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The Effects of Transformation of the Baltic Economies in the Process of European Integration

Abstract. Introduction. *The foreign market with the European Union opens up various prospects for the development of the Baltic countries' economies, considering the obvious lower prices in the West. In any case, it is functional and achieves well-developed infrastructure for transport and other industrial, rural, and service areas that were lost during economic downturns.*

Purpose. *The purpose of this article is to analyze the effects of transformation of the economies of the Baltic countries in the process of European integration.*

Results. *At the beginning of the post-Soviet development period, the Baltic countries began carrying out reforms and joining Euro-Atlantic structures as soon as possible, starting with the EU and NATO. Otherwise, the implementation of reforms would have a minimal negative impact. The analysis demonstrated that the Baltic countries' early EU membership was marked by hostile economic growth after the 2008–2009 global financial crisis. The pace of economic development in the Baltic countries slowed down noticeably.*

Conclusions. *Thus, the country's prospects for EU membership and accession to the European monetary system can be viewed positively. Their economies demonstrated significant success, particularly in the early years after joining the EU. It is important to note, however, that this success has a turning point. In Sweden, for example, a significant increase in GDP was due to foreign investment and financial assistance from various EU funds.*

Keywords*: Baltic countries; Lithuania; Latvia; Estonia; European Union; European integration; economic transformation.*

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Ефекти трансформації економік країн Балтії у процесі євроінтеграції

Анотація. *Після розпаду СРСР розвиток країн Балтії відбувався за подібними траєкторіями з високими та досить стійкими темпами. Загальний ринок з Європейським союзом відкрив різнобічні перспективи для розвитку економік країн Балтії, враховуючи факт наявності нижчої, ніж на Заході, оплати праці, але при цьому функціонуючої і досить добре розвиненої інфраструктури транспорту, окремих галузей промисловості, сільського господарства та сфери послуг, що залишилися у спадок від радянських часів. Метою статті є аналіз ефектів трансформації економік країн Балтії у процесі євроінтеграції. Визначено, що на початку пострадянського розвитку кожна з країн Балтії прагнула якнайшвидше провести реформи та вступити до євроатлантичних структур, насамперед до ЄС та НАТО, але проведення реформ мало й негативні наслідки: приватизація призвела до домінування іноземного капіталу, структурні реформи призвели до деіндустріалізації, «бульбашок» на кредитних ринках, зростання зовнішньої заборгованості, трудової міграції, «відпливу мізків», депопуляції тощо. Проведений аналіз продемонстрував, що якщо перші роки членства прибалтійських країн у ЄС ознаменувалися вражаючим економічним зростанням, то після світової фінансової кризи 2008–2009 років. темпи економічного розвитку у країнах Балтії помітно сповільнилися. Естонія, Латвія та Литва постраждали сильніше за всі північноєвропейські країни. Зроблено висновок, що роки членства країн Білтії в ЄС та приєднання до європейської валютної системи, можна оцінити загалом позитивно. Їхні економіки продемонстрували значні економічні успіхи, особливо в перші роки після входження до ЄС. У той же час важливо відзначити, що досягнутий успіх мав зворотний бік: швидке зростання ВВП значною мірою складалося внаслідок надходження іноземних інвестицій та фінансової допомоги від різних фондів ЄС. Частина цього фінансування була витрачена на споживання, а ПІІ переважно спрямовувалися у фінансову сферу та торгівлю, реальний сектор помітного розвитку не отримав. Естонія, Латвія та Литва і дотепер не змогли зміцнитись на високотехнологічних ринках.*

Ключові слова: *країни Балтії; Литва; Латвія; Естонія; Європейський Союз; європейська інтеграція; транформация економіки.*

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Formulation of the problem. After the collapse of the USSR, the Baltic countries experienced similar trajectories of development with high and fairly stable rates.

In 1991, the European Union established diplomatic relations with the Baltic countries. At the same time, the EU decided to provide economic assistance and support economic reforms in these countries. Since 1991, for

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example, the Nordic countries have implemented a program to support small and medium-sized businesses in the Baltic States: the Baltic Investment Program (BIP). Finland, Sweden, Norway, and Denmark entered the Baltic market primarily through banking services. Branches of the largest Nordic banks, such as Hansabank, Danske Bank, and SEB, were established, as were retail chains like RIMI. Germany also played an active role in developing the new market through the DBN Nord banking network and investments in construction and road infrastructure. Thus, by 2000, the volume of direct foreign investment in the Baltic countries' economies amounted to about seven billion U.S. dollars. Since 1992, the PHARE program has extended to these countries, preparing their institutions for accession to the European Union by restructuring their economies and aligning their legal norms with EU standards. On June 12, 1995, the European Union signed three association agreements with the Baltic States. A free trade regime was established with unimpeded movement of labor and capital. Consequently, there was an outflow of labor from the Baltics to Western European countries, primarily Great Britain and Ireland, which offered the most favorable payment terms.

Nevertheless, the common market with the European Union has opened up diverse prospects for developing the economies of the Baltic countries. Wages are lower than in the West, but they have a functioning and fairly well-developed transport infrastructure, including a developed network of roads and railways. They also have individual industries, such as radio electronics and machine tool building, as well as agriculture and services, which are legacies of the Soviet era.

Analysis of recent research and publications. The Many studies on this issue have appeared to date. For example, A. Åslund analyzes the phenomenon of the Baltic Tigers; Dandashly A., Verdun A., and R. M. Wrobel study the problems of the Baltic countries in connection with joining the Eurozone; Falkowski K., G. Startienė, and R. Remeikienė focus on the specific competitive advantages of the Baltic countries.

However, the multidirectional effects of reforming the Baltic economies in the context of European integration require further research.

Formulation of research goals. The aim of the study is to analyze the effects of the transformation of the Baltic economies in the process of European integration.

Presentation of the main research material. The transition to a market economy in the 1990s was jarring, but the global financial crisis of 2008–2009 was an even greater blow. However, the Baltic economies recovered quickly and continued to grow. Per capita GDP in the Baltic countries has almost tripled during the post-Soviet years (Fig. 1).

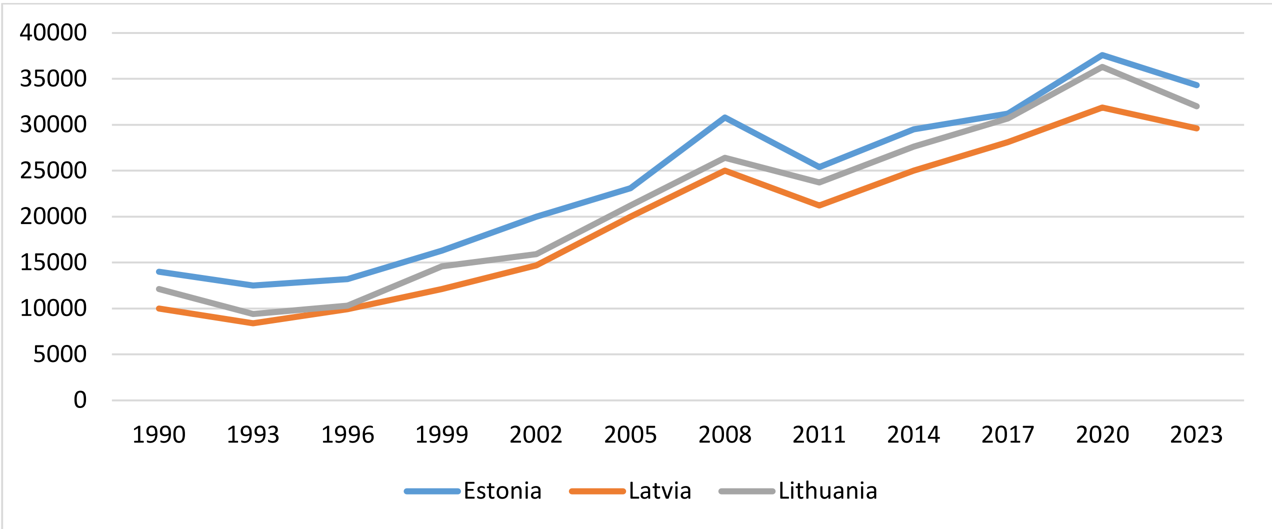

Figure 1 – **Dynamics of per capita GDP of the Baltic countries in PPP in 1990–2023 (2017 prices), US dollars**

Source: [6, 11]

Initially, the post-Soviet development of all three countries proceeded in a similar way. Each sought to implement reforms swiftly and join Euro-Atlantic structures, primarily the EU and NATO. The EU encouraged the "regatta principle": negotiations with European structures were conducted with each country in accordance with the results of its completed "homework." Estonia, the most economically successful country, was the first to be invited to join the EU in 1997, followed by Latvia and Lithuania in 1999. Lithuania reformed its defense sector faster and began negotiations with NATO earlier than the other countries. Regardless of how the Baltic countries competed, they all joined the EU and NATO together in 2004.

The implementation of reforms also had negative consequences. For instance, privatization resulted in the dominance of foreign capital. In Estonia, foreigners held 80-90% of the capital in large enterprises and banks. In

Lithuania, they held an average of about a third, and up to 70% in the financial sector. Currently, the situation has changed slightly in favor of domestic investors, though not significantly. Structural reforms in the Baltic countries were not entirely successful either. They led to deindustrialization, bubbles in the credit markets, growth of foreign debt, labor migration, brain drain, and depopulation. The Baltic countries were greatly affected by the global financial crisis, largely due to their inflated financial sectors: in 2008, they accounted for at least 24% of GDP in Latvia and Estonia, which was twice the percentage in the US at the peak of the "bubble" [2].

When deciding on their admission to the EU, the Baltic countries were classified as transition economies in need of deep structural restructuring because they had high unemployment rates and lower GDPs than other EU members. The Baltic troika used their accession to the EU as an opportunity to achieve economic stability and implement market reforms. The EU budget and its numerous funds provided financial assistance for developing agriculture, creating jobs, supporting small and medium-sized businesses, educational projects, research and development (R&D), etc. In some years, external support for their economy amounted to 25% of their GDP [2].

The first years of the Baltic States' EU membership were marked by impressive economic growth. They were nicknamed the "Baltic Tigers" in reference to their successful Asian counterparts [3]. However, after the global financial crisis, the pace of economic development in the Baltics slowed down noticeably. Among the Nordic countries, Estonia, Latvia, and Lithuania suffered the most in 2008–2009 (Fig. 2).

The policy of aligning macroeconomic indicators with the Maastricht criteria through stringent neoliberal economic reforms (such as cutting public spending, including in the social sector, and raising taxes) was necessary for joining the European Monetary Area. This policy resulted in Latvia and Lithuania having a higher percentage of people living at risk of poverty or social exclusion than the EU average. Out of the 28 EU member states, Latvia and Lithuania had the highest social risk — only North Macedonia and Albania had a worse situation. According to the UN, the total population decreased in all three Baltic states from 1990-1991 to 2019-2020: Estonia's population decreased from 1.56 million to 1.32 million; Latvia's population decreased from 2.64 million to 1.88 million; and Lithuania's population decreased from 3.69 million to 2.76 million. The most educated, qualified, and enterprising people, who are often middle-aged, leave the Baltic countries [1].

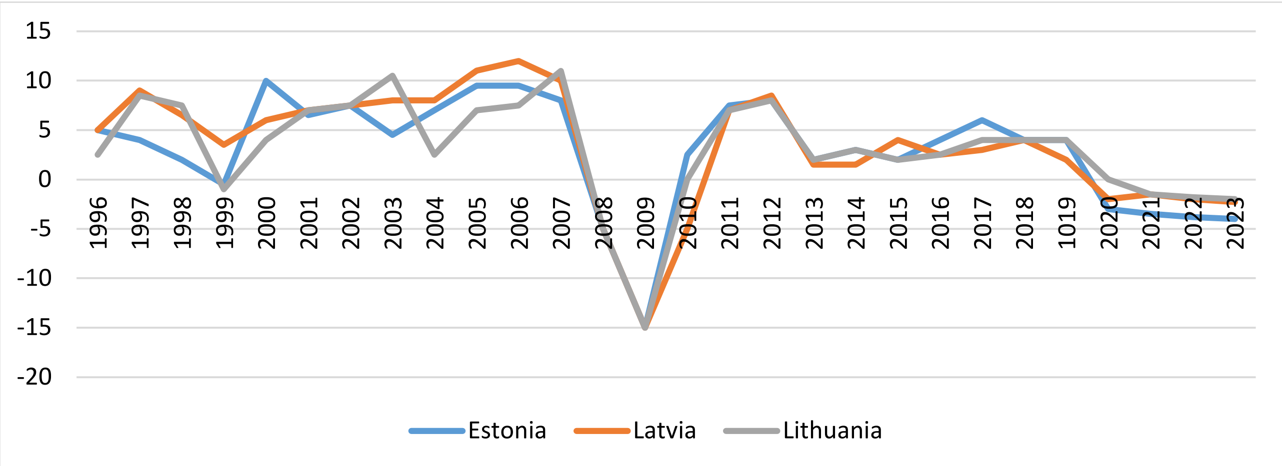

Figure 2 – **Real GDP growth rates in 1996–2023 in the Baltic countries, %**

Source: Source: [6]

The Baltic labor market has been highly volatile and sensitive to global developments. The global crisis of 2008–2009 had a shocking impact on employment similar to that of the initial market reforms. Latvia was the hardest hit of the three Baltic countries, but Lithuania was also severely affected by the structural depression of the 1990s, the 2008–2009 financial crisis, and the 2001 recession. The Estonian economy was slightly more resilient; however, employment there also fluctuated significantly, peaking at 17% in 2010. Such labor market volatility has not been seen anywhere else in Northern Europe.

Estonia, Latvia, and Lithuania suffered more than other European countries from the crisis, primarily due to the openness of their economies and their domestic markets' extreme dependence on bank lending [7]. After joining the EU, the Baltic countries became accessible to Scandinavian banks, primarily Swedish ones, which opened subsidiaries there. These subsidiaries did not protect the economic interests of the host countries, thus becoming creators and amplifiers of crisis phenomena. [9].

A significant portion of the loans were provided in foreign currencies, exacerbating the decline in domestic demand due to the depreciation of local currencies and accelerating national monetary reforms. Without waiting for a full recovery from the crisis, the Baltic countries joined the eurozone one after another. Estonia (2011), the strongest of the three countries, was the first to switch to the euro, followed by Latvia (2014) and Lithuania (2015) [4, 13]. In an effort to integrate into the EU economy, the Baltic countries are seeking areas of specialization where they can excel and participate in the economic life of Europe as a whole and the Baltic Sea region in particular. The greatest number of initiatives are in the areas of cybersecurity and energy security, implementation of the Eastern Partnership program, EU enlargement policy, and implementation of the Single Market concept. Additionally, the Baltic countries have recently attempted to develop high technology. Progress in this area is indicated by the innovative structure of EU exports (Fig. 3).

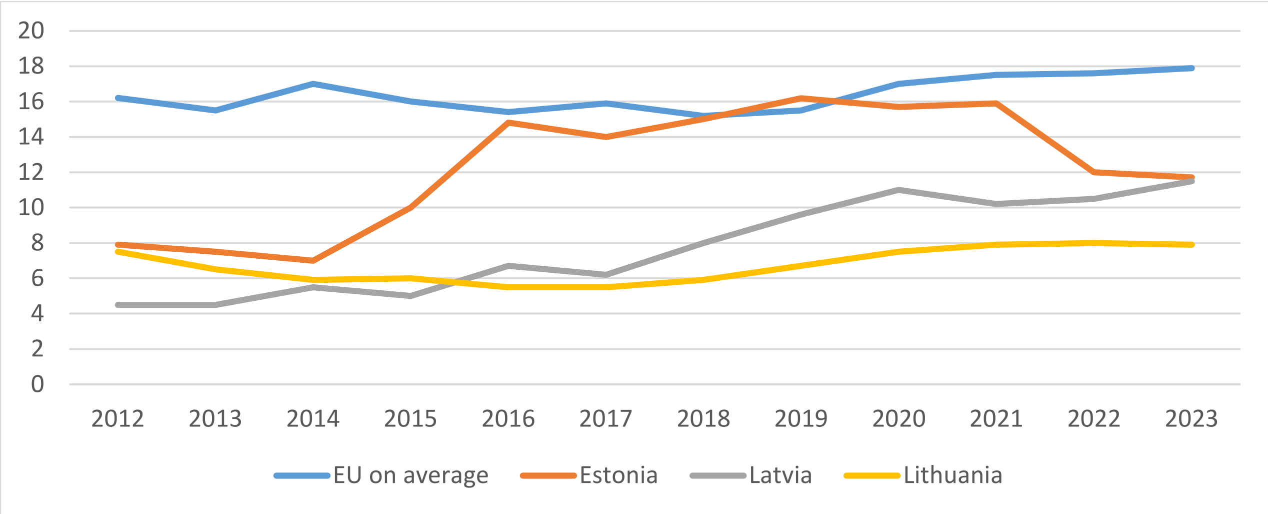

Figure 3 – **Share of high-tech products in the exports of the Baltic States and the EU in 2012–2023, %**

Source: [11]

Estonia's rapid development and catch-up to the EU average, which even surpassed it briefly, slowed down in 2010–2014. Meanwhile, Latvia and Lithuania have shown steady, albeit slow, growth. Overall, however, it is too early to talk about the Baltic countries' leadership or market power. They lag behind other EU members in promoting high-tech goods on global markets. There is a strong correlation between a country's competitiveness in high-tech markets and its ability to maintain high incomes and wages. Lithuania has virtually no comparative advantages in global high-tech trade, while Estonia and Latvia have relatively few. Of the three countries, Estonia is the most successful in this regard, though Latvia has also shown progress in recent years. [5].

Latvia exports some high-tech products, but they are competitive only in CIS markets. In the EU, Latvia’s only advantage is in exporting resource- and labor-intensive goods with a low degree of processing that do not require skilled labor. The decline in productivity in export industries in recent years means the Latvian economy's international competitiveness is gradually declining. To increase the level of applied technologies, the Latvian authorities should stimulate structural changes that facilitate the creation and development of new industries and high-tech companies. This can be achieved through reforms in education, creating institutes for commercializing ideas, bringing the scientific community closer to businesses, changing the tax system, and reducing the shadow economy.

As for the international competitiveness of the Lithuanian economy, statistics show that this country holds a strong competitive position only in markets for traditional products, such as food, chemicals, timber, and textiles — goods that do not require high technology. Research and development (R&D) expenditure in all manufacturing industries in Lithuania is modest. In fact, even what is considered the high-tech sector there does not meet the Organization for Economic Cooperation and Development (OECD) criteria. Among the Baltic countries, Lithuania is an outsider in the high-tech sector.

Throughout the 2010s, Estonia, the high-tech leader of the Baltics, demonstrated relatively better results. Although its indicators of revealed comparative advantage were negative (which indicates an inability to compete with average-level competitors), they were significantly better than those of Latvia and Lithuania. Estonia's comparative advantages were recorded in the radio, television, and communication equipment product group. Latvia's were in pharmaceuticals. Lithuania had no comparative advantages in any major high-tech product groups. However, in some years, it had small leadership in certain products, particularly special tools and devices for medicine and science.

Despite catch-up growth, the Baltic States' economic performance did not improve significantly in the 2010s.

They lag behind the EU average due to their comparatively low labor productivity, a consequence of their limited integration into global value chains. While Scandinavia and Germany specialize in high-tech, human-capital-intensive industries, the Baltic States still have a disproportionately high share of raw material and labor-intensive industries. Following the 2008–2009 crisis, all three republics experienced a significant slowdown in economic growth. Full integration of their economies into the EU has become an unrealistic goal [8, 12].

After joining the EU, all the Baltic countries became dependent on stronger European powers. One price they paid for joining the EU was the closure of many important industries. Brussels requested the closure of the Ignalina Nuclear Power Plant in Lithuania, sugar factories in Latvia were shut down, knowledge-intensive industries are dying out in all three countries, a significant part of the fisheries has been destroyed, and agriculture is shrinking. The need to buy electricity from other countries has had particularly serious consequences. Although Estonia held its position for a long time, now that Brussels has announced a transition to "green energy," Tallinn must comply and shut down its shale energy industry.

The economic problems that arose from forced transformations in the Baltic States are being solved through subsidies from various programs within the framework of the regional "cohesion policy." The EU co-finances Baltic projects up to 70% and sometimes up to 90% of their cost. Estonia, Latvia, and Lithuania began receiving subsidies immediately after joining the EU, primarily through regional support programs from structural funds (Table 1).

Table 1 **Subsidies under EU regional support for the Baltic States in 2000–2027, EUR billion**

Country	2000–2006	2007–2013	2014–2020	2021–2027 (plan)
Estonia	5,0	7,0	7,0	6,2
Latvia	1,0	6,8	7,0	10,5
Lithuania	0,7	3,4	5,8	6,8

Source: [7]

Since 2021, the EU has had a budget of €1.07 trillion, covering multi-annual financial plans for the next seven years. Additionally, a €750 billion fund has been established to assist EU member states in recovering from the economic impact of the pandemic. The outermost regions will continue to receive special EU support. In addition to the amounts listed in Table 1, the Baltic States will receive loans to help rebuild their pandemic-devastated economies. Thus, due to the Corona crisis, they will receive more funds than before. However, this will not continue forever.

Conclusions. Thus, small open economies, especially those without significant natural resources, are rarely able to conduct independent and successful economic development policies. Unlike Singapore and Hong Kong, the Baltic countries do not have an advantageous geographical position, nor have they accumulated rich human capital over the years. Their years of EU membership and accession to the European monetary system can be assessed as generally positive based on GDP statistics. The Baltic countries have demonstrated significant economic success, especially in the first years after joining the EU. Estonia, in particular, has found its niche in complex modern markets and has successfully avoided a demographic crisis, a feat that Latvia and Lithuania have not achieved. Latvia has had a particularly difficult time due to its weak economic structure and inability to fully integrate into international value chains. However, it's important to note that this success had a downside: the rapid GDP growth was largely due to foreign investment and financial assistance from EU funds. Some of this funding was squandered on consumption, and foreign direct investment (FDI) was mainly directed toward the financial sector and trade. As a result, the real sector did not develop noticeably. Estonia, Latvia, and Lithuania were unable to gain a foothold in high-tech markets. The Baltic countries could have fared better if not for the global financial crisis, which was exacerbated by the accelerated pace of European integration. Strict budget austerity and monetary control exacerbated the financial shock, affecting both people's well-being and economic growth. In a sense, one could argue that the consequences of the crisis have yet to be overcome.

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