, but there are both political and economical factors which might override official admission criteria, most often in refusing or delaying membership than actively promoting it or even forcing membership in spite of admission criteria.

In the following, no quantitative data can be presented (with the exception of opinion polls on EU enlargement). Hence, the evaluations of the relative weight of various factors are highly sketchy.

11.3.1. Factors advancing reintegration

During the Cold War, Western and Eastern alliances had their respective organisations in several fields:EEC vs. COMECON, NATO vs. Warsaw Pact, Eurovision vs. Intervision, competing labour union federations, etc. Besides these mutually hostile organisations there were East-West based organisations, like CSCE and ECE (UN Economic Commission for Europe), and global organisations like the United Nations, where the East and the West could negotiate and discuss on a multilateral niveau. As a kind of curiosity, some Socialist countries had managed to get themselves as members in global, but Western organisations like IMF and GATT. However, the

multilateral links between the East and the West were thin and fragile, and confrontation prevailed both on multilateral and bilateral level.

Historical pledge

The Western organisations, notably NATO and EC, in their respective charters welcome any European country, fulfilling membership criteria, as a member. These pledges were constantly repeated in Western rhetoric during the Cold War, in order to diminish the loyalty of Socialist countries' citizens toward the Socialist system. It can be claimed that a moral and political obligation was established to "take in" the Socialist countries into the West, once they were freed from socialism and Soviet rule.

This obligation, however vague or even propagandist, was taken quite seriously by the FSCs, which expected a quick accession to the West, especially to NATO in order to cover their immediate security needs, and they expect the European Union to assist in transition and to make its hefty benefits available. The early statements of the FSCs were optimistic, and admission within a few years was foreseen, but in reality, the process has been much slower than expected.

Although the obligation of the West to let FSCs in belongs at least to some extent to political rhetoric, it can be claimed that it is the driving force of reintegration, the undercurrent. The fact that all Western organisations studied have accepted at least some FSCs as new members or are accepting them in the near-term (EU), is a proof of the universality of reintegration and, hence, gives credibility to honouring the pledge given during the Cold War.

A certain amount of universal reintegration has taken place during the first ten post-Soviet years, but it can hardly be described as phenomenal success. Rather, the progress has been relatively slow and careful, and there are concerns that in the case of NATO, the process has become to a halt.

The Baltics are a special category within the FSCs: they were annexed to the Soviet Union after 20 years of independence and became Soviet republics, unlike the East European countries who remained independent states (at least in theory). The West never recognised the annexation of the Baltics, and thus a special obligation towards the Baltics was established, and it has been well preserved by the Baltic communities in Western countries.

In the author's opinion, the historical pledge of the West towards the FSCs is not only rhetoric, but has contributed to progress in reintegration along the whole length of the front. The extent the pledge will be fulfilled is uncertain but there is still room for optimism. Of the two most important organisations, the EU has cleared major internal obstacles preventing the accession of new members, and it seems to be increasingly committed to welcome some new members in 2004. NATO will decide at its 2002 summit whether the alliance will invite new members or not.

Stability in Europe

From the Western point of view, there are naturally also more or less selfish motives to promote reintegration than the noble fulfilment of a historical pledge. A less selfish motive is the need to stabilise the New Europe, prevent internal conflicts by firstly demanding the FSCs to adopt democratic rule and settle disputes with their neighbours as a condition for membership, and, secondly, making future conflicts practically impossible by tying them to membership (especially in the EU). Stability in Europe could also be promoted by eliminating the so-called grey zone between the West and Russia. This idea is very popular among the FSCs striving for NATO membership, but not at all favoured as much within the alliance.

NATO expansion to the East has been very moderate and careful; only the Czech Republic, Hungary and Poland have been admitted so far. The end of the Cold War has changed NATO's role from a purely military alliance directed against another alliance to a softer one, dominated by peacekeeping and peace-enforcement. Against this fundamental change, an outright and rapid expansion to the East would represent Cold War mentality and has been rejected. NATO has accepted new members, although only three, and so pressures to invite additional FSCs have somewhat diminished. Among the nine candidates, there are countries which could be admitted to NATO relatively easily: Slovenia, which would connect the southern flank of NATO by bridging Italy and Hungary, and Slovak Republic, whose membership would logically follow the admission to NATO of the Czech republic, the other half of former Czechoslovakia.

The Baltics, seen from the stability point of view, are to some extent problematic. As tiny countries with good relations to neighbouring countries (except Russia) and hardly any military strength, they as such are no threat to stability in the region, much less in Europe. But all three are loudly speaking for NATO membership and are eagerly building up their military to meet the NATO requirements. They are not satisfied by the "soft security" provided by the future membership of the EU. They are difficult to defend with their small, flat area and their membership in NATO is fiercely resisted by Russia. Consequently, the invitation of any Baltic state to NATO does not seem probable in 2002. If later a need arises to balance membership(s) of Balkan states with a northern member, Lithuania may be the choice because of its small Russian minority. But NATO is certainly letting the Baltics become the first EU members, before the alliance even considers extending itself to a former Soviet republic.

New markets

Although western countries and especially those geographically close to the socialist countries have traded with these countries for decades, the full potential of this market could not be utilised because of the state monopoly of foreign trade, political restrictions, embargoes of sensitive articles etc. Thus the market reform in the FSCs, liberalising prices, trade and investments opened fully a large market, with a great demand of Western goods. These countries

also provided a highly educated labour force, low wage level and geographical and cultural proximity.

Free trade agreements between the EU and non-CIS countries were concluded in mid 1990s. Most of these countries became WTO members in late 90's. The EU membership of the candidate countries will allow intra-EU movement of goods, capital, services and people between EU15 and the new members, creating a larger European single market after the expiration of various transition periods.

The accession of new FSC members into the EU will increase trade and investments not only with EU15, but probably also with non-EU countries, like the USA, Japan and other Asian countries. An EU membership means access to a huge single market, and the new EU countries will have a competitive edge to other FSCs.

The Baltics are, even grouped together, a small market, not able to attract global or even all-European commercial attention. But their membership in the EU is strongly advocated by the Nordics as well as Germany, who see them as relatively well-developed and rapidly growing markets within the Baltic Sea region (sometimes these countries are referred to as "Baltic Tigers"). All of them are now trading mostly with Nordics and Germany, and receive most of their foreign investments from these countries. It can be claimed that the Baltics may not be economically terribly important to EU as a whole, but regionally they constitute an interesting market, especially to Finland, Germany and Sweden. Their EU membership will make the Baltics even more attractive, also to Russia, to whom they with their "Euro-Russians" can open a gateway to the EU market.

It may be concluded that the FSCs are an interesting market as such, but became more interesting after their EU free trade agreements and will, after their membership in the EU, be part of the larger European single market, offering comprehensively free access to this market. As history shows, the share of EU of the trade of new members will increase substantially. On the other hand, the EU benefits the new members will be enjoying will contribute to their economic growth, adding their imports further. Of course, the single market works also to the benefit of the FSC members' exports.

Public opinion (on EU enlargement)

Public support to EU enlargement is slowly decreasing, the average level of support was 44 % in 1998 and 42 % in 1999. There are, however, significant differences among the individual countries. As a basic rule, those countries being geographically closest to larger FSCs and having strong relations with them, are less supportive than those located far from at least larger FSCs and/or having relatively thin relations with them.

The least supportive region is, consequently, Central Europe (40 % and 37 % respectively in 1998-99), the Southern Europe is more supportive (51 % in 1998-99) and the strongest support comes from Northern Europe (60 % and 59 %). The least supporting countries are (1999 percentage) Belgium (28%), Austria (30%) and Germany (34 %). The three strongest supporters are Sweden (63%), Denmark (61%) and Greece (61%).

The explanation for the above described diversity lies in the fear of negative economic consequences in Central European countries, which already have large numbers of foreign immigrants. The support of the Nordics may come from positive expectations of new markets and from strong historical ties to the Baltics, which, being tiny, are no threat to the rich Nordic countries. The Southern European countries are far from the FSC candidate countries. They may also see some welcome balance to strong Central European members in the entry of the FSCs.

Although the support figures are relatively low for EU enlargement, they will probably play no role, when it comes to acceptance of new members. No EU government is openly opposing enlargement, although certain opposition parties are against at least too hasty and too extensive enlargement.

11.3.2. Factors slowing reintegration

Relations to Russia

Out of the external factors slowing reintegration, the relations of the West to Russia are perhaps the most apparent. Russia, as the successor state of the Soviet Union, has been acting in a rather confrontational way toward the expansion of NATO: it resisted the inclusion of the Czech Republic, Hungary and Poland in 1997. It has made it very clear that it is opposing further expansion of NATO to FSCs, especially former Soviet republics and even to European former neutrals, like Finland and Sweden. There are, of course, differences in tone, but the basic target of Russian foreign policy is to prevent NATO expansion or at least limit it to the minimum.

NATO, , and its members has a dual attitude toward Russian NATO policy: they are not anxious to endanger relations with Russia by a hasty and extensive NATO expansion. On the other hand they do not want to give Russia a practical veto in inclusion of new members in the alliance. The end result has been a careful, delayed, small-scale expansion with vague promises to the nine candidate countries. Another policy has been the Partnership for Peace Program, often called a substitute for membership or a NATO waiting room.

In the case of the Baltics, NATO's relations to Russia have played a significant role. As they are, for the time being, the only NATO membership candidates among the former Soviet republics and are not militarily significant, Russia has at least gained some time in stalling the membership of former Soviet republics to NATO. The Baltics do not have such a role in European strategies which they could exploit to enter NATO, they are simply not important enough to justify seriously damaged relations with Russia. Both the fact that there are candidates that will not cause similar problems with Russia (Slovak Republic, Slovenia) and the up-coming membership in the EU are good excuses for NATO to keep the Baltics outside.

EU's ability to absorb new members

As stated earlier, the Nice summit of December 2000 cleared the structural obstacles of inclusion of new EU members. At Nice, the future composition of the Commission, the numbers of votes at the Council of Ministers, number of members at the European Parliament were decided upon,

as well as the principle of accepting deeper integration among some countries. All these decisions have “made the table ready” for all candidate countries.

However, there are still problems with some aspects of the accession conditions. The crucial question of agriculture is yet to be solved, and will not even be discussed before the French and German elections in 2002. Furthermore, the candidates demand the same benefits as those received by existing members. Here, the Polish agriculture with its hundreds of thousands of small farms is a serious problem, but the agricultures of applicants put together would require such an enormous amount of subsidies and other support that is not possible to cover within the existing Union budget.

Another major question is the free movement of people, where the candidates are demanding the application of this freedom from the first day of membership. Existing members, fearful of an uncontrollable wave of immigrants, are proposing a lengthy (up to seven years) transition period.

Regional policy of the Union is the third major obstacle, the Southern flank of the EU (especially Spain) does not want to get its regional benefits cut because of the entry of new members.

These questions, and probably others, will become the last-moment bargaining topics, when membership negotiations are coming to an end, with the most advanced candidates possibly already at the end of 2002. A danger of delay in concluding negotiations with at least one or a few countries can be considered fairly real, and, hence, the EU enlargement may slow down.

The Baltics, because of their tiny size, are not especially difficult negotiation partners. As to agriculture, Estonia especially has abolished all subsidies and import restrictions and consequently, its farmers will greatly benefit from the membership. Latvia and especially Lithuania are more restrictive than Estonia, but they are no major producers in the vast EU agriculture and hence pose no substantial threat to the CAP.

The free movement of people is partially seen in the Baltics as a threat of losing their highly educated professionals to neighbouring EU countries. However, they demand free movement from the beginning of their membership, but might not be very unhappy with a transition period.

As a whole, the Baltics are perhaps the easiest candidate countries from the EU point of view, as their accession to the EU will not cause any kind of major problems. With a combined population equal to that of Sweden and an economy less than half of that of Finland, the Baltics do not pose the same problems than the large Central European and Balkan candidates.

National interests of existing members

Both the expansion of NATO and enlargement of the EU can be seen among individual member countries as contrary to their national interests. This is quite clearly shown in the EU enlargement opinion polls: the closer the country is to the candidates, the less supportive its people are for enlargement. There are fears of floods of cheap agricultural products from a neighbouring candidate country, or a massive flow of immigrants, infiltration of crime and drugs etc. On a more general level, it is feared the cost of new members will increase taxation.

From the security point of view, a new NATO members or members could pose a threat to regional stability, just as the Baltics' inclusion to NATO could provoke a strong reaction from Russia. Also the possibility to become responsible for the defence of a far away FSC can be seen as a liability, as well as the costs incurred by the needed reform in the armed forces of the new members.

The Baltics, however tiny they may be, have also small neighbouring countries, to whom their EU and/or NATO membership might be a real challenge, if not a threat. Finland and Sweden especially, as former neutral states and with no imminent aspirations to join NATO, are favouring EU membership over NATO as a realistic security arrangement for the Baltics. Denmark and Norway, located relatively far from Russia and being NATO members, are more positive to inclusion to NATO of the Baltics, but Germany, is not willing to endanger its crucially important relations to Russia and thus is not a promoter of invitation of the Baltics to NATO.

The Nordic EU members are strong supporters of EU enlargement, but some worries of especially on the free movement of people have been expressed. On the other hand, the Nordics will face the problem of ageing population, and it might well be that after a relatively lengthy transition period, there would be rather a demand of labour from the Baltics than fear of uncontrolled flow of Baltic workers and of a consequent rising unemployment.

Baltic agricultural exports (trade of industrial goods is already liberated with EU-Baltic free trade agreements) is not seen by neighbouring countries as a major threat, due to the small size and relative inefficiency of the Baltic farming.

11.4. Summary: explanatory factors and reintegration

In the previous sections, the Baltic states were compared as regard to various explanatory factors to reintegration, both factors linked to their initial position and factors of internal nature. In the following, these factors are drawn together to produce a summary comparison between the Baltics. This summary is, of course, very rough and somewhat arbitrary, but it is hoped that it will anyway give an idea of each country's comparative position, measured by its initial position and progress in post-socialist transition. The third category of explanatory factors, the external ones, are not taken into account as it is very difficult to find differences between the Baltics, when it comes to questions of foreign policy, economic interests, public opinion in EU15 etc.

The method below is simple: (the first estimate refers to initial conditions, the latter to post-socialist transition): excellent/higher advanced position is marked by +++, good/lower advanced by ++, satisfactory/higher intermediate by +, neutral/lower intermediate by 0, unsatisfactory/higher slow-progress by – and very unsatisfactory/lower slow-progress position by --. The evaluations concerning initial positions are the author's and reflect his conceptions on the positions of each country as to each explanatory factor. The main criterium is the internal order of the Baltic states, not the position of each country compared to all FSCs.

Table 15. Comparison of explanatory factors

	Estonia	Latvia	Lithuania
Initial position			
Historical experience	++	++	++
Geographic position	+++	++	+
Historical orientation	++	++	+
Lingual proximity	+	0	0
Ethnic composition	-	--	+
Initial economic position	+	½ +	0
Post-socialist transition			
Market reform	++	++	++
Legal transition	+++	+	+
Infrastructure transition	+++	+	+
GDP recovery	+	0	+
FDI per capita	+++	++	0
EU share of foreign trade	+++	++	+
Democracy	+++	++	++
Public opinion on EU membership	-	0	-
Sum of pluses and minuses	25	14 ½	12

On the basis of the above results, Estonia has both a better initial position and post-socialist transition performance than the others, the differences being greater in transition factors than initial position factors. Latvia and Lithuania have almost similar initial position, but Latvia has done slightly better when it comes to transition performance.

All the Baltic states have become members of the CSCE, IMF, the Council of Europe (CoE) and WTO⁷³ and they are all candidates to European Union. There are, however, differences between the Baltics as to the time when memberships and EU candidatures were achieved. When the reintegration success of the Baltics is presented the same way as above, by giving a + for earlier membership/EU candidature and a 0 for later one, the following emerges:

Table 16. Timing of Baltic reintegration

	Estonia	Latvia	Lithuania
CSCE	+ (1991)	+ (1991)	0 (1992)
IMF	+ (1992)	+ (1992)	+ (1992)
CoE	+ (1993)	0 (1996)	+ (1993)
EU candidate	+ (1997)	0 (1999)	0 (1999)
WTO	+ (1999)	+ (1999)	0 (2001)
Sum of pluses	5	3	2

⁷³ Lithuania's parliament has ratified WTO membership in April 2001. The membership enters into force 30 days after the notification by Lithuania to WTO of the ratification. The notification is expected shortly, and thus it is assumed that Lithuania becomes a WTO member in 2001.

The relative success of the Baltics is clear: Estonia has attained all memberships and EU candidature as the first or as one of the first and Latvia has a slightly better record than Lithuania. This result is in harmony with the above summary of the explanatory factors and the order is the same. Although the above methods to determine the differences between the Baltics are rough and summary in nature, they indicate a link between the explanatory factors and actual success in reintegration: the overall position of each country as to explanatory factors corresponds to its success in reintegration.

On the other hand, all the Baltic states have reached the same level of reintegration (or will do so, when Lithuania becomes a member of the WTO). Also in the EU membership negotiations, Latvia and Lithuania have progressed and diminished the gap between them and Estonia. Hence, the differences can be found only in the timing of reintegration: the early lead of Estonia has diminished and will be eliminated by Lithuania's WTO membership. The next big question will be entry into the European Union, where current thinking indicates a simultaneous membership of all the Baltic states, maybe in 2004. Of the remaining two organisations, OECD membership still seems to be several years ahead, perhaps in the latter half of present decade. Membership in NATO will obviously be the most difficult to achieve, as it is clearly dependant on external factors, mainly on NATO-Russia relations.

The Baltics have, in spite of their less favourable initial position as former Soviet republics, progressed considerably in their reintegration. Their proximity to the West (the Nordics and Germany), their equally long (or rather relatively short) period under socialism with Central European and Balkan states and their good, if not excellent record in post-socialist transition have been, in the author's opinion, the main explanatory factors for the succesful reintegration of Estonia, Latvia and Lithuania to the West.

Appendix 1. Reintegration of FSCs to Western organisations, 1990-2000

Country	90	91	92	93	94	95	96	97	98	99	00
ALBANIA		CSCE IMF				CoE					
ARMENIA			CSCE IMF				CoE**				
AZERBAIJAN			CSCE IMF				CoE**				
BELARUS			CSCE IMF								
BOSNIA			CSCE IMF			CoE**					
BULGARIA (CSCE/ORIG.)	IMF					CoE		WTO		EU/H	
CROATIA			CSCE IMF				CoE				
CZECH REP.				IMF	CoE	CSCE*	OECD	EU/L	NATO		
ESTONIA		CSCE	IMF	CoE				EU/L		WTO	
GEORGIA			CSCE IMF							CoE	WTO
HUNGARY (CSCE/ORIG., GATT 73, IMF 82)	CoE							OECD	EU/L	NATO	
KAZAKSTAN			CSCE IMF								
KYRGYSTAN			CSCE IMF							WTO	
LATVIA		CSCE	IMF				CoE			EU/H	WTO
LITHUANIA			CSCE IMF	CoE						EU/H	
MACEDONIA			IMF			CSCE					
MOLDOVA			CSCE IMF			CoE					

COUNTRY	90	91	92	93	94	95	96	97	98	99	00
POLAND (CSCE/ORIG., GATT 67, IMF 86)		CoE					OECD	EU/L	NATO		
ROMANIA (CSCE/ORIG., GATT 71, IMF 72)				CoE						EU/H	
RUSSIA (CSCE/ORIG.)			IMF				CoE				
SLOVAK REP.				CSCE* CoE		WTO				EU/H	OECD
SLOVENIA			CSCE IMF	CoE	GATT			EU/L			
TAJIKISTAN			CSCE IMF								
TURKMENISTAN			CSCE IMF								
UKRAINE			CSCE IMF			CoE					
UZBEKISTAN			CSCE IMF								
YUGOSLAVIA (GATT 66)			- CSCE*** - IMF****								

CSCE = Conference on Security and Co-operation in Europe

CoE = Council of Europe

EU/H = EU Candidate Status, accepted at Helsinki Summit (1999)

EU/L = EU Candidate Status, accepted at Luxembourg Summit (1997)

GATT = General Agreement on Tariffs and Trade (at present: WTO)

IMF = International Monetary Fund

OECD = Organisation for Economic Co-operation and Development

WTO = World Trade Organisation (formerly: GATT)

* Czechoslovakia was original member of CSCE, after separation Czech and Slovak Republics joined CSCE in 1993

** Special Guest to the Parliamentary Assembly of the Council of Europe

*** Suspended from participation in CSCE since 1992

**** Suspended from IMF operations as of 1992

**Appendix 2. Transition indicators of former socialist countries, 1999
(EBRD Transition Report 1999)**

COUNTRY	Market reform	Legal transition	Infrastructure transition	Average transition
ALBANIA	2.59	2.25	1.72	2.20
ARMENIA	2.70	3.00	2.32	2.76
AZERBAIJAN	2.21	2.08	1.72	2.02
BELARUS	1.46	1.75	1.40	1.59
BOSNIA-HERZEG.	1.96	1.25	1.58 ¹	1.51
BULGARIA	2.82	3.25	2.66	3.00
CROATIA	3.04	3.10	2.50	2.94
CZECH REPUBLIC	3.49	2.90	2.92	3.05
ESTONIA	3.46	3.58	3.75 ¹	3.59
FYR MACEDONIA	2.71	3.28	1.90 ¹	2.79
GEORGIA	2.70	1.50	2.50 ²	2.05
HUNGARY	3.68	3.93	3.72	3.81
KAZAKHSTAN	2.66	3.08	2.18	2.75
KYRGYSTAN	2.79	2.75	1.52	2.45
LATVIA	3.13	2.92	2.92	2.98
LITHUANIA	3.13	2.93	2.64	2.91
MOLDOVA	2.70	3.25	2.26	2.87
POLAND	3.48	3.75	3.38	3.59
ROMANIA	2.76	3.18	3.06	3.04
RUSSIA	2.46	2.75	2.32	2.57
SLOVAK REPUBLIC	3.33	3.40	2.15 ²	3.07
SLOVENIA	3.24	3.65	2.98	3.38
TAJIKISTAN	1.96	na	1.10 ³	(1.53)
TURKMENISTAN	1.43	na	1.06	(1.25)
UKRAINE	2.45	2.00	1.70	2.04
UZBEKISTAN	2.05	2.25	1.40	1.99

¹ Roads: na

² Water and waste water:na

³ Roads, water and waste water: na

Appendix 3. Overall Performance Record of Former Socialist Countries

Country	Economic transition	Macroeconomy	Democracy & Governance	Overall average	
Albania	3	2 ½	4	3+	(12.)
Armenia	3 ½	1	4	3+	(13.)
Azerbaijan	3-	2	4-	3	(14.)
Belarus	1+	2 ½	3	2+	(21.)
Bosnia-Herzegovina	2-	Na	na	2-	(24.)
Bulgaria	4+	2 ½	4+	4	(9.)
Croatia	4+	3 ½	2+	3+	(11.)
Czech Republic	4+	5 ½	5	5	(5.)
Estonia	6-	5	6	6-	(2.)
Georgia	3-	1	3	2 ½	(19.)
Hungary	6	5 ½	6-	6-	(1.)
Kazakhstan	4	3	2-	3-	(16.)
Kyrgyzstan	3+	1 ½	3-	3-	(18.)
Latvia	4+	3 ½	5 ½ *	4 ½	(6.)
Lithuania	4+	3	5	4+	(7.)
Macedonia	4	2	2 ½*	3-	(16.)
Moldova	4-	1	3+	3	(14.)
Poland	5+	4 ½	5+	5+	(3.)
Romania	5-	3	3+	4-	(10.)
Russia	3+	1 ½	2+	2 ½	(19.)
Slovak Republic	4+	4	4+	4+	(7.)
Slovenia	5	4 ½	5+	5	(4.)
Tajikistan	1 ½**	1	1 ½*	1 ½	(25.)
Turkmenistan	1**	1 ½	1*	1+	(26.)
Ukraine	2+	1	3	2+	(21.)
Uzbekistan	2-	2 ½	2+	2	(23.)

- Indicator of governance missing

Average

** Indicator of legal transition missing

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