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## ANALYSES

## Baltic economies – a painful downfall after years of prosperity

In the first six months of 2009, the Baltic states' GDP shrank by nearly 20%, which was the worst result in Europe. As a consequence of job cuts in private enterprises and the public sector, the unemployment level has tripled in comparison with the preceding year to exceed 15% in all three countries. It is still unclear from the economic data for the past few months whether recession in the Baltic states will continue to worsen. However, it seems that the economic indices will not fall so rapidly in the next quarters as they did in the first half of the year.

If the governments of Lithuania, Latvia and Estonia manage to stabilise the state budget situation, the greatest challenge they will have to face will be the worsening financial situation of the population, which may give rise to social tensions and public protests.

### The difficult first half of the year

The statistical offices of Lithuania, Latvia and Estonia published economic data from the second quarter of 2009, according to which GDP in Lithuania shrank 22.4%, in Latvia 19.6% and in Estonia 16.6% compared to the same period of 2008. Data for the first quarter showed GDP fell by 13.3%, 18.1% and 15.1% respectively. Such dramatic GDP reductions were caused by the constant worsening of the situation in the key sectors of their economies: industry, trade and the building sector. The decrease in production and trade turnover was an effect of a shrinking internal demand and the falling value of exports (in individual months of the second quarter, the export value in each of the countries reduced by nearly 30% in comparison with the preceding year). The record-breaking recession in the Baltic states is first of all a consequence of the strong susceptibility of their small and open economies to changes of the situation on global markets and of the failure to carry out public finance reforms in those countries at the time of economic growth a few years ago. The economic slump further deepens the existing financial problems of the Baltic states. Budget deficits in Latvia and Lithuania, according to most recent estimates, will reach 10% and 5% of GDP respectively. It may not be ruled out that the worsening economic situation in Lithuania will force Vilnius to follow in Riga's footsteps and apply for a stabilisation loan to the IMF. Estonia has relatively the best financial situation. It still expects to maintain its budget gap at a level lower than 3%, which would allow it to join the Eurozone in 2011.

## Governmental anti-crisis activities

The deep recession and falling budget incomes in Lithuania, Latvia and Estonia has forced the governments of those countries to concentrate on moves aimed at reducing the budget gaps. On one hand, tax levels have been increased (for example, the VAT rate has been raised in all the three countries), and on the other, state expenses are being cut partly through the reduction of the employment and wage levels in the public sector.

The restrictive fiscal policy has failed to slow down the recession, and the steps taken by Vilnius, Riga and Tallinn to counteract an economic breakdown by offering various forms of support to business are rather ineffective due to the scale of the present crisis and the insufficient funds to adopt such a policy (most of the funds received by Latvia from the IMF and the EU have been allocated to the handling of the country's debt and stabilisation of the banking sector). The possible devaluation of the national currencies of Lithuania, Latvia and Estonia, which are linked to the euro, would improve the competitiveness of the Baltic states' exports only to a small extent because the share of imported components and raw materials used in production processes is quite large. The countries' governments, which are unwilling to carry out a devaluation, also argue that it may cause more bankruptcies of individuals and companies who have taken loans in euros. An additional argument raised in the case of Estonia is the need to meet the criteria in order to be able to join the Eurozone (Latvia and Lithuania will not meet the criteria in the coming years due to excessive budget deficits).

## Social consequences of the crisis

The unemployment level in the Baltic states has tripled over the past year increasing from 5.1% to 15.8% in Lithuania, from 6.4% to 17.2% in Latvia and from 4.6% to 17% in Estonia. The rapid increase in unemployment is a consequence of job cuts, first of all in the industrial and building sectors. The difficult situation on the labour market is additionally aggravated due to staff reductions in the public sector (mainly in the administration, although Latvia is also planning numerous job cuts in the healthcare and education sectors; several thousand teachers from among the total number of over thirty thousand will be made redundant this September), dictated by the need to cut state budget expenses. The forecasted continuation of recession in 2010 in the Baltic states will result in further growth of the unemployment rates. This is likely to stimulate economic emigration, which has significantly slowed down over the past few years after the boom ensuing from EU accession. Since social expenses have been reduced, the most serious consequence of higher unemployment levels will be the significant worsening of people's economic situation, which may provoke social tension and protests.

## Forecast

According to recent forecasts, including one presented by Swedbank (the largest bank in the Baltic states), the economies of Lithuania, Latvia and Estonia are unlikely to sustain such dramatic falls of economic indices as in the first two quarters of this year. However, the scale of the present recession, the significant debts of companies and individuals in those countries and the fact that all trade partners of the Baltic states have economic problems indicate that the process of overcoming the crisis will be difficult and the way in which it will be carried out will depend largely on the improvement of the global economic situation. In the second half of this year, the Baltic states may still have problems sticking to the limits of planned budget deficits. However, if a threat to the stability of public finances appears, the governments of those countries may expect assistance from the IMF and the EU, which already granted a loan of 7.5 billion euros to Latvia last December.

*Paweł Siarkiewicz*

## EVENTS

## Lithuania: The future of the planned Ignalina 2 project is uncertain

On 30 July, President Dalia Grybauskaitė publicly called into question the need to build a new nuclear power plant in Lithuania. She stated that before Lithuania chose the direction for development of its energy sector, a rational economic analysis was necessary which would confirm the need to build the nuclear power plant, taking into account the possible emergence of alternative projects in the Kaliningrad oblast and Belarus, which would compete with the Lithuanian one. Grybauskaitė's statement signifies that the previous Lithuanian plans regarding the implementation of the Ignalina 2 project (a large power plant, with a maximum capacity of up to 3400 MW, with four partner states, Lithuania, Poland, Latvia and Estonia, engaged in the project) may change.

Despite her doubts cast in public, the president signed the law concerning the nuclear power plant, which was amended by the Lithuanian parliament at the end of July, which proves that development of nuclear power engineering is still seriously considered in Lithuania, and is strongly supported by the Energy Ministry.

The government ordered an analysis from the international consortium N M Rothschild & Sons to dispel Lithuania's recent doubts regarding the economic feasibility of building a new nuclear power plant, its possible capacity and the selection of foreign investors and partners, as well as the impact of alternative projects in the region on the profitability of Ignalina 2. The analysis is expected to be presented this September. If economic feasibility of the plant's construction is confirmed, the consortium will use the analysis as a basis for the investment's business plan and present Lithuania's negotiating position at the end of the year before talks with potential investors and partners. <jhyn>

## Bulgaria threatens to veto Macedonia's integration with the EU and NATO

On 4 August, Bulgaria sent a sharp protest note to Macedonia, accusing the latter of discrimination against Macedonians who hold Bulgarian citizenship. Sofia for the first time made its support for the process of the Euro-Atlantic integration of Macedonia dependent on Skopje's guarantee of respect for Bulgarian citizens' rights. The note signifies the hard-line approach adopted in foreign policy by Bulgaria's new right-wing government.

Sofia's threats to block the process of European integration are reminiscent of actions taken by Greece with regard to Macedonia, by Slovenia with regard to Croatia and by Cyprus with regard to Turkey, who used their EU membership to shift their bilateral disputes to the level of relations between Brussels and candidates. The recent toughening of Bulgaria's stance is mainly an effect of the takeover of political power by Bojko Borisov's government. He promised a large scale granting of Bulgarian citizenship to compatriots living abroad and

active protection of their rights. The Bulgarian elite and society do not recognise the Macedonian nation and believe that all Macedonians are Bulgarians. Moreover, at least 5% of Macedonians have already applied for Bulgarian citizenship, which requires a declaration of one's identity as a Bulgarian. Prime Minister Borisov, playing on nationalist sentiments, wants to reinforce his internal position at a time of economic crisis and to build a strong Bulgarian influence in Macedonia. However, such moves are likely to sour relations between the two countries. <abalc>

### Albania: the right wins the elections

**It took as long as one month to announce the final results of parliamentary elections in Albania, which was done on 1 August. The victory was gained by the right-wing Democratic Party (PDSH), which governed the country before the elections. It is likely to enter into a government coalition with the small centre-left party Socialist Movement for Integration (LSI). However, it seems that the final opinion on the way the election was conducted, to be presented by the OSCE in late August, will be rather critical, which will significantly reduce Albania's chances of being granted the status of EU candidate.**

PDSH led by Prime Minister Sali Berisha won 46.9% of the votes (70 seats in the 140-member parliament), while the Socialist Party won 45.3% of the votes (66 seats). In effect, the LSI (5.5% of the votes, 4 seats) will play a decisive role in the formation of the government. They decided to enter into coalition talks with the right-wing party although it has co-operated so far with the left (however that was rather a tactical co-operation, accompanied by bitter disputes concerning nominations).

The parliamentary election was an event of great significance for Albania's process of European integration because the EU had made its granting of candidate status to Tirana dependent on the way the elections were to be conducted. An initial OSCE report, which was published shortly after the election, indicated a clear improvement in comparison with the previous elections. Nevertheless, numerous irregularities were specified as well. The lengthy vote-counting process (one month), related problems (a recount of some of the votes) and protests by the left, who refused to recognise the election results, will probably cause the final OSCE report to be unfavourable for Albania and its efforts to be granted EU candidate status. <abalc>

### Germany: The Federation of Expellees asks political parties questions

**Answers by the major political parties regarding their programmes, which had been asked by the Federation of Expellees (BdV) were published on 4 August. The Federation has been building its position as an organisation which has a strong influence on public opinion and political parties before the parliamentary elections. The fact that all parties which had been asked the questions have given their answers proves that the BdV's position is strong. The Federation in this way mobilises its supporters to cast their votes for Christian Democratic parties, whose views are the closest to those of the BdV's.**

On 10 July, before the approaching parliamentary elections, the Federation of Expellees asked the CDU, the CSU, the SPD, the FDP and the Green Party (the Left Party was omitted) to answer questions essential for the BdV. They asked about the recognition of the BdV's right to nominate members of the Council of the Foundation 'Flight, Expulsion, Reconciliation' (the problem of the controversial nomination of Erika Steinbach), the continuation of Germany's financial support for the cultural heritage of Germans who had been forced to resettle, support for the immigration of ethnic Germans to Germany and their integration with society in the country, and the role which in the parties' opinion German minorities should play in Central and Eastern European countries. As expected, Christian Democrats supported amongst others the BdV's right to nominate its candidate to the Foundation Council, the continuation of subsidies for German minorities and privileges for ethnic Germans in granting German citizenship. The Green Party and the SPD were more sceptical about the Federation's demands. The Liberals, potential coalition partners of the CDU and the CSU, presented a moderate view; they did not oppose the BdV's right to nominate its candidates to the Council. However, in their opinion, the composition of the Council may not infringe upon the interests of neighbouring countries (chiefly Poland). The active participation of the BdV in the electoral campaign, of which the aforementioned initiative is just a single example, is intended to reinforce the Federation's position as a key political player and mobilise the most conservative Christian Democratic electorate to vote this September. <ZAL>

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