

## Baltic States

### Estonia

#### Political

Despite a degree of instability due to fractious politics and frequent government collapses, there has been broad continuity in policy. Consensus across the political spectrum was exemplified by the list of reforms undertaken in order to become a member of the European Union (EU). In September 2003, the country voted in favour of EU accession in a nationwide referendum and Estonia acceded on May 1st 2004. There has also been an overall decrease in party fragmentation. That said, March 2004 saw the failure of another government -- Prime Minister Juhan Parts of the political party Res Publica. Parts' government did not survive a non-confidence vote on Justice Minister Ken-Marti Vaher brought about after criticism of Vaher's handling of a controversial anti-corruption plan. It was replaced by Res Publica's coalition partner, the centre-right Reform Party, led by the now newly appointed Prime Minister Andrus Ansip. The Reform Party has a slim majority in parliament.

#### Economic

Estonia is a success story for transition from a Soviet to a free-market economy. The economy rebounded strongly after Russia's 1998 crash, with real GDP growing at least 4% yearly. Growth this year is estimated at 5.9%. Growth is broad-based, and stems from domestic demand and buoyant export growth both to the EU and Russia, combined with substantial FDI inflows. The current-account deficit is expected to remain high, however, shrinking slowly, from 11% of GDP currently to 9-10% in 2005-06. Inflation has been subdued thanks to the currency board arrangement which ties the local currency -- the kroon -- to the euro. Overall, Estonia's economic performance is a contributing factor behind the country being selected -- along with Slovakia and Lithuania -- as the first three new EU entrants to join ERM II -- generally known as the first formal step toward full euro adoption. The country's external debt is sustainable at about 60% of GDP, though debt service is much lower at less than 10% of exports. Forex reserves total over three months' import cover.

### Latvia

#### Political

Deep-rooted divisions and in-fighting plague Latvia's political environment. Due to this, there have been twelve different governments since Independence in 1991. The poor track record of government stability in Latvia did not bode well for the coalition of Einars Repse. He resigned as Prime Minister in February 2004. The next Prime Minister, Indulis Emsis, was the first Green Prime Minister in the enlarged European Union. His government collapsed in October 2004 after Parliament rejected a draft budget motion. Taking Emsis's place is Aigars Kalvitis of the People's Party. Despite the volatility of the government, there has been broad policy continuity and both European Union and NATO membership have been achieved. A main domestic issue is the recognition of Latvia's sizable Russian minority. This debate centres on citizenship laws and language of instruction in schools and has damaged Latvia's relationship with Russia.

#### Economic

Latvia's economy is continuing its record expansion with growth this year forecast at over 7%, higher than the average 5.3% yearly sustained from 1999 through 2003. Main drivers of growth include strong domestic demand and rising exports to the Commonwealth of Independent States (CIS), Estonia, Lithuania, and growing trade integration with the EU. However, robust import demand is boosting the current-account deficit to an unsustainable 9% of GDP. Growth is expected to decelerate to 5.5% in 2005-06 as domestic demand subsides. The external current account deficit will continue to act as a brake on economic expansion during the foreseeable future. While growth remains broad-based and counts among the most robust of the ten EU accession countries, this rapid expansion has exposed the government's failure to bridge the country's fiscal deficit currently at 6% of GDP.

### Lithuania

#### Political

It has been twelve months of change for Lithuania. First, Prime Minister Algirdas Brazauskas' centre-left coalition government presided over the country's accession to the European Union (EU) on May 1st 2004. Then presidential elections, twinned with country's first European Parliament elections, resulted in a win for former President Valdas Adamkus. He re-appointed Brazauskas, who had served under President Rolandas Paksas, who was in impeachment proceedings. The autumn 2004 legislative elections resulted in a win for Brazauskas' party after they struck a deal with the populist Labour Party, Social Liberals and Farmers and New Democracy Union. The Labour Party is a new political force, having only been formed in 2003. The Labour Party was the largest single winner from the October elections; it won 39 seats of the 141-seat legislature.

#### Economic

Lithuania has emerged as one of Europe's fastest growing economies, fuelled by dynamic exports and buoyant consumer demand. Growth is forecast at nearly 7% this year, following several years of growth in excess of 5%. The main growth drivers are currently domestic demand. External debt stock is sustainable at 40% of GDP, with debt service below 10% of exports. The foundation for this rapid growth was laid by an inspired mix of economic policies underpinned by a strong commitment to a currency board arrangement coupled with sound economic policy. Lithuania is among the first three countries chosen for ERM-II membership shortly after Euro accession, paving the way for full euro adoption as early as 2007.