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Globalisation and Small States: The Case of the Baltic States

A distinguishing feature of globalisation process is its supra-macro scale that leaves countries without challenge to pass it, but requires them to find the best approach to it in the given conditions.
In this context, it is important that countries assess their specific conditions and consequent choices with respect to globalisation, no matter what policy they are willing to pursue. Doing this several aspects must be taken into account: the country itself, the region, and the world.
In the case of the Baltic States in general and Latvia in particular three conditions are likely to be important when assessing the ability to take advantage of the process of globalisation in ways that are favourable to the specific country. First, all are small countries[1], second, all countries are transforming their economies from plan to market, starting from the position of constituents of the former Soviet Union, and the third, three small transitional countries represent a region in an economically active area.
There are some important issues to which economists are seeking answer when considering influence of globalisation on small countries.
The first question is **- Is the statuss of being a small country an advantage or a shortcoming?**
The answer to the question comes out from the comparison of advantages and disadvantages of small countries.
The main advantage, according to researches of economists on the topic, is that in small countries it is easier:

- to implement policies that are harmonised in terms of regional considerations, as well as sector based considerations,
- to achieve harmony between politicians and society,
- in the political and social sphere to achieve harmony in society,
- to ensure macroeconomic balance,
- to adapt to changing economic situations, including globalisation.

Difficulties that small countries face include the following:

- economic and political dependence on surrounding environment,
- a limited domestic market and in case of weaker countries also market capacity, that is market size corrected by purchasing ability (the Baltic States account for 7.5 million inhabitants with purchasing ability far below the EU average),
- reduced abilities to use economies of scale and scope (even large enterprises in the Baltic States are only medium size according to the world standards),

[1] It this report the simplest approach is applied, that considers a country that has fewer than 10 million residents being a small country. The number of population is 1.4 million in Estonia, 2.4 million Latvia, and 3.7 million in Lithuania

- higher R&D costs per product unit and lower abilities to maintain national innovation systems, thus hampering competitiveness (the same proportion of R&D expenditures does not reach critical mass for development of innovation systems in small countries),
- greater political vulnerability from external factors (Russian factor in the case of the Baltic States).

Some economists feel that in countries that are moving from a planned to a market economy, being small is more a problem than an advantage, but this fact is of lesser importance in very small countries (among which we also find the Baltic States).

The second question is **- Is a country's development affected by its size?**
The answer is – no in general.

There are large and small states among world's developed countries, as well as there are large and small states outside this list. Iceland, Denmark, Sweden, Finland, and even Austria are countries with population less than 10 millions, while the United States, Japan, also France, Germany, Italy, Canada are large countries, but development levels of these countries are comparable. On the other hand, Albania, Ireland and Norway have about the same size but different development trends.

Investigations on a world scale prove that rather than size, the extent to which the country has chosen the proper development policies, how flexible it is with respect to the global economic system, and to what extent the country is able to turn opportunities offered by the global system into its own advantage influences the countries development.

The same applies to development of post socialistic transition countries. As Table 1 shows, there are large and small countries at the richer end, as well as at the poorer end.

The next question is – **What happens to small countries under conditions of economic globalisation, and does globalisation affect small countries differently than large ones?**

In order to answer question, we must look whether the economic systems of small countries differ from those of large countries? Indeed, there are some peculiarities that make economic performance in small countries more difficult or different, for instance these listed by Slovenian economists (Svetlicic, Damijan et all in Development …) :

- small countries cannot influence world prices,
- in small countries, foreign trade and foreign trade policies are of greater importance than they are in larger countries,
- the economies of small countries tend to be more open (a greater share of GDP is represented by import and export sums),
- in small countries, there is a greater concentration and specialisation of production,
- the economies of small countries are more integrated with the economies of other countries in terms of intra-industry trade,
- in small countries national budget expenditures represent a greater share of GDP,
- economies of small countries are more subject to external influences,
- small countries try to increase their influence by forming coalitions,
- small countries have lesser autonomy.

Table 1.

Number of population, GDP per capita and GDP growth rates in selected post-Socialistic transition countries

	Population, annual average in 1998, mlns	GDP per capita according to PPP, 1997, ECU	GDP growth rates as % over previous year			
			1995	1996	1997	1998
Large countries						
Russia	146.54		-4.1	-3,5	0.8	-4.6
Ukraine	50.04		-12.2	-10.0	-3.2	-1.7
Poland	38.67	7500	7.0	6.1	6.9	4.8
Czech Republic	10.29	12000	6.4	3.9	1.0	-2.2
Belarus	10.19		-10.4	2.8	10.4	8.3
Hungary	10.11	8900	1.5	1.3	4.6	5.0
Small countries						
Bulgaria	8.25	4400	2.1	-10.9	-6.9	4.0
Slovakia	5.39	8900	6.9	6.6	6.5	4.4
Croatia	4.50		6.8	6.0	6.5	2.4
Moldovo	4.31		-1.9	-7.8	1.3	-8.6
Lithuania	3.70	5800	3.3	4.7	7.3	5.1
Latvia	2.45	5100	-0.8	3.3	8.6	3.6
Macedonia	2.19		-1.2	0.8	1.5	5/0
Slovenia	1.98	13000	4.1	3.1	3.8	3.9
Estonia	1.45	7000	4.3	3.9	10.6	4.0

Source: Statistical Yearbook of Latvia, 1999, Central Statistical Bureau of Latvia, Riga, 1999.

It is likely that these peculiarities may be effectively used under conditions of economic globalisation, but also offers specific threats to small countries. In this respect, globalisation influence small countries differently than large ones, but there is not a single answer whether the globalisation affects small countries more positively or more negatively.

Still it is important, that small economies fall more often than large economies into group of countries that have to adjust to, but not into the group of countries that form new challenges under conditions of globalisation. Also the negative effects, that globalisation offers, such as specialisation and concentration of industry, are more dangerous in small countries.

Small and backward countries are beneficiers due to the fact that globalisation is promoting the convergence of the national income of various countries. No doubt, increasing competition is the major threathening factor for such countries.

How can small and backward countries find their place in the global economic system, and is it possible for them to eliminate their backwardness under conditions of increasing competition (and how?)?

This question might be specified to the following one: What are the specific aspects of transition countries in Baltics, and what opportunities do they have to catch up with the developed countries of Europe?
The most important specific aspect of the Baltic States is that their economies are not competitive on a global market, at least at the beginning of transition period. Economies are weak and even more

vulnerable, industrial, trade systems and business traditions are just forming, partners in co-operation are in most cases unfamiliar, and business skills are incomparable in transition countries and countries with strong market traditions. The Baltic States are significantly lagging behind the EU countries (Table 2).

In such conditions, the natural reaction is desire to protect national economies by creating protectionist systems, while positive effects of globalisation may be better utilised in open economies. The Baltic States are more cautious to deep economic integration and are loath to accept limitations on their economic sovereignty. Also it is difficult for politicians and society to understand and assess complicate processes that entail globalisation process, such as trade, market and capital liberalisation, concentration and monopolisation of the various sectors and following increasing economic dependence on other countries, elimination of significance of national state.

Still logical analysis and practical results of almost ten years of political and economic independence lead to conclusion, that basic factors of globalisation – foreign trade, FDI and expansion of multinational companies – all allow the Baltic States to liquidate their shortcomings and to foster development. The Baltic States lack natural resources and existence of creative potential and human resources are considered as basis for development. Especially in such cases FDI promise good challenges to improve technological basis and production methods, as well as optimisation of specific sectors of economies, elimination of threats to competitiveness due to weak capacity of R&D systems. Integration in a global economic system is important in the Baltic States also because of political reasons.

If we conclude that globalisation is not a danger only, but also may be effectively used for development, the question – **Do small countries need special development policies, and what might these policies be?** – must be answered.

No doubt, development policies in the case of the Baltic States must be special because economies are more or less special (small versus large, transitional versus old market economies, backward versus developed, multisectoral versus specialised industrial structure, specific attitude to requirements and consequences of globalisation in small post socialist countries).
The reasonability of such policies in a globalised world depends on:

- harmonisation of political and economic goals,
- the intensity of each country's foreign trade (the openness of its economy),
- the ability of each country to take advantage of the positive effect of FDI,
- the ability of the country to take advantage of those factors that ensure the competitiveness of its economy.

It is likely that the Baltic States have choosen the economic development models that are responsible towards processes of globalisation, however models, as well as development path are not identical. It is important that in all three countries political and economic goals are not contradictionary, but supplement each other.

Table 2

Selected development indicators of the Baltic States in 1998

	Estonia	Latvia	Lithuania
GDP per capita, converted by official exchange rates, ECU	3200	2300	2600
Tha same in % to EU 15 average	15	10	12
GDP per capita, converted by PPP, ECU	7300	5500	6200
Tha same in % to EU 15 average	37	27	30
Value added /employed by branch in % of			

total			
agriculture, hunting and fishing	6.9 / 9.5	4.7 / 17.6	10.1 / 18.6
industry	21.5 / 25.7	24.3 / 18.9	23.6 / 19.5
construction	5.8 / 7.5	5.2 / 5.6	7.9 / 6.9
service	65.9 / 57.3	65.8 / 57.9	58.3 / 55.0
Foreign trade in % of GDP			
exports	79.8	47.7	47.4
imports	89.4	61.0	59.4
Current account bilance, % of GDP	-9.2	-11.0	-12.1
General government debt (at end of year) in % of GDP	4.7	9.9	15.7
FDI flows, % of GDP	10.8	5.6	8.7
Growth indexes, % of previous year			
agriculture	95.0	91.3	97.5
industry (1997)	114.6	113.8	103.3

Source: Statistical Yearbook of Latvia, 1999, Central Statistical Bureau of Latvia, Riga, 1999.

Economic systems in the Baltic States are tipical to a modern small country (except agriculture/industry relation), open and sufficiently liberal, that promotes foreign trade. The share of exports and imports in GDP is high in all countries (Table 2), and it is increasing.

In the field of foreign trade major problem is market formation. During last 5-8 years important changes have occurred in foreign market structure of Baltic countries. The share of Western markets has grown, while the share of NIS (main partners in the past) declines. It is likely that the current market allocation structure (Table 2) will ramain, except low share of Central European countries, while foreign trade amounts ere expected growing.

There are also changes in the structure of exports and imports. In exports, the share of products with higher value added gradualy increases, in imports, the share of capital goods increases.
The main problem in all three countries is low level of competitiveness. This has kept countries from finding their place on the world market quickly and easily, and has led to increasingly negative current account bilance (Table 2). It is well known that the main factor that increases development and competitiveness is innovation that includes new product, technologies and work organisation. In all three Baltic States, FDI is considered major source for innovation. FDI levels are rather high, but their allocation differs – more in industry in Estonia and Lithuania, more in service sector in Latvia.
The national innovation policies are different in countries. It is likely that Latvia takes less care about innovation systems and agents, while the better attitude may be observed in Lithuania and especialy in Estonia. However, the economic systems themselves tend to the model of innovative economics – the share of high-tech industry increases on the year by year basis in all Baltic countries.

There are first signs of higher specialisation and concentration in the economies of the Baltic States. It is important, that Baltic States have started to cooperate by creating joint large-scale enterprises in fields such as banking, financial markets, insurance, computer industry, food production and others. The integration with foreign economies increases through FDI from large foreign companies that can be found in all Baltic countries. In the structure of FDI also, the share of qualitative investment from stable market economies increases, however, especially in Latvia, Russia's investor's position is qiute significant.
The Baltic countries have felt need to strenghten their position in a globalised world by building coalitions. The first level is co-operation on a Baltic's scale that is institutionalised by political (The Council of the Baltic States) and economic (Baltic Free Trade Agreement) means. Baltic States are

active partners of Nordic Countries and countries around the Baltic Sea. The highest level is integration into EU and NATO. It is true that the last two proceses provide both for full complex of globalisation impacts and for the best protection of national states.

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