

國立交通大學

社會與文化研究所

碩士論文

波羅地海三國政治經濟 (1992-1996 年)

The North-South Gap Revisited:
Political Economy of the Baltic States (1992-1996)

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中華民國九十八年十一月

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Abstract

Lithuania, Latvia and Estonia (the Baltic states) are presented almost invariably as the most successful cases of post-soviet development - the only ones with a consolidated democracy, a free market economy and the highest living standards among the former Soviet union countries. Yet despite similar initial conditions upon independence, the Baltic states achieved divergent degrees of economic advancement. Within a decade, Estonia has established itself as ‘economic transition miracle’ and thus taking lead, Latvia as a middle ground and Lithuania has been the slowest and least prosperous among the three.

In contrast to the existing accounts that attribute this phenomenon to economic and socio-cultural factors, I put forth political economy explanation and argue through comparative analysis that institutional and ideological differences between the three states during the initial stage of transition (1992-1996) were decisive to their subsequent development. Moreover, contrary to the existing accounts that attribute the development of Lithuania, Latvia and Estonia to a unitary model of regime change and post-soviet transition, I contend that there have been three pathways of transition in the Baltic states and argue that relationship between state-building and economic development deserves attention.

Keywords: Baltic states, political economy, post-soviet economic transition, state-building



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Abbreviations

CEE	Central and Eastern Europe
CEECs	Central and East European countries
CIS	Commonwealth of Independent States
CP ESSR	Communist party of Estonian Soviet Socialist Republic
CP LTSSR	Communist party of Lithuanian Soviet Socialist Republic
CP LV SSR	Communist party of Latvian Soviet Socialist Republic
CPSU	Communist party of the Soviet Union
EBRD	European Bank for Reconstruction and Development
EHS	Estonian Heritage Society
EIU	Economic intelligence unit
EKK	Estonian Kroon
ENIP	Estonian National Independence Party
EPA	Estonian Privatization Agency
ESSR	Estonian Soviet Socialist Republic
EU	European Union
FDI	Foreign direct investment
FSU	Former Soviet union
GCI	Growth competitiveness index
GDP	Gross domestic product
IEF	Index of economic freedom
IME	Self-managing Estonia (Estonian: Isemajandav Eesti)
IMF	International monetary fund
LDLP	Lithuanian Democratic Labor Party
LNIM	Latvian National Independence Movement
LTSSR	Lithuanian Soviet Socialist Republic
LVSSR	Latvian Soviet Socialist Republic
MEBOs	Manager and employer buyouts
NATO	North Atlantic Treaty Organization
OECD	Organization for economic cooperation and development

SMEs	Small- and medium-scale enterprises
SSR	Soviet socialist republic
UNIDO	United Nations industrial development organization
USSR	Union of Soviet Socialist Republics (Soviet Union)
VAT	Value-added tax
WB	World Bank
WEF	World Economic Forum



I. Problematique: the North-South Gap in the Baltic States

Following the collapse the Soviet Union in 1991, fifteen republics across Europe and Asia fell into an unprecedented political chaos and economic decline. The end of the Union of Soviet Socialist Republics (USSR) ended the monopoly of the communist party which has been the hegemonic institution providing all soviet republics with political control, economic planning, coordination and integration. Thus, when the tightly knit Soviet system began to erode in 1990 and eventually collapsed in 1991, the previously interrelated republics faced the devaluation of the Soviet-time currency (the rouble) which generated triple-digit inflation, the cut-off of previously cheap energy supply from Russia resulted in a dramatic decline in industrial output, which in turn translated into falling living standards. Moreover, there was an absence in the Soviet republics of technical skills, know-how as well as legal, fiscal and institutional frameworks which would work under market economy. In this way, the similarities of the previously soviet republics were substantial (Desai 1997, Dyker 1997, Lavigne 1999).

Despite these similarities at the outset, Lithuania, Latvia and Estonia (hereafter- the Baltic states or the Baltics) by now are considered to be the three most successful cases of development. Starting with the 2000s, the Baltic states were presented invariably in the reports of reputable international organizations as a subcategory within the former Soviet Union (FSU) - the only ones with a consolidated democracy and a free market economy in FSU countries and having the highest living standards among them. In 2000, the European Bank for Reconstruction and Development (EBRD) indicated that within a decade, the Baltic states have already achieved democratic form of government with transparent governance, legitimate freedom and open civil justice (EBRD Transition Report 2000). Moreover, the report indicates that Lithuania, Latvia and Estonia have created a working market economy based on an entirely free price system and trade as well as the private sector accounting for the largest share of GDP. These conclusions were echoed by the Wall Street Journal in 2003: based on the annual changes of the Index of Economic Freedom (IEF) throughout 1993-2003, the Baltic economies were considered to be the fastest economies 'in the history of the Index' to move from a centrally-planned to a market economy. Economic freedom in Lithuania, Latvia and Estonia differed favorably from the other FSU countries. Furthermore, the Baltic states have enjoyed high rankings in Doing Business Rankings published by the World Bank throughout 2000-2007, being among the top 30 among

the most business-friendly countries worldwide. Moreover, the three were placed among the most competitive and innovative countries worldwide in the Growth Competitiveness Index (GCI) published by the World Economic Forum (WEF) during the same period. The potential for growth of the Baltic states were said to rest on increasing living standards, high macroeconomic stability, effective institutions conducive to increasing exports and industrial output, which were taken as particularly vital for these small economies. By any measure, the growth of the Baltic states' economies was unique to the post-soviet world and has led many to refer to it as a 'success story'.

Yet despite these similarities, the three Baltic states have diverged in degrees of development. Within a decade, Estonia has established itself as taking lead with Latvia as a middle ground and Lithuania being the slowest among the three (Table 1, Table 2, Figure 1).

Table 1: FDI in the Baltic states, as % of GDP

	2000	2001	2002	2003	2004	2005
Estonia	7.08	9.08	4.04	10	8.65	22.87
Latvia	5.27	1.59	2.72	2.71	4.64	4.61
Lithuania	3.31	3.67	5.04	0.97	3.44	4.03

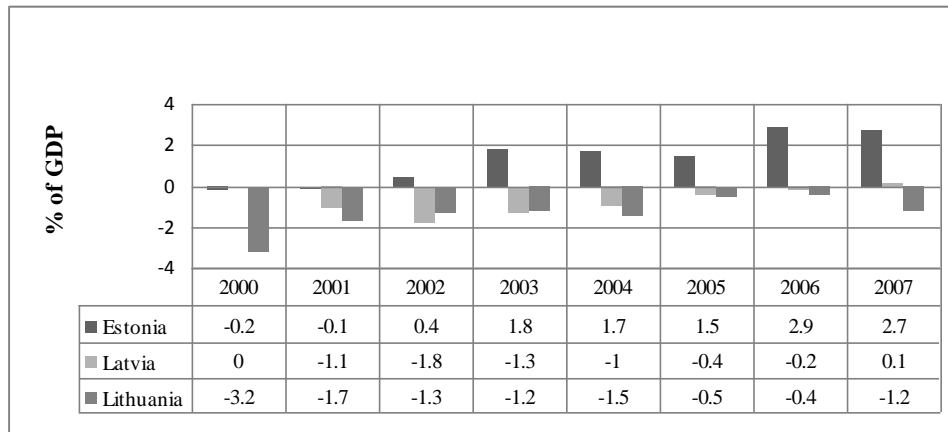
Source: Panagioutou (2001)

Table 2: Monthly labor costs, EUR per month, 2000-2006

	2000	2001	2002	2003	2004	2005	2006
<i>The Baltic States</i>							
Estonia	429.1	496.3	562.4	608.4	650.3	713.4	840.2
Lithuania	391.9	432.7	469.2	486.6	508.3	555.8	646.1
Latvia	343	350	360.9	357.3	388.7	432.6	531.8
<i>The EU-15 average</i>	3225.5	3230.3	3331.4	3435.4	3583.7	3674.9	3496.2

Source: Labour statistics database (Laborsta) of the International Labor Organization (ILO), 2000-2006 at <http://laborsta.ilo.org/>

Figure 1: Budget deficit and surplus in the Baltic States, 2000-2007



Source: Panagioutou (2001)

Moreover, according to some international rankings, Estonia belongs to one of the most rapid and successful performers worldwide. During 2000-2002, the Transparency International ranked Estonia the least corrupt country in the post-communist region, and the IEF qualified Estonia as one of the most economically free in Europe and worldwide (Table 3). Estonia is leading in the world in the field of e-government: in 2005, it held the first e-elections in the world.

Table 3: Index of Economic Freedom rankings of the Baltic states, 2000-2007

	2000	2001	2002	2003	2004	2005	2006	2007
Estonia	24	17	10	8	6	4	7	9
Latvia	45	47	51	43	...	28	39	34
Lithuania	64	44	43	...	22	23	23	19

Source: The Heritage Foundation, 2000-2007 Retrieved from: <http://www.heritage.org/Index/>

Its achievements were dubbed in some sources ‘economic miracle model’ (Stanek 2006). Norkus (2007) has referred to the divergence between the three countries as *North-South gap* in the Baltics.

II. The Political Economy Explanation

In this chapter, I critically review the existing literature on Baltic development and put forth research questions. In the first part of the chapter, I summarize the fundamental aspects of development that the three Baltic countries had in common and discuss the existing accounts on their divergence. I argue that although all explanatory frameworks partially explain the North-South gap phenomenon, they underestimate political variables. The second part of this chapter is devoted to the review of what I call *nationalist perspective* on the post-soviet political economy – its formation, core claims, and inadequacies for explaining the Baltic development. Later, in the third part of the chapter, I put forth research questions and methodology.

2.1 Explanations of the North-South Gap: Missing Variables

2.1.1 Sharing Similarities

The Baltic states are considered to be the most successful cases of post-soviet development. Generally, the existing literature usually attributes their phenomenon to similar factors, such as the role of: (1) *the market*, (2) *external actors*, (3) *historical legacies* and (4) *distinct politics of nationalism*.

The *market explanation* typically represented by economists and international institutions holds that the key to understanding the Baltic development lies in their rapid and comprehensive economic transition policies. The existing literature on transitional economics defines transition as a move from a planned socialist economy to a market economy characterized by private ownership of the means of production and market working as a major adjustment mechanism between demand and supply; the existing accounts almost invariably conclude that all the post-socialist and post-soviet countries embarked on similar ‘package’ (Lavigne 1999), ‘ideal program’ (Desai 1997) of reforms which consisted of three interrelated steps: (a) macroeconomic stabilization through fiscal and monetary policies, (b) liberalization of prices and trade, and (c) structural reforms. The differences emerged in sequence, speed, and scope of the chosen measures (Desai 1997; Dowlah 1992; Kolodko 2000; Kontorovich 1992; Lavigne 1999). Moreover, it was generally agreed that the speed of reforms correlated positively with the success of economic recovery and reorientation. As for the Baltic states, economic transition

here is generally has been conceived to be both more comprehensive and implemented more rapidly than in the other FSU countries and resembled that of the CEECs. Estonia, Latvia and Lithuania were the first to achieve macroeconomic stabilization through the earliest introduction of convertible national currencies (1992-1993), balanced their budget due to tight fiscal policies and implemented far-reaching reforms (such as privatization, banking reform, taxation) shortly after independence which created a new private sector and generated economic growth.

Another line of argument holds that the seminal factor underlying the Baltic phenomenon was its geopolitical situation and puts emphasis on *external actors* facilitating the Baltic development. This explanation argues that after the collapse of the USSR the Baltic states were on the borders of the European Union (EU) and North Atlantic Treaty Organization (NATO) and thus benefited from their guidelines. According to the view of some (Berglof and Roland 1997), it contributed greatly to the reorientation of the Baltic trade and provided them with a democratic orientation. Moreover, it was argued that the Baltic states due to agreements with the EU and NATO have not abandoned the path of capitalist market-based economy and liberal democracy even when governments were changing. After the accession to NATO and EU in 2004, Lithuania, Latvia and Estonia continued the same pathway.

In addition to these perspectives, some scholars (Hood et al. 1997) have argued that the success of the Baltic states is a *regional/historical phenomenon* originating from the experience of the three countries with market-based economies during the Interwar (1920-1940) period. The rationale is that in the Baltic states, which were the only ones among the Soviet countries with a history of independent democracies between the wars, had experienced the shortest period of the Soviet rule. Thus, they retained higher living standards and were advantaged with a memory of the elements of market economy at the outset of transition.

Most importantly, however, it is widely acknowledged that what has distinguished Lithuania, Latvia and Estonia from the other FSU countries, is the role of nationalism in their post-communist economic and political development. What I call *nationalist explanation* has been the dominant explanatory framework in explaining Baltic development. It holds that the key to understanding the Baltic 'success story' lies in a unique model of political economy of transition implemented shortly after independence. It is a commonplace to state that specific *politics of identity* emerged in the Baltics during 1985-1991, crystallized into capitalism- and market-oriented state institutions which in turn implemented unambiguous and decisive market-

oriented reforms during the first post-soviet governments in 1992-1996 (Abdelal 2001; Tsygankov 2002; Gill 2002, 2006).

2.1.2 Existing Explanations of Divergence

Estonia, Latvia and Lithuania have shared many conditions in common, yet they have diverged a great deal despite these similarities. Why? This puzzling issue gave rise to competing explanatory frameworks that can be grouped around two main perspectives, namely: (1) *economic*, and (2) *socio-cultural*.

Economic explanation can be brought down into two groups, each of which attributes the divergence between Estonia, Latvia and Lithuania to different explanatory factor, namely: (a) economic structure upon independence, and (b) geographical situation. Norgaard (1996) has argued that the share of all-union heavy industry enterprises was lower in Estonia and thus the transition was easier. Kala (1994) and Kallas (1996) have pointed out that the geographical proximity of the Nordic countries (Finland, Sweden) gave Estonia an advantage of low transportation costs that increased competitiveness of its exports and attracted foreign investment.

In contrast to the views described above, Panagioutou (2001), Norkus (2007) and Bennich-Bjorkman (2007) have in different ways argued that Estonia's success was down to more than just economics and stated that it was *cultural and social legacies* accumulated during earlier periods that have contributed greatly to a more successful economic development of Estonia vis-à-vis its southern Baltic neighbors. Panagioutou (2001) has demonstrated that lower cultural and political integration into the soviet system in Estonia has proved to be beneficial to its economic restructuring upon independence: a comparatively lower participation of the population in the Communist party of Estonia and the shared Scandinavian identity generated an overall distrust and rejection of the soviet political, cultural and economic domination. Thus, according to Panagioutou, Estonia was more eager to abandon the command economy and to restructure its economy into a market-based one than Latvia or Lithuania. Norkus (2007) and Bennich-Bjorkman (2007) have stated that it was protestant legacy of Estonia that was of pivotal importance to the emergence of the North-south gap in the Baltics. They both have hypothesized that protestant ethics, such as diligent work, emphasis on individual responsibility (Norkus 2007) and a distinct civic culture that survived years of the Soviet occupation (Bennich-Bjorkman 2007)

might have given birth to a group of more competent policy-makers to restructure its economy in the early 1990s.

2.1.3 Missing Variables on Divergence: State-Building

All the factors discussed above undeniably address issues which have been of pivotal importance in divergent pathways of the Baltic economic transition. However, one very important variable, I contend, is missing. During the post-Soviet economic transition, all the *economic transition policies* were inextricably linked with process of *state-building*. Contrary to the Soviet satellite countries in the Central and Eastern Europe (CEE) which retained their autonomous state apparatuses throughout the Soviet period, the formerly constituent USSR republics had no states of their own. Thus, after the break-up of the Soviet system, they were passing not only from a centrally-planned economy to a market-based one, but also from authoritarian Soviet rule to independent statehood and democracy (Pettai and Krentzer 1998, Norgaard 1996). In such way, the post-soviet economic transition, in Mockunas (1993) words, was a ‘politically charged process’. The Baltics states were not an exception.

Moreover, what is apparent to an insider but is virtually left unanalyzed in academic literature is that post-soviet state economic policies in Estonia, Latvia and Lithuania (despite the well-known similarities) were administrated in very different political contexts. Thus, I argue that Baltic politics and its relation to economic transition deserve attention. Contrary to the existing explanations attributing the emergence of the North-South gap to merely economic (initial conditions or economic decisions) or cultural (cultural and social legacies) factors, I put forth a *political economy explanation* which rests mainly on the reinterpretation of the *nationalist explanation*, the dominant explanatory framework in explaining post-soviet Baltic political-economic development mentioned in the previous section. Here I will specify its formation, core claims and accounts of the Baltic states. Later, I will point out the inadequacies of the nationalist explanation in accounting for post-soviet divergence in the Baltic states and put forth the research questions.

2.2 What is Taken to be Similar is Different

2.2.1 The Nationalist Explanation of the Post-Soviet Development

The Baltic states have served as an epitome of *nationalist explanation of the post-soviet development*. Most recent accounts on the post-soviet political economy of the Baltic states typically attribute the development of Lithuania, Latvia and Estonia to a unique model of political economy of transition. It is a commonplace to state that specific *politics of identity* emerged in the Baltics during 1985-1991, crystallized into *capitalism- and market-oriented* first post-soviet governments in 1992-1996 which in turn unambiguously led to liberal democracy and free-market economy in these states. Because of the role of nationalism is given central importance here, I call this explanation *nationalist perspective*.

After the break-up of the Soviet Union in 1991, there has been a widespread assumption that Western liberal democratic capitalism has scored victory over socialist centrally-planned, authoritarian systems and that former communist regimes will thus be invariably replaced by democracies. It was assumed that they will become part of the global democratic change that began in the southern Europe and extended into Latin America in the 1970s, East Asia in the 1980s and occurred in the communist world throughout the 1980s-1990s (Gill 2002). Moreover, the only one alternative to the Soviet centrally-planned economy was seemed to be a free market economy. However, as cross-country studies soon revealed, this was not the outcome. The post-soviet countries soon diverged a great deal in terms of political systems (from democratic to authoritarian) and economic orientations. The Baltic states soon emerged as a specific category within the former soviet countries: the only ones that unambiguously chose liberal democracy and free market economy as their orientation.

Explanations of divergence and the ‘Baltic phenomenon’, as mentioned in the previous chapter, have been many. The most recent explanation points out that crucial in determining the political outcomes of the post-communist transition was the *identity* vis-à-vis the former regime (pro-Soviet/anti-Soviet or ambiguous) of those leading political actors who implemented the transition in each state.

Abdelal (2001), Tsygankov (2002) and Gill (2002, 2006) have traced the origins of divergence back to *perestroika* (1985-1991), the period of regime change before the official collapse of the USSR in 1991. This Soviet reform gave voice to variety of forces, each of them

having their own purpose/motives, and competing/cooperating with each other based on their interpretation of perestroika. Analyses in this line of argument drew cross-country comparisons and focused on divergent *politics of nationalism* during perestroika period and *post-soviet orientations* resulting from it in each country.

(1) Politics of Nationalism and Post-Soviet Orientations

Perestroika ('restructuring' in Russian) was a reform launched in 1985-1991 by the USSR leader Michail Gorbachev as a response to major economic decline in the Soviet union and aimed at transforming stagnant, inefficient USSR economy into a more efficient one. In order to achieve these goals, two additional policies were launched: *glasnost* ('openness') and *democratizatsiya* ('democratization'). Glasnost meant an increased openness about past (historical) and present problems (such as corruption, ecology, crimes etc) in media and public life, whereas democratizatsiya was aimed at transforming a previously one-party rule¹ to a union with a strong centre (Moscow) and strong soviet republics. On the one hand, perestroika policies dismantled the long-standing monopoly of the communist party through the creation of new institutions (*Congress of People's Deputies*, the Soviet 'government' and *Supreme Soviet*, the new bicameral Soviet 'parliament') and introduction of direct, multicandidate elections to these bodies (March 1990). On the other hand, inasmuch as perestroika was aimed at transforming the Soviet Union rather than dismantle it, the Soviet authorities were still controlling all production, trade, monetary networks and military forces were still in hands of the Communist Party of the Soviet Union (CPSU) in Moscow. By now, scholars generally agree that this paradox was one of the main reasons of the failure of perestroika. The communist party was the core of Soviet system as such, and economic and political chaos it generated as well as unintended surge of nationalism eventually turned the pace into opposite direction: after the failed coup in August 1991, the USSR ceased to exist (Dowlah 1992).

It is this process of nationalism that, according to the nationalist explanation, deserves attention. It is agreed that perestroika gave voice to new forces with their own purposes and motives which competed/cooperated with each other based on their interpretation of the

¹ The USSR (Union of Soviet Socialist Republics) nominally was a centralized democracy. In fact, however, it was a union with a strong center (Moscow) exercising hegemonic control over its constituent republics through a single Communist party. All the Soviet state organs (judiciary, executive, legislature) and media were completely subordinated to it, and both politics and economy depended on one party (Davies 1998).

perestroika and USSR system as such. While perestroika was a political change occurring still within the USSR system, the proposals centered on the notions of pro- and anti-sovereignty/autonomy/independence. Moreover, these forces used the existing Soviet institutions and popular support as their main vehicles. Generally, they emerged within two levels: (1) *republican* official (the incumbent republican communist parties), and (2) *societal* semi-official (popular fronts) and informal (independent groups). The interplay of these actors vis-à-vis the Soviet regime during 1985-1991 is usually referred to as *politics of nationalism*, or *identity politics*. Here follows a description of the general characteristics of each actor, common to all the then Soviet republics:

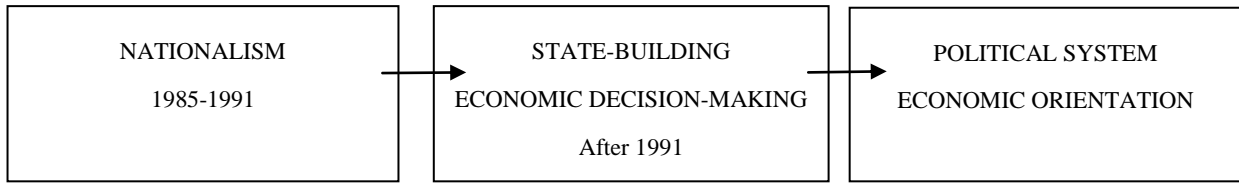
1. Republican Communist Parties. Until 1989, the republican communist parties were merely subordinate political bodies faithful to the Communist Party of the Soviet Union (CPSU). After the perestroika was launched ('strong centre and strong republics'), their status has changed (Dyker 1992). On the one hand, they were given more of an autonomous control over their republics. On the other hand, however, they were still subordinate to Moscow as the perestroika was meant merely to reform rather than dismantle the Soviet system. Thus, when the political climate was changing, they had to balance between the CPSU and local reformists. Generally, party apparatuses have split into two groups: (1) reformists, those embracing reforms and supporting perestroika change, and (2) hardliners, or conservative, uncompromising communists unwilling to yield to any changes within the established USSR system.
2. Popular fronts. According to the definition in the Soviet times, the popular fronts were 'organizations formed to mobilize the people to the building of socialism under the leadership of communist parties' (Clemens 1991). Under the perestroika, given the willingness of Gorbachev to receive support to mobilize people to restructuring of the system into a more decentralized one, the popular fronts were encouraged throughout the USSR as a device to accelerate the change. They were organized by local reform-minded forces and granted the authorization by the USSR authorities in Moscow. Initially, they were formed to represent all forces favoring perestroika within the system and thus covered simultaneously a number of various groups, organizations and movements. They, in contrast to other dissent

organizations were given access to mass media (printed press, radio). Throughout the USSR, the popular fronts included an educated and intellectual elite as well as communist party members that promoted reform.

3. Independent movements. Glasnost policy offered an opportunity for various organizations and groups to give voice to protests against environmental damage, forced industrialization, Russification and repression of national culture (Misiunas and Taagepera 1993). They were led mainly by common people, dissidents from established Soviet system (students, writers, artists etc) and all those that have been outside the ruling communist party. Gill (2006) calls them 'minority nationalists' mainly because their voice did not reach the Soviet authorities directly since they, in contrast to popular fronts, did not have access to the media.

The politics of nationalism had the *USSR system as its focal point*, and the main issues have been *republican sovereignty/autonomy/independence*. After the break-up of the Soviet Union in 1991, the formerly Soviet republics became independent and this conflict lost its importance. When the union disintegrated, the previously central regulating power ceased to exist, and countries were deprived of political system and economic regulation. Contrary to the former Soviet satellite countries in the CEE which had retained their own institutions and had a relative autonomy over their economies during the communist rule, the countries that used to belong to the USSR had nothing of their own. Therefore, the most immediate issues after independence were simultaneous *state-building* and *economic measures* to fight down huge economic decline and destabilization. The situation itself was unprecedented: no experience, nor know-how or clear strategies existed on how to deal with the political and economic change. In such way, the nationalist approach holds that the configurations of powers that emerged during the regime change prior to the official collapse of the USSR in 1991 were the matrix from which newly independent post-soviet states were built. Namely, the powers were responsible for the adoption of *constitutions, legislature, state institutions*, some forces split up and formed *political parties* to compete for the new order. Moreover, these were the actors chiefly responsible for the building of foreign relations and economic policies in each post-soviet state, and the *interpretation of the Soviet political and economic system* became crucial. This, according to this line of argument, was the general framework of post-Soviet development (Figure 2).

Figure 2: Post-soviet development: general framework



Actors: USSR authorities
Republican authorities
Societal forces

Actors: Former communists
New political elites

Unit of analysis: motives/purposes
relations between the actors

Unit of analysis: constitutional system
electoral rules
economic reforms

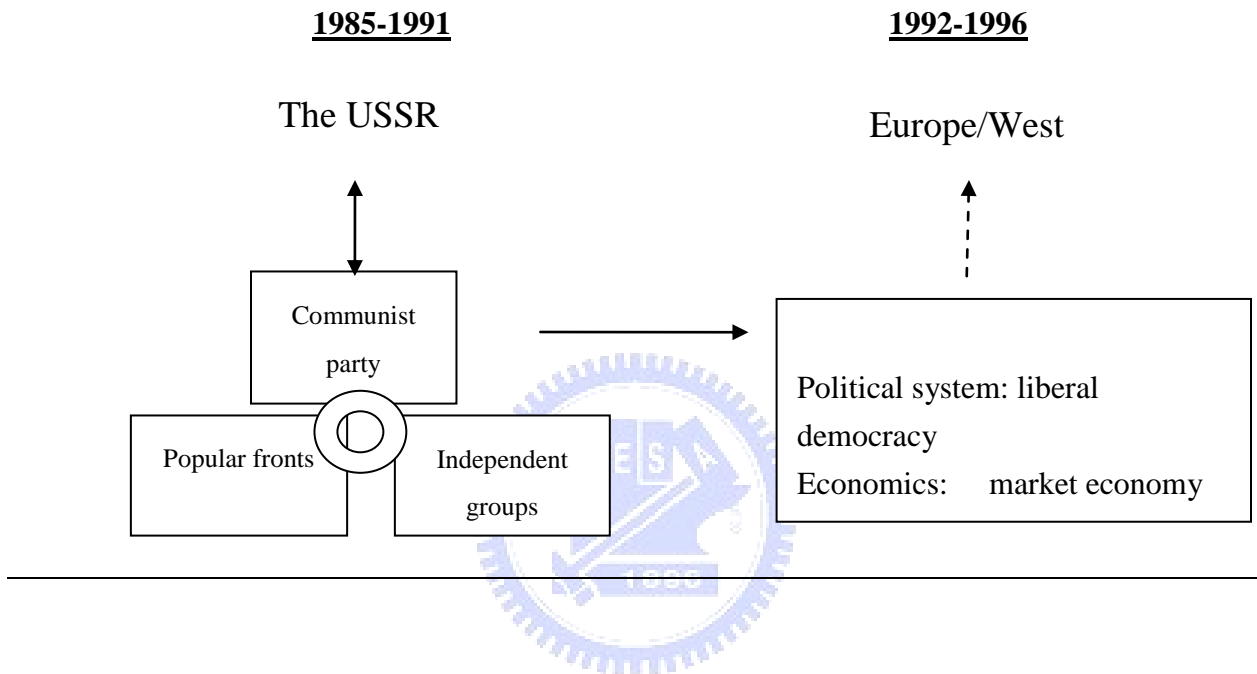
In such way, the *nationalist perspective* states that crucial in determining the political economic outcomes of the post-communist transition was the relationship between republican (communist parties) and societal (popular fronts and independent groups) actors during the perestroika period prior to the official independence. Abdelal (2001), Tsygankov (2002) and Gill (2002, 2007) have in different ways argued that different power dynamics during that period gave birth to divergent political actors who came to rule independent countries after 1991, each of them identifying as *pro-Soviet*, *anti-Soviet* or *ambiguous*. In other words, the main argument was that *identity* of those leading political actors who implemented the transition was the source of political-economic divergence in the post-soviet era.

(2) The Baltic Model According to the Nationalist Explanation

The nationalist explanation assumes that the three Baltic states formed a subgroup among the FSU countries. The existing accounts of political economy in the Baltics typically attribute the development of the three states to a uniform model. It is widely acknowledged that what has distinguished Lithuania, Latvia and Estonia from the other FSU countries, is a consensual, cooperative relationship between republican communist parties and societal forces (popular

fronts and independent groups). This symbiotic relationship is said to shape an exceptionally coherent, purposive and single-minded post-soviet political (Gill 2002, 2006) and economic (Abdelal 2001, Tsygankov 2002) orientations in these countries (Figure 3)

Figure 3: Baltic model of development according to the nationalist explanation



Gill (2002) has demonstrated that despite the similar initial conditions and widespread expectations about democratic development, political systems in the former soviet countries have diverged greatly. Based on two principal criteria for evaluation of the democratic nature of the political system - free and fair regular elections and a widespread observance of political and civil rights - Gill breaks the FSU countries down into three categories: (1) *democracies* (Lithuania, Latvia, and Estonia), characterized by the presence of the two components, (2) *façade democracies* (Russia, Ukraine, Moldova, Armenia, and Georgia) exhibiting limited freedom and fairness of elections and only some observance of political and civil rights, and (3) *non-democracies* (Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan) with noncompetitive, non-free elections and limited or absent observance of political and civil rights. Gill (2007) stated that the crucial in determining the political outcome of the post-communist transition was the identity of those leading political actors who shaped

that transition. Where the transition was in the hands of popular fronts and independent groups (those proposing the idea of a ‘free nation’ and rejecting Soviet rule), Gill has showed, democracy has been the outcome (the Baltic states). In contrast, where the republican Communist parties (hardliners eager to maintain the status quo of hegemonic Soviet power) remained firmly in central control and were able to exclude popular fronts and independent groups, the post-soviet political system was a non-democratic one. Following the same logic, where the transition has been shaped by republican Communist parties but under pressure from active popular fronts and independent groups, façade democracy has been built.

In addition to Gill, Abdelal (2001) and Tsygankov (2002) have been puzzled by variations in the *foreign economic orientations* of the post-soviet states. In particular, they have highlighted three categories of countries in relation to their stance toward the former central authority (Russia): (1) Lithuania, Latvia and Estonia, the only ones that chose a rapid disengagement from Russia and a more pro-Western orientation, the only ones among FSU countries to reject the membership in Commonwealth of Independent States (CIS)² and unambiguously chose to re-orientate their trade relations to the Western Europe; (2) Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan, in contrast, preferred to maintain strong monetary ties with Russia, and (3) Ukraine, Moldova, Armenia, and Georgia falling between the two extremes. Those countries, according to them, which were endowed with historically strong and coherent national identities were more willing to break with the Soviet era, despite the economic costs of doing so (the Baltic states). Those countries, in turn, that had weaker national identities were ambiguous toward their post-soviet future or were even eager to maintain strong ties with formerly Soviet centre (Russia). In their view, similar to Gill’s argument, the crucial to the economic orientation outcome was the relationship between the republican (communist parties) and societal (popular fronts and independent groups) actors during the perestroika period. Moreover, theoretically, Abdelal (2001) saw the post-soviet divergences as standing in a sharp contrast to the existing theories of economic nationalism as understood in the realist tradition. As traditionally understood, economic nationalism is a perspective of political economy that emerged during the 16th-18th centuries in Europe together

² Commonwealth of Independent States (CIS) was a union created in December 1991 by the former Soviet republics. It is aimed at forming ‘a common economic space grounded on free movement of goods, services, labour force, capital; to elaborate coordinated monetary, tax, price, customs, external economic policy; to bring together methods of regulating economic activity and create favorable conditions for the development of direct production relations’ (Interstate Statistical Committee of the CIS 2009).

with the birth of strong national states. For a long time, it has been one of the dominant ideologies of political economy and took many forms, such as protectionism, mercantilism, and statism (Gilpin 1987). The fundamental presumption of economic nationalism is that *the state* which is an autonomous (free from societal interests), rational and unitary entity driven by the three simultaneous objectives of security, wealth, and power, is at the core of international politics and economic development. Contrary to the economic nationalism described above, Abdelal proposed that crucial in determining the political outcomes of the post-communist transition was the *identity* ('national purpose') of those leading political actors who implemented that transition.

Abdelal (2001) attributed this symbiosis to 'nationalist' character of the incumbent communist elites. He argued that the fact of illegal Soviet annexation in 1940³ nurtured patriotic sentiments of Baltic communist leaders who were communists only on the surface. Thus, Abdelal argues, after the Pandora box was opened during perestroika, the Baltic communist parties soon cooperated with powerful and active popular fronts. Moreover, the notion of 'Europe' was central to the interpretation of the nation in the Baltic States during the late-1980s - 1990s. Lithuanians, Latvians and Estonians viewed themselves as a part of Europe, the imagined community to which they belonged culturally and historically and membership of which they were deprived by occupation. This notion of Europe was contrasted with the notion of Eurasia, and most importantly, Russia. Slightly different from Abdelal, Gill (2006) attributed the symbiotic relationship of the three forces to the strength of popular front and independent groups. These actors, according to him, were driven by long-suppressed national sentiments (cherished in underground activities during the Soviet time) and exerted influence on republican communist parties which soon embraced their ideals. Furthermore, the Baltic states modeled their post-soviet constitutions and state institutions under their Interwar (1920-1940) republics⁴.

³ The point to be made here is that most of the democratic countries in the world never recognized the annexation of the Baltic states as legal. Some countries refused to recognize the incorporation of the Baltic States de jure and only recognized the Soviet governments de facto or not at all. This policy of non-recognition gave rise to the principle of legal continuity which led that de jure, the Baltic States remained independent under illegal occupation throughout 1940-1991. On the contrary, the USSR never formally acknowledged its presence in the Baltics as occupation and considered the Soviet Socialist Republics of Lithuania, Latvia and Estonia as its constituent republics. Until now, the government of the Russian Federation and state officials maintain that the Soviet annexation of the Baltic states was legitimate and that the Soviet Union liberated the countries from the Nazis.

⁴ The period between the two world wars (1920-1940) in the Baltics is a period of modern nation-states with predominantly agricultural, export-oriented market economies and relatively high living standards in all three countries. It began with declarations of independence from the Russian Empire in 1918 and ended with a forced

To sum up, the rationale proposed by the most recent *nationalist perspective* is that due to widely shared historical memory of the pre-Soviet nation-states with democracy and market economies from which the Baltic states were deprived by the illegal Soviet occupation, the incumbent communist parties, popular fronts and independent groups during perestroika (1985-1992) have shared a single vision of their nations. The main focal point was Europe as an ‘imagined community’ they once belonged to, and opposition to Russia/USSR, chiefly associated with alien rule. Thus, after the official independence in 1991, the three Baltic states produced coherent, nationalist-minded states responsible for economic restructuring and democratization. Thus, the *orientation* and the *outcome* was the same for the three: Western-style liberal democracy and a free market economy.

2.2.2 What is Taken to be Similar is Different

While the *nationalist perspective* of the post-soviet political economy contributed greatly to

illegal incorporation into the USSR in 1940. In 1918, as a result of the collapse of Germany and Russia, Lithuania (16th February), Estonia (24th February) and Latvia (18th November) gained independence from the Russian Empire and for the first time established their modern nation-states (EIU Country Profile 1993; Misiunas and Taagepera 1993; Reardon 1996; Reardon and Lazda 1993). In 1920, Estonia (2nd February), Lithuania (12th July) and Latvia (1st August) signed peace treaties with Soviet Russia (Treaty of Tartu, Latvia-Soviet Riga Peace Treaty, Soviet-Lithuanian Treaty) and began the process of nation-building. In accordance with other European countries, all three countries established democratic regimes with very liberal electoral laws and unicameral parliaments (Seimas in Lithuania, Saema in Latvia and Riigikogu in Estonia) exerting the principal power. These regimes, as opposed to Bolshevik revolution, received a broad Western support. In the realm of economy, the Baltic states soon established their own convertible currencies (Litas in Lithuania, Lats in Latvia and Kroon in Estonia). Moreover, the three Baltic states implemented land reforms which formed a new class of independent peasants and paved the way for the predominantly agrarian, export-oriented market economies. Nevertheless, due to the lack of democratic traditions and multiethnic societies, new political regimes based on nationalist ideology and strongly nationalist parties emerged. Strong presidential institutions with powerful presidents emerged: Antanas Smetona in Lithuania (1926), Karlis Ulmanis in Latvia (1934), and Konstantin Pats in Estonia (1934). The communist parties were banned, and the national intelligentsia was organized in national-liberal parties. Under strict control of the state and its economic policies, the Baltic states were among the first European countries to overcome the economic crisis that hit in the late-1920s and accumulated gold reserves which were put for safekeeping in Western banks (Norgaard 1996). However, the rise of Germany led to rivalry with the Soviet Union. On 23 August 1939, the first German-Soviet Non-Aggression Treaty (known as Molotov-Ribbentrop Pact) assigned Lithuania to the German sphere of influence. A month later, the second Molotov-Ribbentrop Pact, reassigned Lithuania to the Soviet sphere. In October 1939 the Soviets pressured Lithuanian leaders to sign a Treaty of Mutual Assistance. At first the Baltic States tried to pursue a firm policy of neutrality and to find a balance between German and Russian interests in the region. However, as a result of Molotov-Ribbentrop Pact and on the pretext that the Baltic States were not capable of defending the sovereignty by themselves, the Soviet Union demanded military bases to be placed in their territory. Getting no help from the West, the Baltic States had to yield to Soviet demands. Later on, the USSR took full control of the Baltic states. Threats and demands from the Soviet government caused the lawfully elected governments to be replaced by Soviet puppet governments which applied for admittance to the USSR in August 1940. The Baltic states thus ceased to exist.

explaining the similarities of political-economic *orientation* in the Baltic states, it fails to account for different levels of development in each of them. Moreover, although the emergence of the North-South gap phenomenon would suggest that variations in political economy of transition in each state, the existing literature tends to overlook that. The most recent accounts of the *North-South gap* takes the uniform Baltic political economy model (as described above) for granted and downplays the differences. In the post-Cold War media, academic accounts and reports of international organizations, the Baltic states were seen as ‘success stories’, countries that scored a victory of capitalism over communism and market economy over centrally-planned one. This helped to assert them as one category and many scholars tended to believe that Lithuania, Latvia and Estonia took very similar pathways. This assumption is deceiving, however.

Contrary to this perspective, I contend that there have been *three* models of political economy in the Baltic states during 1992-1996. They resulted from divergent inter-power relations during the perestroika, and shaped divergent strategies of economic transition during that period, with long-term economic outcomes. In other words, I agree that processes of *nationalism, state building* and *economic restructuring* were inextricably linked together, but aim at reinterpreting the existing *nationalist perspective* and argue that differences in political economy have paved the way for the emergence of differences in economic transition.

2.2.3 Research Methods and Data Collection

Deceiving conclusions have been drawn while comparing the three Baltic states with the other FSU countries. Thus, I will compare the three –Lithuania, Latvia and Estonia – with each other. My analysis applies a typical method of comparison which consists of (1) distinguishing contrasting outcomes of development under similar initial conditions and (2) comparing how the relationship between particular variables differs in different contexts (Winckler and Greenhalgh 1988, Hamilton and Biggart 1988, Hsieh 2005). The fact that the Baltic states had developed different outcomes (economic transition strategies) under similar economic conditions (Soviet cultural, social, political and economic legacies, geographical position, size, natural endowments and population) has made the Baltic states ideal cases for comparison. Many scholars and analysts in the field applied this method of comparison which allowed them to draw theoretical conclusions.

In order to specify the focus of analysis, I have developed a periodization of the Baltic transition, making distinctions between three stages, namely:

1. Initial period of transition (1992-1995/6). Period of the most immediate post-soviet reforms going simultaneously with the process of state-building. The goal and orientation of the Baltic states have been the same – liberal democracy, free market economy and integration into Western economic and political world through transnational organizations (EU and NATO). In order to achieve the transition to a market economy, the Baltic states had to forego the dominant role of the state in economy and allow market mechanism to work. The essential precondition for the economic transition was *macroeconomic stabilization* carried out using monetary and fiscal policies to stabilize inflation and create conditions for future economic growth. Simultaneously with monetary stabilization, *liberalization* of prices and foreign/domestic trade (abandonment of fixed price regime, reduction of subsidies, introduction of tariffs etc) was implemented. In addition, *structural reforms* such as privatization (to create a private sector) and banking sector and financial system reforms (to create a two-tier banking system and ensure financing for state budget) had to be introduced.

2. Beginning of integration with the NATO and EU (1996/8-2004). Economic growth as a result of reforms implemented during the initial period of transition; guidance from cross-national institutions and organizations (such as the World Bank, EBRD etc); since 2000 – economic boom, also known as ‘Baltic Tiger’ market by diminishing levels of unemployment, growing budget surplus and the highest GDP growth rates in the EU.

3. 2004- present. Post-EU and NATO accession period. Usage of trans-national funds to fight down the regional disparities, social problems, and developing knowledge economies. Most recently – economic crisis, with Estonia experiencing the earliest slow-down and Lithuania the latest.

In this thesis, I focus on differences between Estonia, Latvia and Lithuania that shaped divergences during this period because it set the pace for subsequent development. I argue through comparative analysis that, despite often-emphasized similarities, there have been *two*

major factors that differed in each Baltic state during the initial period of transition and were decisive in post-soviet divergence. First factor that led grounds to divergent degrees of development was *constitutional order* (political system, power relations between state institutions) and *state-society relations* that emerged out of complex politics of nationalism during perestroika and was constitutionally/legally established after independence. Second, equally important determinant was *ideology (purpose and motive) of the first post-soviet policymakers* that shaped the character of political leadership and thus set the pace for economic transition.

Therefore, I will reinterpret the *politics of nationalism during perestroika (1985-1991) and post-soviet state-building* in the Baltic states. I use the general framework of regime change in the USSR and look at how given actors – republican communist parties, popular fronts, independent groups – competed/contested in Estonia, Latvia and Lithuania. I highlight their identities and claims about national identity and relational dynamics that rest on sovereignty/independence/autonomy goals. This clear-cut analytical framework elaborated in existing literature allows me to prove that despite the often-emphasized differences, Lithuania, Latvia and Estonia reacted to the political changes of perestroika differently. I classify politics of nationalism in the Baltic states into three generalized types, namely: *horizontal contestation* (Estonia), *triangular cooperation* (Latvia), and *vertical confrontation* (Lithuania). These differences in power dynamics during perestroika, in my view, resulted in different types of constitutional order, with political leaders, parties that had contrasting purposes and linkages to society.

Furthermore, I will demonstrate that divergent economic transition strategies in each of the state were linked to contrasting political motives and goals of the first post-soviet policymakers. The connection between culture/ideology and political-economic outcomes in transitional countries has been pointed out by many authors, e.g. Hamilton and Biggart (1988) and Chun (2000). Hamilton and Biggart (1988) have indicated that the three newly industrialized countries in East Asia – Japan, South Korea and Taiwan – have differed much in the degree of state intervention into their economies. They have categorized three models of state/business relationships, namely: South Korea's 'strong state model', Taiwan's 'strong society model', and Japan's 'strong intermediate power model'. The authors claimed that each model derived from a distinct strategy of legitimization of political leadership. In South Korea, the existing model was

a product of a Confucian ideal state, whereas in Japan it was patterned under previous imperial structure and in Taiwan the focus on family and distance to the state gave birth to ‘strong society model’. In similar way to Hamilton and Biggart, Chun (2000) links a unique strategy of political legitimization of the KMT to democratization process in Taiwan. For him, the democratization of Taiwan was not the victory of individual freedom over authoritarianism as the post-Cold war explanations tend to hold, but rather an expression of hegemony of the same ruling elite which sought different ways to maintain the control over the state. Taking advantage of these insights, I look at *identities, motives and purposes of the key policymakers* that implemented the transition in the Baltic states. I argue that their divergences translated into different institutional frameworks for economic transition, with respective timing and economic outcomes.

Data for my empirical study consists of two groups: major and supplementary. The quarterly reports by the Economic Intelligence Unit (EIU Country Profile 1993, 1995) and annual report by the Organization for Economic Co-operation and Development (OECD, 1999) were useful sources providing detailed accounts of institutional settings and economic decision-making in each state during the initial stage of economic transition (1992-1995). Academic journal articles and books written by experts in the field have also been used in order to map out Baltic governmental institutions and their role in economic restructuring (Norgaard 1996; Reardon 1996; Reardon and Lazda 1993). In addition, data from country-specific case studies also have been collected to highlight differences between the three (Brown 1993; Lauristin and Vihalemm 2009). Audiovisual material available online gave interesting information concerning bureaucratic apparatus and decision making (Laar 2000; Laar 2006; Laar 2007).

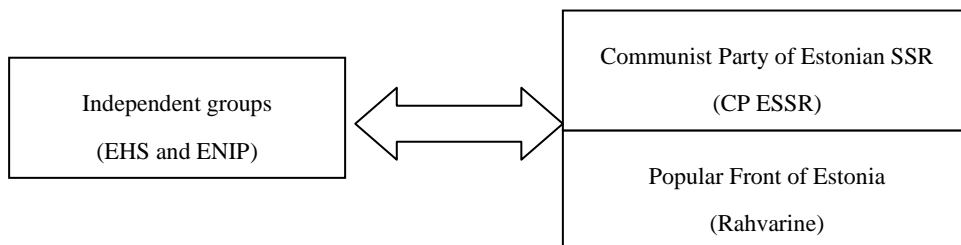
III. Politics of Nationalism and Post-Soviet State-Building in the Baltic States

The existing accounts typically attribute regime change in the Baltics during perestroika (1985-1991) and post-soviet orientations in the three states to a single model characterized by a consensual, cooperative relationship between republican communist parties and societal forces (popular fronts and independent groups). This symbiotic relationship is said to shape an exceptionally coherent, purposive and single-minded post-soviet political and economic development. Contrary to these generalizations, I demonstrate that due to demographic, cultural and social factors there have been *three* models of regime change (politics of nationalism) in the Baltic states, namely: *horizontal contestation* (Estonia), *triangular cooperation* (Latvia), and *vertical confrontation* (Lithuania). Moreover, different *constitutional order* (political system, power relations between state institutions) and *state-society relations* emerged out of the divergent politics of nationalism during perestroika and were constitutionally/legally established after independence.

3.1 The Estonian Model

The Estonian political transition during the perestroika took a form of *horizontal contestation* between reform-minded communists, popular front of Estonia (Rahvarine) and a joint alliance of independent groups - three equally strong actors with different demands/strategies but all sharing a strong opposition toward the existing Soviet order (Figure 4).

Figure 4: Balance of powers in Estonia during perestroika (*horizontal contestation*)



A strong ethnic threat (a significant part of the Estonian population was non-Estonian) had a consolidating effect on the three, and conservative hardliner communists opposing both perestroika and independence were soon marginalized and lost their voice in politics. Furthermore, the Estonian politics of nationalism during perestroika had a distinct character where the notion of sovereignty/autonomy/independence was going along with increasingly clear and consistent economic orientation towards free market economy. After the independence, the adoption of parliamentary democracy concentrated the political power in the parliament (the Riigikogu) and exclusion of a significant non-Estonian population from voting list created an opportunity for a brand new group of policymakers to come to power.

3.1.1 Communist Party, Popular Front and Independent Groups in Estonia

Communist party of Estonian Soviet Socialist Republic (CP ESSR). The peculiar characteristic of the CP ESSR was that it was overrepresented by Russian immigrants with native Estonians occupying only the lowest ranks and thus having virtually no control of the political, economic and social life of Estonia (Misiunas and Taagepera 1993; Steen 1997). The existing literature attributes this peculiarity to two main reasons: (1) the Soviet policies of industrialization and colonization and (2) characteristics of the Estonian society (such as low birth rates, low level of political participation, directly or indirectly related to protestant ethics). It was made clear that the Baltic states were the most economically advanced and industrially developed when the Soviet Russia occupied them, which subjected them to a higher influx of heavy industry workers from all parts of the USSR. Estonia, being the most modern and having the lowest birth rates among the three, was hit severely by this immigration. The overall composition of population changed dramatically (Table 4). This demographic situation was also reflected in the CP ESSR leadership, where most of the highest-ranks were given to non-Estonians (mostly Russians) with Estonians occupying only the lowest ranks.

Table 4: Birth rates, immigration and percentage of native population in the Baltic states during the Soviet occupation

<i>Birth rates in the Baltic states, 1940-1980¹</i>					
	1940	1950	1960	1970	1980
Estonia	16.1	18.4	16.6	15.8	15
Latvia	19.3	17	16.7	14.5	14
Lithuania	23	23.6	22.5	17.6	15.1
USSR	31.2	26.7	24.9	17.4	18.3

<i>Immigration in the Baltic states, 1950-1980²</i>			
	1955-1959	1965-1969	1975-1979
Estonia	3.6	9	4.9
Latvia	7.9	14.2	9.1
Lithuania	-6	5.8	6.2

<i>Percentage of people belonging to the republican nationality</i>					
	1960	1965	1970	1975	1980
Estonia	74.1	70.9	68.2	65.7	64.5
Latvia	61.7	58.8	56.8	54.5	53.5
Lithuania	79.4	79.8	80.1	79.9	80.1

Source: Misiunas and Taagepera (1993)

Notes

- 1: Per year and per thousand population
- 2: Thousands, average for given period

Thus, the CP ESSR had (1) a clear ethnic divide and (2) was associated strongly with alien rule. In the light of this, driven both by the resentment with the political/economic situation as well as rational calculations, a number of native Estonian communists from lower ranks of CP ESSR attempted to push for improvement in the realm of economy. As a result, Estonia emerged as an ‘economic laboratory’ since as early as the 1970s and the 1980s, a unique case in the USSR (Mockunas 1993; Panagiotou 2001). Different reforms were aimed at increasing the efficiency of the economy of Estonian SSR within the framework of the Soviet Union. The major turning point during the perestroika in Estonia was the change in leadership of CP ESSR. In 1988, the then First Secretary of the CP ESSR, Siberian-born Karl Vaino known for his reluctance to learn Estonian, was replaced by the Soviet authorities (as a part of openness policy of perestroika) with a native Estonian, relatively liberal-minded Vaino Valjas⁵. He became the first native communist

⁵ During the 1970s and 1980s, Valjas was considered to have Estonian nationalist inclinations and was therefore

party leader of Estonia since 1940. Since then, the reformist stance became stronger and the CP ESSR began to push for the development of Estonia's autonomy within the USSR and regarded the attainment of sovereignty for the Estonian SSR as one of its main tasks. The native leadership gave a certain degree of legitimacy to the CP ESSR and expelled hardliner interests. In such way, the CP ESSR began to cooperate with the popular front.

Popular front of Estonia (Eestimaa Rahvarinne, or Rahvarinne). Founded by reformist communists of the CP ESSR, the Rahvarinne was the first popular front in the USSR. It was a continuation of previous mobilizations aimed at reforming the economy of the ESSR. Rahvarinne's predecessor was so-called Four Man Proposal, the first proposal for economic sovereignty among all Soviet republics, published in 1987 in the Tartu newspaper 'Edasi'. Edgar Savisaar (Head of the State Plan Committee of the Estonian SSR), Siim Kallas (specialist of finance), Miik Tiima (sociologist) and Tiit Made (TV political commentator) advocated the idea of 'self-managing Estonia' (Isemajandav Eesti, IME). The IME proposal put forth autonomy of the Estonian SSR over its budget, and its right to implement institutional reforms on the republican level (Miljan 1994). The proposal gained a widespread support from the society but was rejected by the CPSU authorities in Moscow. This compelled one of its authors, Savisaar, to create the popular front of Estonia in 1988 (announced on 13 April 1988). As in the other Baltic states, the Rahvarinne initially demanded sovereignty within the reformed USSR but soon became a very broad movement counting other reformist communists and Estonian intelligentsia among its members.

Independent groups. In the late-1980s, Estonia saw a rapid growth of independent grassroots movements whose number, organization and influence was not matched in any other Soviet republic at that time. The largest of them were two: the Estonian Heritage Society (EHS) and the Estonian National Independence Party (ENIP), the first political party in the Soviet Union apart of the Communist Party of the Soviet Union (CPSU). Bennich-Bjorkman (2003) traces what he calls Estonian 'counter-elite' to the Estonian 'second society' during the Soviet period. Bjorkman talks about Estonian society in which informal interpersonal connections were very

appointed as Soviet ambassador to Venezuela and Nicaragua in 1986. As the Estonian independence movement gained momentum in 1988, the relatively liberal Valjas was recalled from Nicaragua and was appointed by Gorbachev to this post (Misiunas and Taagepera 1993).

strong particularly among dissidents, students at Tartu university department of history and department of journalism. The author traces the existence of such a mobilization to the Interwar period (1920-1940) when social initiatives mixed with interpersonal collaboration were particularly important in the lives of Estonians. His argument about ‘alternative society’ is supported by Panagioutou (2001) findings. Panagioutou points out that the degree of perception of Russian dominance as alien was much greater than in Latvia and particularly Lithuania. The author uses reluctance to learn Russian and exclusion of Estonians from politics as examples of a clear division between ‘us’ and ‘them’ in Estonia throughout the Soviet period.

3.1.2 ‘Horizontal Contestation’

As can be seen from the descriptions above, hardliner communists opposing both perestroika and independence were soon marginalized and lost their voice in politics. Thus, all the three actors shared the opposition toward the existing Soviet regime. The differences emerged only in the contents of their demands. On the one side, reformists of CP ESSR with the First Secretary Valjas and Rahvarine members initially supported the idea of *autonomous Estonia within the reformed USSR* and then headed toward independence. Moreover, the agenda of economic reforms played an important role in their actions. On the other side, a joint alliance of independent groups (EHS and ENIP) continuously pushed towards *independence*. Legal continuity of the state and citizenship issue became the focal points of their agenda during perestroika. Both sides contested for political power through the use of institutions and support of society, thus I call their struggle *horizontal contestation* among three equally strong actors in two blocks.

The first Soviet direct legislative elections – elections to the new Soviet-imposed parliament, the Supreme Soviet of the Estonian SSR – were held on March 18, 1990. Altogether 392 candidates competed, and a total of 105 deputies were elected to the Soviet. The Rahvarine as well as the reformist communists won the majority of the seats. The anti-independence forces, representing mostly the Russian-speaking minority in Estonia and other communists both gained around 25 seats. During its first session, the new Supreme Soviet re-elected the former CP ESSR member Arnold Ruutel as its Chairman, who thus became the head of the state.

Parallel to the first block, the independent group alliance consisting of EHS and ENIP

created Estonian Congress (Eestia Kongres), an alternative, independent parliament. It was formed as a counterweight to the CP ESSR and Rahvarinne and the other Soviet-imposed institutions which were condemned illegitimate and thus inappropriate to represent interests of the Estonian nation. In March 1989, EHS and ENIP started the campaign to establish the Congress of Estonia, a national parliament that would function outside of illegally imposed Soviet institutions, would act in accordance with the Interwar law and thus had a legitimate right to represent the interests of the state (Estonia Institute 1994). The reason was that the Supreme Soviet was regarded as a creature of the Soviet system. Moreover, it was elected by Russian settlers and soldiers as well as Estonian citizens. The campaign started with a registration of citizens who had lived in Estonia before June 1940 and their descendants, living both in Estonia and abroad, to elect the Estonian Congress. In November 1989, a nationwide General Citizen's Committee was formed by local committees. By early 1990, the campaign had registered more than 600 000 (Misiunas and Taagepera 1993) Estonian citizens and nearly 30 000 applicants for citizenship. On 24 February 1990, over 90 percent of the registered citizens elected a 429-member Congress from over 1 100 candidates, some of whom lived abroad. Persons affiliated with no party got the most seats (109), the Rahvarinne (107), EHS (104), ENIP (70) and CP ESSR (39) supported candidates were also elected (Clemens 1991). This body met three times a year, in March, May and October. On 11-12 March, a 78-member council, the standing body of the Estonian Congress, was elected. The most strongly represented parties in the council were ENIP and EHS, whereas the Rahvarinne did not score high and top-ranking communists were not in its ranks. The Congress of Estonia claimed a legitimacy enjoyed by no other political body in Estonia. It established itself as a political body that had both moral and legal right to negotiate independence. It was uncompromising in its demand for immediate independence and expulsion of conservative- and pro-soviet-minded Russians.

3.1.3 'Extraordinary Politics' (1992-1994)

As elsewhere in the USSR, the official break-up of the Soviet union meant the end of independency/sovereignty/autonomy conflict. The most immediate issue was state-building. Countries had to adopt new constitutions, pass the necessary legislation. In addition, new political parties and forces formed to compete for the new order.

In Estonia, the compromise between the previously mentioned two blocks was reached by the establishment of the Constitutional Assembly, an ad hoc institution formed jointly to draft a new constitution. The ex-communists headed toward a stronger presidential institution, but they were unable to gather efficient support. The EHS and ENIP members associated with the Estonian Congress stated that it is a strong parliament with a merely ceremonial role of the president that is conducive to a stable democracy. Thus, the final decision was a constitution which established a *parliamentary democracy* and was ratified by referendum in June 1992. According to the new constitution, the political supremacy was given to a 101-member unicameral parliament (Riigikogu) elected in direct elections for a 4-year term. The Riigikogu was given an ultimate authority over legislation, all positional decisions (appointment of the government and the president) as well as state budget and treaties with foreign countries. The president cannot serve more than two consecutive 5-year terms and must be elected by a two-thirds majority in the parliament. However, as a response to demands from society, one-time exception was agreed for the first post-soviet parliamentary elections in 1992: in a simultaneous ballot, direct presidential elections shall be held, and the final choice made by the parliament. In addition to the 1992 constitution, *the law of citizenship* was passed. It defined citizens of Estonia as those who lived in Estonia in June 1940⁶ and their descendants 'regardless of their ethnic background' (The Riigikogu of the Republic of Estonia 2006)⁷. Thus, a great majority of non-Estonians (mostly Russian settlers and army officials) were excluded from participation in the national elections for few following years.

The first post-soviet parliamentary elections in Estonia held on September 20, 1992 resulted in victory of forces associated with independent groups and popular front during the perestroika period. These forces produced a *right-of-centre ruling coalition*, whereas parties consisting of reformist communists formed a *centre-left opposition*. The electoral victory was scored by three major parties: (1) the five-party National Alliance Pro Patria (Isaama, also known as Fatherland Alliance)⁸ led by a 32-year old historian Mart Laar and uniting members of

⁶ Date of the first mass deportations to Siberia organized by the occupational Soviet forces.

⁷ Others were given a two-year period of naturalization. required two years of residence (counting from March 30, 1990), and additional one-year waiting period, a modest level of competence in Estonian, and a bath of loyalty to constitution. In practice, very few non-Estonians residing within Estonia's post-1945 borders were descendants of persons living there in June 1940. In January 1995, the Riigikogu passed a new Citizenship law that raised the residency requirement to five years of residency requirement plus the one-year waiting period (but only for new immigrants), pulling Estonia closer to prevailing European norm on this issue (EIU Country Profile 1993).

⁸ Pro Patria (Isaama, Fatherland Alliance) member parties: Estonian Christian Democratic Party (Eesti Kristlik-

independent groups active in Estonian Congress during the independence struggle; (2) the above mentioned Estonian National Independence Party (ENIP) led by a political prisoner Lagle Parek; and (3) Moderates, a centrist alliance uniting the Social Democratic Party and centre-right agrarian Rural Centre Party. The Moderates were led by Marju Lauristin, a sociologist and co-founder of the popular front (Rahvarine). The opposition split into two groups: (a) the centre-left camp consisting of the Estonian Coalition Party (led by former First Secretary of the CP ESSR Tit Vahi and uniting former communist officials) and the social liberal Estonian Centre Party led by Savisaar, one of the most prominent reformist communists during perestroika); and (b) two protest groups – Estonian Citizen and Royalist Party.

In simultaneous presidential elections, four candidates were competing: an ex-communist Arnold Ruutel, an Estonian American political scientist Rein Taagepera⁹, a famous Estonian writer and filmmaker Lennart Meri¹⁰ and the only female candidate Lagle Parek, a former political prisoner who was also a leader of the ENIP. Taagepera himself admitted that he had little chances to win, and one of the main reasons why he ran was ‘to take away votes from Ruutel and help Meri to win the elections’ (Taagepera 1993). Thus, the elections resulted in a runoff in the Riigikogu by two top vote getters: Ruutel (41.8 percent of popular vote) and Meri (29.5 percent of the popular vote). The final choice, was made by the nationalist-dominated Riigikogu and was contrary to the popular choice: Meri instead of Ruutel was nominated the president. As the winner of Riigikogu elections, the Pro Patria leader Mart Laar was appointed

Demokraatlik Erakond, EKDE), Estonian Christian Democratic Union (Eesti Kristlik-Demokraatlik Liit, EKDL), Estonian Conservative People's Party (Eesti Konservatiivne Rahvaerakond, EKRE), Republicans' Coalition Party (Vabariiklaste Koonderakond, W), Estonian Liberal Democratic Party (Eesti Liberaaldemokraatlik Partei, ELDP) (The Riigikogu of the Republic of Estonia 2008).

⁹ *Rein Taagepera* (b. 1933) was an Estonian-American political scientist. He studied in Morocco (high school), Canada (physics), and United States (international relations), worked as political scientist at the University of California, Irvine. Taagepera was a member of the Constitutional Assembly in 1991 (Taagepera 1993).

¹⁰ *Lennart Meri* (1929-2006) was the son of the Estonian diplomat and translator. He studied in nine different schools and in four foreign languages (German, French, Russian and English) as the family spent many years in France in Germany. In 1941, after the Red Army occupied Estonia, his family was deported to Siberia and forced to work in labor camps. After the war, Meri family came back to Estonia. In 1953, Lennart Meri graduated cum laude from the Faculty of History and Languages in Tartu university. However, Soviet administration did not allow him to work as a historian and he found work as a writer, dramatist and a cinematographer. Along with that, he traveled in the USSR (Meri was never allowed to cross the USSR border) and made several expeditions to Eurasia. His encounters with the colonization of Siberian ethnic groups and inadequacy of Soviet central economic planning inspired much of his movies that gained international recognition (‘The Winds of the Milky Way’, silver medal in New York Film Festival) but were banned in the USSR. During his travels, he made extensive contacts and built networks with a number of cultural figures and intellectuals (Office of the President of the Republic of Estonia 2009, Liukkonen and Pesonen 2008).

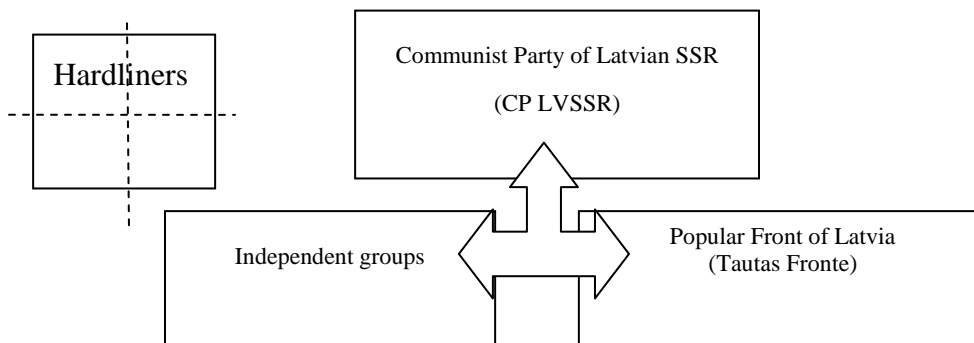
Prime Minister by President Meri. Under the guidance of Laar, the newly independent government broke the network of former communist officials and appointed new, young civil servants as departments' heads. Thus, the executive power has fallen into the hands of brand new policymakers.

To sum up, the political basis for economic reform was the Riigikogu (legislative power) and the government (executive power) dominated by a brand new political elites previously associated with independent nationalist groups during perestroika period. These elites represented only a part of societal interests and had a distant relation with a significant part of population: after the adoption of the citizenship law, non-Estonian (mostly Russian) government, army, communist party officials, soldiers and industrial managers were deprived of electoral rights. This type of political leadership can be called 'extraordinary politics' as defined in political science. Furthermore, the legacy of previous economic experiments under Soviet rule provided Estonia with approximate guidelines to start reform. Parliamentary democracy, nationalist rule and distant relations from society, added some economic know-how was the first set of factors that came to shape its economic transition pathway.

3.2 The Latvian Model

The Latvian political transition during perestroika was characterized by *triangular cooperation* between three forces – nationalist-minded wing of constituent communist party with its leader, popular front and independent movements – all working for a common goal, although in different ways (Figure 5).

Figure 5: Balance of powers in Latvia during perestroika (*triangular cooperation*)



The result was similar to that of the Estonian political transition: the conservative, pro-Soviet communists (hardliners) disappeared entirely from the post-soviet political arena, popular front split up and formed different parties which paved the way to dissidents and grassroots activists to come to power. As in Estonia, a significant part of population was deprived of the right to vote. Unlike in Estonia, however, the post-soviet leadership was rather fragmented, as the political leaders grouped themselves according to their contrasting interpretations of citizenship issue of non-Latvians.

3.2.1 Communist Party, Popular Front and Independent Groups in Latvia

Communist party of Latvian SSR (CP LVSSR) The CP LVSSR had the lowest percentage of native members in its ranks among the Baltic states and throughout USSR at that time (Steen 1997). Another distinguishing trait was an internal division of hardliners hostile to perestroika and opposition supporting Gorbachev’s reforms. The most prominent figure among the hardliners was Boris Pugo, the First Secretary of the CP LVSSR – he later fled to Moscow and became one of the participants of the coup in August 1991 in Moscow. The opposition, in contrast, gradually made increasing demands for the restoration of the Republic of Latvia. The opposition was represented by a popular communist Anatolijs Gorbunovs.

Popular front of Latvia (Tautas Fronte) Tautas Fronte was founded in October 9, 1988 by a non-communist journalist Ivars Godmanis. Around two-thirds of its members were also members of the communist party. As in the other Baltic states, it soon developed into a broad pro-independence movement.

Independent groups. In 1987, Latvia was the first Soviet republic to hold unprecedented public and anti-Soviet and anti-occupational demonstrations in Riga: the commemorative day of the 1941 deportations and the anniversary of the secret protocols of the Molotov-Ribbentrop pact. The main organizers of these so-called ‘calendar demonstrations’ were a group of human rights activists formed by dissidents, students and intelligentsia in July 1986 in Liepaja. Shortly after the ‘calendar demonstrations’, other grouping sprang up in Latvia (such as Environmental protection Club, Writer’s Union movement) that simultaneously began to make demands for Latvia’s sovereignty, and later-independence. Similar to Estonia, a nationalist movement, the Latvian National Independence Movement (LNIM) was formed and sought to register all who were citizens of the inter-war Latvia and their descendants. It created an alternative parliament (Citizen’s Congress), similar to the Estonian Congress.

3.2.2 ‘Triangular Contestation’

Like many soviet republics during perestroika, the CP LVSSR experienced the change in leadership which changed the balance of powers in Latvian political transition. In September 1988, the hardliner Pugo, First Secretary of the CP LVSSR was replaced by Vigris, a native Estonian. Since then, the communist party allied with the popular front and in July 1989, the CP LVSSR declared Latvian sovereignty and economic independence – the priority of domestic legislation over union legislation and the right of Latvia to ignore economic directives from Moscow. In March 1990 elections to the Supreme Soviet (as in the other two Baltic states later renamed Supreme Council), the Tautas Fronte members got a majority and a reform minded communist Gorbunovs became the Chairman (thus head of state) and Tautas Fronte leader Godmanis the Chairman of Council of Ministers (prime minister). On May 4, 1990, the Supreme Council declared its intention to restore the independence on 4 May 1990. In addition, law on elections was passed and the new constitution sketched out. The consensus was that the political system of Latvia is parliamentary democracy with a unicameral parliament (Saeima) with 100 members elected in general, equal, direct, secret and proportional elections for a four-year term was thus to elect the president as a ceremonial head of state for a term of four years (The Saeima of the Republic of Latvia 2002).

3.2.3 Mixed Leadership (1993-1995)

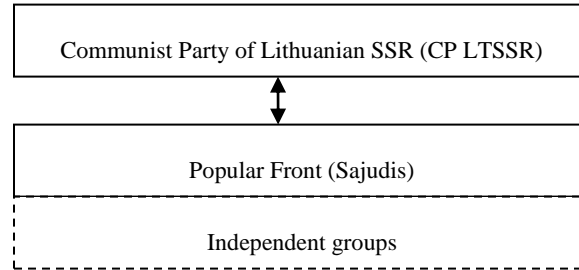
In contrast to Estonia, the ethnic issue has been the central factor shaping the post – soviet political formation in Latvia, with economic agenda being of secondary importance. The fact that Latvia had the largest percentage of non-natives in the Baltic states (Table 4) meant that the ethnic Latvians were underrepresented in many aspects of political, economic and social life and thus political parties that competed for the new parliament (the Saeima) placed the question of future citizenship of non-Latvians at the centre of their political agendas. Interpretations of the issue varied greatly, and based on these interpretations number of coalitions and mixed groupings have formed (Pabriks and Stokenberga 2006).

As an outcome of that, the first post-soviet democratic elections produced a mixed, coalition-based Saeima where coalitions grouped with each other based not on their economic programs, but on the interpretation of citizenship issue. The first run-off Latvian Way (right-of-centre coalition formed by successors of Tautas Fronte and headed by ex-communist Gorbunovs) lacked a governing majority and thus formed governing coalition with other moderate groupings - Christian Democrats and Peasants' Union (two-party coalition representing native Latvian peasants). On the other side, there have been LNIP (radical nationalist party led by a Latvia émigré from Germany Joahims Zigeris), For Fatherland and Freedom (alliance of formed of perestroika period independent nationalists and Tautas Fronte), and Harmony (left-of-centre coalition led by former foreign minister of transitional government Janis Jurkans).

3.3 The Lithuanian Model

Lithuania formed an exception between the three. In great contrast to Estonia and Latvia, the political transition in Lithuania (1985-1992) was marked by an overt *vertical confrontation* between the broad-based, amorphous popular front (Sajudis) that acted together with independent groups and the Communist party of Lithuanian SSR (CP LTSSR). The CP LTSSR was marked by a dual character: it included popular native communists who, being indeed loyal to Moscow on the one hand and being aware of nationalist movements in Lithuania due to their knowledge of native culture and language on the other, could manipulate their stance to gain support from masses when the system was changing (Figure 6).

Figure 6: Balance of powers in Lithuania during perestroika (*vertical confrontation*)



The point to be made here is that the absence of a strong ethnic threat (majority of population were native Lithuanians) did not have a consolidating effect as it was in the case of Estonia and Latvia, and intensive interplay of powers was marked by a continuous internal tug-of-war when one side was alternately dragged by another. The societal actor proved to be decisive in the post-soviet state-building: social costs of radical and poorly implemented economic restructuring policies implemented by Sajudis while Lithuania was still under the USSR rule provided ground for rising ex-communist strength; the exclusion of potentially pro-soviet electorate did not happen in Lithuania as it was the case in Estonia and Latvia. Thus, the post-soviet Lithuanian leadership resulted in the coming back of former communist nomenklatura. Moreover, the contesting powers produced a semi-presidential form of government with two pillars- the parliament (the Seimas) and the president.

3.3.1 Communist party, Popular Front and Independent Groups in Lithuania

Communist party of Lithuanian SSR (CP LTSSR). In great contrast to Estonia and Latvia, the communist party of Lithuania was overwhelmingly Lithuanian. The proportion of indigenous persons in the CP LTSSR was the highest among the Baltic states (Misiunas and Taagepera 1993; Steen 1997). The main reason, as many studies have showed, was that the native population was the largest, as the result of high birth rates typical to a catholic society. Thus, the influx of Russian settlers to society at large was smaller which resulted in a more homogenous ethnic situation. In the light of this, the CP LTSSR had two basic features that differentiated it from its Estonian and Latvian counterparts, namely: (1) the opposition to the communist party (although very strong among the Lithuanian population during the entire Soviet era) was weaker than in

Estonia and Latvia, and (2) the CP LTSSR was characterized by a dual character: it included popular native communists who, being indeed loyal to Moscow on the one hand and being aware of nationalist movements in Lithuania due to their knowledge of native culture and language on the other, could manipulate their stance to gain support from masses when the system was changing. This peculiarity of the CP LTSSR began to play an important role since 1988. As a part of leadership change implemented in the other two Baltic states and the rest of USSR, Lithuania experienced communist party leadership change. In 1988, Algirdas Brazauskas, previously the Chairman of the State Planning Committee was appointed by the USSR authorities the First secretary of the CP LTSSR. Since then, he became one of the major figures during political struggle. Contrary to Estonia and Latvia where ethnic cleavage within communist party was apparent due to long-term overrepresentation of non-natives, in Lithuania that was not the case. Thus, the underlying motive of Algirdas Brazauskas was control over republic rather than national goal at large. This goal, combined with his personal charisma, shaped the CP LTSSR stance during the perestroika.

Popular front of Lithuania (Sajudis). Unlike in Estonia and Latvia, the popular front of Lithuania (known as Sajudis) was dominated by non-communists, mostly artists, intelligentsia, dissidents, although counted a small number of reform-minded communists among its members. It was formed in October 1988 at the Academy of Sciences, and soon elected a music professor, pianist Vytautas Landsbergis as the Chairman of Sajudis Council. Since then, he became the leading figure during Lithuania's political transition towards independence. Moreover, in contrast with Estonian Rahvarinne, Sajudis did not have a clear strategy of economic reform on its agenda. Rather, its primary goal was the restoration of legal continuity of the Lithuanian republic, with economic reform being a secondary and loosely defined goal. In other words, the Sajudis was strong in appealing national sentiments of the society but weak in economic strategy and planning.

Independent groups. Similar to the other two Baltic states, the grassroots organizations were extensive in Lithuania and represented a wide range of environmental, cultural, historical and later – political interests. Unlike in Estonia and Latvia, however, they did not form a separate political force. The reasons, I submit, were two: (1) the absence of ethnic threat from Russian settlers which created Estonian Congress in Estonia and Citizen's Congress in Latvia did not have the consolidating effect in Lithuania, and (2) most of the grassroots groupings became part

of a broad-based Sajudis which itself was of non-communist nature.

3.3.2 'Vertical Confrontation'

Thus, the political transition to the perestroika in Lithuania was marked by an overt confrontation between the two powers: the broad Sajudis movement favoring the independence and complete restoration of market economy and CP LTSSR, opposing independence and ambiguous towards Gorbachev's reforms. On the surface, the CP LTSSR with a dual character collaborated with Sajudis. In substance, that was a vertical confrontation which led to the most rapid and radical regime change among the three Baltic republics on the other hand, and to unexpected post-soviet developments on the other.

Since its foundation in 1988, Sajudis gained a wide support from the population which compelled the CP LTSSR to take measures to maintain its authority over republic. The first step was the secession of CP LTSSR from the Communist Party of the Soviet Union (CPSU) in 1988. Thus, the Communist party of Lithuania became the first communist party in the Soviet union to become independent from Moscow. The move was praised by the international media as proving that 'Lithuanian communists are indeed nationalists', however, records of Brazauskas' speeches with Gorbachev (Clemens 1991) indicate that Brazauskas was clearly opposed to program of Sajudis demanding independence: he wanted to improve the relationship between the CP LTSSR and Soviet authorities in Moscow and thus gain a stronger hold over the country. In a number of interviews and local newspapers and television he criticized Sajudis demand for the withdrawal of the Soviet army from Lithuania, appearance of the national flag and called the claims of sovereignty 'irrational'. Moreover, the CP LTSSR was the only among the Baltic states not to pass declaration of sovereignty, as it was done in 1989 in Estonia and Latvia. The discourse and stance of the CP LTSSR changed only after it started to lose public trust as a result of growing power of the Sajudis.

Despite the change in CP LTSSR, the victory in the political transition was won by Sajudis in 1990: as in Latvia and Estonia, it won the majority of votes in the 1990 elections to the Supreme Soviet with Landsbergis as its Chairman (thus the head of the state). The steps taken by the Sajudis-led government were the most radical among the three Baltic states: (1) on March 11, the Supreme Council declared the restoration of Lithuanian independence, the first case in the USSR,

later (2) began the process of state-building, and (3) launched reforms for economic restructuring. (The Seimas of the Republic of Lithuania 1999).

After the independence declaration, the Sajudis evoked a strong opposition from the Soviet authorities: the independence was proclaimed unconstitutional by the highest legislature organs in Moscow, the USSR imposed economic blockade on Lithuania during April-June 1990, and on 13 January, 1991 began an open military aggression ('Bloody Sunday'). However, supported by the population, the Sajudis government continued the process of state-building. First, it decided to transfer its powers to Independent Envoy of the Republic of Lithuania in Washington with Lithuanian American Stasys Lozoraitis as its head. Moreover, Prime Minister (Prunskiene) was appointed and made contacts with the Western countries. In addition, the Sajudis started economic reforms to restructure the Soviet-type economy to a market-based one, such as introduction of interim currency (*talonas*, coupon), privatization of agriculture, re-establishment of the Central Bank. The important point to be made here is that all the reforms were administrated when Lithuania tied by energy, trade, monetary, fiscal and political dependency with the USSR. The disruption with the system has generated economic chaos, and Sajudis soon became to be blamed by communists for economic decline.

The rapid economic restructuring without a clear-cut plan and under dependence on USSR, combined with economic blockade caused resentment among population and Sajudis began to loose its support. While the society was unhappy with economic reforms, it did not gave up its support for independence. Thus, such situation paved the way for communist power: in 1990, the then independent communist party of Lithuania reformed itself into the Lithuanian Democratic Labor Party (LDLP) under the leadership of Brazauskas. At the same time, the Sajudis split, some of its members organized political parties, and its leader Landsbergis withdrew from politics.

3.3.3 New Kind of Hegemony (1992-1996)

As a result of these conflicting views, a mixed political system, sometimes referred to as 'semi-presidentialism' (Clark et al.1999) and different from those of Estonia and Latvia, was established. According to the new constitution, state power shall be executed by the Seimas

(legislative authority), the President of the Republic and the Government (executive power), and the Judiciary. The President has more powers than in Estonia or Latvia: he, according to the constitution, decides the basic issues of foreign policy and, together with the Government, conducts foreign policy; holds the right of legislative initiative at the Seimas and also the right to veto the laws passed by the Seimas; the president appoints and dismisses, upon the assent of the Seimas, the Prime Minister. He charges him to form the Government and approves its composition. In cases provided for by the Constitution, the President may dissolve the Seimas (the Seimas of the Republic of Lithuania 2009). Furthermore, in contrast to Estonia and Latvia, a mixed electoral system has been introduced. According to it, the unicameral national legislature (Seimas) comprises 141 deputies and is elected for a four-year term. Seventy seats in the Seimas are distributed on the basis of proportional representation. Each party receiving over 5% of the nationwide vote is allotted a number of seats proportional to its share of the party list vote (after adjusting for the percentage of votes cast for parties not achieving the 5% threshold). The remaining 71 seats are determined on the basis of majority voting in single mandate districts (a single mandate is elected in each of 71 districts). The individual receiving over 50% of the vote fills each seat. If no candidate receives a majority, the winner is determined in a second round pitting the top two vote getters against each other. This system, according to Ramonaite (2006) was and continues to be favorable to the largest parties.

The first post-soviet parliamentary elections in Lithuania held in October 1992 resulted in a hierarchical power structure consisting of the leftist, well-organized and tightly interconnected ruling majority of the ex-communists (LDLP, the reformed CP LTSSR party headed by Brazauskas and Lithuanian Social Democratic Party) and a rather weak, fragmented and marginalized nationalist opposition (Sajudis/Homeland Union and Lithuanian Christian Democratic Party). Similar to the parliamentary election results, the presidential election also resulted in the victory of the ex-communist Brazauskas, previously the First Secretary of the CP LTSSR. Thus, Lithuania became the first among post-Soviet countries and the only one Baltic state to re-elect its former communists.

The main reason for this was mostly down to societal factors and power balances between the two blocks in preceding period of regime change. As it was mentioned in the previous section, Sajudis government during perestroika period has started to implement a radical economic reform the social costs of which became unexpectedly high. These became the

dominant motives of the ex-communist discourse - by the 1992 elections, The LDLP campaigned itself as a party of experienced, competent administrators, and, most importantly, flaunted itself as a party of 'national unity' which does not distance the primary goals raised during the path to independence, such as the transition to a market economy and reintegration with Europe. It appealed mostly to the rural population, pensioners and old Soviet industrial elites who were hit most severely by the reforms. Moreover, it was the organizational and political weakness of nationalists themselves that paved the way for the ex-communists. After the defeat in the parliamentary elections, Landsbergis withdrew from politics. As the presidential election approached, two candidates started their campaign: an émigré Stasys Lozoraitis, Lithuania's ambassador to the USA and a member of Lithuanian government in exile. Although nominated by Landsbergis and backed up by the Christian Church and some right-wing parties, he competed with Brazauskas as an independent candidate. Lozoraitis clearly stated that his Western credentials are superior to Brazauskas' communist past, whereas Brazauskas proudly depicted himself as not lacking the nationalist credentials either. The main arguments have been the secession from CPSU in 1989 and support for Sajudis. Brazauskas support was particularly strong among peasants, pensioners, and the country's ethnic minorities (mostly Poles and Russians). His rival Lozoraitis received a strong support mainly from urban population, intelligentsia and the younger generation (Clark 1995; Ramonaite 2006).

To summarize, the vertical confrontation between the CP LTSSR on the one hand and Sajudis/independent groups on the other during perestroika in Lithuania resulted in a mixed political system with two pillars of political power – the parliament (the Seimas) and the president; a mixed electoral system was favorable to large parties; contrary to Estonia and Latvia where citizenship law allowed brand new policymakers to come to power, Lithuania due to social and political reasons has experienced the transformation of its former communists representing popular interests; the power relations in the first post-soviet Lithuanian state were characterized by a hierarchical relationship between majority leftist ex-communist ruling elites and marginalized nationalists.

Contrary to generalizations of the existing accounts of the Baltic development that typically attribute regime change during perestroika (1985-1991) and post-soviet orientations in the three states to a single model, I have demonstrated that due to demographic, cultural and social factors

there have been *three* models of regime change (politics of nationalism) in the Baltic states, namely: *horizontal contestation* (Estonia), *triangular cooperation* (Latvia), and *vertical confrontation* (Lithuania). Horizontal contestation between the equally strong constituent reformist communists, popular front and independent groups combined with ethnic threat in Estonia produced a parliamentary system with rather distant relations to society. In contrast to Estonia, vertical confrontation between double-faced communist party and amorphous popular front in Lithuania gave birth to a semi-presidential political system and has paved the way for the transformed Soviet-era communists to come to power. Moreover, the absence of ethnic threat in Lithuania resulted in much closer state-society relationships than in Estonia. Latvia, where the political regime change during perestroika was characterized by triangular cooperation, was a case in between the two: on the one hand, nationalists took power after independence and acted autonomously from society. On the other hand, in contrast to Estonia, the ethnic issue has been the central factor shaping the post – soviet political formation in Latvia, with economic agenda being of secondary importance.



IV. Three Models of Political Economy of Transition in the Baltic States (1992-1996)

Although some economic reforms have been introduced even before the independence, it was only the first post-soviet elections that economic transition programs started in each country. During the first years of independence, the Baltic states were still a part of collapsing Soviet economy: they were connected by fiscal and trade links with the former Soviet countries, had a huge share of all-union industrial enterprises and disrupted links to the world economy and were experiencing an unprecedented economic decline. Generally, the Baltic states implemented the same ‘package’ of measures common to all the post-communist countries. The essential precondition for the economic transition was *macroeconomic stabilization* carried out using monetary and fiscal policies to stabilize inflation and create conditions for future economic growth. Simultaneously with monetary stabilization, *liberalization* of prices and foreign/domestic trade (abandonment of fixed price regime, reduction of subsidies, introduction of tariffs etc) was implemented. In addition, *structural reforms* such as privatization (to create a private sector) and banking sector and financial system reforms (to create a two-tier banking system and ensure financing for state budget) had to be introduced.

The orientations and goals have been the same, but strategies chosen and their long-term economic outcomes differed. This chapter illustrates that these divergences in the Baltic states were due to differences in institutional settings and ideologies of policymakers during this period. Contrary to the dominant nationalist explanation that attributes the Baltic states to a unitary model of political economy, I demonstrate that there have been three models of political economy of transition that have shaped the emergence of the North-South gap in subsequent periods.

4.1 ‘Economic Nationalism’ and the ‘Shock Therapy’ in Estonia

In Estonia, the dominant force during this period was a cohesive group of young enthusiasts previously associated with independent nationalist groups during perestroika period (Pro Patria Union led by Laar, ENIP and EHS), and now having majority in the Riigikogu (legislative power)

and the government (executive power). They were autonomous from popular interests: the citizenship law excluded a significant part of industrial elites, Russian settlers, Soviet army officials out of the electoral list.

I argue that the group of post-soviet Estonian policymakers that implemented ‘shock therapy’ rested on a certain kind of rationale which reflected what Abdelal (2001) called ‘economic nationalism’. To him, economic nationalism contains an imagined, constructed symbol of a nation, a group sharing that symbol and group identity defined by orientation towards an ‘imagined community’ and against the ‘other’. This vision, in turn, is closely connected to concrete economic goals. In the case of Estonia, the political elites that formed the base for economic reforms were, as mentioned above, mostly a group of people previously associated with independent groups and having a definite goal of independence and break-up with the Soviet system. These were well-educated, well-organized young nationalists, cemented during the Soviet era through various common informal activities and political transition during perestroika. The group shared the same notion of Estonia as part of the West/Europe, an imagined community it once belonged to and was deprived of by illegal Soviet occupation and as an opposite to the USSR/Russia (Laar 2006, 2007). When the independence was officially recognized and the victory in the state apparatus won, this identity translated into a clear economic orientation – a free, private-enterprise-based market economy with trade ties with Western countries as an opposition to command, state-ownership-based, self-managing Soviet economy. Thus, the common goal was not political domination over the state, but rather an idealized one. This kind of politics of identity, combined with enthusiasm of young people, maintained by internal cooperative spirit and made possible by institutional autonomy was, I argue, the crucial in ‘shock therapy’ (Kolodko 2000, Kontorovich 2001) transition policies during this period. A package of simultaneous reforms - introduction of tight monetary and fiscal policies, successful reorganization of the collapsing banking system, centralized and transparent privatization program and rapid implementation of the rule of law - were the pillars of Estonia’s success during that period that set the pace for further development.

The first step of the newly elected nationalist parties was signing of coalition plan between the Riigikogu and the government which became crucial in enacting the economic reforms. To ensure consensus in the face of opposition which was not willing to cooperate and favored a gradualist approach to economic transition, the Prime Minister Laar initiated a firm

and stable support of actions to be created in the Riigikogu. The document assigned cabinet seats among ruling nationalist parties in the government, presented a comprehensive government action plan and obliged all the members to vote in favor of economic reforms. The central objectives of the government action plan were reduced state intervention, opening up to market forces and encouragement of business-friendly environment. These policies were implemented through internal decisiveness and cooperation with Central Bank (led by ex-reformist Siim Kallas, previously associated with the IME proposal) and society.

The nationalist-dominated state immediately authorized the Central Bank to slow down the money supply, which resulted in high interest rates and significantly reduced inflation. When banking crisis occurred in Estonia as a result of the collapsing Soviet system, the Riigikogu passed the law which applied a tough approach – it established rigid reporting procedures, regulations which created a highly competitive environment; many ineffective banks were caused to close, and only the strongest survived (Knobl 2002). As a result, foreign banks soon opened their branches in Estonia, and Estonian banks began to expand their operations abroad. Moreover, this rationalization of banking system soon dismantled a collapsing Soviet-style banking system and created a two-tier system with a clear distinction between the Central Bank occupying the first tier and commercial banks on the second. In addition to monetary policy, Estonia applied a very tight fiscal policy where the public spending (social benefits, wages, pensions etc), typically high during the Soviet era, were reduced considerably. This policy was accompanied by the introduction of a clear taxation system. In 1994, Estonia was the first in Europe to introduce a flat-tax rate personal income tax. The simplicity of taxation increased popular trust in the system and guaranteed stable tax collection. These two measures – reduced state spending and new taxation system – balanced the budget and generated new revenue. As for privatization program, it was modeled under the so-called German Treuhand model, where authority to monitor, authorize and implement both large- and small-scale privatization of previously state-owned enterprises was given to one institution. In Estonia, it was the Estonian Privatization Agency (Eesti Erasmus, or EPA) which was subordinated to the Ministry of Finance and funded by the state budget. The unique feature of the privatization process in Estonia was the opened to foreign capital – a significant part of large Soviet-style enterprises were sold to foreign owners, with locals sharing a part of stocks. Moreover, the now foreign-owned firms were given a three-year tax holiday. In a long-term, the openness to foreign capital

helped to reconstruct old-style factories and enterprises, brought a new technological and managerial know-how.

As in the case of other post-communist countries, the ‘extraordinary politics’ in Estonia did not last long. The rule of Laar government and nationalist-dominated Riigikogu ended in the end of 1994, when Laar was forced to leave the post by the vote of no confidence. The main reasons were internal split, lack of experience, but most importantly – dissatisfaction of the population (mainly peasants, pensioners and ethnic minorities) with the social costs of the reforms, such as lifting of social benefits and decrease in agriculture due to privatization process. However, the foundations for private sector, entrepreneurial activities, environment conducive to both domestic and foreign business as well as stabilized budget led by the first post-soviet policymakers had a long-lasting influence on Estonia’s development.

4.2 Mixed Leadership and Fragmented Transition in Latvia

Although perestroika-period independent nationalists and those associated with Tautas Fronte were given way in Latvia, the post-soviet leadership here was much more fragmented than that of Estonia. Coalitions here grouped with each other based not on their economic programs, but on the interpretation of citizenship issue, a fact that made the development of a united economic transition strategy impossible. The ruling coalition in the Saeima was composed of right-of-centre Latvian Way (headed by Gorbunovs), Christian Democrats and left-of-centre Peasants’ Union. The government, in turn, was formed by Latvian Way and LNIP, two coalitions that had conflicting views on citizenship. Due to this fragmentation, the successors of independent nationalists and Tautas Fronte failed to reach consensus as was in the case of Estonia where government action plan provided a basis for a coherent decision-making.

Thus, the overall strategy of economic reforms during the initial period of transition in Latvia was not as coherent, decisive and single-minded as in Estonia. The generally tight fiscal policy here was sometimes interrupted by a rather high spending (such as wages, social benefits) when government yielded to popular demands, and an increased taxation was introduced to compensate that, a move that was not as conducive to the formation of competitive business environment as was in the case of flat-tax personal income rate in Estonia. Moreover, agriculture was given a high priority on the decision-making and the aim to assure the self-sufficiency of

agriculture (dominated by native Latvians) led to certain protectionist policies, such as import restrictions which in turn slowed-down trade reorientation from FSU to Western Europe.

On the other hand, however, significant achievements of Latvian transition have been tight monetary policy which was made possible by autonomy of the Central Bank (led by Einars Repse) from the state and various interest groups. Control of monetary supply resulted in high interest rates, which strengthened national currency and contributed greatly to fighting down high levels of inflation. In addition, the Central Bank imposed limited lending rules to commercial banks, a move that created competitive banking environment in which, similar to Estonia, weak and inefficient banks were forced to close and only the strongest survived. In a long term, it resulted in a strong banking system and made Latvia known as financial centre in the Baltics. The privatization program here was patterned under Estonian model where responsibility was given to a single autonomous institution. The State Property Fund was established in Latvia and government was open to foreign investment, although not to such high extent as in Estonia. This privatization strategy, combined with high interest rates, created a competitive environment and was thus conducive to a rapid modernization - the newly privatized enterprises were forced to choose between restructuring of their managerial and technological base in accordance to capitalist principles, or to go bankrupt. Moreover, privatization that accelerated during this period has significantly cut off unemployment by creating workplaces and contributed to increase of living standards of society at large.

4.3 New Kind of Hegemony and Ambiguous Transition in Lithuania

In sharp contrast to the two, the political power in the post-soviet Lithuanian state was divided between the ex-communist president Brazauskas and the Seimas (legislative power) characterized by a hierarchical relationship between majority of leftist ex-communists (the LDLP and Lithuanian Social Democratic Party) and marginalized nationalists (Sajudis/Homeland Union and Lithuanian Christian Democrats). The ex-communists were elected by the majority of population on the platform of the same orientations previously set forth by the nationalist-minded Sajudis during regime change – a free market economy and democracy – but not at the expense of decreasing living standards. Thus, the ruling majority rested mainly on the support of those hit most severely by the Sajudis reforms during 1990-1992, namely, the old Soviet era

industrial elites, pensioners, and rural population.

International observers and scientists have often portrayed the bipolar party system in Lithuania consisting of one large, powerful party and opposition in positive light and contrasted it with ‘undemocratic’ political leadership of Estonia and Latvia (Clark 1995). In the view of many, Lithuania had the most stable political scene among the Baltic states. Indeed, the post-soviet Lithuanian state during that period resembled a typical democratic two party system and was stable (Clark et al 1999). Yet it was not conducive to a successful economic transition, however. The underlying reason was ideological nature of the Lithuanian ex-communists. Contrary to widely accepted belief that Lithuanian communists collaborated with nationalist during the period of regimes change and thus were ‘patriotic’/’nationalist’, I contend that the post-soviet leadership here was rather an expression of a new kind of hegemony of the old communist bureaucratic apparatus, with control over power rather than long-term state benefits as the primary goal. The LDLP, Lithuanian Social Democratic Party and President Brazauskas were successors of the CP LTSSR which, in the light of perestroika, started to lose its political and economic power. The failure of nationalist-led Sajudis provided an opportunity to reconstruct and compete as a new force.

The basis for this group was a tightly-knit network of hierarchical connections that have developed during the Soviet period. For a long time, the organization of the communist party rested on so-called *nomenklatura system* in which people were appointed to high and medium positions based on the list of qualified persons. In such a system, the bureaucrats were subjected to rules, punishments and awards as well as various benefits (Antanaitis 2008). This nomenklatura-style network, with a goal of maximizing internal benefits, continued into the post-soviet period. As a result, almost all significant posts in state apparatus were filled by members of this group, often regardless of competence and professional commitment. Added to this, there has been eagerness to maintain support from the electorate – pensioners, rural population, ethnic minorities, and industrial elites. Moreover, the nationalist opposition was rather weak: Sajudis/Homeland and Christian Democrats have distinguished themselves by their anti-communist and anti-Russian rhetoric, however, its economic policies have been loosely defined (Ramonaite 2006).

These three factors – corporate nomenklatura culture, its dependency on societal needs and absence of strong alternative to ex-communists – have shaped Lithuanian economic

transition which was far less effective, more corrupt and slow pace of than in Estonia or Latvia. The 'gradualist' (Kolodko 2000) strategy in Lithuania became to be marked by a relatively loose monetary policy, lack of fiscal discipline, high levels of state control and complicated privatization process which resulted in slowest speed of recovery, lowest living standards, larger portion of soviet legacy and lower competitiveness among the Baltic states (World Bank Country Study 1998).

In contrast to the rational and decisive Estonian state's attitude toward economic restructuring, Lithuanian leadership was very ambiguous. On the one hand, the state wanted to maintain the electoral support. On the other, it promised to continue the free market reforms. Given the situation, these two goals were irreconcilable and thus the transition process was marked by many conflicting policies.

Lithuania's monetary policy was subjected to government intervention: the Central Bank was highly dependent on the state which pushed for an increased money supply to cover rapidly decreasing living standards, a policy that resulted in low interest rates and weak currency. Under such conditions, high levels of inflation were maintained for a long time. To even greater extent than Latvia, Lithuanian state yielded to popular demands and kept high levels of public spending, such as agricultural credits, various types of subsidies, funding for the remained soviet-style enterprises; this lack of fiscal discipline, combined with an absence of a clear taxation system and poor tax collection ran the state budget into deficit, and Lithuania had to take loans from international organizations. During the banking crisis, the banking sector in Lithuania remained under excessive political influence and control (EIU Country Report 1995) . Contrary to the tough Estonian and Latvian policies imposed on a number of ineffective banks, the government here continued to finance them, since most of the managerial staff belonged to the *nomenklatura* network. Moreover, the privatization program followed the same logic: unlike in Estonia or Latvia where outsider privatization was preferred, Lithuania lacked a central governing institution and applied the so-called manager- and employer buyouts (MEBOs) where the existing large-scale soviet style enterprises were sold for vouchers (redeemable government coupons) to their previous managers and employers. In such way, the old-fashioned managerial, entrepreneurial and technical skills continued for a long and, most importantly, a certain class of ex-nomenklatura managers formed along with this privatization. Furthermore, while Lithuania has reoriented its trade towards Western Europe, it remained the Baltic republic most closely linked

to other post-Soviet countries. As a consequence, the Lithuanian economy has also been hit most severely by the Russian crisis in 1998 (OECD Report 2000). The first government lasted until 1996, but the former Soviet nomenklatura rule continued until 2000 (Antanaitis 2008), as the electoral law was favorable to larger parties.



V. Conclusions

The Baltic states started their transition towards a market economy at approximately the same time and shared a lot of similarities from the outset. In the light of this, the goal and orientation of the three have been the same – liberal democracy, free market economy and integration into Western economic and political world through transnational organizations (EU and NATO). Yet despite these similarities that the Baltic states have shared at the beginning, they have achieved varying degrees of success (the North-South gap). Within a decade, Estonia has established itself as having the highest living standards, budget surplus and revenues from foreign direct investment as well as being the most technologically advanced among the three. Moreover, according to some international rankings, Estonia belongs to one of the most rapid and successful performers worldwide, a fact that compelled some to refer to its development as an ‘economic transition miracle’. In contrast to their northern Baltic neighbor, Latvia’s performance was more modest, with Lithuania lagging behind the two almost invariably of indicator taken. *Why did the Baltic states that have shared substantial similarities at the outset achieve varying degrees of success? What generalizations can be drawn from examples of the Baltic states?* These have been the central questions of this thesis.

5.1 Institutional Settings, Ideologies and Contingency

Competing explanatory frameworks attempted to account why the Baltic states diverged a great deal despite the similar initial conditions. These explanations can be grouped around two main perspectives, namely: (1) *economic*, and (2) *cultural*. Contrary to these, I have put forth an alternative, *political economy* explanation. I looked at the relationship between state-building and economic transition during the initial period of the post-soviet economic transition (1992-1996) and argued through comparative analysis that institutional settings and ideological differences between Estonia, Latvia and Lithuania were discernable. In Estonia, parliamentary system and exclusion of a significant part of population from electoral rights brought to the stage a brand new group of policymakers that enjoyed a great level of autonomy from society. Fueled by politics of identity, they have implemented decisive, radical and rapid market-oriented transitional policies during 1992-1994. In Latvia, a strong ethnic threat produced highly

fragmented political leadership during 1993-1995 that adopted mixed economic transition policies, more moderate than these of Estonia. Lithuania was an exception among the three. Here, failure of the perestroika-period nationalists to maintain public support brought to power ex-communist president and parliamentary majority which, resting on the Soviet-style nomenklatura networks and having control over state rather than successful transition as their primary goal, were more ambiguous toward market reforms. As a result, Lithuania's transition during 1992-1994 was the slowest and least consensual in the Baltic states.

Moreover, one may also notice that a great role was played here by contingency. A number of factors combined together and created unpredictable situations, with unintended consequences. Similar to Estonia, the rationale of Sajudis in Lithuania has rested on 'economic nationalism'. During 1990-1992, it implemented radical economic restructuring policies that share much in common with those of Estonia adopted only two years later, during 1992-1994. Moreover, the both groups had a very limited knowledge on economy: for Sajudis head Landsbergis, it was a generalized image of the Lithuanian Interwar Republic and idealized Scandinavia, for Laar in Estonia – book of Milton Friedman and fascination with German reforms. Yet the destinies have been radically different: in Lithuania, the reforms were premature as the country was still under the USSR control; nationalists stood alone. In Estonia, the nationalists experienced the same defeat and for the same reasons, but only after the radical policies started working. The LNIP in Latvia had similar goals as the Estonian ENIP and EHS, yet no one has expected that the issue of citizenship will become a major dividing line for the new policymakers and will make the necessary political consensus on decision-making impossible. All in all, the process of restructuring itself was very dynamic, rapid and thus fragile.

Furthermore, I have argued that these differences were decisive to the emergence of the North-South gap as they set the pace for subsequent periods and had long-term economic outcomes. Thus, findings of this thesis contrast greatly to the accounts of nationalist explanation of post-soviet development where the Baltic states are seen as belonging to a unitary model of regime change and political-economic restructuring. I have demonstrated that what is taken as Baltic model of transition is actually Estonian model.

5.2 State-Building and Baltic Development

Different disciplines have raised question on what are the underlying reasons of success or

failure of development, and the answers depended on cases chosen. Generally speaking, there have been several significant explanations. In the 1950s, a modernization theory emphasizing worldwide social, political, individual and economic change, inextricably linked with the U.S. post-war politics began to appear in the writings of American social scientists. They believed that economic advancement and modernization of so-called Third World comes out from extensive inflow of ideas, capital and human resources from the West through communications, media, and migration. In the 1970s, a new wave of literature produced by the Latin American thinkers shifted attention to negative causes of participation in global capitalist development. It was argued that economic dependence on trade, aid and investment results in slow economic growth and unequal income distribution. Political dependence on foreign states and foreign firms, in their view, results in dependency of the state on external forces or capitalist elites. The experience of East Asia (Japan, South Korea and Taiwan) violated the predictions of dependency theory and helped to formulate theories of 'developmental state' and 'embedded autonomy'. It concluded that external economic involvement may produce internal growth and the state is able to serve the internal needs.

The developments after the break-up of the USSR in the early-1990s have been unprecedented and thus provided a battleground for the existing theories of development. There has been a widespread assumption that former authoritarian regimes and centrally-planned economies will be invariably replaced by democratic forms of government and free market economies. However, as cross-country studies soon revealed, that was not the outcome. The post-soviet countries soon diverged a great deal in terms of political systems (from democratic to authoritarian) and economic orientations. The Baltic states soon emerged as a specific category within the former soviet countries: the only ones that unambiguously chose liberal democracy and capitalist market economy as their ultimate goal.

My detailed analysis of the initial period of transition in Estonia, Latvia and Lithuania (1992-1996) points to the importance of the state, namely, dynamics of state-building, bureaucratic apparatus, decision-making in the process of economic transition. Further analysis needs to be done to test the relation between these variables in subsequent periods and comparisons with East Asian cases might give new impetus and insights to state-centered theories of development.

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Appendix

Map of the Baltic states



Source: http://2005.travel-service.ee/img_wys/baltic%20map%201.GIF