



SOCIAL AND POLITICAL DIMENSIONS
OF THE EUROZONE ENLARGEMENT
IN THE CASE OF THE BALTIC STATES

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The Eastward Enlargement of the Eurozone

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Abstract

This Regional Input is a supplement to Ezoneplus Working Paper No. 13 on the Social Dimension of the Eastward Enlargement of the Eurozone.

Political transition from authoritarian to democratic society has been extensive in all three Baltic States. The Baltic States are often examined together in political studies despite of the fact that there is much more variation among these countries in the political sphere than in the economic and social spheres. The problems stemming from the political sphere might be even more crucial for EU enlargement because of their relative instability and slow working comparing that to the economic and social concerns. Therefore this study emphasises some major political differences between the Baltic States that should be taken into account when analysing EU eastward enlargement processes.

The paper aims to analyze social and political dimensions of eurozone enlargement in the Baltic States emphasizing also negative consequences of transition and integration processes and their possible impact on EU accession.

Keywords : Regional Input, The Baltic States, Social Dimension, Political Dimension

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Contents

FOREWORD.....	5
Part I. SOCIAL DIMENSIONS.....	6
1.1. Introduction.....	6
1.2. Social Issues.....	8
1.2.1. Inequality.....	8
1.2.1.1. Origins and consequences of inequality.....	8
1.2.1.2. Measurement of inequality.....	11
1.2.1.3. Income distribution in the Baltic States.....	13
1.2.1.4. Explaining inequality in the Baltic States.....	17
1.2.2. Poverty.....	20
1.2.2.1. Definition of the poverty concept.....	20
1.2.2.2. Poverty assessment in the Baltic States.....	22
1.2.3. Unemployment.....	28
1.2.3.1. General trends in unemployment of the Baltic States.....	28
1.2.3.2. Structural unemployment.....	30
1.3. Social protection system.....	34
1.3.1. General overview social protection systems.....	34
1.3.1.1. The concept of social protection.....	34
1.3.1.2. Social protection systems in the European countries.....	36
1.3.2. Poverty Reduction Strategies.....	38
1.3.2.1. The role of poverty reduction in sustainable human development.....	38
1.3.2.2. Poverty reduction strategies in the Baltic States.....	39
1.3.3. Pension Systems.....	42
1.3.3.1. Overview of the pension systems in the Baltic States.....	42
1.3.3.2. Three pillars old-age pension system.....	46
1.3.3.2. Some considerations regarding the pensyon systems.....	51
1.3.4. Social and Unemployment Assistance.....	52
1.3.4.1. Unemployment assistance and insurance.....	52
1.3.4.2. Social Assistance.....	55
1.3.5. Labour Market Policies and Institutions.....	59
1.3.5.1. Active labour market policies.....	59
1.3.5.2. Regulation of work relations.....	60
1.3.5.3. Wage bargaining.....	62
1.4. Conclusions.....	66
References I.....	69
Appendix 1.1. Inequality in CEE candidate countries and EU members.....	76
Appendix 1.2. Unemployment by education, sector and profession.....	77
Appendix 1.3. Expenditures on social protection in the Baltic States, 2000-2002.....	78
Appendix 1.4. Unemployment assistance and insurance in the Baltic States in 2001.....	79
Appendix 1.5. Expenditures on passive labour market policy measures.....	80
Appendix 1.6. Social Benefits in the Baltic States as a percentage of GDP in 1995-2000..	81
Appendix 1.7. Expenditure on active labour market measures in Baltic States, 1995-2001	82
Part II. POLITICAL DIMENSIONS.....	83
2.1. Introduction.....	83

2.2. The Institutional Aspects of the Political Systems	84
2.3. Issues in Baltic Politics after Independence	87
2.4. Political Attitudes and Values.....	89
2.5. Attitudes towards the European Union.....	91
2.6. Party Systems	93
2.7. Parties and Euroscepticism.....	96
2.8. The Non-governmental Sector	98
2.9. Conclusions	100
References II	101
Appendix 2.1. Parliamentary Elections in Estonia	103
Appendix 2.2. Parliamentary Elections in Latvia	104
Appendix 2.3. Parliamentary Elections in Lithuania	105
Appendix 2.4. Governments in Estonia.....	106
Appendix 2.5. Governments in Latvia	107
Appendix 2.6. Governments in Lithuania.....	108
Appendix 2.7. Support for Membership in EU	109
Appendix 2.8. Approval of the New Regime	110

FOREWORD

The Baltic States as the only former Soviet republics among the EU accession countries are usually considered to be successful in their economic and political transition. These countries have made remarkable economic and political progress after regaining independence in 1991. Transition from the centrally planned to rather liberal form of market economy has led to quick development of the Baltic economies accompanied by serious social and political problems. The absorptive power of people with tremendous economic, social and political changes is limited. The majority of the Baltic States' population as well as other transitional countries cannot adjust quicker with such rapid changes. Poverty, increasing inequality and structural unemployment are natural consequences of adjustment processes.

Political transition from authoritarian to democratic society has been extensive in all three Baltic States. The Baltic States are often examined together in political studies despite of the fact that there is much more variation among these countries in the political sphere than in the economic and social spheres. The problems stemming from the political sphere might be even more crucial for EU enlargement because of their relative instability and slow working comparing that to the economic and social concerns. Therefore this study emphasises some major political differences between the Baltic States that should be taken into account when analysing EU eastward enlargement processes.

The paper aims to analyze social and political dimensions of eurozone enlargement in the Baltic States emphasizing also negative consequences of transition and integration processes and their possible impact on EU accession. The paper consists of two main parts. First part analyses social dimensions of euro zone enlargement paying attention to common features and differences of social issues and policy implications in the Baltic States. The second part of the paper stresses political dimension of transition and EU enlargement analysing institutional aspects of political systems, political values and attitudes together with assessments of regime change and the popular stance towards EU.

The authors of the first part of the paper are Tiiu Paas (team leader), Marit Rõõm, Orzolya Szirko, Reilika Liiv and Christopher Schumann. The second part of the paper is compiled by Allan Sikk. Using research assistance of Kalmer Gross and Raimo Poom. The authors of the paper are thankful to Jaan Masso (part I) and Piret Ehin (Part II) for their valuable comments. The usual disclaimer applies.

Part I. SOCIAL DIMENSIONS

1.1. Introduction

The Baltic States provide an interesting case for generalizing transition, EU eastward enlargement and regional integration processes and for developing a new field of economics – economics of transition and integration. Needless to say that the Baltic States are the only former Soviet republics among the EU accession countries. They have made remarkable economic progress after regaining independence in 1991. Due to their historical background, the Baltic States have some previous experience of developing under market economy conditions. These countries are also familiar with the main principles of integration thanks to the experience they gained in the framework of the CMEA (the Soviet-led Council for Mutual Economic Assistance). Thus, for the Baltic States accession to the EU means reintegration into Europe. That explains partly why the Baltic States' sometimes stand out as positive and promising exceptions among the countries in transition, particularly among the former Soviet republics.

More than a decade lasting structural adjustment and economic reforms have also had serious social consequences and costs that may have negative impact on reintegration into Europe and on the efficiency of joining the euro zone. The speed of the transition and integration processes is a disputable question. Is the conversion in accordance with the expectations or is it proceeding more slowly and at a lower level than expected? From the point of the transitional countries, the transformation processes have often been even quicker than expected, placing the population under serious pressure. The absorptive power of people is limited. The majority of the population in the transitional countries cannot adjust quicker with such rapid changes and natural consequences are structural unemployment, lack of properly qualified labour force, poverty, increasing inequality and concurring problems that are sometimes difficult to solve by rather poor countries.

Under the former central planning regime the Baltic States alike the countries of Central and Eastern Europe were characterized by a more egalitarian income distribution than western market economies. This situation has changed dramatically after the onset of transition; as a

consequence the income inequality has been rising much faster than in any of the established market economies during the same period. By 1999, income inequality in the Baltic States countries had been caught up with the average level observed in the EU and OECD countries. The results of the study developed on the basis International Social Survey Program (ISSP) data of 1999 show that the people from the post-socialist countries are less willing to tolerate existing income inequalities, even after the actual level of income inequality and other determinants of attitudes are taken into account (see Marc Suhrcke, 2001). Thus, additionally to absolute poverty people seriously suffer from the consequences of increasing relative and subjective poverty. This is very likely to have important implications for the political support of reform policy and for emphasizing the necessity do deal seriously with social consequences of European integration and transition processes in the Baltic States.

This part of the paper (Part I. Social Dimensions) aims to explore the main social issues of the Baltic States concentrating on inequality, poverty, unemployment and social protection problems. The social issues prompt the questions on relevant policies to the people most seriously affected by rapid economic and political reforms. According to the directions of European Commission (1997) the main target of improvement of European social protection system has to be the encouragement of people to be more active and competitive in the labour markets in order to increase the labour market participation rate of declining and aging European population. This target is also important for the Baltic States.

This part of the paper falls into two main sections. Section 1.2 presents the overview of the main social issues giving emphasis on increasing economic inequality, poverty and unemployment. Section 1.3 analyses the social protection system of the Baltic States paying attention to poverty reduction strategies, social assistance and insurance, labour market policies and labour regulations. The empirical part of the paper bases mainly on the data of national authorities of the Baltic States and international organizations (the World Bank, European Commission, UNDP).

1.2. Social Issues

1.2.1. Inequality

Inequality is a topic that is obtaining rising attention in the context of European integration and transition processes. Newly introduced freedoms of capital and labor movements as well as open trade create opportunities for many, but the development leaves some population groups behind. It is not only the domestic distribution of incomes that is of concern. While nations, cultures and economies move closer towards each other, people are getting more aware of differences across borders and distribution of the total income in the enlarged Europe. Widening gaps between poor and rich may hamper social cohesion not only within the countries but this gap may also keep people from supporting further integration. In addition, inequality may have negative consequences for economic growth.

The Baltic States are faced with inequality even more thoroughly because of their transition from socialist to market economies. Their societies have undergone fundamental restructuring in which some took the chances of the moment while others perceive themselves as losers of the transition. This part of the paper describes the extent to which inequality is present in Estonia, Latvia and Lithuania.

1.2.1.1. Origins and consequences of inequality

Origins of inequality

Inequality is a social and economic phenomenon that every society is confronted with. The degree of inequality does differ widely across and within countries and there is a variety of explanations. Most of the theoretical discussions on inequality have been undertaken in the field of development theory and among others inspired by Kuznets and by the neoclassical growth theorists in the 1950s. (eg. Solow, Kaldor) Kuznets (1955) observed a regular connection between development and inequality. The famous Kuznets hypothesis claims that in the course of early development, economies show rising degrees of inequality, while in later stages, inequality declines. This relation described by an inverse U-shaped curve can be explained by shifts in the production and employment structures. The Kuznets' hypothesis has been object of much empirical research in the last decade. Many have verified (eg. Barro 1999) it but still some doubt its validity (eg. Anand and Kanbur 1993).

In neoclassical growth and distribution theory, people are paid according to their marginal products. The original framework, based on the concept of perfect competition, has been elaborated for other market form and the theory of human capital has been included in recent models (for an overview, see Aghion and Howitt 1998). It is undoubted that an individual's human capital is decisive for placement on the labor market and for income potentials.

While these theories state a relation between general development and inequality and cross-country convergence of income levels, other approaches revealed other determinants of inequality and do not predict declining dispersion of income levels but persistent or even growing inequality. A group of researchers identified capital market imperfection to be responsible for persistent inequality. (eg. Banerjee and Newman 1993, Lindh and Ohlsson 1998, Stiglitz and Weiss 1981) They argue that lacks of information lead to a biased allocation of capital. Groups within a society that are initially poorly endowed with capital goods tend to have restricted access to credits and therefore make relatively few investments in physical or human capital. As this affects their success on the labor markets and their occupational choice, groups with low initial wealth will in the long run have fewer opportunities to break into the sphere of jobs with high earnings potential. Inequality will be persistent as long as credit rationing works against the relatively poor.

Others see social stratification as a threshold against decreasing inequality. (eg. Benabou 1994, Durlauf 1994 and 1996). Within countries, people with similar educational level, preferences and social status tend to geographically separate from other stratum of the society and form own neighborhoods. In areas with rather rich population, positive local spillover effects can be observed for example with respect to education and labor market access, whereas in poor neighborhoods, the potential for positive spillovers is low. Since social stratification is in general kept among generations, the degree of inequality in the whole society may not decrease but in the opposite rather increase.

Kane and Morisset (1993) identified inflation as another possible reason for growing differences in income distribution. They argue that in times of high inflation, rich are likely to adapt to this situation and shift their financial assets in order to prevent losses or even to profit from the situation. They are not as much affected by real losses in labor incomes and transfers as middle-class and low-income groups who have no instruments to circumvent setbacks.

Consequences of inequality

Inequality is undoubtedly considered a phenomenon that has negative consequences for countries. First of all, it leads to dissatisfaction in the society and to social tensions. Of course, it depends on the cultural norms, preferences and traditions of every society to which degree inequality is perceived negatively and when this makes people change their behavior. In cases where the income distribution is considered to be unjust, people's reaction may range from a change in voting behavior up to riot, unrest or even revolution. While in the case of social unrest, where fights and casualties may occur, the negative effect is obvious, slight changes in the legislation or the public atmosphere can have negative impacts on economic growth as well. It is argued that the insecurity of property right and low investment incentives are key factors in this context. If the disposal of properties is possibly subject to changes in the future, incentives for investment are low because the expected returns are tainted with question marks. Low propensities to invest hamper business activities and further economic growth. (eg. Benhabib and Rustichini 1996, Alesina and Perotti 1996, Benabou 1996)

Rodrik (1997) underlined that countries with a high degree of internal division (inequality, ethnic separation) and weak institutions of conflict management (government institutions, democratic rights and social safety nets) have been in the past decades more vulnerable to macroeconomic shocks and experienced sharper drops in the growth patterns than countries with more equal distributions.

Drawbacks in economic growth in return are considered to have negative consequences for inequality. Or putting it the other way round, economic growth does create an environment in which improving equality is easier than without growth. This relation is based on the trickle-down theory that claims that in the course of economic growth, the surplus in income will reach all social groups and ultimately "trickle down" to the poorest population. (see Aghion and Bolton 1997) While it is widely accepted that without growth, redistributions of income and properties are difficult to push through, it is questioned if the fruits of economic growth actually reach the groups with low social status. Lobbying, biased participation in political processes and information asymmetries are some of the possible reasons for delay or failure. Redistribution policies and targeted transfers are expected to be more effective in reducing inequality than general economic development. Public investments in infrastructure and education are crucial in the sense that they may be good measures to improve equality of opportunities, reducing the negative effects of local spillovers and spatial disparities and correcting for the imperfections of markets. (eg. Ferreira 1996) Institutional development of

the capital market may particularly offset the negative selection mechanisms described above. (Braverman and Stiglitz 1989) Though, many surveys have found a negative impact of tax-based redistribution policies on economic growth, which imposes restrictions on future actions of governmental agents. (Alesina and Rodrik 1994, Benabou 1996, Chang 1998, Persson and Tabellini 1994)

On the other hand, an overall regressive redistribution does have a direct positive impact on decreasing of inequality, since the poor and disadvantaged are provided with means to cover their basic needs and thereby a minimum level of welfare is set. But despite these measures, in a society with high inequality, the potential for unsatisfactory and social tensions are high.

1.2.1.2. Measurement of inequality

Dimensions of inequality measurement

Inequality is by its nature a relative phenomenon. Obviously, the question of inequality only arises in a group people where its members have different amounts of incomes to their disposal. The starting point for any inequality considerations is a comparison these amounts or - in other words - the distribution of incomes.

The term "income" should be interpreted not only in monetary terms. Income can have many different dimensions. Access to basic consumption goods or possession of status goods are examples for other connotations of income that reveal the living standard of different individuals. Hence, inequality can be conceptualized "as the dispersion of a distribution, whether that be income, consumption or some other welfare indicator or attribute of a population". (World Bank 2002)

In general, monetary income is a good proxy for the welfare of different members of a society since it represents the power to satisfy the own needs. The more diverse the distribution of income, the higher the range of different sets of goods that the individuals or households can choose to have to their disposal. Since most of the survey data on income are gathered on the household level, it does make a difference how different structures of households are taken into account. Since there are synergetic effects within households and since children do in general need less food than adults, different weights are attributed to different members of the households. The distribution of "equivalent" household income might lead to different results than the distribution of per capita or per household member distributions.

In this analysis, monetary income per household member is chosen as the dimension in which inequality is measured.

Indices for measurement

There are many different analytical tools that can be used in order to discuss the problem of inequality. The most common tool used to display inequality graphically is the "Lorenz-curve". It plots the distribution of income on two relative scales each in the range from 0 to 1 ranking the individuals according to their income. The curve has a concave form. The numerical Gini Index is closely related to the Lorenz curve. It ranges between 0 and 1 (or 0 to 100) and indicates how far away the distribution is from the state in which all individuals have the exact same income. In reality, we can observe values between 0.2 (20) representing very equal and 0.6 (60) very unequal societies. Cornia and Court (2001) found that inequality is perceived to be very high, if the Gini exceeds 0.4 (40). In addition to the Gini, comparing the mean income of different quantiles (eg. deciles or quintiles) in the society and calculating the ratios between them allows a closer look at the characteristics of the distribution.

The measurement indicators mentioned so far are of purely descriptive nature. But many argue that inequality should not only be analyzed on the basis of pure comparisons but should take normative components into account by using concepts of social welfare functions. In opposition to the former measurement approaches, these approaches allow to value deviations of the mean for the poor in a different way than for the rich. They emphasize the relative scarceness of income of the poor more than the relative abundance of income of the rich. This can be done by introducing a parameter that puts more weight to downward and less weight to upward derivation from the mean. The Dalton and the Atkinson index are the most famous ones in this respect. (see Cowell 1993) The value of parameter can be chosen in the context of the purpose of the study or according to known preferences of the society. As mentioned in part 2, not all societies perceive inequality in the same way and this subjective differences can be mirrored in the choice of the value of the parameter. But since this study cannot rely on well-defined estimations for parameters for subjective evaluation of inequality, it uses the descriptive measures Gini-index and quantile-ratios.

1.2.1.3. Income distribution in the Baltic States

Data

Data on income distributions in the Baltic States can be taken from household budget surveys (HBS) that have been carried through by the national statistical offices. Most of the data has been published by the national institutions themselves, but additional data can be found in the publications of the World Bank, the United Nations and in the WIID database.¹ If not indicated otherwise, the numbers refer to disposable income per household member. It must be stated, that in different publications, the data for the same years and countries may differ widely. Especially for the observations in the early 1990's many inconsistencies can be found which is partly due to changing definitions of income and partly to biases in the samples. For 1990 and 1991, there is no reliable data available. The surveys undertaken in the past years improved in their methodology and deliver more comparable data. For Lithuania, since 1997 the deciles have been reported on the base of expenditure on consumption. But because income and expenditures are closely related in every household, the correlation of the distribution of disposable income and of expenditure on consumption is high and comparability is maintained. Though with respect to the decile and quintile ratios, expenditure data may bias the results downwards since the share of the expenditure on consumptions is higher among the poorest households than among the richest.

Gini indices

In the course of the 1990's, the Baltic States have experienced a huge increase in inequality. In a study by Milanovic (1999), all transition countries in the sample reported in 1989 a Gini between 20 and 26, which identifies them as relatively egalitarian societies. Because of the major role of the state in employment and the little extend of wage differentiation in this sector in all Soviet republics, the Gini index of 22.6 (0.226) for Latvia in 1989 appears to be reasonably representative for all Baltic States before independence. Estonia, Latvia and Lithuania were all on the same low level of inequality.

In the following years, enormous changes in the Gini index have taken place. The Gini index for Latvia rose continuously to 32 in 1996. Lithuania reached a level well beyond 30 already in

¹ WIID: World Income Inequality Database. Joint Programme of the World Institute for Development Economics Research (WIDER) and the United Nations Development Programme (UNDP). Link: <http://www.wider.unu.edu/wiid/wiid.htm>

1993 and the Gini in Estonia jumped even up to 40. In the years 1992-1994, the difference between the Baltic States was tremendous. But as shown in figure 1, this difference became less drastic during the recent years. The Gini of Lithuania remained more or less constant at about 33 and Latvia has reached the same level in 1997 and displays rising Ginis up to 34 in 2000. In Estonia, it has declined slightly in the course of the decade down to 37, but it still exceeds the inequality of the two other Baltic States.

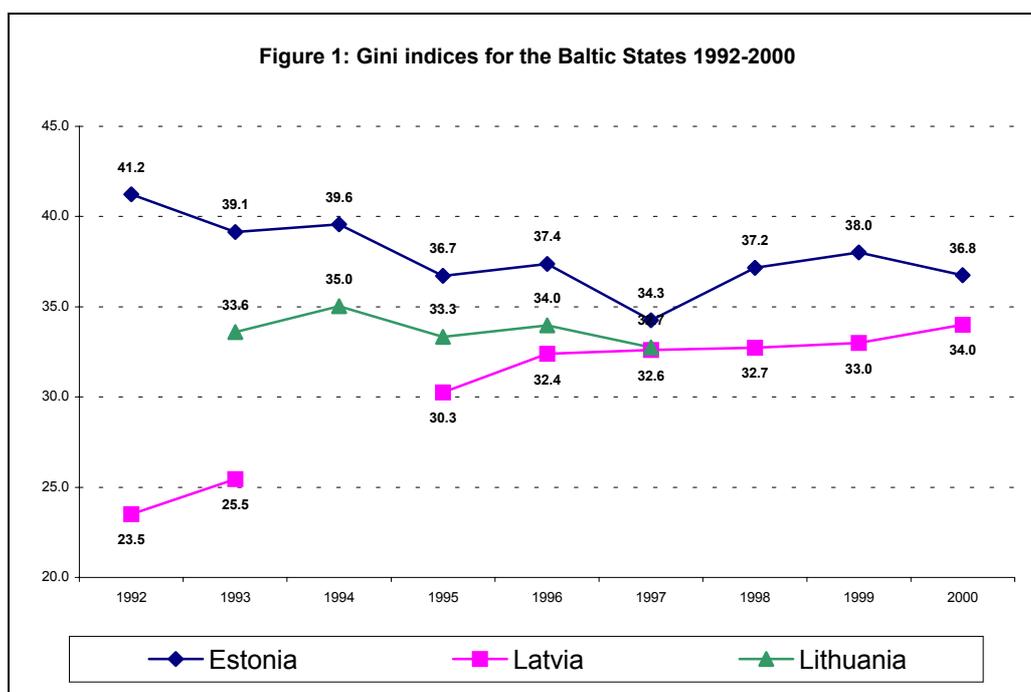


Figure 1. Gini indices for the Baltic States in 1992-2000

Sources: National Statistical Offices, WIID, Milanovic (1999), UNDP, World Bank

Quintile distribution

The differences in inequality between the countries are reflected in the distribution among the population quintiles as well. (See table 1) In 1996, the average income of the poorest 20 % was relatively higher in Latvia than in Lithuania and Estonia where it was in the range of 7 %. In the center quintiles (II, III and IV) the income shares of Estonians was significantly lower than those of Latvians and Estonians.

In each of the countries, the poorer half of the population earned little more than a quarter of the total income while the richest quintile accounted for more than 40 %. In the share of the richest, the biggest differences among the countries can be observed. In Latvia, they earn 40.4% of the total income, in Lithuania 41.4 % and in Estonia 44.8 %. The relatively higher

extend of inequality in Estonia is not so much a result of the drawback of the poor but rather due to the higher wealth of the rich. In Latvia, the span between the richest and the lowest quintile is the smallest which corresponds to the lowest Gini in figure 1.

Table 1. Distribution of income by quintiles

Country	Year	I.	II.	III.	IV.	V.	Total
Estonia	1996	6,9	11,7	15,1	21,5	44,8	100,0
Latvia	1996	7,7	13,0	16,9	22,0	40,4	100,0
Lithuania	1996	6,7	12,6	16,8	22,6	41,4	100,0
Estonia	2000	6,6	12,3	15,5	21,6	44,1	100,0
Latvia	2000	6,4	13,2	16,7	21,3	42,4	100,0
Lithuania ¹	2000	7,7	12,4	16,6	22,1	41,1	100,0

¹ based on consumption expenditure data

Sources: National Statistical Offices, UNDP, WIID

A comparison of the quintile distribution of 1996 and 2000 shows few changes. It should be noted, that in 2000, the poorest population in Lithuania is relatively better off than in the other countries. In Latvia, the poorest have lost a considerable share of the total income. On the other end of the distribution scale, the income share of the richest quintile increased by 2 %. Inequality has risen in Latvia. In Estonia, we observe a slight rise in the income shares of the “middle classes”, while the share of the richest (but as well of the poorest) has dropped.

Quintile and decile ratios

A look at the decile and quintile ratios does confirm some of the tendencies, but not all. Especially the decile ratio for Estonia has fluctuated a lot. Most of the years, it has reached a two digit figure and it went up to even 14,4 in 2000, due to a decline in the income share of the poorest 10 %. Except for 1997, the quintile ration stays between 6 and 7.

In Latvia, the ratios showed lower values until recently. After staying lower than 6, the quintile ration has reached the high level of Estonia in 2000. The quintile and decile ratios in Lithuania are significantly lower than in the two northern Baltic States. But it should be taken into account that they are based on expenditure data which means that they may be downward biased. The overall picture is quite diverse. The income distribution in the Baltic States is still exposed to a lot of variation from year to year, ranging between 8 and 14 in their decile ratios and between 5 and 7 in respect to quintile ratios.

Table 2. Distribution of income by quintiles and deciles

Country	year	I. decile	X. decile	I. quintile	V. quintile	highest to lowest decile	highest to lowest quintile
Estonia	1996	2,4	29,7	6,9	44,8	12,3	6,5
Estonia	1997	2,9	27,8	7,9	42,6	9,4	5,4
Estonia	1998 ²	2,7	29,6	7,3	44,8	11,1	6,2
Estonia	1999 ²	2,7	28,5	7,2	43,7	10,8	6,1
Estonia	2000	2,1	28,5	6,6	44,1	14,4	6,8
Latvia	1996	2,6	25,3	7,7	40,4	9,6	5,2
Latvia	1997	2,6	25,2	7,6	39,5	9,9	5,2
Latvia	1998	2,2	26,0	6,9	40,3	11,9	5,8
Latvia	1999			7,2	39,3		5,4
Latvia	2000			6,4	42,4		6,7
Lithuania	1996	2,1	26,2	6,7	41,4	12,7	6,2
Lithuania	1997 ¹	3,1	26,3	7,7	41,0	8,5	5,3
Lithuania	1999 ¹	3,1	25,3	7,9	40,2	8,1	5,1
Lithuania	2000 ¹	3,1	24,5	7,7	41,1	7,9	5,3

¹ based on consumption expenditure data ² data for 4th quarter of the year

Sources: National Statistical Offices, WIID, UNDP.

Comparison to other countries

In order to interpret the numbers presented, comparisons to other countries should be made. Appendix 1.1. shows the Gini, the decile and quintile shares and ratios for the present European Union members and the East and Central European candidate countries as reported in the Human Development Report 2001.

In the Baltic States, the level of inequality is quite high in comparison to the other transition countries that intend to join the European Union. In Hungary, the Czech Republic and Bulgaria, inequality has not risen so drastically in the course of transition. Their Gini indices show values around 25, the Slovak Republic had an initial jump that was even lower. Romania and Slovenia have a little higher Gini, but the only country among the Central and South-Eastern European candidate countries, that reached a Gini above 30 is Poland, a country that was exposed to a certain extend of inequality more than other socialist countries even before the changes. (Milanovic 1999) Poland is the only Central European transition country that comes close to Latvia and Lithuania in terms of inequality. In Estonia, the gap between rich and poor is still higher. The figures for the decile and the quintile ratios draw a similar picture. The decile ratios of the other candidate economies are far from having two digits. Most of the quintile ratios lie between 3,5 and 4,5.

The group of the present EU member countries is more diverse. Not surprisingly, countries with a traditionally high level of taxes and substantial redistribution like the Scandinavian countries have low levels of inequality. Their Gini as well as the ones for Belgium and Austria is around 25. Germany after reunification reported a Gini of 30 while the Netherlands and all Mediterranean countries except for Italy are above this level. The highest extend of inequality among the European Union members can be observed in the United Kingdom and in Ireland. Their Gini is as high as 36. These are as well the only two countries with a double-digit decile ratio. With respect to the quintile ratios, only the UK, Ireland the Netherlands and the Mediterranean countries are in the range of the level of Latvia, Lithuania and Estonia.

1.2.1.4. Explaining inequality in the Baltic States

In this part, possible explanations for the development of inequality in the Baltic states are discussed. It is based on the observations described in the previous part as well as additional information provided by the national statistical offices and the national UNDP Development reports.

The first obvious observation is the initial rise in inequality in the course of early transition. Milanovic (1999) proposed that the rise in inequality in the course of transition is a result of a “hollowing out” of the middle class. Despite of the rising differences among the wage earners in the public sector, which is one source of rising inequality, shifts in employment from the state sector towards the private sector on one side and unemployment on the other side contributed to inequality. In the private sector, income levels are generally higher while transfers for unemployed are low in each country, especially in Estonia. It is reasonable to believe that not only the restructuring from state to private sectors but as well the restructuring from agriculture and industry towards service contributed to inequality. The service sector, especially in the field of financial services, offers higher wages in average. Income levels in the agricultural as well as in the industrial sector have not kept track with the development in the third sector. Although there is a connection between restructuring the labor markets and the production processes, the case of the Baltic States cannot be taken as an approval of the Kuznets hypothesis. The predicted rise of the Kuznets curve refers rather to countries with an initially dominant agricultural sector. In the Baltic States, agriculture is of minor importance, it contributes only between 5 and 10 % to the gross value added in the economies.

There are two more aspects that should be mentioned when explaining the initial rise of inequality. All three Baltic States have privatized their economy rapidly after independence. This process started during a period in which the capital markets were themselves in a process of stabilization. In the beginning, there was not much transparency in the capital markets and we can refer to the argument of capital market imperfections and information asymmetries. During the early 1990's the number of persons that had access to capital via financial institutions was limited and since the privatization procedures favored those in possession of capital, groups with an initial advantage in wealth or information could use the opportunity to get control of profitable assets. At the same time, the Baltic States experienced hyperinflation. A large share of population that depended on wages and transfers suffered from a real depreciation of their income, while those being able to invest in real estate or build up a new firm as entrepreneurs were able to set a base for future high income potential.

Estonia had higher degrees of inequality throughout the decade while Lithuania's inequality remained on the same level that Latvia reached only in the late 1990's. On the one hand this may be explained by differences in social policies of these countries in the first years after independence. Up to 1995, Estonia's social policy was based on a link of transfers to the minimum wage. During these years the minimum wage was lower than in Latvia and Lithuania. The latter countries tied their social policy to additional indicators which put poor people in these countries in a position that was better as in Estonia in relation to the richer population groups. But as we have seen, the share of the poorest decile in Estonia has not been lower than in Latvia and Lithuania in the latter half of the decade and all three countries have elaborated strategies and targeted instruments for poverty reduction (see following parts). When explaining differences in inequality, the tax systems should be mentioned in this context. Estonia introduced a system that taxes income by a flat rate of 26 %. Redistribution is lower than in the other Baltic States.

It is interesting to see which population groups represented in the different quintiles and deciles. In general, we can state that among the poor, the share of old-aged pensioners as well as of unemployed is rather high. These groups suffered most from the transition since they have not been able to adapt to the new situations as the others. Education is another important determinant of wages as well. People with low education ordinarily earn lower wages and are therefore strongly represented in the lower deciles. In addition, people with low education are more strongly threatened by unemployment and in case they lose their job,

they have fewer chances to get a new one. Among the poor, we can also observe a higher share of families with a high number of children.

On the other end of the distribution scale, we have a high share of entrepreneurs and self-employed. They receive higher incomes not only from labor but also from capital assets. The educational level is in average higher in the upper deciles and especially young people that graduated from universities receive high earnings.

Another factor that is decisive for the relative income position is the geographic location. In all countries, regional differences in the wage levels can be observed. Income potentials in urban centers are much higher than in rural areas or in those characterized by mono-industrial structures left over from Soviet times. In Estonia, Tallinn, Tartu and Pärnu and their hinterland have a stronger economic position than other areas. In Latvia, the strongest areas are Riga and Ventspils, while in Lithuania, the income levels in Vilnius, Kaunas and Klaipeda are above the others. Urban centers have higher share of the 25-44 year-old that often show high entrepreneurial activities. On the other hand, region with high shares of farm households and regions with high unemployment contribute to the bottom part of distribution. This is especially the case for north- and south eastern municipalities in Estonia and for the region Latgale in Latvia. At the same time, in these areas the share of the Russian speaking minorities is higher than in the other regions. Thus, there is an ethnic dimension of wage distribution as well.

The observations with respect to regional differences in income seem to confirm the theory of local spillovers to be important for the emergence of inequalities. The potential for positive spillovers is much higher in urban centers and can be expected to be low in rural areas. As long as deprived regions cannot improve their human capital endowment and attract investments, regional disparities will remain and the spatial dimension of inequality will persist.

Finally, it should be stated, that the Baltic States have reached high growth rates in the past years. There is no sign that the high inequality in comparison to other European countries act as thresholds for economic growth. Inequality seems not to undermine the process of institution building, impede investments and reduce competitiveness.

In conclusion it should be said that inequality has risen quite drastically in the Baltic States in the past decade. Starting from a relatively "egalitarian" distribution in Soviet times, Latvia and Lithuania have reached dimensions of inequality similar to those in the UK, Ireland and the

Mediterranean countries. In Estonia, the level is even higher. Societies in the Baltic States are also exposed to unequal distributions more than all other Central and Eastern Europe candidate countries. When they will join the European Union and later the euro zone, they will form a group among the countries with the highest inequality.

As possible reasons for this development, shifts in the structure in economic production and employment have been identified. The public sector has declined and gave way to private production and the agricultural sector and industries have lost importance relative to the service sector. These shifts left some groups behind, especially low-educated, newly unemployed and the elderly. There are as well geographic and ethnic dimensions of inequality.

The situation in the early stage of transition has also contributed to the changes in inequality. During the period of hyperinflation and the process of privatization, capital market imperfections and information asymmetries lead to unequal opportunities and to a rise in inequality.

1.2.2. Poverty

1.2.2.1. Definition of the poverty concept

Poverty and inequality are closely linked to a given mean income. Poverty is a narrower concept than inequality. It is defined through the censored distribution of individuals or households below a certain low level of income (the poverty line) not through the whole distribution of income. The more unequal is the income distribution, the larger is the share of population living in income poverty.

In general the concept of poverty is defined as inability of people to afford an adequate standard of consumption. At the same time the answer to the question, what is the adequate standard of consumption, is very much a subject of discussions and it has significant variation between countries and over time. Thus, the concept of poverty consists of objective and subjective aspects.

Economists ordinarily consider poverty in both absolute and relative terms. According to the absolute approach, the poverty line is determined as the sum of minimum needs in respect to nutritious food, clothing, household, transport, communication, etc, and respectively the income required in order to cover all these minimal needs. Thus, poverty in absolute terms means that consumption is falling below the fixed level of minimum consumption.

The relative approach interprets poverty in relation to the prevailing living standards of the society, recognizing the interdependence between the poverty line and the entire income distribution. Two approaches are used for definition of the relative poverty line (Anand, 1997; pp.242-279):

- 1) The poverty line is defined as the income level which cuts off the lowest p percent of population in the national income. The choice of p is arbitrary. This indicator of the relative poverty line quantifies the extent of poverty.
- 2) Poverty is defined in relation to contemporary living standards like half of average (mean, median) income level of the society. Poverty in relative terms means inability to afford the average consumption level that people have.

Poverty in relative terms will never disappear. John Black in Oxford Economic Dictionary (Black, 1997, p. 360) stated that if an absolute standard of poverty is accepted it is at least conceivable that technical progress will eventually lift everybody above the poverty line, but if poverty is relative, the poor will be always with us.

If poverty line is defined, the percentage of population in poverty refers the incidence of poverty or level of poverty. The poverty gap indicates the total income needed to bring all poor to absolute poverty line.

Dealing with the stated concepts of absolute and relative poverty is not sufficient for exploring all poverty issues. Poverty is generally regarded as being multidimensional concept. It is a situation where an individual or a group of people finds itself with extremely limited material and social resources. Such people find it difficult to obtain necessary means for nutritious food, shelter, clothing, medical care, education; they cannot afford to meet cultural and intellectual needs; they feel insecure about future and do not see any prospects of their life improvement. That is concept of subjective poverty.

Multidimensional approach to the concept of poverty has plenty of disputable questions, which are also discussed by defining the poverty concept and elaborating the poverty reduction strategies for the Baltic States. There is still confusion over the question whether the statement that “poverty is multidimensional” means that 1) poverty itself relates to income but the causes of poverty are multidimensional or 2) the concept of poverty is multidimensional and relates to more than just income (Poverty Reduction..., p.38).

As result of debates about poverty as a complex issue, the responsible authorities² of the Baltic States in collaboration with representatives from the international organizations elaborated the national approaches for definition of the poverty concept (Table 3).

Table 3. Definition of poverty concept in the Baltic States

Country	National approach for definition of poverty
Estonia	From a societal point of view, poverty is a social problem. Certain population groups lack material resources, and are deprived of a standard of living which is considered necessary for socio-economic participation in society. From an individual (household, social group) viewpoint, poverty is a socio-economic condition in which the primary physiological and social needs of the subject are not met.
Latvia	Poverty is a condition where people are unable to satisfy their basic needs due to insufficient material, cultural and social resources.
Lithuania	Poverty limits a person's chance to live a free, long, healthy and creative life in an adequate environment, that is, to live a respectable life.

Source: Poverty Reduction in Estonia, Latvia, and Lithuania, Riga: UNDP, 2000, p. 36-38.

These definitions include elements of absolute, relative and subjective poverty and emphasize the limitation of resources considered to be necessary for socio-economic participation of all people in normal society life. These definitions are used as the starting points for assessment of poverty and elaborating national poverty reduction strategies of the Baltic States.

1.2.2.2. Poverty assessment in the Baltic States

It is obvious that due to the some differences in understanding the concept of poverty, there is also lack of unified methodology for assessment of poverty despite of numerous studies about poverty issues in the Baltic States (Keune, 1998; Kutsar and Trumm (eds), 1999; Sileika and Blaziene, 2000; Trapenciere, *et al*, 2000; Kuddo, *et al*, 2002) and in other post-socialist countries (Klugman, *et al*, 2002; Milanivic, 1997).

The basic indicator for assessing poverty is the poverty line, which states the income level supposed to be enough to avoid the inadequately low level of consumption. The border between the adequate and inadequate level of consumption is very difficult to settle. Various

² The main national organizations dealing with poverty issues are the Ministry of Social Affairs in Estonia, Ministry of Welfare in Latvia and Ministry of Social Security and Labour and National Social Committee in Lithuania.

indicators have been elaborated in order to define this border, and methods for calculation and implementation of these indicators have significant variations between the countries depending on the level of economic development, geographical location, culture, habits and norms of consumption, etc.

Thus, the poverty line indicators are subjects of discussion and these indicators depending first of all on the countries' economic and demographic situation. Some poverty line indicators settled by the international organizations are presented in the table 4.

Table 4. International indicators of poverty line

International organization	Poverty line indicators
World Bank	2.15 or 4.30 USD (PPP) per capita per day (depending on the level of development of a country, it's geographical location, etc)
European Union (Social Protection Committee, 2001)	60% of the national median income.
UNICEF (United Nations Children's Fund)	35-40% of average salary.

The table is compiled using the following *sources*: EU, Social Protection Committee, 2001; World Bank, 2000; Kuddo, *et al*, 2002.

According to the European Union approach, people are living below the poverty line if their annual per capita income after social transfers is below the 60% of the national median income. This income does not include irregular income and income from selling assets. The Baltic States as the EU accession countries must also follow this basic requirement in order to settle the poverty line indicators.

The assessment of the poverty situation in the Baltic States bases on the data of the household surveys conducted by the national statistical authorities. The main information about the poverty line indicators, risk groups and some results of assessment of the poverty situation in the Baltic States is resumed in the table 5.

Table 5. Assessment of poverty in the Baltic States

Means and approaches for exploring poverty	Estonia	Latvia	Lithuania
1. The main data source.	Estonia's Household Income and Expenditure Survey conducted by the Statistical Office of Estonia.	Household Budget Survey conducted by the Central Statistical Bureau of Latvia; Labour Force Sample Survey.	Household Surveys conducted by the Statistical Office of Lithuania.
2. The main national organizations dealing with poverty.	Ministry of Social Affairs.	Ministry of Welfare.	Ministry of Social Security and Labour; National Social Committee.
3. Poverty line	Absolute poverty line: minimal expenditure by household members which consist of a) costs of a minimal food basket; b) housing costs, and c) basic clothing, education and transport expenditures. Relative poverty line: 60% of national median income.	Absolute poverty line: the nationally set minimum monthly per capita income level. Relative poverty line: 75% of the average per capita income at the disposal of a Latvian resident.	Absolute poverty line: about two minimal subsistence level (MSL). Relative poverty line: 50% of average per capita consumption expenditure.
4. Poverty layers	1) direct poverty (the incomes per household member are 80% or even less of the absolute poverty line); 2) endangering subsistence (the incomes are 81-100% of poverty line); 3) poverty risk (the incomes are 101-120% of poverty line).	1) people with low income (the nationally set minimum monthly income), 2) 50% or less of the value of Latvia's full subsistence goods and services basket. 3) people with 75% of the average per capita income at the disposal.	1) by relative poverty line; 2) by absolute poverty line; 3) by extreme poverty line (MSL).
Poverty distribution (1999)	Direct poverty – 14% of households; Poverty endangering subsistence – 10% of households; Poverty risk – 19% of households (Absolute poverty line was 89 USD in 1999).	Persons with low income (49 USD) – 15.8%; 50% of the full subsistence basket per person (70 USD) – 31.2%; 75% of the average income per capita (79 USD) – 39.3%.	By the relative poverty line (68.7 USD) – 15.8%; By the absolute poverty line (65.3 USD) – 13.1%; By the extreme poverty line (MSL= 31.3 USD) – 0.9%.
Risk groups	Young families with children; households with unemployed family members; persons with disabilities; elderly people.	Families with three and more children; single-parent households with children (particularly headed by woman); households with unemployed family members; elderly people, families which depend on incomes from agriculture.	Families with children; households with unemployed family members; farmers, pensioners, people with low education.

Sources: National Statistical Offices of the Baltic States; National Poverty Reduction Strategies of the Baltic States, Poverty Reduction in Estonia, Latvia, and Lithuania, Riga: UNDP, 2000

In calculating Estonia's absolute poverty line, the levels of minimal expenditure by household members were taken as a starting point. The minimal expenditure consists of 1) costs of a minimal food basket; 2) housing costs, and 3) basic clothing, education and transport expenditures. The absolute poverty line is a dynamic indicator, which is adjusted annually according to changes in the cost of living.

In Estonia the settled level of minimum expenditure was 78.6 euros (1226 EEK) per household member (per month) in 2000. The costs of a minimal food basket were at the same time 38 euros (593 EEK). This absolute poverty line makes up 70.3% of national median per capita income. According to the European Union standard (see Table 4) this absolute poverty indicator is comparatively high in Estonia.

The share of population living below the poverty line has been rather stable in Estonia during the period 1996-2001. The most drastic change in poverty situation was in the years 1999 and 2000 when the after-effects of Russian crisis on Estonian economy appeared. The poverty level rose by almost 2 percentage points mostly due to increase of unemployment. In 2001 the situation stabilized and the share of Estonian population living below the relative poverty line stated by the European Union (60% of national median income per capita) was 17% (about 230 000 persons) (Household Living Niveau, Statistical Office of Estonia, 2002, pp. 34-37 and p. 60).

There are several poverty layers in Estonia: 1) direct poverty (the incomes are 80% or less of the absolute poverty line); 2) endangering subsistence (the incomes are 81-100% of the poverty line); 3) poverty risk: the households and individuals remain in the poverty risk area if their incomes per household member are 101-120% of the poverty line (Poverty Reduction ..., UNDP, Riga, 2000).

A person is considered to be poor in Latvia if his or her income is less than 1) 75% of the average income at the disposal of an individual Latvian resident; 2) 50% of the value of Latvia's full subsistence goods and services basket. People with extremely low income have a monthly income that is less than the nationally set minimum level.

The consumption patterns of the Latvian households indicate that the largest share of the limited resources accessible to Latvia's poor is spent on food and housing. Poverty is more widespread and entrenched in rural areas. In rural areas more than 70% of the population live below the crisis subsistence minimum, while in urban area this indicator is about 50%.

Although the highest risk group for falling into poverty is families with three or more children, age remains a factor that can increase a person's risk of falling into poverty. Discrimination in the labour market based on age can be a serious obstacle for people in forties and fifties seeking employment (Poverty Reduction ..., UNDP, Riga, 2000, pp.31-32).

A study on the relationship between ethnicity and poverty has concluded that ethnicity is not of major relevance regarding the distribution of poverty in Latvia. Other personal characteristics, such as education, and rural/urban settlement, are much more important in explaining differences in poverty level in Latvia (Aasland, 2000).

In calculation Lithuania's absolute poverty line indices of a Minimal Subsistence Level (MSL) and State-Supported income (SSI) have been in use since the beginning of 1990s. The SSI is approximately 10% higher than the MSL. Despite of its progressive loss of value in relation to the initial consumption basket, the MSL is still applied in developing social policy in Lithuania and it is also referred as political and social poverty line. It represents the minimal income guaranteed by the government and the state-supported income (SSI). The absolute poverty line is about two MLS.

The Lithuania's Statistical Office calculates also relative poverty line, which forms an amount equivalent to 50% of average consumption expenditure. The relative poverty line in Lithuania is almost equal to the average social insurance pension and it covers 40% of the Lithuanian average wage (after taxes). Poverty tends to be more widespread among certain segments of the Lithuanian population and it is more likely appearing among those who are only marginally participating in the active economic life, or those who have dependent family members. Pensioners have higher poverty rates than the average, with almost 21% living in poverty. 30% of farmers and 40% of the unemployed or people who for other reasons were not working were also poor. The lack of good education is also serious risk factor of poverty in Lithuania. The distribution of poverty among people with university education, and those with only basic or secondary education differs by as much as six or seven times (Poverty Reduction ..., UNDP, Riga, 2000, pp.17-18).

There is no doubt that the level of economic development of the Baltic economies has had a major impact on the scale of poverty in these countries. During the first period of reforms (1991-1995) the Baltic States' economies experienced a significant downturn. On the basis of the concept of relative poverty, the levels of inequality significantly increased during this period. In 1996, 21.4% of Latvians had per capita income below the 50% of the average per

capita income, 18% of the Lithuanians lived below the relative consumption poverty line (50% of average expenditures), and 12% of Estonians lived below the 50% of per capita median income (18% below the 60% median income – the officially stated income poverty line in EU) (Lantz-de Bernardis, 2002; Household Living Niveau ...,2002). In the EU member states the average share of population living below the poverty line was 17% in 1996.³

In conclusion, despite of some cross-country differences in developing methodological approaches for exploring poverty issues, it is possible to summarize

- 1) The concept of poverty and indicators used for assessment of poverty in all three Baltic States are closed to those used in EU and OECD countries.
- 2) The majority of the Baltic States' population was significantly suffered from the transition processes, especially during the first years of transition. The main risk groups for poverty are the families with small children, people with low education, unemployed, elderly people and people from rural areas.
- 3) The differences in using methodological approaches and statistical indicators for assessing poverty in the Baltic States complicate direct comparison of poverty situation between these countries. Using additionally also the self-assessment information expressed by the families within the various studies developed in the Baltic countries (see Gassmann, 2000), it is possible to suggest, that the share of population that suffers from poverty is the biggest in Latvia. In Lithuania the share of people who were living under the relative poverty line (50% of average consumption expenditure) was around 16% in the end of 1990s. In Estonia 17% of population lived below the relative poverty line (60% of national median income per capita) in 2001. These indicators are roughly in accordance with the average share of population living below the poverty line in the EU member states.

³ When comparing the corresponding indicators with the EU it should be born in mind that the data collected for the EU countries were collected with surveys which in some sense have a different methodology (the equivalence scales 1 : 0.5 : 0.3 were used in the EU, 1: 0.8: 0.8 in Estonia). The poverty line was the same – 60% of national median.

1.2.3. Unemployment

As mentioned in previous sections when losing a job person becomes at great risk of poverty. In the following sections we will study the social transfers and social insurance systems in the Baltic States, meant to provide a person with some minimal income when one has lost a job. As the size of the transfers is small and social insurance systems are still developing, the income level of a person falls considerably, when becoming unemployed. Therefore unemployment can be considered one reason of increasing inequality and poverty and as can be seen in the following the distribution of unemployment is partly correlated with the distribution of inequality (if we look for example at regional differences, as well as age-groups and professions).

1.2.3.1. General trends in unemployment of the Baltic States

Unemployment in the Baltic States⁴ has been increasing in the 90s due to the restructuring process of the economies and in 2001 was at rather high level even compared to the European Union average. Under the communist system unemployment did not officially exist and in practice everyone was provided a job and obliged to have a one. In the beginning of transition unemployment started to increase when the privatisation process began and the Baltic States lost their close connection to the Russian market, which supplier they had been.

Compared to the stable economies high unemployment in the Baltic States was an expected result of the transition process. The general decrease in production, which was initiated mainly by the fall in the product demand, led to the decrease in labour demand and formed the pool of unemployed. The following changes in the structure of production caused the need for reallocation of labour, which in two ways increased unemployed. First, reallocation of people from so called old sectors (the less productive ones, the ones with the decreasing product demand) to the new emerging ones took time. Secondly labour force was not as mobile as could have expected. It has been argued that due to the nature of Soviet education system, characterised by narrow specialisation, people in the post-Soviet countries find it more difficult to change profession and sector of employment. So that opposite to the expectations from the beginning of transition, unemployment rate in the Baltic States has by

⁴ The Baltic States are described by significant differences in the registered and labour force survey based unemployment rates. The registered unemployment is about half of the labour force survey based unemployment rate. As it is generally agreed that the labour force survey based unemployment provides the most adequate information about the general picture of unemployment in the country, the survey based data is used in the following analysis.

now, when reallocation between the old and new sectors should be more or less finished, remained still at the high level.

It should be noted that the development of unemployment has not followed exactly the same trend in all three Baltic States. While Latvia and Lithuania experienced the highest unemployment rates in the mid 1990s, then in Estonia the unemployment rate has been gradually rising peaking in the year 2000. After 1995 unemployment rates in Latvia and Lithuania were falling until the Russian crises. Due to the effects of the Russian crises the unemployment rates started to increase again in all the Baltic States, in 2000 they were at the range 14-16%. In Estonia and Latvia unemployment has decreased from the year 2000, while in Lithuania it has shown the upward trend.

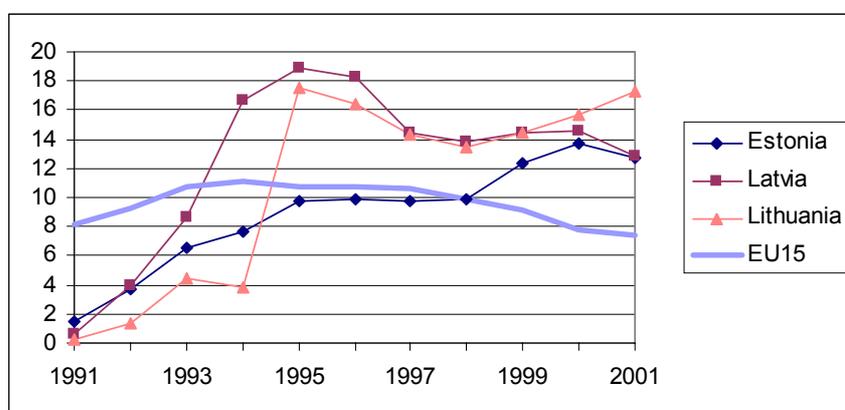


Figure 2. Unemployment rates in the Baltic States and EU15

Source: ILO and local statistical offices for the Baltic States, Eurostat for the EU15

What were the reasons for the different development of unemployment in Estonia? It has been argued that the sharp increase in unemployment in Estonia in the middle of 90s was prevented by a decrease in labour supply due to emigration to the other former Soviet countries (the development which was to some extent observed in the other Baltic States also) and leaving to the retirement (Eamets, Philips, Annus 1999). The other possible reasons for the small unemployment in Estonia have been found in the successful privatisation of state enterprises. The privatisation technique chosen in Estonia was direct sales (often to foreign owners), which ensured investments to the companies and therefore lead to the stable employment. While in Lithuania privatisation took place by distributing vouchers to the people, which lead to no investments in the enterprises and large rent-seeking activities by the managers and workers trying to cash the profits and receive high wages, which ended in financial collapse of the enterprises (Nesporova 2002).

1.2.3.2. Structural unemployment

Long-term unemployment

It is usually argued that unemployment in the Baltic States is mainly structural, i.e. there are available vacant jobs, which cannot be filled because of lack of workers with suitable qualifications. The main reasons for this are found in the educational system, which gives “wrong type of education”, and low regional mobility.

The Baltic States can be described by the rather large share of long term unemployment (unemployed more than a year), which supports the idea of structural unemployment. The share of long-term unemployment was steadily increasing in the Baltic States during the first half of 90s. From then on, about 50 percent of the unemployed had been without a job for more than one year. In 2001 the share of long-term unemployment was lowest in Estonia (48,1%), which is a little higher than the EU15 average (44,0%), and higher in Latvia (59,1%) and Lithuania (56,2%). Generally, the share of long term unemployment is larger in regions where unemployment rate has persistently been high. Besides the regional characteristics, the persons experiencing long unemployment spells can usually be characterised by low skills and qualifications.

Unemployment by gender

Compared to the EU the Baltic States are remarkably different in terms of the male/female labour market performance. The male unemployment rate in the year 2001 was much higher compared to the female unemployment rate in all three Baltic States. Still it should be noted that this describes the overall trend only in Estonia, where female unemployment rate has been lower almost throughout the transition period since 1995. The other two Baltic States have earlier experienced different developments.

The lower unemployment rate among female workers can mostly be explained by the decrease of women participation rate. The other factors leading to lower women unemployment rate are sector specific (female employment in the public sector and service sectors, which have not experienced employment decrease). It has also been argued that the willingness of women to take up lower paying jobs have helped women to stay out of unemployment (Nesporova 2002).

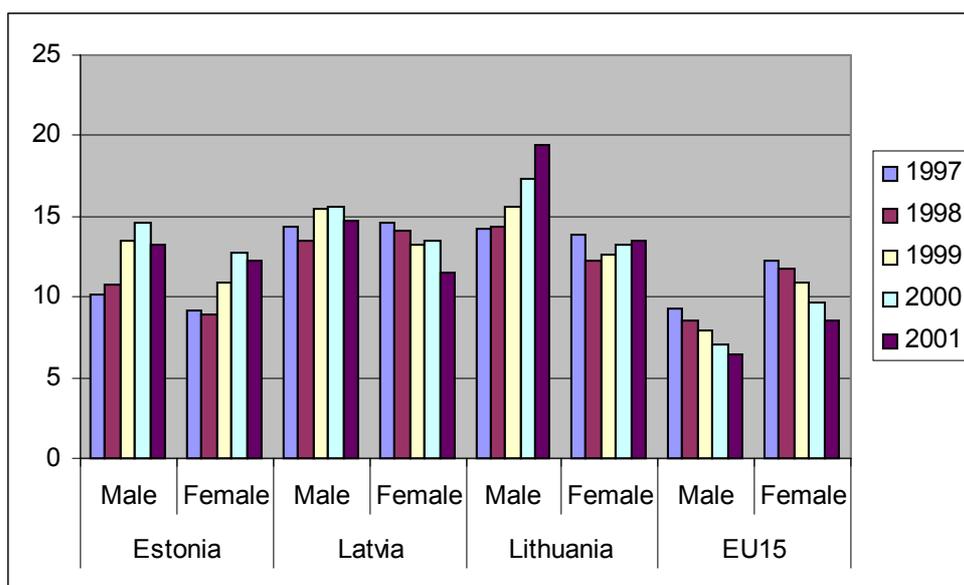


Figure 3. Unemployment rate by gender

Source: ILO and Eurostat

Youth unemployment

Youth unemployment rate was in the Baltic States as well as in EU in 2001 about 1.7 times higher compared to the age group older than 25. Although the youth unemployment is a problem in EU it seems to be even more severe problem in the Baltic States as the youth unemployment rate was in 2001 more than 20 percent in all the Baltic States compared to 14,0% in EU. The share of long term unemployment among youth is also extremely high: in 2000 being highest in Lithuania where 46,8% of the young unemployed have been looking for a job for more than a year, while in Latvia the share was 38,7 and in Estonia only 24,8. Generally the main reasons for the high youth unemployment rate are found in the shortcomings of education system, which has not yet been fully reformed according to the market needs.

Still the high unemployment among youth in the Baltic States is somewhat surprising and should be noted it has not been the case throughout the whole transition period. As the transition process changed the structure of production and therefore the existing human capital depreciated, the young people having modern education and being more open to innovations were often preferred to the prime aged workers. But as the initial restructuring

was finished, work experience regained its value. On top of that, the decreasing labour demand and increasing unemployment put young into unfavourable situations as the employers are usually looking for workers with some experience. So due to the absence of practical working skills, the school graduates, who lack professional training, find it hard to find work. As there is an otherwise redundant but qualified workforce available, youths with little experience are unable to compete.

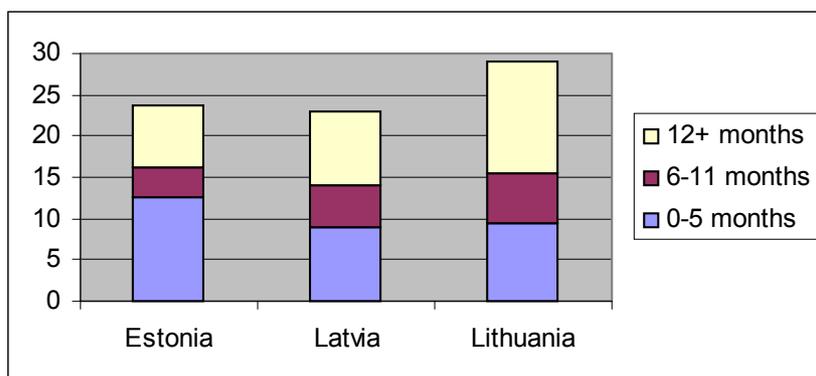


Figure 4. Youth unemployment rate by the duration of unemployment spells in 2000

Source: Eurostat

It should be noted, that educational attainment is an important factor effecting unemployment among youth, and as we shall shortly see the general unemployment rate too. In Estonia the youth unemployment rate among the less than upper secondary educational group was 41,8 % in 2000, while being 17,6% among tertiary education group. The similar trends characterise Latvia and Lithuania. The positive effect of higher education is especially strong in Latvia where the unemployment rate among the young people with tertiary education level was 5,4%.

Unemployment by qualifications

The previous sector of employment and profession of the unemployed describes the structure and changes in employment. Compared to Germany for example the structure of the pool of unemployed by the previous work experience is not substantially different (see appendix 1.2). It can be noted that the share of people with work experience in the primary sector is lower in Germany compared to the Baltic States. There are minor differences among the Baltic States in terms of the sector composition of the unemployed. For example in Lithuania where the production and employment in industry decreased most sharply, the

share of unemployed with previous work experience in industry is the highest. While when looking at the composition of the pool of unemployed by profession, it can be seen that in Germany the share of clerks, technicians and associate professionals is much larger compared to the Baltic States and share of less skilled workers generally lower.

As mentioned educational attainment is an important factor determining unemployment. Unemployment rate is lower among more educated people in the Baltic States, which is the result similar to EU countries. The differences in unemployment among educational attainment are most pronounced in Estonia, where it has been argued that the vocational education is one of the main problems causing for example youth unemployment. While in Lithuania there are no large differences among persons with upper secondary education and the ones without it.

Unemployment by ethnic group

The ethnical issues are important in the Baltic States determining unemployment. The two Baltic States, Estonia and Latvia, have a very large Russian minority, 28% and 32% respectively. The share of non-Latvians and non-Estonians is even higher 45% and 35%. In Lithuania Russians form only 6% and the non-natives altogether 17% of the population. Most of the non-natives are Russian speaking and their knowledge of the official language is usually poor, which is one reason for the higher unemployment rate of the non-natives in the Baltic States. The other reasons for the higher unemployment rate of non-natives are their qualifications, which are usually specific to the decreasing industries.

In Estonia Russian speaking population in some regions, the industrial cities in Ida-Viru county, forms the majority of the inhabitants. The unemployment in these regions is high mainly due to the decrease in production, which was concentrated on the mining and energy production. So the regional disparities of unemployment are partly connected with the ethnical issues.

In May 2000 the unemployment rate of Lithuanians was 13.6%, which is much lower when compared to the Russians 22.1%, Poles 17.1%, and representatives of other nationalities 22.9%. In the second quarter of 2000 the rate of unemployment among the non-Estonians was 16,3 compared to the 11,3 of the Estonians. In Latvia unemployment rate of Latvians in 1998 was 10,8% while Russians had unemployment rate of 21,0%.

Unemployment by region

Although the Baltic States are small at their area, there is substantial variation in unemployment rate at the county level. Generally unemployment tends to be lowest in big cities and the regions with diversified industrial economy, regions offering good opportunities for tourism and recreation and areas bordering more developed countries. The regions with the highest unemployment are usually the ones with mono-industry and rural areas (Eamets 2001).

Can be said that the regional differences in unemployment are caused by the traditional structure of production and low regional labour mobility. The last one is generally thought to be influenced by socio-psychological reasons as well as the poor performance of housing market and infrastructure. According to the survey results from Estonia only 10% of the respondents in the region with high unemployment were ready to move if they were unemployed (Estonian Human Development Report 1996). In general people with higher education were more willing to move from one region to another.

In conclusion it should be said that high unemployment in the Baltic States has been a problem since the middle of 90s. The reasons of unemployment have been argued to be mainly structural due to the changes in the production structure, educational system and low regional mobility. Therefore unemployment is not equally distributed among labour groups and regions.

1.3. Social protection system

1.3.1. General overview social protection systems

1.3.1.1. The concept of social protection

The concept of social protection is rather new and still evolving. During the decades the definition of social protection has widened as larger range of measures has been incorporated under the term. Currently the topic of social protections is again in the centre of attention and economists in different institutions have addressed the issue of redefining the concept in the light of developments like rising public expenditures, aging populations, widening of borders and increasing international competition.

According to the traditional definition social protection is public measures meant to provide income security to individuals (Holzmann, Jørgensen, 2000). There is general agreement that the overall goal of social protection is to improve welfare and reduce poverty. While in the past decades there has not always been consensus about what is welfare improving when taking into account all the indirect effects of policies. Therefore the exact measures used to target the goal have belonged to very wide complex.

Currently in the World Bank Social Protection Sector the social protection is defined as: “a collection of measures to improve or protect human capital. Social Protection interventions assist individuals, households, and communities to better manage the income risks that leave people vulnerable”. The definition of social protection was reviewed during the preparation of Social Protection Sectors new strategy (Social Protection Sector..., 2000) which was aimed at first to assist individuals and communities to better manage risk and secondly to provide support to the critically poor. The idea was that the social protection system should provide a safety net to the poor but also to help them out of poverty and therefore the social protection system can be viewed not as the expenditure on social transfers but primarily as investment into human capital. The goal was that social protection systems focus more on the causes of poverty rather than the symptoms.

Social protection system's reform was also started by the European Commission in 1999 in the context of deepening integration of European countries and Union enlargement process, as well as aging of society. According to the new developments the social protection system should respond to four main objective (Report on Social Protection..., 2000):

- to make work pay and provide secure income;
- to make pensions safe and pension systems sustainable;
- to promote social inclusion;
- to ensure high quality and sustainable health care.

The European social protection system is currently still under reform. The European countries generally characterised by generous social protection systems are also described by sub-optimal level of employment. The trade off between equality and efficiency has initiated proposals for the ways to develop European social protection system with the goal to sustain the social justice while resisting international competition.

Generally social protection system's measures are thought to belong to four large areas: social insurance, direct transfers, social funds and labour market institutions. The goal of social protection system can be tackled mainly by two ways: there are measures which are directed to help people to escape poverty and measures to provide certain minimal income to the ones in poverty. Social insurance (like health insurance, unemployment insurance, pension insurance etc) as well as most of the direct transfers should provide people some minimum income. Some labour market regulations like minimum wage and labour unions activities are directed to the same goal to provide people certain income above the minimum level or level considered to be fear. While there are other measures like active labour market measures and several other social funds directed to provide people the possibility to escape poverty by for example increasing their qualifications.

1.3.1.2. Social protection systems in the European countries

The Baltic countries are currently facing the task to reform their social protection systems, which is directly affected by the accession process to the European Union. Therefore the following analysis concentrates on the social protection systems in the European countries.

Social protection systems in Europe are currently rather different from each other. Generally social protection systems in Europe are categorised into three or four different groups by the extent of state intervention.

Gösta Esping-Andersen (1990) defines three different social protection systems in Europe identified by three measures: by the extent to which state institutions separate social protection from labour market, influence income distribution and involve non-public institutions. According to these measures, the Scandinavian countries differentiate as social democratic welfare regimes aimed at ensuring high equality and trying to maintain full employment by active labour market measures. The continental West European countries are characterised by conservative corporatist welfare regimes, where social protection is linked to social insurance and differences induced in labour market are preserved. The Anglo-American welfare states represent liberal welfare regime with means-tested poverty protection and private social protection providers.

Ebbinghaus (1999) distinguishes four different social protection models in Europe. Again the Nordic countries, which can be described as welfare states, where the social protection system

is highly developed, social expenditures are very large, taxes are high and labour market strictly regulated. The opposite example in Europe can be Great Britain and Ireland with rather liberal social protection system. Then Central European countries, where social expenditures are smaller and social protection lies more on social insurance. Southern Europe with again smaller social expenditures, while labour market is regulated but there exist large hidden sector.

Table 6. Social protection and labour market institutions in European countries

	Nordic countries	Central-Europe	Southern-Europe	Anglo-American
Social protection	Universal welfare state, oriented on social services	Oriented on social insurance and tax transfers	Oriented on tax transfers	Liberal
Social expenditures	High, financed mainly by taxes	Average, financed mainly by taxes on wages	Average, financed mainly by government debt and taxes on wages	Average, financed by taxes and private investments
Labour market regulations	Regulated, lifetime employment	Regulated, lifetime employment	Regulated, high share of hidden sector employment	Deregulated
Wage agreements and unions	Coordinated wage negotiations, centralised unions, high union density	“Social partnership”, coordinated wage negotiations, centralised unions	Decentralised wage negotiations, weak unions	Decentralised wage negotiations, small unions

Source: Ebbinghaus, 1999

The Baltic State social protection systems can be currently described as rather liberal and therefore it can be argued that most similar to the Anglo-American system (look also at the size of social expenditures in appendix 1.3). In the following part of the chapter the social protection systems in the Baltic States are analysed in depth. The development of social protection systems in the Baltic States can be described by the National Strategies for Poverty Reduction elaborated in the Baltic States in order to reduce poverty. The several areas of social protection systems in the Baltic States, like pension systems, social benefits and labour market institutions, are analysed thereafter.

1.3.2. Poverty Reduction Strategies

1.3.2.1. The role of poverty reduction in sustainable human development

A serious consequence of poverty is exclusion of a part of population from the socio-economic participation in society life. This exclusion also consists of danger that poverty is reproducing new poverty and as a consequence human capital as well as competitiveness of countries will seriously decline. Therefore alleviation of poverty has been an official concern of the European Commission and its member states since the mid-1970s when the first poverty programmes were adopted.

The poverty issues assumed new urgency in Western Europe with the slowing of economic growth and rising unemployment in the 1980s. At the beginning of the 1990s nearly 50 million Europeans were living under the poverty line (Eurostat, 1994; p.185). Toward the end of the decade this number had already risen to 60 million Europeans (Eurostat, 2000; Sainsbury and Morissens, 2002, p.3). Therefore, the problems of increasing poverty are at the centre of the studies and policy debates of the European Commission.

In 2001 the European Union endorsed a policy document on poverty and social exclusion (Joint Report on Social Inclusion, 2001), which analyses the situation across the member states and identifies the key challenges for the future in order to strengthen the European social model. It is thus a significant advance towards the achievement of the EU's strategic goal of greater social cohesion in the Union during the period 2001-2010; thus, including also the period of adjustment with the EU eastward enlargement.

There is an overall agreement that economic growth is a pre-requisite for poverty reduction. While many studies have proven a correlation between economic growth and poverty reduction, there are also some findings which indicate that economic growth alone is not enough to ensure broad-based improvement in people's welfare and the character of growth also matters (see Lantz-de Bernadis, 2002). The UNDP study conducted in 1996-1997 examined the relationship between growth and the share of people living in income poverty in 38 countries; most of them were developing countries. The results of the study showed that economic growth *per se* was not enough to guarantee poverty reduction. Neither moderate growth (up to 4%) nor high growth (more than 4%) were complete assurances for poverty reduction. In the countries with moderate growth, 48% of cases showed increase in poverty. In the cases of high economic growth, only two of five countries had witnessed poverty increases. The results of the study showed that growth in countries with high degree

of inequality had less effect on poverty reduction, since the increases in income are channelled disproportionately to the more advanced groups (ibid).

Implementation of poverty reduction strategies has to involve various institutions which have the goal to guarantee a sustainable economic development. The sustainable human development concept stresses human capital formation and the need to maximize the participation of people in society and the economy. People who have lost out in the development process, those who are permanent poor, have neither choices nor access to opportunities.

The poverty reduction strategies are playing an important role in widening people's choices and their access to opportunities. The role of the social protection system in reducing poverty is manifold. It has to support the most vulnerable groups of population, to reduce poverty risk and to encourage people to improve their human capital. That is important precondition for achieving sustainable human development and stable economic growth.

1.3.2.2. Poverty reduction strategies in the Baltic States

The increasing inequality and officially recognized existence of poverty and unemployment are the new phenomena for the post-socialist societies. Therefore, it took some time to recognize the existence of poverty also in the Baltic States. Estonia, Latvia and Lithuania started tackling the issue of poverty and elaborating the poverty reduction strategies only in the second half of the 1990s. The UNDP, World Bank, EC and ILO had a remarkable influence on dealing with this issue and implementing measures in order to alleviate the consequences of poverty in the Baltic States.

The Baltic States have elaborated their National Strategies for Poverty Reduction with the support of the UNDP Poverty Strategies Initiative Programme. All three strategies stress the importance of the following three elements in poverty reduction:

- 1) promoting economic growth;
- 2) investing in human capital;
- 3) strengthening the social protection system.

The role of the social protection system in reducing poverty is rather modest in the Baltic States. For instance, in the case of Estonia, missing social transfers (child allowances, disability pensions, etc) would increase the share of population below the poverty line about

seven percentage points (Household Living Niveau..., 2002, p. 60). The situation was similar in the EU in 1996.

The level of relative poverty in the Baltic States is more or less in accordance with the EU member countries' poverty level but differences are significant in the level of the absolute poverty. In order to reduce absolute poverty, more emphasis should be given on investing into human capital and promoting economic growth. Therefore, the poverty reduction strategies have to create more opportunities for lifestyle improvement and for widening people's choices in order to participate in society and the economy.

The main tasks of the poverty reduction in the Baltic States are settled according to the main requirements of the international organizations. They could be summarized as follows:

- 1) to lessen the social and economic vulnerability of those groups of population living below the poverty line;
- 2) to reduce poverty risk factors,
- 3) to create opportunities for lifestyle improvement;
- 4) to advance and improve the use of human capital.

Using these main tasks as a basis, the poverty reduction initiatives are directed to guaranteeing a basic coping capacity for those groups of the population living below the poverty line, and to preventing and reducing the risk of poverty. A great emphasis is given on strengthening labour market policies so as to promote employment and income generation activities.

The main poverty reduction targets emphasized in the poverty reduction strategies of the Baltic States are resumed in the Table 7.

Latvia's and Lithuania's poverty reduction strategies consist of very concrete tasks and deadlines for eliminating poverty and reducing the number of people with very low income. In Estonia's strategy paper only the basic areas of poverty reduction are presented giving attention to the target groups for poverty reduction strategies. These target groups of the Estonian poverty reduction strategy are:

- 1) young families with children;
- 2) the unemployed and job-seekers, in particular long-term unemployed;
- 3) individuals with low incomes (underemployed, involuntary part-time workers, underpaid qualified employees, workers with low professional qualifications);
- 4) individuals with special needs and their households (people with disabilities and/or chronically ill);

5) elderly people (people over 60 years of age); 6) marginal groups: individuals insufficiently integrated into societal structures (around 50 000 – 70 000 persons).

Table 7. Poverty reduction targets in the Baltic States

Country	The basic areas for poverty reduction or/and main targets
Estonia	<p>A general increase in the population's material resources.</p> <p>Better access to opportunities provided by the community and guaranteed participation in policies (regional policy, labour policy, social policy).</p> <p>Vertical redistribution of community resources (social policy, tax policy.</p> <p>Development of human resources (culture; education and health policies).</p> <p>Formation and mobilization of public opinion (information and media policies).</p>
Latvia	<p>Reduction of the number of people with low income to 10% of the population by 2015.</p> <p>Reduction of the total number of low-income and poor people to 25% of the population by 2015.</p>
Lithuania	<p>Eliminating extreme poverty by 2003.</p> <p>Reduction of relative poverty to 10% of the population by 2005.</p> <p>Reduction of the level of poverty suffered by the poorest social groups to 15% of the population by 2005.</p>

Sources: National Poverty Reduction Strategies of the Baltic States; Poverty Reduction in Estonia, Latvia, and Lithuania, UNDP, Riga, 2000

The development and implementation of poverty reduction programs requires systematic collaboration of various institutions and also involvement of various community levels of the Baltic States:

- 1) public sector (national and local government bodies and their structures);
- 2) private sector (profit-seeking structures like insurance companies, private care, training and employment agencies, real estate agents);
- 3) tertiary sector (non-governmental, non-profit organizations aiming to reduce poverty and other community groups like churches, private charities).

Reducing poverty strongly depends on the level and nature of economic growth. But this growth alone does not guarantee reduction of poverty in the Baltic States. Poverty reduction takes place within a broader process of distributional dynamics. There is an increasing evidence that the poverty reducing targets will not be met at the projected growth rates and the current levels of inequality. It is seems to be obvious that the elaborated poverty

reduction targets will be difficult to meet in the Baltic States even if these countries will have comparatively high and stable economic growth.

Accession of the Baltic States to European Union requires development of elaborated strategies giving continuing emphasis to social protection of people and at the same time improving the flexibility of the labour markets. In some sense these are controversial tasks. The changes in the Baltic labour markets and their institutions have contributed to rises in wage inequality and also in overall inequality. Certain flexibility in approaches dealing with poverty issue and implementation of poverty reduction strategy means taking into account a country' specific situation is inevitable.

1.3.3. Pension Systems

1.3.3.1. Overview of the pension systems in the Baltic States

Estonia, Latvia and Lithuania had quite scanty inherited pattern in the field of the social security and pension system after becoming independent in 1991 from the Soviet Union. The system was the same in three countries, retirement ages were set very low: 55 for women and 60 for men. There were also special allowances for selected occupations that even reduced the average effective retirement age. In addition to that the demographic situation not only in the Baltic States but also world-wide is moving to the population ageing through decreasing fertility rate and increasing life expectancy. The age structure of the population in the Baltic States and the average percentages in the European Union is given by the table 8.

Table 8. Age structure in the Baltic States and average in the European Union (% of population)

	0 – 14 years old	15 – 64 years old	64 years and over
Latvia	16.55	68.15	15.3
Estonia	17.08	68.14	14.78
Lithuania	18.75	67.69	13.56
Average in the European Union	17.44	66.83	15.73

Source: Countries. [<http://www.countries.com/countries/>].

The situation where the amount of working people was decreasing and the amount of pensioners was increasing generates need for reforms in the field of pension systems. Based on an analysis of pension systems around the world, the World Bank (1994, by the means of

Fox) recommends a combination of pay-as-you-go and funded pension systems. Achieving such an arrangement involves setting up a multi-pillar system that includes the following elements:

- Pillar 1 - a mandatory pay-as-you-go public pension system designed to provide an income floor for all elderly persons;
- Pillar 2 - a mandatory funded and privately managed pension system - one whose current reserves are equal to or greater than the present value of all future pension payment liabilities, based on personal accounts (the Latin American approach) or occupational plans (the OECD approach)
- Pillar 3 - a voluntary system (also funded and privately managed), with strong government regulation, to provide for additional savings and insurance.

The main difference between the Latin American and the OECD approach is that the former is based on individual choices and workers themselves choose their investment manager and the latter is based on employers or union choices choosing the investment manager for group. Latin American approach may have higher administrative and marketing costs and workers may be uninformed but OECD approach might have principal-agent problem if employer does not act in workers' interest.

Through many discussions all three Baltic States decided to adopt the three-pillar pension system and choose the Latin American approach. The first country was Latvia then Estonia who adapted the whole new pension system and Lithuania has not yet implemented the entire new scheme. Short presentations of the pillars are given in the table 9 with starting dates.

Table 9. Three-pillar old-age pension systems and starting dates in the Baltic States

	1 st pillar	2 nd pillar	3 rd pillar
Latvia	Notional defined contribution pay-as-you-go (NDC PAYG) pension scheme, launched in January 1, 1996	The state mandatory funded pension scheme, launched in July 1, 2001	Privately-managed voluntary funded schemes, launched in July 1, 1998
Estonia	State-managed pay-as-you-go (PAYG) pension scheme, launched in April 1, 2000	Privately-managed mandatory funded pension scheme, launched in July 1, 2002	Privately-managed voluntary funded schemes, launched in August 1, 1998
Lithuania	State-managed pay-as-you-go (PAYG) pension scheme, launched in April 1, 2000	The state mandatory funded pension scheme, aim to launch in January 1, 2003	Privately-managed voluntary funded schemes, launched in January 1, 2000

The table is compiled using the following sources: Fox; Koivu; Vanovska, 2002.

In addition to setting up new money collecting and paying system also retirement age was increased. New retirement age in Latvia is 62, that is reached step-by-step by six months a year, for men this age is reached in 2003 and for women in 2008. In Estonia the retirement age of men and women was equalized at the level of 63, it is reached also step-by-step by six months a year, for men in 2001 and for women in 2016. In Lithuania the retirement age was set at 60 for women and 62,6 for men, so that the age is increased 4 months for women and 2 months for men every year.

Due to reformations in the field of old-age pension systems also disability and survivor's pensions were overlooked. Review of the disability pensions and survivor's pensions in the Baltic States are given by the tables 10 and 11.

Table 10. Disability pension in the Baltic States

	Disability pension	
	Qualifying conditions	Benefits
Latvia	3 years of insurance.	Granted according to three categories of disability. <u>Category I</u> : 0.45 times the average wage in 3 consecutive of last 5 years, plus average wage times ratio of actual contribution years to total possible number of years between age 15 and retirement. Minimum is 1.6 times the minimum state social security benefit. <u>Category II</u> : 0.4 times the average wage in 3 consecutive of last 5 years, plus average wage times ratio of actual contribution years to total possible number of years between age 15 and retirement. Minimum is 1.4 times the minimum state social security benefit. <u>Category III</u> : Minimum state social security benefit (30 lats).
Estonia	Aged 16 to 63 with 1 year to 14 years of insurance coverage or credited pensionable service depending on the age of pension claimant.	Based on the old-age pension and corresponding to the loss of capacity for work between 40-100%.
Lithuania	Disability involving either permanent or prolonged incapacity for work. Depending on age, person must have minimal social insurance work record.	Varies according to degree of disability.

Source: Social Security Administration. Estonia; Latvia; Lithuania.

To qualify for the disability pension person must have minimal social insurance record that differs between the three countries as it seems from the table. Benefit systems are also a little bit different but depending on the loss of capacity to work in all of these countries.

Table 11. Survivor’s pension in the Baltic States

	Survivor’s pension	
	Qualifying conditions	Benefits
Latvia	Deceased was insured or was a pensioner at time of death.	50% of potential old-age pension of insured for one survivor; 75% for two survivors; 90% for three or more. Payable to children and to dependent brothers, sisters, and grandchildren. The full-orphan's pension is based on the potential old-age pensions of both parents. Minimum survivor pension is equal to state social security benefit.
Estonia	Survivors incapable of gainful activity. Deceased had 1 to 14 years of insurance coverage or pensionable service depending on age.	40% of potential old-age pension of insured for one survivor; 70% for two survivors; 100% for three or more. Survivors include children, stepchildren, siblings, and grandchildren under age 18 (24 if student) or disabled; a parent, stepparent, surviving spouse, or guardian not gainfully employed and raising the deceased's children, brothers, sisters, or grandchildren under 14 years of age.
Lithuania	The deceased must have been a pensioner or, at the time of death, must have had the length of coverage necessary for award of a disability pension.	Eligible survivors include children up to age 18 (24 if student) and a spouse who has reached old age or is disabled. The spouse receives 20% of the deceased wage earner's total benefit. Each child receives 25% of the deceased's pension. Total entitlement may not exceed 80% of the deceased worker's pension.

Source: Social Security Administration. Estonia; Latvia; Lithuania.

Qualifying for the survivor’s pension is depending on the situation of the deceased, was he/she pensioner or did he/she had the necessary insurance record in all of the Baltic States. If disability benefits were mainly influenced on the degree of disability then survivor’s benefits are mainly influenced on the age, family status and number of survivors.

There are also differences between the old-age pension systems (three pillars in the table 9) in the Baltic States that might not emerge in this table. Hence each pillar in three countries is described properly as follows.

1.3.3.2. Three pillars old-age pension system

1st pillar in Latvia, Estonia and Lithuania

In Latvia, there is NDC PAYG pension scheme as 1st pillar. 1st pillar started by giving an account to everyone paying the social tax that looks like a savings account. The so to say capital in the account earns a rate of return just as a savings account would. This rate of return is equal to the growth of the sum of wages on which contributions are collected. Social insurance contributions (20% of payroll) are recorded in these individual accounts but real contributions are used to finance the current pension expenditures. At the retirement the pension paid is equal to the total capital in the person's account, divided by the expected postretirement life span for all those of that person's age. The pension will be indexed, adjusting for price changes. A table of average life expectancy at retirement is published by the government every year. The general formula for the first pillar is $P=C/G$, where K is notional capital and G is expected lifetime after retirement, named as G-value. The minimum retirement age will be 60 years but the system provides strong incentives to work longer. If a person retires at the age of 60, the replacement rate is not less than 40% of pre-tax earnings for a person with a normal work career (Vanovska, 2002). If a person postpones retirement until the age of 65, the replacement rate will be around 60% (Ibid.).

There is also a guaranteed pension minimum that is essential especially during the transition period to the pure NDC scheme. The guaranteed pension minimum is presently financed within the social insurance budget, but it would be appropriate to finance it with general revenues from the state budget. Up to the year 2002 the guaranteed level for the old age pension was of the same amount as the state social security benefit (available to persons that have no employment prospects, for example, due to congenital disorders), provided by residence based social security (Vanovska, 2002).

In Estonia 1st pillar does not include personal accounts for each worker, but is still financed by the social tax (33% of payroll wherefrom 20% goes for the pensions today and 13% goes for health insurance). The State Pension Insurance Register stores information on the social tax paid on each person's salary, but the collected money is also used to finance the current pension expenditures as in Latvia. The old-age pension in Estonia consists of three components. The formula of the 1st pillar is following: $P=M+L+I$, where M is the main component that is an amount fixed by the Parliament for each fiscal year, L is length-of-

employment component taken into account up until December 31, 1998 and I is the insurance component depending on registered social tax paid after January 1, 1999.

Also on Estonia there is set minimum amount of the old-age pension that does not depend on the paid social tax. A person is entitled to the state old-age pension if his/her employment in Estonia is at least 15 years. As in Latvia also in Estonia people can retire earlier than legally stipulated retirement age. They can retire up to three years before but in such case the amount of pension is reduced by 0.4% for each month falling short of the stipulated retirement age. As to the postponed retirement pension, the pension is increased by 0.9% for each month that a person postpones his/her application for the pension.

In Estonia public servants have the right to additional state old-age pensions with the increase of the years of service. If one has been in service for 10-15 years the pension is increased by 10%, 16-20 years of service guarantee 20% additional pension, 21-25 years 25%, 26-30 years 40% and over 30 years the pension is increased by 50%.

In Lithuania the current social insurance pension (1st pillar) consists of two parts and the formula is as follows: $P=M+E$, where M is the main component that is the minimum pension and E is the earnings-related supplementary component that provides a supplementary pension for those who are covered by pension insurance and is dependent on the insurance period and the level of personal insurance contribution. The supplementary pension component is calculated separately for every individual according to an established formula.

In Lithuania there are also certain privileged pension schemes: pensions for state military and officials of internal affairs and pensions for scholars. Pensions for scholars are considered as compensation of low salaries for academic work. Special state pensions are awarded for distinguished people and resistance victims. All of these pensions are paid along with social insurance pensions.

2nd pillar in Latvia, Estonia and Lithuania

The 2nd pillar is also quite different in three countries. In Latvia it is like part of the 1st pillar where the contributions dedicated for savings in the 2nd pillar scheme is scheduled to increase gradually, proportionally reducing the contribution rate for the 1st pillar. In 2001-2006 the rate is 2% of the contribution wage that will be transferred, in 2007 it will be 4%, in 2008 8%, in 2009 9% and in 2010 10%, reaching the same proportion for both pillars [10%

(1st pillar) +10% (2nd pillar) = 20% of payroll]. As the financing of the 2nd pillar is in the framework of public pension scheme, all subsidies for the individual, paid by the state budget or other social insurance budgets (in case of child care, military, unemployment etc.) are respectively attributed for both schemes. The State Social Insurance Agency keeps the individual accounts and functions as pension fund, it contracts with the asset managers and insurance providers on behalf of the public sector.

Until January 2003, the sole 2nd pillar asset manager will be the State Treasury, which has authorisation to invest assets only in the Latvian State securities and term deposits with the banks. From January 2003, participants in the state funded pension scheme will also be able to choose private asset managers, offering a broader scale of financial instruments. The scheme's participants have a right to change asset manager during the participation period, but not more than once a year. As the 2nd pillar is a public scheme, any participant's capital left after death and prior to retirement shall be remitted to the state pension budget for financing survivor's benefits for the dependent family members (children) in accordance with the 1st pillar law. In such cases, spouses have no rights to survivor's benefits either in the 1st or in the 2nd pillar. (Vanovska, 2002).

2nd pillar in Latvia is mandatory for those people that were under the age of 30 at July 1, 2001, voluntary for those people that were 30-49 years old in that time and people that were over the age of 49 at July 1, 2001 can not participate in this pillar.

In Latvia people have two options to use the pension capital in the 2nd pillar at the retirement: 1) add the capital in the 2nd pillar with the capital in 1st pillar; 2) transfer the capital in the 2nd pillar to the life insurance company, which subsequently provides a lifelong annuity.

Contrary to the NDC scheme provision, the 2nd pillar offers more diversified options at retirement. For instance, life insurance apart from standard life pensions offers products like joint annuities, which in case of death of the insured person will be continued as a disbursement of the pension to the surviving spouse; delay of starting of disbursement of the pension (up to 10 years) with subsequent increase in pension amount; determined periods during which a different amount of pension can be disbursed, etc. As other options in public old-age pension provision does not anticipate any survivors benefit for the surviving spouse, a joint annuity purchase could improve living standards for these persons. In comparison

with advantages offered by the life insurance, the option of refunding will guarantee a stable pension adjustment in proportion to price and wage sum increase. (Vanovska, 2002).

In Estonia 2nd pillar is based on pension funds. A working person himself/herself saves for his/her pension, paying 2% of the gross salary to the pension fund and the state adds 4% out of the current social tax that is paid by the employee, and retains 29% of 33% (wherefrom 13% is still for health insurance, 4% is set aside to ensure the concrete persons personal future and 16% is received for state pension). So the 2% does not come from social tax like in Latvia, but is saved from the persons own salary. If a person has joined the 2nd pillar employer transfers 2% of the employees' salary to the Tax Board, state adds 4% of the social tax that is paid by the employer. The Tax Board will transfer the 2%+4% to the bank account of the Estonian Central Depository for Securities in the Bank of Estonia. Estonian Central Depository for Securities as the registrar of the Estonian Central Register of Securities will calculate the number of pension fund units corresponding to the received amount of employees pension account and will transfer the money to the pension fund chosen by the employee.

Participation in the 2nd pillar in Estonia is mandatory for those people who were born in 1983 and later. Participation is voluntary for the persons who were born in 1942-1982. People who were born before 1942 can't participate in this pillar.

In Lithuania the 2nd pillar is not in force yet but it is planned to be so that 5% of the current contribution rate will be transferred for the 2nd pillar to the pension funds, the pension insurance contribution rate makes up 25% of the wages of the person covered by the pension insurance scheme.

2nd pillar in Lithuania is planned to be mandatory for persons up to 40 years old, voluntary for persons in 40 to 50 years old. Persons that are older than 50 years old are not allowed to participate in the 2nd pillar.

3rd pillar in Latvia, Estonia and Lithuania

3rd pillar in Latvia is voluntary (as also in Estonia and Lithuania) based on the law "On Private Pension Funds" that was adopted by parliament in June 5, 1997 and is effective from July 1, 1998. People can save contributions voluntarily to private pension funds. In Latvia there are two types of private pension funds (PPF), open PPF and closed PPF. Open PPF

can offer services to everyone. The members of closed PPF can only be employees of PPF founders. There are no restrictions to the founders of a closed PPF, but founders of an open PPF can only be commercial banks and life insurance companies that are registered in Latvia.

There are also tax incentives if joining the 3rd pillar. The benefits are taxed at normal rates, but the existing taxation policy provides a favourable tax regime for contributions made to PPF. 1. Contributions to the PPF, made on behalf of the employees of the company are deductible from taxable profits; 2. Contributions made to a PPF, which do not exceed 10% of the annual taxable income of the employee are deductible from income; 3. If the total amount of employers' contributions to PPF, as well as insurance premium payments on employees' life, health and accidents insurance together do not exceed 10% of gross wage of the insured person, these expenditure are not subject to the mandatory social insurance contributions (Vanovska, 2002).

In Latvia also as in Estonia the minimum age is 55 at which a private pension funds benefits can be claimed. After that age the participant of the pension plan in Latvia has three options: 1) the accumulated pension capital is paid out as lump sum; 2) the annuity policy with the life insurance company is purchased, that provides a lifelong annuity (PPF provides capital accumulation only, there are no option to receive annuity from PPF); 3) the accumulated pension capital is transferred to the State Social Insurance Fund and combined with the 1st pillar.

In Estonia 3rd pillar gives two options, firstly people can start saving by contributions to a voluntary pension fund or secondly they can enter into a contract on the supplementary funded pension with a life insurance company who has the respective activity license. In the 3rd pillar amounts of contributions are not prescribed by the state.

In Estonia tax incentives are made so that contributions can be deducted from taxable income up to the amount of 15% of the income of the year. Income tax is charged on the payments at the reduced rate, which is 10%. Insurance pension is exempt from income tax, if it is paid in periodic equal or increasing amounts, determined on the basis of a pension insurance contract, up until the end of lifetime. Payment of pension will start at the time agreed in the contract but not earlier than at the age of 55.

In Lithuania the 3rd pillar came into force in January 1, 2000 with the “Law on Pension Funds”. Contributions to the pension fund may be paid by the person itself or by employer on behalf of employee.

At the field of tax rebates in Lithuania contributions into the pensions fund and long-term life insurance are treated nearly equally, in respect to allowances of personal income tax and corporate income tax. The difference is in ceilings: for life insurance annual ceiling is the sum of four monthly minimum salaries established by the government, but in pension fund the annual ceiling is 25% of persons’ annual taxable income, so tax incentives are more favourable for pension funds from where high-salaried persons can make more.

In Lithuania, differently from Estonia and Latvia, people can use the capital in the 3rd pillar not prior to 5 years before the first pillar pension age. After that age person has three options to use the pension benefits: 1) the accumulated pension capital is paid out as lump sum (like also in Latvia); 2) the annuity policy with the life insurance company is purchased, that provides a lifelong annuity (like also in Latvia); 3) the accumulated pension capital is paid as an amount held in the pension account by paying it out in portions periodically, no less frequent than once in three months.

1.3.3.2. Some considerations regarding the pensyon systems

Critics have pointed to the transition costs in the field of financing the new pension systems. The more workers who participate and the larger the contributions to the second pillar, the higher the transition costs. The Baltic countries estimate that the transition will cost 0.5 to 1 percent of GDP annually for 5 to 10 years. They will likely finance part of the costs from privatization funds and borrow the rest. Lithuania has considered borrowing from the World Bank. Thanks to their relatively modest external debt levels, borrowing should not cause any problems in the Baltic countries (Koivu, 2002).

All three Baltic States are moving towards higher retirement age and pension systems that are more related to persons’ lifelong income. In Latvia and Estonia the pension schemes for three-pillar systems are effective in all pillars, in Lithuania the 2nd pillar will probably set to work in 2003. There are differences between all three countries in all of the three pillars of the old-age pension system and also little differences in disability and survivor’s pension systems.

Even though Baltic States are situating close to each other and are having quite the same history we can not say that they have the same pension schemes, they have differences like there are differences in the pension schemes of the member states of the European Union.

If Estonia, Latvia and Lithuania are joining the European Union there would take place the coordination of legislation so that people from one member state working in the other one can get pension from both of them. The pension systems in the member states of the European Union are different and also the retirement ages are different. If a person works or lives in many countries and pays social taxes in some of them then going into retirement he/she gets pension that develops into the pension amounts from the countries where he/she had paid social tax during his/her lifetime calculated on the years that he/she worked in the concrete country. Hence one can get pension from many different countries according to different legislations that are in force in these countries. There is the same rule in the field of retirement, disability and survivor's pensions in the European Union that if a person receives a retirement, disability or survivor's pension in one of the European Union country, he/she has the right to receive the pension in another Member State if he/she lives there (The European Union On-Line). Joining the European Union expands the opportunities having righteous pensions for the citizens of the member states of the European Union and also for the citizens of the three Baltic States joining the same union.

1.3.4. Social and Unemployment Assistance

1.3.4.1. Unemployment assistance and insurance

In the Soviet planned economy unemployment did not exist officially; consequently there was no support system for the unemployed. With the emergence of the unemployment problem unemployment assistance was introduced in all the three countries in 1991. The benefits were characterised by low substitution rates and were not tied to social tax contributions or employment record. A flat-rate unemployment assistance benefit financed from the national budget is currently in force only in Estonia.

The unemployment benefit systems were reformed recently (Latvia 1997, Lithuania 1996, Estonia⁵ 2002) with the introduction of unemployment insurance. In Latvia and Lithuania, the unemployment insurance is a component of the social insurance system, and is financed

⁵ The first payments will be made from 2003 because of the minimum insurance record requirement.

from social contributions. In Latvia the responsibility for the payments lies with the State Social Insurance agency (SSIA), in Lithuania the funds administered by the State Social Insurance Fund (SSIF), which transfers a fixed percentage of the social contributions to the Employment Fund (Social Report 2000, p.76). In Estonia, insurance contributions that are transferred from employers and employees to the Unemployment Fund (Töötukassa) are not considered to be a part of the social tax.

A common prerequisite of receiving any unemployment benefits is the registration as an unemployed at the local labor office (Estonia – Employment Service, Latvia – State Employment Service, Lithuania – State Labor Exchange) and active search for employment, which means visits to the labor office at least every 30 days in Estonia and Latvia and on appointments in Lithuania. The payment of benefits may be terminated if the person refuses a suitable job offer.

In Annex 1.3 unemployment insurance systems in the Baltic States and in addition the unemployment assistance system in Estonia is outlined. It should be noted, that in the Estonian insurance system the minimum contribution record requirement is binding, and the unemployed who fail to fulfil this criterion can apply for unemployment assistance. To be eligible for assistance a record of employment is required as well, however there are many exceptions to this rule. No work history is required if the person was as a parent taking care of a disabled child up to 18 years of age or of a child up to 8 years; was in hospital; was taking care of a disabled or sick or old relative (written contract required); was in prison. In addition, being a full-time student, an entrepreneur or in military service is considered to be equivalent to being employed.

In Lithuania there is no unemployment assistance, but there are numerous special cases, where the unemployed are granted minimum benefits without having the required insurance record. This involves unemployed individuals did not have an insurance record for valid reasons⁶ or following their placement in public works or completion of vocational training

⁶ Individuals dismissed from work:

1) on the employer's initiative; 2) on the employer's will; 3) if the employee's fault is not the reason for depriving him of the rights to be employed in certain jobs; 4) on the employee's application by reason of circumstances out of his control; 5) on the employee's application.

Unemployed individuals:

1) who are guardians of persons declared legally incapable, who nurse disabled persons of group 1 or group 2 (members of their families and close relatives); 2) who have been discharged from the national defence service (servicemen of active service), if prior to their conscription they were not employed under employment contract; 3) who are graduates from vocational training schools, tertiary schools and institutions of higher education; 4) who have been released from places of confinement; 5) women with children under 8 years of age and men who are single parents of children of the above age.

with sufficient total duration. The unemployed, whose benefit payments were not extended, become again eligible after public works or training. (Law on Support of the Unemployed, Chapter IV)

In Latvia the following groups are covered with unemployment insurance: conscripts in the National Armed Forces during their service; persons bringing up a child during the child care period until the child has reached the age of a year and a half; persons serving their sentence in penitentiaries; persons who are fully provided for by the state; apprentices who are mastering a trade in individual (family) enterprises and are registered with the Latvian Chamber of Tradesmen; pupils and students of educational and boarding institutions who are employed during the production or study internship. (Social Report 1998, p. 50)

Estonian and Latvian unemployment insurance benefits are set as a percentage of previous earnings and decrease with the duration of the unemployment spell. In Latvia the percentage depends in addition on the length of the employment record. Lithuanian insurance benefits are not related to previous earnings, but only to the employment record, maximum benefits are received with over 25 years of previous employment. Unemployment benefit rates are tied to the previous earnings of the recipient in most of the EU countries (except Ireland), the rate typically decreases with the length of unemployment, which should motivate active search for employment. However, in most of the EU countries at the beginning of the unemployment period, the benefit is set at a higher proportion of previous earnings (except Greece and Italy).

As can be seen from the table, for those actually receiving unemployment benefits, the average replacement rate is relatively low in all the three countries. However, Estonian unemployment assistance and Lithuanian insurance recipients may apply for social assistance if their households' income falls below a certain level.

The average shares of unemployed who received benefits in the year 2000 are represented in the table below. In Estonia and Latvia only approximately a quarter of the actual unemployed received benefits. There is a relatively large gap between the number of unemployed estimated in household surveys (ILO definition) and registered unemployed; from the latter the largest share to receive benefits was in Estonia where the rate of benefit was lowest. In Lithuania the discrepancy between the actual and registered unemployment was smallest and

share of benefit recipients from the actual unemployed twice as low as in the other countries, which could be at least partly explained by the shorter duration of the benefit.

Table 12. Average % of unemployed receive benefits in 2000

	Estonia	Latvia	Lithuania
Registered unemployment	57.4	38.5	15.2
ILO unemployment	27.7	24.4	11.6

Sources: Joint Assessment of Employment Policy Priorities in Lithuania, 2002; Joint Assessment of Employment Policy Priorities in Latvia, draft, 2001; Joint Assessment of Employment Policy Priorities in Estonia.

1.3.4.2. Social Assistance

In all the three Baltic countries social assistance is provided in the form of social services and various social assistance in cash benefits and subsidies. In Estonia and Latvia there are assistance benefits provided on the state level. These include mainly categorical benefits, which are not means tested, like family benefits, child allowance and funeral allowances. In Estonia and Latvia there is a universal child allowance, paid until the age of 16 (or 19 if attending school) in Estonia and 15 (or older, if attending secondary school) in Latvia. In Lithuania the whole social assistance system is decentralized, family benefits are payable until the child is 1,5 years or 3 of age years under special circumstances. In appendix 1.6 spending on family related benefits and social assistance benefits are shown as a percentage of the GDP. In Estonia and Latvia considerably more is expended on family benefits than social assistance. In Estonia, these benefits lie in the heart of political debates, because the benefits are relatively low compared to wages, but because of the universal coverage raising the rate would mean a large burden on the state budget.

All the Baltic countries have established a social assistance benefit in order to guarantee a minimum level of income for low-income households. The following gives an overview of the main types of in cash benefits and then describes in more detail the social assistance benefit, which is designed in all the three countries to guarantee the recipients a minimum level of income.

In Estonia social assistance for low-income households was introduced in 1991 in the form of food coupons; from 1993 a cash subsistence allowance is paid. In 1994 in addition a

housing and heating subsidy was introduced for low-income households, a part of reasonable housing and heating costs were reimbursed. In 1995 the Law on Social Care was enacted, which redefined the principles of social assistance and from 1997 the subsistence allowance and housing compensation is paid out as a single social assistance benefit. (Arvo Kuddo, Reelika Leetmaa, Lauri Leppik *et al*, p. 32-33)

Latvian social assistance is regulated by the law On Social Assistance, effective since 1996, which prescribes four municipal social assistance benefits: the poor family social assistance benefit; the apartment benefit; the benefit for care; the funeral allowance. Overall responsibility for social assistance lies with the Social Assistance Fund under the supervision of the Ministry of Welfare, but payments to individual applicants are managed by local government authorities and financed from their general budgets. In cash social assistance benefits form 69-75% of the local government expenditure on social assistance. (Social Report 2001, p. 34) Apart from these, the local governments may pay other benefits; most frequently benefits related to food, the upbringing of children and medical services are paid.

As stated earlier, Lithuanian state social assistance has been decentralized and the jurisdiction lies in the hands of local governments. The main in cash benefits are: social pensions, family benefits, funeral allowances, social assistance benefits for low-income households (means tested) and compensations for housing and utility expenses. The social services include free access to healthcare and pre-school and school-based childcare. Social assistance benefits are payable for only six months, so for an unemployed it is possible to receive unemployment insurance payments and social assistance only for a combined period of twelve months. (Human Development Report 2000, p.59)

Social assistance benefit for low-income households

In Estonia social assistance benefit is means tested and its duration is not limited. It is designed to bridge the gap between the disposable income of a household (net of reasonable housing costs) up to a subsistence level that varies by household size (32 euros for single, person 25.6 euro for each additional household member). An unemployed is eligible for social assistance only if he is registered at the Employment Service and seeks employment. The eligibility for assistance of university students not living at parental home is currently subject to political debates.

In Lithuania the social assistance benefit is a means-tested payment calculated on a household basis. It is based on a target income per household member (currently 38 euro); and the payment is calculated as 90% of the difference between the household's actual income and this target level. The duration of this benefit is limited to 6 months, but it can be sometimes extended. Access to all aspects of social assistance requires that the recipient, if able-bodied and of working age, should be registered as unemployed. (Joint Assessment ..., 2002, p. 25)

In Latvia the corresponding benefits is called the poor family social assistance benefit. The duration of both is limited to three months if the family has members able to work, and to six months if not. The Latvian social assistance payments are found to be considerably variable across regions, because local governments had the authority of to set the criteria for entitlement for assistance and also determine its level. (Joint assessment ..., 2001, p. 22) The average poor family social assistance benefit granted has been decreasing and the expenditure on different additional benefits is rising. (Social Report 2001, p. 34) In 2000 the Latvian Cabinet of Ministers approved the Concept Paper of Provision of Guaranteed Minimum Income (GMI) Level, which sets out a reform of social assistance. The new system will substitute the several types of benefits paid currently by a single means tested benefit, which will be equal to 21 Lats (37.3 euro) per family member minus the income of the family. (Social Report 2001, p. 22-23)

In Latvia and Estonia studies have found, that the targeting of social assistance benefits is relatively poor. Assuming an eligibility line of LVL 28 per capita per month, Branco Milanovic (2000) concludes that the probability that a poor is receiving local social assistance is equal to 2% compared to a non-poor's probability of 1.4%, in terms of money amounts, 76.7% is "leakage". (p. 10). Although the means test should consider family incomes in the three previous months, savings and property, local governments implement it in very different ways.

In Estonia Arvo Kuddo, Reelika Leetmaa, Lauri Leppik *et al* (2002) completed recently a comprehensive study of the social assistance systems effects on the labor market. They found, that poor families receive 32,5% of social assistance, while non-poor families 67,5%. This problem is caused at least partly by the insufficient means testing procedure, where only the household income of the previous month is considered. For certain types of families the benefit system reduces work incentives even for higher than minimum wages considerably. (p.83)

In Lithuania, the rates of social assistance benefits are low relative to net earnings when in employment. There are, however, some instances where people on social assistance could face disincentives to moving into employment. A person with one adult and two child dependants receiving the maximum level of social assistance, for example, would have an income equivalent to over 70% of the net income he would receive if earning the average wage. There is concern that inadequate means testing under social assistance means those individuals can receive assistance in cash and make use of privileges irrespective of other income and property they have at their disposal; at the same time long-term unemployed with real needs may be excluded because of the duration limit on receipt of assistance. (Joint assessment ..., 2002, p. 25)

In conclusion, all the three countries have started building up their social support systems soon after the restoration of their independence. In each country an unemployment insurance system was introduced, where the unemployment benefits depend on the length of payment of social contributions and on previous income (except Lithuania). The rate of benefits decreases with the duration of the unemployment spell. In Estonia there will remain a flat-rate unemployment assistance benefit system for those unemployed, who don't qualify for insurance benefits. However, a relatively small share of the unemployed are receiving insurance benefits in Latvia and Lithuania and the average substitution rates of the benefits are low in all the Baltic states compared to EU countries. If the unemployed persons' household income falls under a certain minimum, he or she becomes eligible for social assistance benefits from the local government. In Estonia the rate of unemployment assistance is so low, than a large share of recipients may apply for social assistance.

In Estonia and Latvia social assistance is provided from the national and local government's budget, Lithuanian social assistance is completely decentralized. The benefits paid from the national budget are mainly universal and categorical, including for example family related benefits and funeral benefits. On the local government level various social assistance benefits and services are provided, including income support for low-income households and compensation for housing costs. In Estonia and Lithuania the benefit is designed to bridge the gap between a defined target income, which varies by family size, and the family income, in Latvia such a system will be implemented shortly.

Social assistance benefits are found to be poorly targeted in the Baltics, in some cases the benefits may create disincentives to start working even at a higher wage than the national minimum. The duration of assistance benefits is limited in Latvia and Lithuania, which may

leave some groups, like long term unemployed without income support. In Latvia the rates and the eligibility criteria are considerably variable across regions, because the local governments have the discretion to decide over the size of the benefit and the form of payment.

In Estonia and Latvia expenditure on family benefits from the state budget exceeds spending on social assistance many times. Child allowance benefits are low compared to mean income, but because of the universal coverage raising the rate of child allowance would put a heavy pressure on the budget.

1.3.5. Labour Market Policies and Institutions

Labour market policy, in terms of measures directed to the unemployed, to bring them back to employment, and regulations of labour relations (labour contracts, working time, holidays, employees' dismissal and wages) are analysed in the following part.

1.3.5.1. Active labour market policies

Compared to the EU countries, active labour market policy measures are insufficiently funded in all three Baltic States. The expenditures on the active labour market measures accounted for 0.06% of GDP in Estonia, 0,16% in Latvia and 0,12% in Lithuania in 2001. This is a very small fraction compared to the respective average rate of 1.12% in the EU.

At the same time the participation of the unemployed in the programs provided by the active labour market policy measures is low too. There are minor differences among the Baltic States: the involvement of the registered unemployed persons in the active labour market measures was in 2001 highest in Estonia – 8%, followed by 4% in Latvia and 3% in Lithuania.

It is argued that even these few labour market programs are not appropriately targeted. The groups involved might not necessarily be those to which greatest priority should be given. Apparently, there is not much analysis done on the effects of these programs, but there is a need for this kind of analysis, which would serve as a basis for developing well-targeted and successful programmes.

There are some differences in the implementation of active labour market programs in the Baltic States (see appendix 1.7). While training absorbs the biggest share of funds in all the countries, the share is somewhat lower in Lithuania compared to Latvia and Estonia. In terms of participation training is the most important active labour market measure in Estonia. In Latvia and Lithuania public works receive significantly larger proportion of budget than in Estonia, where the share is rather modest. The percentage of participants in public works was not so different between Estonia and Lithuania, consequently in the former country the expenses per participant were considerably smaller. In Latvia and Lithuania there exist job clubs (organisations with the aim to stimulate the initiative of unemployed and teach them job search techniques) which have rather high participation rates compared to other active labour market measures, but only a small percent of the total expenditure is allocated on them. In Latvia there is no subsidy to start a business, as it exists in Estonia and Lithuania.

1.3.5.2. Regulation of work relations

The regulation of employment relations in the Baltic States mainly corresponds to international standards: the most important ILO conventions are ratified and the legislation assures the protection of employees' rights in terms of work time, holidays, and termination of contracts. There are several measures to protect employees in less favourable conditions like old-aged employees, pregnant women and women with children, disabled persons etc. The work relations are regulated in Estonia with the Labour Contract Act, in Lithuania with Law of Employment Contract and in Latvia with the Labour Law. In the Baltic countries the status of civil servants is regulated by separate laws and employment contracts shall not be concluded with civil servants.

The arrangement of work time

There is 40 hours upper limit for the regular weekly working time. In Latvia also the regular daily working time may not exceed 8 hours. Regular time is reduced for employees exposed to special risks, adolescents and children.

The laws specify limitations for overtime work and for work during night – time. The overtime is limited in (Latvia to 200 hours a year, in Lithuania – 120 hours a year; in Estonia – 200 hours per year and 4 hours per day). The overtime work may be organized in general only with the consent of the employee (except in the cases like natural disaster, the accident, damage on the property of the employer and completion of the work the consent of

employee is not necessary). The additional compensation for overtime work is 100% of established wage in Latvia and 50% in Lithuania and Estonia. In Latvia and Lithuania there is 50% compensation for work during night-time. In Estonia the additional compensation for an hour of work in the evening time (6 PM – 10 PM) must be at least 10% of the workers usual wage rate. The night-time work (10 PM – 6 AM) has to be compensated with 20% of additional wage. The usual wage rate has to be doubled if the worker is required to work on holidays. It is not allowed to apply overtime or night-time work to pregnant women and minors.

Part-time work may be provided upon agreement by parties but must be provided upon request of pregnant or breastfeeding woman and employees raising children. The percent of employees working part-time in the Baltic States in 2001 was small compared to EU15 average (18,0%) with the respective numbers of 7,4% in Estonia, 8,7% in Lithuania and 10,0% in Latvia.

Vacations and holidays

The duration of regular vacations is 4 weeks (28 days) in all three countries. Extended holidays are specified for employees with children, those exposed to special risk etc. For instance in Estonia the extended regular vacation of 35 calendar days is meant for teenagers, disabled persons and public servants of central and local government bodies. The extended regular vacation of 56 calendar days is granted to the principals, researchers, teachers, tutors and other pedagogical specialists of universities, colleges, research institutions, schools and nursery schools. Workers in underground jobs, those working in unhealthy conditions and in other specified jobs have the right to an extra vacation. During holidays employer must pay in Lithuania and Estonia average wage, in Latvia 5/7 of average wage. In addition to the regular annual paid leave there are pregnancy and maternity leave, parental leave, leave without pay, study leave (the latter only in Lithuania and Estonia).

Termination of labour contracts

Regulations on the termination of labour contract in the Baltic States are generally thought to be rather strict compared to EU countries. The notification periods in case of dismissals are in Estonia 2-4 months, in Lithuania 2 months and in Latvia 1 month. The compensation for the termination of contract varies from 1 to 4 monthly wages in Latvia, from 2 to 4 monthly wages in Estonia and from 1 to 12 monthly wages in Lithuania. The compensation is lower

than in the Southern European countries but still rather high, especially in Lithuania, compared to most EU countries.

The notification periods and compensations are lower in case the employee is dismissed due to the misconducts of the employee or long-term incapacity for work. Employer is prohibited to terminate the employment contract with pregnant woman, woman raising children or disabled persons. It is prohibited to terminate the employment contract during the employees temporary incapability to work and while the employee is on holiday.

Table 13. Advance notice periods and severance pays in case of dismissals in Baltic States *

Length of record at the present employer	Estonia		Latvia		Lithuania	
	Notice Period	Severance Pay	Notice Period	Severance pay	Notice period	Severance pay
Up to 5 years	2 month	2 month average pay	1 month	1 month average pay	2 month	2 (4) month average pay
5-10 Years	3 month	3 month average pay	1 month	2 month average pay	2 month	3 (6) month average pay
10-20years	4 month	4 month average pay	1 month	3 month average pay	2 month	4 (8) month average pay
More than 20 years	4 month	4 month average pay	1 month	4 month average pay	2 month	6 (12) month average pay

* The notice periods and severance pays indicated in the table are subject to some exceptions, e.g. in Lithuania the higher severance pays (numbers in parentheses) are applied in cases of layoffs other than liquidation of firms, reduction of production etc.

1.3.5.3. Wage bargaining

In the Baltic States wage bargaining takes place mainly at the individual level. The union membership and collective agreements coverage are low compared to EU countries (the union membership is estimated to be from 15 to 25 per cent in the Baltic States and collective agreements coverage not much higher). At national level the minimum wages are determined in the Baltic States in the wage bargaining process, but at other levels collective bargaining (sector and enterprise level) is rather uncommon.

The national level bargaining and nation-wide minimum wages

Baltic States introduced the national level bargaining already in the beginning or transition process. National level bargaining takes place mainly in tripartite bodies, which include

members from government, employers and unions. One of the main tasks of national level bargaining is to decide the level of minimum wage. Other questions in the bargaining have been reforms of labour market legislation, social reforms and pensions.

The nation-wide minimum wages exists in all three countries. The minimum wages were set already in the beginning of transition period, then at the similar level compared to the Western European countries, when considering the relationship to average wages⁷. During 90s the importance of minimum wages decreased as the average wage increase was faster than minimum wages. But by the 2001 the importance of minimum wages has increased again and the share of minimum wages to average was in Lithuania 43,4%, in Latvia 37,7% and in Estonia 29%. (In Latvia the minimum wage since 1st July 2001 was 60 LVL (104 euro) and in Lithuania from 1st January 2001 430 LTL (125 euro), in Estonia since 2001 1600 EEK (103euro)). The importance of minimum wages should increase further: for example according to the contract by unions and employers in Estonia by 2008 the share of minimum wages to average should be 41%. As average wages are higher than median then it can be considered that minimum wage level 40% of the average wages is rather high compared to EU countries.

The regional level bargaining

Regional level bargaining is not developed in the Baltic States (with the exception of a sector level agreement from Ida-Viru county in Estonia, which is described by a very high unemployment rate and only a few large enterprises). In general social partners in the Baltic States have weak regional structure, in some cases there are no local organisations. One of the main reasons for the lack of regional level bargaining in the Baltic States is the small geographical unit.

The industry level wage bargaining

Industry level bargaining is also rather rare in the Baltic States. According to the estimations industry level agreements cover about 10-17% of the workers in the Baltic States. The idea of the industry level agreements is usually to provide minimum standards. It is argued that one of the main problems in the industry level bargaining is the weak employer associations. It has been noted that trade unions have been helping to establish employer federations in branch

⁷ Unfortunately in the Baltic States there is no official data about the median wages. And therefore the importance of minimum wages in the Baltic States and EU countries is hard to compare, as in EU countries the importance of minimum wages is usually measured as minimum wages and median wages relationship.

level to have the social partner in the negotiations. It is expected that industry level bargaining will develop more when the employers will organise themselves.

Most of the industry level bargaining takes place in the public sector or sectors with large privatised enterprises. For example Latvia has industry agreements covering industries such as energy, nursing and healthcare, construction, education, culture, forestry, food industry, trade and fishing. In Estonia industry level agreements exist for example in the industries like forestry, energy, transport, healthcare and education. In Lithuania the industry level agreements are least developed in the Baltic States. There are only a few examples of industry agreements in Lithuania (compared to 26 agreements in Latvia and 13 in Estonia in 2000) for example the agreement in telecommunication industry (Due, Mailand 2001).

The enterprise level bargaining

Besides the national level agreements, enterprise level agreements are the most common in the Baltic States. Still the initiative to bargain is usually taken by the trade unions and should be noted that employers are not interested in concluding the collective agreements. Still employers are under legal obligation to conclude the agreement if the employees wish to do so, but in practice there are often disputes where employers attempt to avoid signing agreements. Most of the enterprise level agreements are concluded in the public sector, in large public sector enterprises or in privatised enterprises. Enterprise level bargaining is remarkably less developed in foreign companies (Due, Mailand 2001).

The estimates of enterprise level agreements' coverage in the Baltic States vary.

- According to Due and Mailand (2001) the coverage of collective agreements in Estonia is from 6-14%. According to the data from the largest union in Estonia – about 14 % of the workers was covered by collective agreements in year 2000.
- In Latvia Due and Mailand (2001) report the coverage to be 10-30 %, while the rate of unionisation 10-40%. Antila and Ylöstalo (1999) report that Latvia is the Baltic country with the highest rate of unionisation 25 %.
- In Lithuania Due and Mailand (2001) report the coverage to be 10-30%. While Antila and Ylöstalo (1999) report the union density to be 15%.

So it can be concluded that wages are mostly bargained in the individual level, but nation wide minimum wages still affect wages in the Baltic States.

In conclusion it can be said that the protection of employees is rather strong in the Baltic States, but the role of unions in the wage bargaining process is small. At the same time labour market policy directed to bring unemployed back to employment is under-funded in the Baltic States. The main issues of the labour market policy from the overview presented above are gathered in the following table 14.

Table 14. Labour market institutions in the Baltic States

The labour market institutions	The current state
Active measures	<ul style="list-style-type: none"> • Under-funded • Cover only a small fraction of the unemployed
Dismissal of workers	<ul style="list-style-type: none"> • Rather strict compared to EU • The notice periods at the average level of EU • The severance pay rather high - especially in Lithuania
Vacations	<ul style="list-style-type: none"> • Regular vacation: 4 weeks • extended for employees with children • paid pregnancy and maternity leave • study leave in Lithuania and Estonia
Work time	<ul style="list-style-type: none"> • Regular work time 40 hours per week • Part-time work is less common compared to EU • Part-time work must be provided upon request for pregnant or breastfeeding woman and employees raising children
Wage bargaining	<ul style="list-style-type: none"> • Takes place mainly at individual level • Nation-level minimum wage • Industry level agreements rather uncommon

1.4. Conclusions

The European Union social protection system is not universal. It does not offer clear positive experience for the new member countries in order to develop the social protection system that supports population's adjustment processes with the new economic and political systems and improves stabilization processes in the labor markets. There are four models of social protection systems developed in the EU current member countries (Anglo-Saxon or liberal welfare regime, continental or conservative corporatist regime, Scandinavian or social democratic regime and Southern-European regime) which conceptions and policy measures have experienced both success and failure.

The social protection systems of the Baltic States are not homogenous and they do not exactly follow any of the four social protection models used in the EU member countries. They can be currently described as rather liberal and therefore it can be argued that the Baltic States social protection systems are most similar to the Anglo-American system.

The real value of social protection costs has been declined in all three Baltic States since regaining independence in 1991. The share of social protection costs in GDP has declined in Latvia and Estonia and there was only a small increase of this share in Lithuania during the recent decade. As a consequence, people are not receiving fully acceptable social support in order to adjust with all tremendous changes of transitional societies and to avoid a rapid increase of inequality and poverty. Increasing inequality and poverty are serious issues creating social tensions and having a negative impact on human capital formation and economic growth of the Baltic States.

The main risk groups for poverty are the families with small children, people with low education, unemployed, elderly people and people from rural areas. In recent years the links between poverty and employment have been strengthening. People without a job have a serious threat to fall into poverty. But due to high number of low pay job incidences also many employed people and their family members have the threat to fall into poverty.

As the general decrease of employment and changes in the production structure has lead some regions and groups of population in poverty, social tensions put pressure on policy makers to address seriously the issues of poverty, inequality and unemployment. Aftermath, severe policy debates have started in the Baltic States. The employment protection regulations, increasing minimum wages, social benefits and pensions should reduce poverty by decreasing the incidence of low payment. While there is a pressure to increase the social

protection of people, there also exists a growing concern that wage developments, which are initiated by national trade unions and which sometimes exceed the productivity growth, may decrease labour demand. At the same time labour market institutions which serve policy measures for decreasing inequality and poverty may reduce labour flexibility and increase unemployment. Development of unemployment insurance and assistance systems may discourage job seekers sometimes leading them to voluntary unemployment and learned helplessness. As a consequence, employment will decrease and the burden on national budgets will increase inducing growth of inequality and poverty. Strict labour regulations may create dual labour markets with both insiders (protected workers) and outsiders (jobseekers and temporary workers), as well as have adverse effects for disadvantaged groups in labour market. Thus, the role of labour market institutions in terms of reducing inequality and poverty is controversial.

The development of the Baltic States' social protection systems has to base on the good information system about real economic situation of all population groups. Social protection system has to be more targeted on supporting the most vulnerable groups of population and offering proper instruments in order to encourage people to be active in the labor markets and to improve their own and family members' human capital. Unfortunately, it is not always the case at the moment: large share of benefits are often received by people not in poverty, despite of their low levels social benefits discourage job search.

In the case of the Baltic States as small transitional societies, the controversial role of social protection system, particularly of institutions and labour policies in reducing poverty could be overcome by increasing productivity and flexibility of labour force. The key issues are the development of more innovative skills at lower school levels and of the complex problem-solving techniques at higher school levels, improving the quality of vocational education and increasing the amount of workplace training, as well as expanding the active labour market programs and creating better conditions for lifelong learning. The development of labour market policy measures in the Baltic States has to ensure the fulfilment of the main goals of labour policy which are: 1) improving of allocative efficiency (matching supply and demand), 2) improving dynamic efficiency (increasing the quality of the labour force) and 3) improving the sense of equity and social justice among labour force participants. It is important to ensure higher levels of employment that at the micro level could reduce social exclusion, and at the macro level improve the ability to finance social expenditure.

In summary, solving possible negative social consequences of rapid transition and EU eastward enlargement processes in the conditions of declining and aging European population needs big investments into human capital (education, training and health of people) and implementing national strategies oriented to sustainable development. Sustainable development ensures that the needs of current generations are met without impeding future generations in meeting theirs to the same extent. The enrichment of current generations is acceptable only if it strengthens welfare resources and improves the factors of development by investing in infrastructure, technological development and human resources. This should improve the position of current generations and, at the same time, increase the development potential of future generations.

By elaborating and implementing strategies for development of the Baltic States three components of welfare – economic, social and environmental – should be taken into account. The determinants of the economic factor of development are intensive internalization, innovation and development of new technologies, particularly in the field of innovation and communication. The role of the human factor increases in step with the role played by know-how, innovation, organization and management, and other quality factors in global competitiveness. The content of the human factor is changing: individual characteristics such as level of education and health (the human capital) are accompanied by the growing importance of social relations shaped by interaction between people (social capital). This implies that social development will play a more important role in social cohesion and inclusion.

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Appendix 1.1. Inequality in CEE candidate countries and EU members

Country	Year	Gini	I st decile	X th decile	I st quintile	V th quintile	highest to lowest decile	highest to lowest quintile
Slovak Republic	1992	19,5	5,1	18,2	11,9	31,4	3,6	2,6
Hungary ¹	1998	24,4	4,1	20,5	10,0	34,4	5,0	3,5
Czech Republic	1996	25,4	4,3	22,4	10,3	35,9	5,2	3,5
Bulgaria	1997	26,4	4,5	22,8	10,1	36,8	5,0	3,6
Romania	1994	28,2	3,7	22,7	8,9	37,3	6,1	4,2
Slovenia	1998	28,4	3,9	23,0	9,1	37,7	5,8	4,1
Poland ¹	1998	31,6	3,2	24,7	7,8	39,7	7,8	5,1
Austria	1987	23,1	4,4	19,3	10,4	33,3	4,4	3,2
Denmark	1992	24,7	3,6	20,5	9,6	34,5	5,7	3,6
Sweden	1992	25,0	3,7	20,1	9,6	34,5	5,4	3,6
Belgium	1992	25,0	3,7	20,2	9,5	34,5	5,5	3,6
Finland	1991	25,6	4,2	21,6	10,0	35,8	5,1	3,6
Luxembourg	1994	26,9	4,0	22,0	9,4	36,5	5,4	3,9
Italy	1995	27,3	3,5	21,8	8,7	36,3	6,2	4,2
Germany	1994	30,0	3,3	23,7	8,2	38,5	7,1	4,7
Spain	1990	32,5	2,8	25,2	7,5	40,3	9,0	5,4
Netherlands	1994	32,6	2,8	25,1	7,3	40,1	9,0	5,5
France	1995	32,7	2,8	25,1	7,2	40,2	9,1	5,6
Greece	1993	32,7	3,0	25,3	7,5	40,3	8,5	5,3
Portugal	1995	35,6	3,1	28,4	7,3	43,4	9,3	5,9
Ireland	1987	35,9	2,5	27,4	6,7	42,9	11,0	6,4
UK	1991	36,1	2,6	27,3	6,6	43,0	10,4	6,5

¹ based on consumption expenditure data

Source: UNDP Human Development Report 2001

Appendix 1.2. Unemployment by education, sector and profession

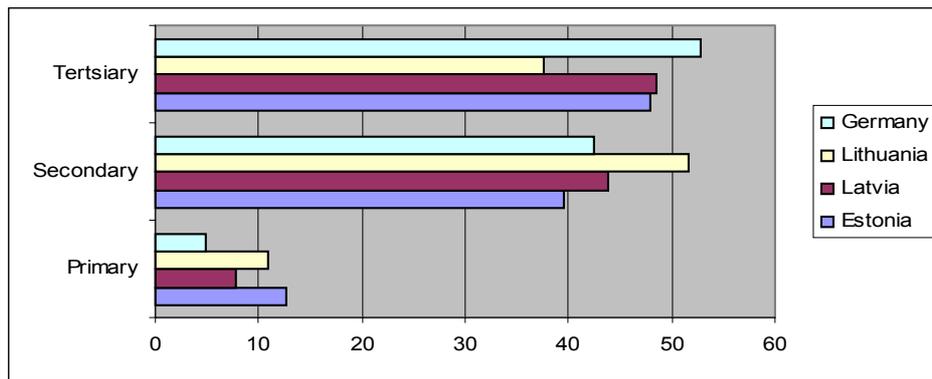


Figure 1. Share of unemployed by sector of the previous job in year 2000

Source: ILO

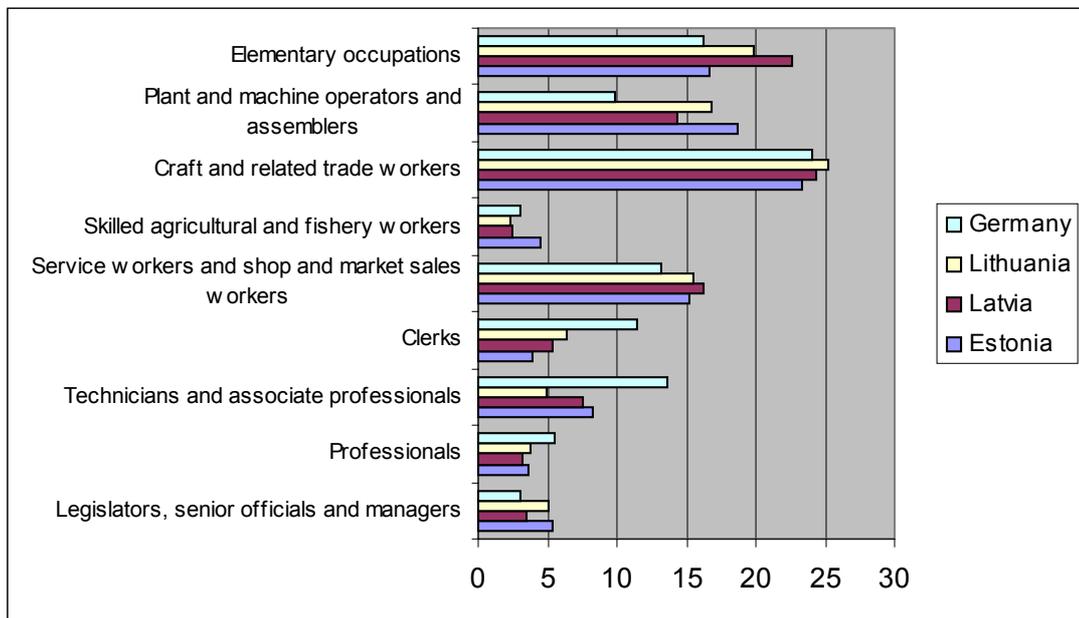


Figure 2. The distribution of unemployed by their profession in year 2000

Source: ILO

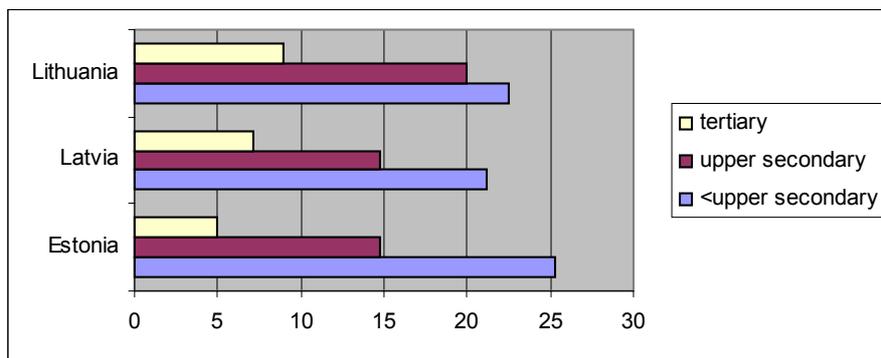


Figure 3. Unemployment rates in the Baltic States by educational levels in year 2000

Source: Eurostat

Appendix 1.3. Expenditures on social protection in the Baltic States, 2000-2002

		2000	2001	2002
Estonia	Social protection transfers (% of budget)	30,83	32,41	31,19
	Health care (% of budget)	15,18	15,59	15,01
	Education (% of budget)	10,46	10,95	10,94
	Total government budget (% of GDP)	35,20	32,92	34,90
Latvia	Social protection transfers (% of budget)	...	39,6	37,3
	Health care (% of budget)	...	10,4	10,7
	Education and science (% of budget)	...	6,4	6,6
	Total government budget (% of GDP)	32,6	32,3	32,1
Lithuania	Social protection (all together) (% of budget)	50,8	50,7	...
	Total government budget (% of GDP)	20,9	20,6	

Sources: Rigięelarve 2002 lühiülevaade. (2002), Rahandusministeerium, 29 p.; National Budget 2002: the Explanations. (2002), Ministry of Finance, Latvia. Statistical Office of Lithuania

Note: Expenditures from the central government consolidated budget

Appendix 1.4. Unemployment assistance and insurance in the Baltic States in 2001

	Estonia		Latvia	Lithuania
Type of benefit	Assistance	Insurance	Insurance	Insurance
	Flat rate			
Rate of benefit		1-100 th day – 50% 101-360 th day - 40% of previous earnings	1 st to 3 rd month 50- 65%, 4 th to 6 th month 37.75- 48.75%, 7 th to 9 th month 25- 32.5% of average contribution payment salary	Varies with the length of insurance record between min. and max. benefit (when insurance record 25 years or longer)
Average benefit (EUR)	26	-	80	50
Maximum benefit (EUR)	26	528 ⁸ (150% of last years national average wage)	444	70 (twice the minimum subsistence level)
Minimum benefit (EUR)	26	-	-	38 (state supported income)
Average wage (EUR)		352	282	277
Ratio of average benefit to average wage	7.3%	-	28.5%	17.9%
Maximum time Payable	180 days	360 days	9 months	6 months
Required insurance/ employment record	180 days of work during the 12 months prior to becoming unemployed	Not less than 1 year during the 2 years prior to registering	Total insurance contributions not less than 1 year, 9 months of insurance contributions in the 12 months before registering	Worked and paid social contributions for least 24 months during the last 3 years
Source of Funds	Insured person: none ⁹ . Employer: none. Government: total cost.	Insured person: 0.5- 2% of wages and other compensations (in 2001 1.5%) Employer: 0.25-1% of payroll (in 2001 0.5%)	Insured person and employer: 1.90% of payroll. Government: Contributes for active military personnel and for individuals taking care of children under 18 months old.	Insured person: None. Employer: 1.5% of payroll is transferred to the unemployment fund. Government: Allocations from state budget in case of deficit.

Sources: Tiiu Paas, Raul Eamets, Jaan Masso, Marit Rõõm 2003; Social Report 2001; Lithuania, Latvia and Estonia – Key Indicators 1999-2001; Law on Support of the Unemployed 1998; Töötuskindlustuse seadus 2001.

⁸ theoretical

⁹ Insurance system funded by both employer and employee started in 2002 (see text)

Appendix 1.5. Expenditures on passive labour market policy measures

	1995	1996	1997	1998	1999	2000	2001
Total budget on passive measures (million EUR)							
Estonia	1.7	2.5	3.2	3.6	7.7	7.6	8.2
Latvia	15.3	17.1	21.8	29.8	54.0	47.7	42.2
Lithuania	6.4	10.3	10.9	11.3	14.2	21.9	20.0
Expenditure on passive measures, percentage of total budget on labour policy							
Estonia	40.5%	44.8%	47.3%	49.9%	65.3%	63.8%	61.5%
Latvia	-	-	-	75.8%	82.2%	80.6%	78.1%
Lithuania	46.4%	50.9%	42.9%	33.7%	40.0%	50.7%	41.0%

Sources: Tiiu Paas *et al* 2003

Appendix 1.6. Social Benefits in the Baltic States as a percentage of GDP in 1995-2000

	1995	1996	1997	1998	1999	2000
Estonia						
Child allowance	1.71%	1.54%	1.45%	1.58%	1.50%	1.56%
Social benefits	0.83%	0.70%	0.63%	0.56%	0.44%	0.37%
Latvia						
Family related benefits from the national budget	n.a.	1.4%	1.3%	1.3%	1.3%	1.3%
Social benefits from local budgets	0.62%	0.50%	0.41%	0.36%	0.36%	0.35%
Including apartment benefits	n.a.	0.22%	0.17%	0.16%	0.13%	0.10%
Lithuania						
State Benefits to families raising children	0.33%	0.35%	0.36% ¹⁰	0.53%	0.59%	0.58%
Benefit to residence with low income	0.29% ¹¹	0.26%	0.22%	0.50%	0.47%	0.51%
Including compensation for expenditure on heating, hot and cold water	0.12%	0.22%	n.a.	0.19%	0.14%	0.17%

Sources: Arvo Kuddo *et al*, 2002; Social Reports 1998, 2000, 2001, Ministry of Welfare of the Rep. Latvia; Social Reports, 1999-2001, Ministry of Social Security and Labour of the Rep. Lithuania.

¹⁰ A benefit for families with 3 or more children was introduced in Nov 1997

¹¹ Until 1998 does not include expenditure on heating and catering.

**Appendix 1.7. Expenditure on active labour market measures in Baltic States,
1995-2001**

	1995	1996	1997	1998	1999	2000	2001
Total budget on active labour market measures (millions of EUR)							
Estonia	1.7	2.2	2.6	2.4	3.0	3.2	3.7
Latvia	-	-	-	9.5	11.8	11.5	11.8
Lithuania	3.8	5.6	9.0	12.6	12.9	10.6	16.6
Expenditure on active measures, per cent of total labour policy budget							
Estonia	40.5%	39.7%	38.3%	33.5%	25.7%	26.6%	28.0%
Latvia	-	-	-	24.2%	18.0%	19.4%	21.9%
Lithuania	28.1%	27.4%	35.4%	37.5%	36.2%	24.6%	34.1%
Breakdown of spending on active measures, Estonia							
Labour market training	64.2%	66.2%	68.9%	72.2%	67.7%	65.8%	73.2%
Training allowances	17.3%	14.4%	13.3%	10.7%	12.8%	13.2%	13.2%
Subsidy to employer	1.2%	2.3%	2.3%	2.7%	3.9%	4.5%	6.1%
Subsidy to start a business	13.3%	10.8%	9.7%	9.6%	8.9%	9.8%	7.9%
Public works	4.0%	6.3%	5.7%	4.8%	7.0%	6.8%	-
Breakdown of spending on active measures, Latvia							
Public works	-	-	-	34.0%	31.0%	33.0%	36.0%
Labour market training	-	-	-	62.0%	65.0%	62.0%	60.0%
Job clubs	-	-	-	4.0%	4.0%	5.0%	4.0%
Breakdown of spending on active measures, Lithuania							
Retention of jobs	0.0%	0.4%	0.6%	0.8%	1.7%	2.8%	2.1%
Labour market training	69.8%	63.1%	52.3%	48.5%	52.2%	43.9%	42.2%
Public works	10.3%	14.6%	13.6%	21.9%	26.2%	34.1%	33.7%
Start of own business	7.8%	2.9%	1.4%	0.8%	0.3%	0.4%	0.6%
Support of employment	12.1%	19.3%	31.9%	27.7%	19.3%	16.7%	18.2%

Source: Tiiu Paas *et al* 2003

Part II. POLITICAL DIMENSIONS

2.1. Introduction

Part I of the working paper analysed the socio-economic dimensions of the eurozone enlargement in the Baltic states. The impact of political sphere (institutions, public attitudes etc) on the introduction of Euro is likely not as direct as the effect of economic conditions. Still, the economic and social changes have been accompanied by introduction of completely new political systems that might be as crucial for the enlargement process as the working of effective working of economies. Transition from the centrally planned to rather liberal form of market economy and re-direction of the trade relations has led to relatively stable and swift economic development in the three countries, yet introduced previously virtually unseen problems (increasing income inequalities and high levels of unemployment in some regions). The political re-orientation from authoritarian to democratic rule has been as extensive and has been accompanied by the need to build the institutions up from a scratch (as all three countries just did not change the regime, but also became independent), and also international re-orientation of affiliations. Even though the institutions characteristic to democracies (i.e. free and fair elections, authentic rights of free speech and organization etc) are in place and have not faced any important challenges, we have witnessed mushrooming of political parties and volatile elections; surveys have indicated rather high levels of uneasiness with the working of democracy in the countries. One could speculate that the political transition could take much longer to reach a stable condition than the economic transition – to be sure, the central institution of market economy (exchange of goods at the market) takes place on a daily basis, while one of the central institutions of a democratic system (elections) is active only once in several years. Thus, the problems stemming from the political sphere might at the end of a day prove to be even more crucial for enlargement because of their relative instability and slow working than the economic concerns.

The second part of the working paper starts with a description of the basic characteristics of central institutions of the political systems, with some extra emphasis on the factors particularly relevant to the process of EU-enlargement: the constitutional issues and institutions related to accession to the EU. Overview of the most important issues in the Baltic states' politics is given in section 2.3 with outline of the major changes during the last decade. Section 2.4 turns to the question of political values and attitudes together with assessments of regime change, while section 2.5 more specifically analyses the popular stance

towards EU. The last three sections are dedicated to the political organizations: section 2.6 gives a general account on the countries' party systems, section 2.7 examines the Euroscepticism among political parties, and the last section assesses the strength of non-governmental sector considering their influence on the EU integration processes.

Even though the Baltic states are often examined together in studies, in the political sphere there is maybe even more variation among them than in the social sphere generally. On one hand it is clear that the Baltic states are close neighbours, have much in common in their recent history, and all three are currently aiming to join the EU. At the same time, as the following sections will also at times reveal, there are in some respects important political differences between them. Thus, while giving a general overview of the countries' political systems, the sections below will also indicate some important differences.

2.2. The Institutional Aspects of the Political Systems

After regaining independence, all three Baltic states have developed fairly stabile democratic institutions, as has also been repeatedly noted in the EU Accession Progress Reports. All hold free and competitive elections regularly both on national and local level. Concerning the institutional design of the countries, Lithuania has chosen somewhat different path than the two northern Baltic states. While Estonia and Latvia are principally parliamentary democracies with popularly elected assemblies and indirectly elected presidents, Lithuania has a semi-presidential system with both parliament and president elected by popular vote. Thus, Latvia and Estonia are considered more or less univocally parliamentary democracies, while Lithuania is even more presidential than its western neighbour Poland (Krouwel 2000 9). In addition to being directly elected by the population, the president in Lithuania enjoys many more executive powers (for instance in the sphere of foreign policy) than its Estonian and Latvian counterparts. Yet, as there is some evidence of high popular support for stronger presidential powers in both countries and respective legislative initiatives have been set forth, the present situation might change towards more presidential systems.

As for the electoral systems, all three countries use some form of PR (Proportional Representation) on national elections. In Estonia two-tier system of party lists is used, with about half of the 101 mandates allocated in twelve regional constituencies with open lists and the rest (the compensational mandates) on the nationwide level with closed lists designed to ensure the proportionality of electoral outcomes. In Latvia, parties compete for 100 mandates

in five regional constituencies with open list where voters can cast both positive and negative preference votes for candidates. Lithuanian electoral system is somewhat different as a parallel system combining PR with single-mandate constituencies is used. A nationwide multi-member district returns 70 members and 71 representatives are elected in single-mandate constituencies. In addition all three countries use 5 per cent national thresholds for representation in the parliament (7 % for electoral coalitions in Lithuania).

Due to the use of PR electoral systems, the number of parties has been relatively high in all three (for electoral results see Tables 1–3 in Appendix). Currently, the parliaments consist of six party factions in Latvia and Estonia and seven in Lithuania. Consequently, the Baltic states have usually not experienced single-party governments. Instead, the majority of cabinets have been multi-party coalitions. There has been even some experience with minority governments in Estonia and Latvia (for the lists of cabinets see Table 4–5 in Appendix). As there are no foreseeable radical changes in electoral laws in near future, the tradition of multi-party governments and occasional minority cabinets can be expected to continue.

A crucial element of any country's political system is the constitution. In the light of prospective membership in the EU, the question raises what amendments there need to be done and how the constitutions can be amended at all – especially whether a popular referendum is needed. In the final phase of EU enlargement, all three Baltic states are facing similar tasks. The governments need to ask their citizens whether they agree with amendments to the constitutional laws and/or whether they want their country to become a member of the EU. The political debate in Latvia and Estonia about amending the constitutions has been similar in that the central issue is in the delegating a part of country's sovereignty to international organizations. There seems to be a general consensus between the three states that the question of becoming a member of European Union has to be put on a public vote. At the same time there is no consensus among politicians and law experts as to what and how should be amended in connection with accession to the EU (*Juridica* 2002, VIII).

Different viewpoints of possible amendments vary from not amending the constitution at all to adding certain chapters to the constitution. While still in 2001 some top Estonian politicians were opposed to amending the constitution and amendments were mostly favoured by foreign experts (Albi; *Juridica* 2001, IX), the draft law of constitutional amendments is currently being read in the parliament.

The government of Latvia has proposed an amendment to the Constitution, relating to Latvia's prospective membership in the EU, and it reads as follows: 'Latvia's participation in the European Union is to be decided by a popular referendum, which is [to be] proposed by the Saeima. If at least one-half of the Saeima members so request, then the amendments to Latvia's participation in the European Union will be decided by popular referendum.' Some legal experts have expressed their concern about the word 'participation', finding that a referendum could be held not only to decide to join the EU but also to terminate membership in the EU, if the Latvian people so decide. Such a provision (similar to one in Denmark) could undermine the stability of the Union and brand Latvia as a politically problematic state (*Constitutional Watch*, vol 10, 2/3).

Lithuania, on the other hand, has had to eliminate a constitutional incompatibility with the *aquis* that did not fully enable the free movement of capital related to the acquisition of land. The amendment to law which permits selling land to foreigners is known as the 'hot potato' of Lithuania's political debate. While right-of-centre parties in office moved that the constitution be amended, the social democrats taking office over from the liberals, viewed the idea with suspicion. They tried to persuade the EU to allow a transitional period for Lithuania, during which selling of land would not be tolerated (*The Baltic Review*, vol 21). The question of whether to amend the constitution or try to implement the compromise solution through accession negotiations with the EU has finalized with the decision to amend the constitution. On 7 March 2002 the Lithuanian Parliament (Seimas) approved the amendments to Article 47 of the Constitution of the Republic of Lithuania enabling legal persons to acquire into ownership land plots of agricultural purpose.

Another important institutional aspect associated with the accession is the organization of bodies dealing with the European integration matters. In all three countries the arrangement for ensuring systematic and effective management of European integration is relatively similar. All three have established the so-called secretary to whom the general co-ordinating task is given. These institutions have to co-ordinate the internal preparations for joining the European Union. The offices support ministries in their preparatory work, ensure a co-ordinated and balanced approach by monitoring the harmonization of national legislation and act as a body conducting strategic planning and analyses. These co-ordinating offices work in all three Baltic countries under direct authority of Prime Minister who also chairs a ministerial committee or commission. The mission of the latter is making political decisions in the preparatory process and formulate the pre-accession strategy. In Estonia and Latvia there is

also a council for senior civil servants that includes representatives of ministries and additionally in Estonia, representatives of the Central Bank. The councils' task is to facilitate the inter-ministerial cooperation and to act as co-ordinating bodies where solutions are to be found for more complex issues involving more than one ministry.

Line ministries in the Baltic countries are responsible for performing EU integration related tasks within their respective competencies. The whole *acquis communautaire* has been distributed between the ministries according to their statutes and areas of activity. In all three countries the Ministry of Foreign Affairs is in a special position as it is responsible for the accession negotiations and managing the relations under the Europe Agreement. In Estonia the Ministry of Justice is also crucial since it monitors the compatibility of the new draft acts with the *acquis* and approves the annual legislative drafting plans of all other ministries. In Latvia the Ministry of Finance and two ministers of Special Assignment (Minister of Special Assignment for State Reform Affairs and Minister of Special Assignment for Co-operation with International Financial Agencies) are important for internal co-ordination of integration process. In all three Baltic parliaments, European Affairs Committees have been established. The committees' task is to assist the integration process on the parliamentary level, to work on legal acts harmonization and to co-operate with government.

All three countries have also established institutions to disseminate information about the European Union. Additionally in Estonia there is the EU Information Secretariat, which has to contact and co-operate with different institutions, organizations and lobby groups in order to increase public awareness in EU related matters. In Lithuania there is Translation, Documentation and Information centre plus nine local European Information Centres.

2.3. Issues in Baltic Politics after Independence

The most essential political issues that have been standing before the three Baltic states after regaining their independence are mostly of common nature. Firstly the beginning of nineties is described as an active search for security in the Baltic region. Here the foremost concern laid in the still-present Soviet (Russian) troops in all three Baltic republics. Lithuania due to many factors was the first to secure withdrawal of former Soviet armed forces in 1993. Estonia and Latvia had to undertake strenuous negotiations with Russia over questions of the future of military pensioners who did not want to leave the countries. Therefore treaties laying down the exact timetable for the withdrawal of troops were not signed until 1994.

According to these treaties Russian troops were pulled-out from Estonia and Latvia by mid 1994.

While the Baltic states had been accepted to the European Council, the IMF and the UN earlier, it was not until the middle of nineties that the three countries almost simultaneously launched their bid for EU and NATO membership. Working towards these goals meant dedicating most of the political agenda for it. Despite the fact that first wave of NATO enlargement in 1998 passed with no serious consideration of possible inclusion of the Baltic countries, success of their integration process was nevertheless noticed. Moreover it came with the fact that Estonia was in 1997 identified by the European Commission as one of six countries belonging to the Luxembourg group, which were to start actual accession negotiations with the EU. Finally European Commission's recognition of also Latvia and Lithuania as possible candidates (the Helsinki group) has played down the international self-asserting nature of these bids and allowed much more attention to be paid to internal issues.

Even here the three states can be seen sharing the same problems. The key feature here as identified by many is ensuring the rule of law and building a working democratic polity. Whereas the Baltic states have built up a comprehensive legislative framework to achieve these goals, issues such as enforcement of law, administrative capacity and rooting out corruption are seen as problems currently to be dealt with. Transparency International lists Baltic states in its Corruption Perceptions Index 2002 in following order: Estonia 29th, Lithuania 36th and Latvia 52nd place. Its report on the Baltic states (*Global Corruption Report 2001*; p.124-137) notices that on one hand Estonia has achieved progress in all of these categories, it still needs to improve the accountability of local government institutions. Lithuania and Latvia on the other hand are strongly lacking decisive action, with the situation being the worst in Latvia, where corruption is found to be a systematic problem on all levels of government.

In case of Estonia and Latvia the Russian-speaking minority has also been an issue constantly on the political agenda. Roughly one third of Estonian population is Russian-speaking, whereas in Latvia the figure reaches over 40 per cent. Both Estonian and Latvian citizenship laws designed in early nineties excluded most Russian-speaking people from obtaining an automatic citizenship. Throughout the nineties Russia used this fact for accusing Estonia and Latvia of political discrimination of minorities. However all those accusations were found groundless by numerous international observers, OSCE missions being the most prominent of them. Yet for Estonian and Latvian societies it has not been easy to integrate the Russian-

speaking minority. While many positive initiatives have brought the communities closer to those of Estonians and Latvians, there are still problems with high rates of unemployment and crime and to some extent, especially when citizenship is concerned, with their legal status.

In socio-economic sphere there has been a general movement from issues of economic freedom and privatization to social issues like combating excessive personal and regional inequalities and unemployment after independence. The change from greater 'efficiency' to greater 'equity' in thinking can be explained by the time-specific context. In the beginning of transition to capitalist economy the market institutions had to be constructed from scratch and as the distribution of income during the Soviet era was perceived to be too equal (with costs to efficiency), economy justice of any kind was considered to be neither an important political end nor a problem at all as the people were relatively equal anyway. Yet, the situation has changed with the countries' adoption of relatively liberal economic policies, especially so in Estonia. On one hand, it was later accompanied by notable economic growth that led to international appraisal of the economic policies put through. On the other hand, the fast track to liberalization led to problems previously non-existent, especially growing economic inequality between groups of population and regions of the countries. In the political sphere that has led to increasing popularity of ex-communist or left-wing parties in Lithuania and Latvia and re-toning of political rhetoric to focus more on the social issues in all three countries. Yet, given the very liberal economic policy (especially if compared to the neighbouring Scandinavian countries), the claims for more social orientation in politics have been comparatively moderate.

2.4. Political Attitudes and Values

The *political regime change* from communism to multiparty democracy has been generally approved by the Baltic populations.¹² However, there are significant differences among the countries and titular and Russian ethnic groups. In Estonia approximately two thirds of population approve of the current regime, while in Latvia and Lithuania the population is clearly less endorsing the new regime with overall support level slightly over 50 percent in Latvia and a little below that in Lithuania (see Table 8). The Russian-speakers are somewhat less approving of the new regime everywhere (on average about five per cent less than the titular group). Relatively lower support for democratic regime in Lithuania is also reflected in

¹² This section is primarily based on the *New Baltic Barometer V* survey published in Rose 2002.

the fact that there is higher support for more authoritarian power configurations as only about half of the population would like neither communist, military, authoritarian nor technocratic rule (Rose 2002: 12–14), corresponding figure about Estonia and Latvia reaching approximately two thirds. The aspirations for somewhat more concentrated power are also indicated by the fact that the presidents clearly enjoy the highest level of trust among the political institutions in the Baltic states, whereas the trust is significantly higher among the titular ethnic groups than Russian-speakers (Ibid: 16). Yet, in principle the majority of people in the Baltic countries could be classified as ‘confident democrats’ (not approving suspension of parliaments and not considering it likely), Estonians being the most optimistic in this respect (almost two thirds confident democrats, compared to slightly over 50 percent in Latvia and Lithuania, yet nowhere more than 20 percent considers the suspension of parliament likely, Ibid: 21).

Thus, it looks like the people are more satisfied with democracy as a principle (and not willing to discard it) than with the actual working of it. One reason for negativity could be the perception of high level of corruption. Popular perception of bribe-taking and corruption among the civil servants is rather high, especially so in Latvia and Lithuania, where more than 90 percent of the population believes that most of the officials are engaged in such activities (about two thirds in Estonia¹³), and where people are also much more ready to bribe or use other corrupt practices than in Estonia (almost two thirds in Lithuania). These findings are in odd contrast with the levels of interpersonal trust, as Estonians are generally more distrustful than their two southern neighbours (about a fifth does not trust anybody, not even the people they know and only a third trusts almost everyone, compared to almost 50 percent both in Latvia and Lithuania, Ibid: 19). That could be perhaps connected to the relatively stronger individualism among Estonians. At the same time, according to the World Value Studies, all Baltic states are similarly characterized by domination of *survival* values as opposed to *self-expression* (post-modern) values prevalent in the Western Europe (Inglehart 2000)¹⁴. This has led commentators to conclude that in addition to introduction of the Western institutions, a mental change is needed from ‘ingrained attitudes toward foreigners, hard but uncooperative work habits, and the relations between women and men’ (Taagepera 2002: 255), or in other

¹³ This finding is also confirmed by the Transparency International’s *Global Corruption Report 2001* (Hodess et al 2001: 234–235) where Estonia stands out as having the lowest level of perceived corruption among the Eastern European candidate countries.

¹⁴ *Survival* values are characterized by higher priority to economic and physical security over self-expression and quality of life; low satisfaction with the life as whole and beliefs in male supremacy. *Self-expression* is characterized by the opposites (Taagepera 2002: 256).

words, individualistic distrust should be replaced by more co-operative attitude, as the former does not lead to high level of societal development.

When looking at the approval of *economic regime* (Table 8), a relatively similar picture as in the case of political regime change appears. Perhaps the most important difference between the countries here is the fact that current economic regime is seen harsher than the political regime only by Lithuanians. In Latvia and Estonia, the Russian-speakers' evaluation of the economic regime is slightly worse than in the case of political regime, whereas the titular nations show somewhat more content with the former. The Lithuanians are clearly more nostalgic for the former economic regime than people in the two other countries as in addition to the bad evaluation of the current economic system as many as 80 percent of the population endorses the socialist economic model (indeed, the approval ratings are relatively high in Estonia and Latvia as well, respectively about 65 and 70 percent; Rose 2002: 22-23). This might be connected to the fact that the stated coping level is clearly lower in Lithuania – where a third of the population does not consider themselves to cope economically, the same figures for Estonia and Latvia being around a quarter (Ibid: 29). As for the future prospects, the titular nations in Latvia and Estonia believe slightly more in improvements than deterioration of their own economic situation, in Lithuania the groups are in par, while Russian-speakers in all countries clearly fear the deterioration more (around third deem improvement and around half deterioration, Ibid: 28). This could be linked to some remaining industrial restructuring, which will generally affect the Russian-speakers more than titular nations (for instance the reorganization of the power supply industry in North-Eastern Estonia that predominantly employs non-titulars).

In sum, while the populations seem to be democratically minded and in principle also accepting the transition to market economy, their evaluations of the current situation, both in economic and political terms, are relatively sceptical and pessimistic.

2.5. Attitudes towards the European Union

The Baltic opinion on the EU has been characterized by comparatively low levels of support and high proportion of undecided respondents. General descriptive data (CEEB) shows that although the supporters of integration have consistently outnumbered the opponents, the public in the Baltic countries is considerably less enthusiastic about the EU membership than in other candidate countries (Ehin: 41). The EU image among the Baltic publics deteriorated

significantly in the first half of the 1990s. In 1991 the attitudes towards the EU were mostly positive, negative opinions of the EU were virtually absent. More than half of the respondents in Lithuania, 45 percent in Latvia and 38 percent in Estonia reported positive attitudes towards the EU. Between 1991 and 1996 the net attitude score (positive attitude minus negative attitude) deteriorated by 23 percentage points in Estonia, 30 points in Latvia and 33 points in Lithuania (Ibid: 42). Between 1996 and 1997, the EU's image among the Baltic public increased by 11 percent on average. This reversal of the previous negative trend coincided with the European Commission's recommendation to open accession negotiations with selected CEE countries (Ibid: 41).

In the final phase of the enlargement the three Baltic states remain less supportive to EU membership than other candidate countries. The Baltic electorates' lack of enthusiasm about the EU membership stands in deep contrast with the active pursuit by the national governments. However, as already noted in the previous chapter, negative assessments of the governments and the effectiveness of the political process do not necessarily indicate pessimism about democracy as a general principle, especially in the context of political transition (Ibid: 31).

According to Eurobarometer, in October 2001, 59 percent of people of the Candidate Countries regarded their country's future membership to the European Union a good thing (CEEB 2001). The average proportion of people of Candidate Countries who regarded membership as a negative thing was 10 percent and 22 percent viewed it as a neutral thing. Compared to that the Baltic support for future EU membership was lower than the average Candidate Countries' support and also lower than support measured among present EU members.

In October 2001, opposition to EU membership in three Baltic states ranged from 17 percent in Latvia to 11 percent in Lithuania with Estonia's 14 percent in the middle. 41 percent of respondents in Lithuania and 33 percent of respondents both in Latvia and Estonia supported their country's membership of the European Union.

In April 2002, the opposition level had increased in Latvia (+7) and Estonia (+6). In Lithuania, the opposition level decreased from 11 percent to 9 percent. At the same time the outright support for membership has not changed significantly since autumn 2001. The analysis shows a slight increase in Lithuania (+1) and Estonia (+2); and a slight decrease in support in Latvia (-1) (CCEB 2002).

The support for membership of the European Union was slightly different when the respondents were asked about their preferences if they were to cast a vote 'tomorrow'. 50 percent of respondents in Lithuania, 46 percent in Latvia and 38 percent in Estonia would vote for the membership, indicating that more people say they would vote for membership than people who say that membership would be a good thing.

Leaving out the respondents who would not go to vote or who do not know how they would vote, 71% of Lithuanian voters declared in October 2001 to vote for the EU membership and 59% of voters both in Latvia and Estonia would vote for membership. In April 2002, however, a drop of 7 percentage points in support was measured in Latvia (52% of pro-voters), in Estonia the percentage of pro-voters remained the same (59%), and in Lithuania it rose 4 percentage points (75%).

In sum, the support for the EU accession has been relatively low in the Baltics compared to other candidate countries. Yet, out of those not undecided, majority has been always supportive of potential membership. Also, the support has been relatively volatile and often significant changes in its level have been due to single specific events – perhaps the most peculiar of these was clear increase of support in Estonia after the country's victory at the Eurovision song contest (which primary connection to EU is its name).

2.6. Party Systems

As appears from Tables 1 to 3, the party systems in three Baltic states have not been very stable through the democratic years, even though the tables somewhat play down the continuity as it is difficult to account for all splits and mergers.¹⁵ Almost all elections have seen appearance of strong new contenders to the power and often major parties have disappeared from parliaments. On the last elections in Latvia and Lithuania, New Era and New Union respectively appeared seemingly from nowhere¹⁶ only to end up first and second in the final results. In Estonia, analogous phenomenon occurred in 1995 with the rise of Reform Party and strong performance of newly formed Res Publica on 2003 elections in

¹⁵ Thus some parties that seem to arise from nowhere are actually splits from old parties and some that seem to disappear in fact have merged with some other party.

¹⁶ In fact, the parties were formed around popular and charismatic former Central Bank governor and State Prosecutor respectively.

Estonia could be predicted considering their success on 2002 local elections.¹⁷ On the ‘extinction’ side, leading party in many Latvian governments, the Latvian Way did not make it to the present parliament; leading party from 1995 to 1999 in Estonia, the Coalition Party, entered the sitting parliament with very weak electoral performance and was abolished in 2002; in Lithuania the conservative Homeland Union (the successor of the Lithuanian National Front, Sajudis) also had an extremely poor election in 2000 despite having an absolute majority in the parliament after the previous elections.

Generally, the party system has been somewhat more turbulent in Lithuania and Latvia compared to Estonia, even though the picture has neither been very enduring in the latter. This can partly be explained by the more advanced and earlier introduced system of public funding of parliamentary parties in Estonia that might have worked as a barrier against new contenders (that do not receive funds from the public purse). Yet, as mentioned above, the situation might change in Estonia easily as well.¹⁸

The political profiles of the parties in the Baltic states (in post-communist countries in general) are much vaguer than in Western European countries. Usually, the parties’ roots in society are rather weak (indicated by low levels of membership, for instance) and the party leaders and their personal ambitions have been more important than the parties’ political/ideological outlines. Only few more general conclusions can be drawn. Firstly, Estonia and Latvia (but clearly not Lithuania) stand out among all post-communist countries as having only minuscule ex-communist parties that have played very minor role in the countries’ politics if entering the parliaments at all. In Lithuania, the situation is almost the opposite, as the former communist, now Democratic Labour Party is the biggest party in the country and its leader Algis Brazauskas has held the post of president before and is the sitting prime minister. The reason for this dissimilarity can be found in the difference between the local Communist Parties at Soviet times – the local titular nation had much more power (vis-à-vis the ethnic Russians) in the Lithuanian branch than in the northern Baltic republics, where the ethnic Russians, often ‘imported’ from Russia, were clearly more powerful. For these reasons Communist Party there accommodated much more easily with the democratic politics (Taagepera 1993).

¹⁷ The Reform Party was to large extent formed around former Central Bank governor, although the majority of its ranks came from the merged Liberal Party.

¹⁸ Before the 2000 elections there was a wide consensus among the students of Baltic party systems that the Lithuanian party system was the most stable among the countries. Indeed, the last elections made this claim very doubtful. Similar thing can indeed also happen in Estonia.

One of the important questions in national politics, also strongly connected to the EU accession process (as the Commission has stressed its importance in Progress Reports), has been the issue of national minorities – mostly in Latvia and Estonia as the ethnic minorities account only for a fifth of the population in Lithuania. The role of ethnicity in structuring the party systems has been somewhat different in Latvia and Estonia. In the former the party for which its *raison d'être* is the representation of the Russian community's interests, For Human Rights in a United Latvia, is very strong, being the second biggest party in the parliament. In Estonia, the ethnic parties are clearly much weaker as by far the most important of these, Estonian United People's Party, was supported only by six per cent of the electorate on last elections. The local elections of 2002 indicated that its support might be even declining. One reason for the difference between the strength of Latvian and Estonian ethnic parties is clearly the proportion of the Russian-speaking community – ethnic minorities make up 42 per cent of population in Latvia and 35 in Estonia. Still, perhaps more important has been the success of some non-ethnic Estonian parties (especially the Centre Party) in acquiring the support of Russian-speaking minority.

It is much more difficult to account sensibly for the placement of parties on a left-right scale. As noted above, the parties' programs do not easily reflect their ideological placements and tend to be relatively populist. Also, often there is divergence in the placement on the dimensions of economic and social issues. For instance, some nationalist parties are relatively left wing economically (as the predominantly rural People's Union in Estonia). Even if some parties are definable in left-right terms, their actual political behaviour (for instance in coalition making) reflects more *realpolitik* and their particularistic interests in gaining power rather than being firmly rooted in their ideological inclinations (a good example of that is the present Estonian coalition government between Reform and Centre party, once fierce enemies and far antipodes regarding their economic policy programs). Still, some features clearly stand out. In Estonia, virtual non-existence of left-wing parties was claimed for years – now some parties are trying to fill up the niche. Still, there is clearly no radical left in Estonia (the absence of far-left is also evident in Latvia and Lithuania) and the leftist ideas in general are not strong in politics. However, nationalism and radical market liberalism that were both extremely influential in the first part of 1990's have been clearly declining. Most of the major parties belong ideologically to the centre and no foreseeable governing coalition for some years to come can be seen to change the present broad principles of economic policy. Most critical in this respect in the longer term is the low level of electoral turnout – mostly in

Lithuania and Estonia – that constitutes potential base for populist parties (or parties just more populist than present ones).

2.7. Parties and Euroscepticism

As noted above, public opinion in the Baltic states towards the accession to EU is among the most critical in the Eastern European candidate countries. This section analyses the question of Euroscepticism among the parties and attempts to account for the seeming discord between the critical public and largely enthusiastic parties.

Research on Baltic party positions on EU enlargement and more closely on Euroscepticism suggests that parties, which represent dissenting opinions toward closer European integration, do so, only in the category of ‘soft Euroscepticism’ (Taggart and Szczerbiak 2001, Henderson 2002). The term ‘soft Euroscepticism’ is opposed to ‘hard Euroscepticism’, which implies outright rejection of the European political and economic integration. Hence ‘soft Euroscepticism’ is described as contingent or qualified opposition to the EU in fields such as policy questions or national interests.

In Estonia, the public opinion towards the accession has most of the time been the least favourable among the Baltic states (see Table 7). At the same time, the party-based Euroscepticism has been probably least developed there. There is only one minuscule party represented in the parliament that is clearly and homogeneously yet relatively mildly Eurosceptic – the ex-communist Social Democratic Labour Party that made it to the parliament only through running in the list of (ethnic Russian) United People’s Party and has two MP-s. The other parties that can be unambiguously classified as Eurosceptical are extra-parliamentary and constitute a mixed bag – including nationalist, ethnic Russian, Christian and populist parties that are neither likely at all to make it to the next parliament (Mikkil and Kasekamp 2002). Certainly ‘mainstream’ parties have also at times voiced less euro-enthusiastic opinions by even some of their top leaders and have in their ranks even some rather hard-line Eurosceptics. These include the now governing parties, the (center-left) populist Centre Party¹⁹ and the market liberal Reform Party as well as the agrarian Estonian People’s Union from the opposition side. Yet, there have not been any attempts to change the general party policies towards the issue and the euro-enthusiastic view continues to dominate the mainstream party politics in Estonia.

¹⁹ Surprisingly, Taggart and Szczerbiak (2001) place the Center Party in the eurosceptic camp.

In Latvia, Three separate forces represent the soft Euroscepticism on party-political scene (Taggart and Szczerbiak 2001). Firstly the Social Democratic Union can be classed as a Eurosceptic party, because of its main emphasis on focusing on internal problems rather than on accession to EU. Secondly 'For Fatherland and Freedom/Latvian National Independence Movement Union', although publicly pro-EU, the party has become more Eurosceptic in its opinions. As a right-wing nationalist movement and also one of the coalition partners in late 90s it did more than once obstruct the passing of amendments into the tight national citizenship laws, based on popular fears and rhetoric against Russian minority. This suggest that if the party should be forced into opposition it may move towards a position advocating for preserving national values or sovereignty independent of EU. 'For Human Rights in United Latvia' may be counted third among the Eurosceptic parties in Latvia. Formed Socialist Party and People's Harmony Party it represents an array of different views, but considers itself standing mainly for the problems of Russian-speaking minority. They have shown permanent interest in strengthening relations with Russian government and may be said to be dependent on the views of the latter on EU enlargement (Kalnis 2001). Only recently along with gradual softening of Moscow's stance on EU enlargement the party has become to accept Latvia's orientation toward EU membership. Nevertheless widely different political opinions in the party itself can still steer the party back to its former course.

In Lithuania, in contrast to the other two countries, the peasants are the leading force behind Euroscepticism and the arguments are put forth by two parties (Taggart and Szczerbiak 2001): the Centre Union of Lithuania and the Lithuanian Peasants Party (also translated Farmers Party). Similarly to their Latvian counterparts, they too fall under the category of soft Eurosceptic parties. Firstly Euroscepticism seems not to be at heart of the Centre Union's agenda since they are best described as populists. Nevertheless after their election fiasco in 2000 they are set to put more use into this rhetoric; after all, the Peasants Party has succeeded in securing a stable support with open confrontation of the EU integration. As indicated, the Peasants Party has lead the Eurosceptic discourse in Lithuania with the opinion that the EU is disadvantageous for Lithuanian agriculture (Huang 2000a, 2000b). Their most successful bid has since been for local communities election in 2000 that brought them second best result in Lithuania with the most seats in about quarter of the councils.

To sum up, Euroscepticism has been mostly the playing field of non-mainstream parties in the Baltic states. Even when some of the major parties voice any Eurosceptic views, they tend to be relatively mild and/or do not constitute the prevalent line in the party. Also, the

European issue has had no significant impact on structuring the party systems, which is in contrast to the strong division among the populations. On one hand, the major parties' positive stance on EU issues can be associated with the fact that they either share governmental responsibilities, have done so before or are expecting to in the future, thereby imposing restraints on party behaviour and leaving the issue to minor players (rather common phenomenon in Western European countries as well, Sitter 2001). On the other hand, until lately the question of EU-membership seemed perhaps much more remote to the voters than national political issues (e.g. economic and social policy) and despite divergence of views with major parties on European issues, they found the congruencies on other issues more important and worth casting their vote. Some additional support for this premise is given by the fact that as the membership is becoming more and more realistic and closer, Estonia has seen mushrooming of tiny parties that take fairly hard-line Eurosceptic stance (who try to exploit the issue to become successful) and somewhat diminishing enthusiasm on the part of mainstream parties coupled with more attention to Estonia's national interest on the accession negotiations.

2.8. The Non-governmental Sector

Assessing the Baltic societies in the frames of EU enlargement has also witnessed growing attention towards issues relating to civil society, in particular, the non-governmental organizations (NGOs). It is clear already from pre-accession period that successful implementation of policies and projects can be achieved only with active public participation and therefore a closer look on NGO sector in the Baltics is needed.

However, during the last decade, particularly low level of civic activity has been noted in all three Baltic states, as in most of the Eastern European countries (Clemens 2001). In numbers the Estonian NGO sector is most advanced as over 14,000 registered non-profit organizations are active, compared to 7,000 in Lithuania and 5,000 in Latvia (of which only about 1,500 can be considered active, NGO Sustainability Index 2001). Yet, most of the NGO's are housing associations, sports clubs, hobby clubs etc. Only a fraction is concerned with more substantive matters (charities etc) and even the latter's influence on national policy is extremely limited. Nevertheless influence of non-profit sector on policies is perhaps stronger in Estonia, where certain areas as for example environment protection have seen a growing public attention and positive policy initiatives mainly due to NGO activity on various

levels. In explaining this observation the abovementioned numbers offer quite clear insight to the weaknesses or strengths of voluntary sector of a particular Baltic state.

On the other hand the countries' imminent EU membership will put even more pressure on NGO sector. Causes for concern arise especially in relation to generally underdeveloped agricultural advocacy or support groups (Smith-Sivertsen 2000). In Latvia and Lithuania weak resources of environmental organizations could also not sustain high requirements for public participation when implementing EU projects. As noted by the Human Development Report the underdeveloped rural NGO network can be perceived as a serious obstacle in attracting EU structural funds. In this sense the development of voluntary organizations can have a direct impact on the ability of Baltic states to take a full advantage of EU membership as of beginning.

In trade union activities, Latvia is a forerunner among the Baltic states. Almost every third Latvian claims to belong into a trade union organization (Smith-Sivertsen 2000). Aside from institutional problems among the organizations themselves they take credit for being the only major group that the government has so far recognized as equal partners in tripartite talks. While Lithuanian trade unions have also seen an increase in membership lately, it has continued to decline in Estonia (Freedom House 2002). Even though the trade unions are engaged in tripartite talks together with the government and employer associations in all three countries, they still face immense challenges in transforming themselves from Soviet era obligatory effectively state-led organizations into trade unions suitable for the frameworks of market economy, and in establishing themselves as influential actors in national politics. Perhaps the most powerful NGOs in the Baltic states are the third parties in the tripartite relationship, representing industry, trade or business (Clemens 2001). For instance, in Estonia, the representatives of such associations have often been appointed to councils of state-owned enterprises and institutions involved in designing policies. Future EU membership with the recognition of principles of social partnership and dialogue can be seen as the best scenario for resolving the inevitable tension between trade unions and industry-run interest groups (Woolfson and Beck 2002). Yet, recent experience in Estonia, where both the unions and employers' association came to fierce odds with the representatives of government over the rise in minimum wage, is not promising for these purposes.

2.9. Conclusions

The Baltic States are usually considered to be relative success-stories of democratic transition. Yet, as the previous paragraphs have argued, the countries are in several respects far from being politically convincingly stable. There are noteworthy pressures for changes in the institutional system, relatively disaffected populations, fledgling party systems and rather weak non-governmental sector. Yet, that has not until now lead to any turn away from democratic principles and surge towards joining the EU. As noted, Euroscepticism has remained for the most part playground for marginal rather than core parties. This coupled with rather Eurosceptic populations (compared to most of their Eastern European neighbours) has lead to an interesting situation. On one hand, the populations of the Baltic states are rather apathetic about transitions to market economy and the EU, yet the major parties (at least those sharing the governmental responsibilities) have been for the most part putting through very market-liberal policies and have been enthusiastic towards the EU. At the same time, joining the EU would mean rather adopting more socially oriented policies or at least clearly more regulatory principles, rather than pursuing further the neo-liberal strategies. Indeed, significant part of the Euroscepticism has been based on the notions that the EU is far too 'socialistic', quite the opposite to the Euroscepticism voiced by the Scandinavian left that the EU undermines the principles of their social democratic welfare state. Thus the toning down of neo-liberalist rhetoric in politics might not only be seen as an adaptation to popular sentiments, but also preparation for the EU membership and making the latter more appealing to the population who will be the ultimate decider of joining in all three countries. In addition, even if some of the possible changes in the institutional framework, altering party policies and resulting volatile party systems might contribute to the perceived instability of the countries, it could in the longer run help the countries to stabilize by decreasing the levels of disaffection and bringing the political context of the countries closer to the EU and especially their closest Scandinavian neighbours there.

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Appendix 2.1. Parliamentary Elections in Estonia

	20 Sept 1992		5 March 1995		7 March 1999	
	Votes %	Seats	Votes %	Seats	Votes %	Seats
Estonian National Independence Party	8.8	10	-	-	-	-
Pro Patria / Fatherland Union	22.0	29	7.9	8	16.1	18
Coalition Party (CP and Rural Union in 95)	13.6	17	32.2	41	7.6	7
Estonian Centre Party	12.2	15	14.2	16	23.4	28
Moderates	9.7	12	6.0	6	15.2	17
Independent Royalists	7.1	8	0.8	0	-	-
Better Estonia/Estonian Citizen	6.9	8	3.6	0	-	-
Estonian Greens	2.6	1	-	-	-	-
Estonian Entrepreneurs' Party	2.4	1	-	-	-	-
Estonian Reform Party	-	-	16.2	19	15.9	18
Estonian United People's Party	-	-	5.9	6	6.1	6
Right Wingers' Party	-	-	5.0	5	-	-
Estonian Country People's Party	-	-	-	-	7.3	7
Others and independent candidates	14.6	0	8.4	0	8.4	0
Total	100.0	101	100.0	101	100.0	101

Source: Adapted from Rose et al 1998.

Appendix 2.2. Parliamentary Elections in Latvia

	5-6 June 1993		30 Sept 1995		3 October 1998		5 October 2002	
	Turnout: 89.9%		Turnout: 72.6%		Turnout: 71.9%		Turnout: 72.5%	
	Votes %	Seats						
Alliance Latvia's Way	32.4	36	14.7	17	18.4	21	4.9	0
National Conservative Party	13.4	15	6.3	8	-	-	-	-
Popular Harmony Party / For Human Rights in a United Latvia	12.0	13	5.6	6	14.2	16	18.9	24
Latvian Farmers' Union (with Greens in 2002)	10.7	12	-	-	2.5	0	9.5	12
Equal Rights Movement	5.8	7	-	-	-	-	-	-
For Fatherland & Freedom (with Latv National Cons Party in 98 and 02)	5.4	6	12.0	14	14.7	17	5.4	7
Christian Democratic Union/ First Party	5.0	6	-	-	2.3	0	9.6	10
Democratic Party 'Saimnieks'	4.8	5	15.2	18	1.6	0	-	-
Popular Movement for Latvia	-	-	15.0	16	1.7	0	-	-
Latvian Unity Party	-	-	7.2	8	0.5	0	-	-
United List - Farmers, Christian Democrats	-	-	6.4	8	-	-	-	-
Latvian Socialist Party	-	-	5.6	5	-	-	-	-
People's Party	-	-	-	-	21.2	24	16.7	21
Social Democratic Alliance	-	-	-	-	12.8	14	4.0	0
New Party	-	-	-	-	7.3	8	-	-
New Era	-	-	-	-	-	-	23.9	26
Others	10.7	0	12.1	0	2.8	0	7.1	0
Total	100.0	100	100.0	100	100.0	100	100.0	100

Source: Adapted from Rose et al 1998..

Appendix 2.3. Parliamentary Elections in Lithuania

	25 October 1992		20 October 1996		8 Oct 2000	
	Turnout: 75.2%		Turnout: 52.9%		Turnout: 58.6%	
	Votes %*	Seats	Votes %*	Seats	Votes %*	Seats
Democratic Labour Party	44.0	73	10.0	12	31.1	42
Homeland Union ("Sajudis")	21.2	30	31.3	70	8.6	9
Christian Democratic Party	12.6	18	10.4	16	3.1	2
Social Democratic Party	6.0	8	6.9	12	**	7
Coalition for a United Lithuania			-	-	-	-
Centre Movement	2.5	2	8.7	13	2.9	2
Electoral Action for Lithuania's Poles	2.1	4	3.1	1	1.9	2
National Union	2.0	4	2.2	3	0.9	0
Liberty (Freedom) Union	0.4	0	1.6	0	1.3	1
Christian Democratic Union	-	1***	3.2	1	4.2	1
National Party Young Lithuania	-	-	4.0	1	1.2	1
Women's Party / New Democracy Party	-	-	3.9	1	**	2
Liberal Union	1.5	0	1.9	1	17.3	34
Peasants' Party	-	-	1.7	1	4.1	4
Political Prisoners & Deportees	-	1***	1.6	1	-	-
New Union (Social Liberals)	-	-	-	-	19.6	29
Moderate Conservative Union	-	-	-	-	2.0	1
People's Union 'For the Fair Lithuania'	-	-	-	-	1.5	1
Modern Christian Democratic Union	-	-	-	-	-	1***
Others and independents	7.7	0	9.5	4	0.5	2
	100.0	141	100.0	137	100.0	141

* – refers to PR part, ** – in PR part with Democratic Labour Party, *** – contested single-mandate districts only

Source: Adapted from Rose et al 1998.

Appendix 2.4. Governments in Estonia

Prime Minister	Period	Coalition Partners
Mart Laar (Pro Patria)	Oct 21, 1992 – Sep 26, 1994	Pro Patria + ERSP + M + Liberals
Andres Tarand (M)	Nov 8, 1994 – Apr 5, 1995	Pro Patria + ERSP + M + Liberals + Right Wingers'
Tiit Vähi (KE)	Apr 17, 1995 – Oct 11, 1995	KMÜ + K
Tiit Vähi (KE)	Nov 7, 1995 – Nov 21, 1996	KMÜ + RE
Tiit Vähi (KE)	Dec 1, 1996 – Feb 25, 1997	KMÜ
Mart Siimann (KE)	Mar 17, 1997 – Mar 25, 1999	KMÜ + AP
Mart Laar (Fatherland Union)	Mar 25, 1999 – Jan 8, 2002	Fatherland Union + RE + M
Siim Kallas (RE)	Jan 28, 2002 –	RE + K

ERSP: Estonian National Independence Party; M: Moderates; KMÜ: Coalition Party and Rural Union (comprising Coalition Party [KE], Rural Union [EM], Country People's Party [EME], Pensioners' and Families' League [EPPL] and Farmers' Assembly [PK]); K: Centre Party; RE: Reform Party; AP: Progressive Party; Fatherland Union: merger of RK 'Isamaa' and ERSP since 2 Dec 1995.

Source: Adapted from *European Governments 1945-2002*.

Appendix 2.5. Governments in Latvia

Prime Minister	Period	Coalition partners
Valdis Birkavs (LC)	Jul 8, 1993 – Jul 14, 1994	LC + LZS
Maris Gailis (LC)	Sep 15, 1994 – Dec 21, 1995	LC + TPA
Andris Skele (non-party)	Dec 21, 1995 – Jan 20, 1997	LC + LZS + LNNK + TB + DPS + LVP
Andris Skele (non-party)	Feb 13, 1997 – Jul 28, 1997	LC + LNNK + TB + DPS + LKDS/LZS
Guntars Krasts (TB/LNNK)	Aug 7, 1997 – Apr 29, 1998	LC + TB/LNNK + DPS + LKDS/LZS
Guntars Krasts (TB/LNNK)	Apr 29, 1998 – Nov 26, 1998	LC + LNNK/TB + LKDS + LZS + LZP + LNRP
Vilis Kristopans (LC)	Nov 26, 1998 – Jul 6, 1999	LC + TB/LNNK + JP + LSDA
Andris Skele (TP)	Jul 16, 1999 – Apr 12, 2000	TP + LC + TB/LNNK
Andris Berzins (LC)	May 5, 2000 – Nov 5, 2002	LC + TP + TB/LNNK + JP
Einars Repše (JL)	Nov 7, 2002 –	JL + LPP + ZZS + TB/LNNK

LC: Latvia's Way; LZS: Farmers' Union; TPA: Political Union of Economists; LNNK: Latvian National Conservative Party; TB: For the Fatherland and Freedom; TB/LNNK: Fatherland and Freedom Union (merger of TB and LNNK 21 Jun 1997); DPS: Democratic Party Saimnieks; LVP: Latvian Unity Party; LKDS: Christian Democratic Union; LZP: Green Party; LNRP: Latvian National Reform Party; JP: New Party; LSDA: Social Democratic Alliance; TP: People's Party; JL: New Era; LPP: First Party; ZZS: Green and Farmers' Union.

Source: See Table 4.

Appendix 2.6. Governments in Lithuania

Prime Minister	Period	Coalition partners
Bronislovas Lubys (LDDP)	Dec 2, 1992 – Mar 10, 1993	LDDP
Adolfas Slezevicius (LDDP)	Mar 10, 1993 – Feb 8, 1996	LDDP
Mindaugas Stankevicius (LDDP)	Feb 15, 1996 – Nov 27, 1996	LDDP
Gediminas Vagnorius (TS(S))	Dec 10, 1996 – Mar 25, 1998	TS(S) + LKDP + LCS
Gediminas Vagnorius (TS(S))	Mar 25, 1998 – May 3, 1999	TS(S) + LKDP + LCS
Irena Degutienė (TS(S)) (acting)	May 4, 1999 – May 18, 1999	TS(S) + LKDP + LCS
Rolandas Paksas (TS(S))	May 18, 1999 – Oct 27, 1999	TS(S) + LKDP + LCS
Irena Degutienė (TS(S)) (acting)	Oct 27, 1999 – Oct 29, 1999	TS(S) + LKDP + LCS
Andrius Kubilius (TS(S))	Oct 29, 1999 – Oct 19, 2000	TS(S) + LKDP + LCS
Rolandas Paksas (LLS)	Oct 26, 2000 – Jun 20, 2001	LLS + NS
Eugenijus Gentvilas (LLS) (acting)	Jun 20, 2001 – Jul 3, 2001	LLS
Algirdas Brazauskas (LSDP)	Jul 3, 2001–	LSDP + NS

LDDP: Democratic Labour Party of Lithuania (merged with LSDP in 2001); TS(S): Homeland Union (“Sajudis”); LKDP: Christian Democratic Party; LSDP: Social Democratic Party (merged with LDDP in 2001); NS: New Union (Social Liberals); LLS: Lithuanian Liberal Union; LCS: Centre Union of Lithuania

Appendix 2.7. Support for Membership in EU

Favourable replies (unfavourable in brackets) to question concerning potential referendum on membership (percent of all respondents).

	1995 ^a	1996 ^a	1997 ^a	2000 ^b	2001 ^c	2002 ^d
Estonia	44 (14)	29 (17)	35 (14)	46 (28)	38 (27)	44 (28)
Latvia	47 (12)	34 (13)	40 (13)	44 (33)	46 (32)	42 (37)
Lithuania	42 (7)	35 (6)	40 (13)	39 (28)	50 (20)	50 (17)
Bulgaria	50 (8)	49 (4)	57 (4)	60 (5)	80 (3)	73 (7)
Czech Rep.	43 (11)	43 (11)	49 (13)	55 (22)	54 (18)	51 (18)
Hungary	46 (12)	47 (15)	56 (9)	54 (14)	70 (10)	74 (6)
Poland	68 (5)	70 (7)	62 (8)	62 (20)	54 (26)	53 (24)
Romania	70 (2)	80 (2)	71 (6)	72 (4)	85 (3)	85 (4)
Slovakia	48 (6)	46 (9)	62 (8)	62 (13)	66 (11)	69 (10)
Slovenia	53 (14)	47 (15)	57 (18)	58 (21)	56 (22)	56 (28)
Average of 13 applicant countries:	51 (9)	48 (10)	53 (11)	55 (19)	65 (18)	78 (22)

^a 'If there were a referendum tomorrow on the question of your country's membership of the EU, would you personally vote for or against membership?' CEEB 6,7,8.

^b Taylor Nelson Sofres Central Europe survey.

^c 'How would you vote in a referendum about EU membership?' CCEB 2001.

^d 'If there were to be a referendum tomorrow on the question of (country)'s membership of the European Union, would you personally vote for or against it?' CCEB 2002.

Appendix 2.8. Approval of the New Regime

Replies to the questions ‘Where ... [on a scale from –100 to +100] would you put our current system of governing with free elections and many parties?’ (political regime) and ‘Where ... [on a scale from –100 to +100] would you put our current economic system?’ (economic regime).

		Lithuania		Latvia		Estonia	
		Lithuanians	Russian-speakers	Latvians	Russian-speakers	Estonians	Russian-speakers
Political regime	Approve (over 0)	47	42	56	49	71	65
	Disapprove (below 0)	42	43	33	42	19	27
Eco-nomic regime	Approve (over 0)	41	38	59	49	76	63
	Disapprove (below 0)	51	49	31	41	14	28

Source: Rose 2002: 9.