

# SOCIAL CONSEQUENCES OF TRANSITION AND EUROPEAN INTEGRATION PROCESSES IN THE BALTIC STATES

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## ABSTRACT

More than decade-lasting economic reforms and structural adjustment have had serious social consequences and costs that may have negative impact on the Baltic States reintegration into Europe and joining the EU. The main social consequences of the transition and EU integration processes are the increasing inequality, poverty, social exclusion and unemployment as the new phenomenon for the post-socialist societies. The paper aims to analyze poverty and social exclusion as the main consequences of rapid transition processes in the Baltic States. Both, direct and indirect approaches are used for assessment of poverty. The assessment results allow us to conclude that at the present time the Baltic societies are still characterized by the deprivation and the people's adjustment to the quick changes caused by the transition and integration processes is not finished yet. In order to solve the possible negative social consequences of the rapid transition and European integration processes big investments into human capital and development of the social protection systems according to the national strategies oriented to sustainable development are unavoidable.

*Keywords:* poverty, social exclusion, social consequences of transition, economic integration, the Baltic States

*JEL:* I31, I32, C23, P36

## INTRODUCTION

The transformation processes have often been quicker than expected, placing the population under serious pressure. The absorptive power of people is limited and not all individuals of the transitional countries have shared economic success. Poverty, social exclusion, increasing inequality and structural unemployment are natural consequences of adjustment to transition and European integration processes. Poverty is mainly related to individuals and households, whereas social exclusion is related to society and the individuals' relations with society. Poverty may be a cause as well as a consequence of social exclusion focusing on distributional issues and lack of material and social resources. Poverty results in exclusion of a part of population from the socio-economic participation in society life. This exclusion also consists of danger that poverty is reproducing new poverty and as a consequence human capital and competitiveness of countries will decline.

The paper aims to analyze poverty and social exclusion as the main consequences of rapid transition processes in the Baltic States. Of the former Soviet republics only the Baltic States are the EU accession candidates. The Baltic States' favourable location between East and West and market economy experience of the period between the two world wars are important initial conditions of transition influencing economic development and the EU accession processes of these countries. After regaining their independence in 1991, the Baltic States' governments have followed almost similar principles of economic policy that were directed to solving the following main tasks: 1) liberalization of prices and gradual elimination of all state subsidies; 2) privatization of state owned enterprises; 3) introducing a separate currency

by means of a currency board system (Estonia and Lithuania) or regular pegs (Latvia); 4) maintaining conservative fiscal policy; 5) implementing a comparatively liberal foreign trade regime.

The Baltic States provide an interesting case for generalizing transition and EU eastward enlargement processes and developing a new field of economics – economics of transition and integration. Real influence of the Baltic economies on the EU eastward enlargement processes can not be significant due to very small size of the Baltic markets compared to the markets of the EU current member states (EU15). The share of the Baltic States' population is only 2% of the EU15 population. The GDP of the Baltic States is forming about 0.3% of the EU15 GDP and the per capita GDP (PPP adjusted) is only about 30% of the EU15 respective indicator (34% in Estonia, 26% in Latvia and 28 % in Lithuania) (Straubhaar, 2001, p. 170).

The paper consists of three main parts. The first part of the paper views some considerations regarding the poverty and social exclusion concepts as the main consequences of rapid transition and EU eastward enlargement processes. In the second part of the paper the poverty assessment results in the Baltic States are presented. Both, direct and indirect approaches are used for assessment. The third part of the paper analyses social protection measures and poverty reduction strategies elaborated for overcoming the negative consequences of transition and for supporting social cohesion in the Baltic States. Social cohesion and inclusion are the necessary preconditions in order to achieve stable economic growth and to support the integration of the Baltic population with the EU enlargement.

## **1. POVERTY AND SOCIAL EXCLUSION**

In general, the concept of poverty is defined as people's inability to afford an adequate standard of consumption. At the same time the answer to the question, what is the adequate standard of consumption, is very much a subject of discussions and it has significant variation between countries and over time. Thus, the concept of poverty consists of objective and subjective aspects. Economists usually consider poverty in absolute and relative terms. According to the absolute approach, the poverty line is determined as the sum of minimum needs relating to food, clothing, household, transport, communication, etc, and respectively the income required in order to cover all these minimal needs. Poverty in absolute terms means that consumption is falling below the fixed level of minimum consumption.

The relative approach interprets poverty in relation to the prevailing living standards of the society, recognizing the interdependence between the poverty line and the entire income distribution. Two approaches are used defining the relative poverty line (Anand, 1997; pp.242-279):

- 1) The poverty line is defined as the income level that cuts off the lowest  $p$  percent of population in the national income. The choice of  $p$  is arbitrary. This indicator of the relative poverty line quantifies the extent of poverty.
- 2) Poverty is defined in respect of contemporary living standards like half of average (mean, median) income level of the society. It means inability to afford the average consumption level that people have.

Poverty in relative terms will never disappear. John Black in Oxford Economic Dictionary (Black, 1997, p. 360) stated that if an absolute standard of poverty is accepted it is at least conceivable that technical progress will eventually lift everybody above the poverty line, but

if poverty is relative, the poor will be always with us. If poverty line is defined, the percentage of population in poverty refers the extent of poverty or level of poverty. The poverty gap indicates the total income needed to bring all poor to absolute poverty line.

The poverty line states the income level supposed to be enough to avoid the inadequately low level of consumption. The border between the adequate and inadequate level of consumption is difficult to settle. Various indicators have been elaborated in order to define this border (see table 1). The methods for calculating and implementing these indicators have significant variations between the countries depending on the level of economic development, geographical location, culture, habits, norms of consumption, and etc.

Poverty is generally regarded as being a multidimensional concept. It is a situation where an individual or a group of people finds itself with extremely limited material and social resources. Such people find it difficult to obtain necessary means for nutritious food, shelter, clothing, medical care, education; they cannot afford to meet cultural and intellectual needs; they feel insecure about future and do not see any prospects of their life improvement. A serious consequence of poverty is exclusion of a part of population from the socio-economic participation in society life.

There is still confusion over the question whether the statement that “poverty is multidimensional” means that 1) poverty itself relates to income but the causes of poverty are multidimensional or 2) the concept of poverty is multidimensional and relates to more than just income (Poverty Reduction..., p.38). Sometimes the terms “poverty” and “social exclusion” have been used synonymously with reference to the multidimensional concept of poverty.

The concept “social exclusion” was taken up in 1985 by Jacques Delors, the former president of the European Commission. In the same year, the European Poverty Programme was extended to include the issue of social exclusion. It was recognized that the concept “social exclusion” is more appropriate to analyze the multitude of current societal problems like unemployment, instability of families, shortage of welfare benefits and international migration in a common framework (Rodgers, et al, 1995). Social exclusion is ordinarily used as a broader and more comprehensive concept than poverty. The impact of social exclusion on people is observable by poor living conditions at the level of households and individuals.

The causes of social exclusion result from the failure of institutions to integrate individuals into society. But these causes are not limited by the failure of institutions. The analyses of various research studies and approaches (Gaudier, 1993; Silver, 1994; Berghman, 1998) allows us to agree with the suggestion presented by Regina Berger-Schmitt and Heinz-Herbert Noll (2000, p. 18), that social exclusion should be conceptualized as the failure of one or more of the following four systems:

- 1) The democratic and legal system promoting civil integration.
- 2) The labour market promoting economic integration.
- 3) The welfare state system promoting social integration.
- 4) Family and community system promoting interpersonal integration.

In the case of the Baltic States like other transitional countries the causes of social exclusion and poverty are interrelated.

## 2. POVERTY ASSESSMENT IN THE BALTIC STATES

Additionally to dividing assessment of poverty in absolute and relative terms, the approaches to assessment of poverty can also be divided into direct and indirect. The indirect approach estimates the resources that a person has, assuming that this amount of resources determines his/her living standard. The baseline indicators for indirect assessment of poverty are the absolute and relative poverty lines. The direct approach to poverty assessment tries to measure poverty based on the people's evaluations of their own welfare, which depends on individual behaviour and preferences. Thus, the fact that the resources are equal does not mean that the resulting welfare is equal. The people's evaluations of their own welfare also partly characterize the level of social exclusion as a property of society.

The poverty line states the income level supposed to be enough to avoid the inadequately low level of consumption. The border between the adequate and inadequate level of consumption is very difficult to settle. It is obvious that due to the some differences in understanding the concept of poverty, there is also lack of unified methodology for assessment of poverty despite of numerous studies about poverty issues in the Baltic States (Keune, 1998; Kutsar and Trumm (eds), 1999; Sileika and Blaziene, 2000; Trapenciere, *et al*, 2000; Wilder and Viies, 2001; Kuddo, *et al*, 2002) and in other post-socialist countries (Klugman, *et al*, 2002; Milanivic, 1997 and 1999 ).

Some poverty line indicators settled by the international organizations are presented in the table 1. According to the European Union approach, people are living below the poverty line if their annual per capita income after social transfers is below the 60% of the national median income<sup>1</sup>. This income does not include irregular income and income from selling assets.

Table 1. International indicators of poverty line

<b>International organization</b>	<b>Poverty line indicators</b>
World Bank	2.15 or 4.30 USD (PPP) per capita per day (depending on the level of development of a country, it's geographical location, etc)
European Union (Social Protection Committee, 2001)	60% of the national median income.
UNICEF (United Nations Children's Fund)	35-40% of average salary.

The table is compiled using the following *sources*: EC, 1998, Social Protection Committee, 2001; World Bank, 2000; Kuddo, *et al*, 2002.

The main information about the poverty line indicators, risk groups and some results of assessment of the poverty situation in the Baltic States is resumed in the table 2.

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<sup>1</sup> When comparing the corresponding indicators with the EU it should be born in mind that the data of EU countries were collected with surveys which in some sense have a different methodology (the equivalence scales 1 : 0.5 : 0.3 were used in the EU, 1 : 0.8: 0.8 in Estonia). The poverty line is the same – 60% of national median.

Table 2. Assessment of poverty in the Baltic States

Means and approaches for exploring poverty	Estonia	Latvia	Lithuania
1. The main data source.	Estonia's Household Income and Expenditure Survey conducted by the Statistical Office of Estonia.	Household Budget Survey conducted by the Central Statistical Bureau of Latvia; Labour Force Sample Survey.	Household Surveys conducted by the Statistical Office of Lithuania.
2. The main national organizations dealing with poverty.	Ministry of Social Affairs.	Ministry of Welfare.	Ministry of Social Security and Labour; National Social Committee.
3. Poverty line	Absolute poverty line: minimal expenditure by household members which consist of a) costs of a minimal food basket; b) housing costs, and c) basic clothing, education and transport expenditures. Relative poverty line: 60% of national median per capita income.	Absolute poverty line: the nationally set minimum monthly per capita income level. Relative poverty line: 75% of the average per capita income at the disposal of a Latvian resident.	Absolute poverty line: about two minimal subsistence level (MSL). Relative poverty line: 50% of average per capita consumption expenditure.
4. Poverty layers	1) direct poverty (the incomes per household member are 80% or even less of the absolute poverty line); 2) endangering subsistence (the incomes are 81-100% of poverty line); 3) poverty risk (the incomes are 101-120% of poverty line).	1) people with low income (the nationally set minimum monthly income), 2) 50% or less of the value of Latvia's full subsistence goods and services basket. 3) people with 75% of the average per capita income at the disposal.	1) by relative poverty line; 2) by absolute poverty line; 3) by extreme poverty line (MSL).
Poverty distribution (1999)	Direct poverty – 14% of households; Poverty endangering subsistence – 10% of households; Poverty risk – 19% of households (Absolute poverty line was 89 USD in 1999).	Persons with low income (49 USD) – 15.8%; 50% of the full subsistence basket per person (70 USD) – 31.2%; 75% of the average income per capita (79 USD) – 39.3%.	By the relative poverty line (68.7 USD) – 15.8%; By the absolute poverty line (65.3 USD) – 13.1%; By the extreme poverty line (MSL= 31.3 USD) – 0.9%.
Risk groups	Young families with children; households with unemployed family members; persons with disabilities; elderly people.	Families with three and more children; single-parent households with children; households with unemployed family members; elderly people, families which depend on incomes from agriculture.	Families with children; households with unemployed family members; farmers, pensioners, people with low education.

Sources: National Statistical Offices of the Baltic States; National Poverty Reduction Strategies of the Baltic States, Poverty Reduction in Estonia, Latvia, and Lithuania, Riga: UNDP, 2000; Author's compilations.

In calculating Estonia's absolute poverty line, the levels of minimal expenditure by household members were taken as a starting point. The set of minimal expenditure ordinarily consists of 1) costs of a minimal food basket; 2) housing costs; 3) basic clothing, education and transport expenditures.

The absolute poverty line is a dynamic indicator, which is adjusted annually according to changes in the cost of living. In Estonia the settled level of minimum expenditure was 78.6 euros (1226 EEK) per household member (per month) in 2000. The costs of a minimal food basket were at the same time 38 euros (593 EEK). This absolute poverty line makes up 70.3% of national median per capita income. According to the European Union standard (see Table 1) this absolute poverty indicator is comparatively high in Estonia. The share of population living below the poverty line has been rather stable in Estonia during the period 1996-2001. The most drastic change in poverty situation was in the years 1999 and 2000 when the after-effects of Russian crisis on Estonian economy appeared. The poverty level rose by almost 2 percentage points mostly due to increase of unemployment. In 2001 the situation stabilized and the share of Estonian population living below the relative poverty line stated by the European Union (60% of national median income per capita) was 17% (about 230 000 persons) (Household Living Niveau, Statistical Office of Estonia, 2002, pp. 34-37 and p. 60).

There are several poverty layers in Estonia: 1) direct poverty (the incomes are 80% or less of the absolute poverty line); 2) endangering subsistence (the incomes are 81-100% of the poverty line); 3) poverty risk: the households and individuals remain in the poverty risk area if their incomes per household member are 101-120% of the poverty line.

A person is considered to be poor in Latvia if his or her income is less than 1) 75% of the average income at the disposal of an individual Latvian resident; 2) 50% of the value of Latvia's full subsistence goods and services basket. People with extremely low income have a monthly income that is less than the nationally set minimum level. The consumption patterns of the Latvian households indicate that the largest share of the limited resources accessible to Latvia's poor is spent on food and housing. Poverty is more widespread and entrenched in rural areas. In rural areas more than 70% of the population live below the crisis subsistence minimum, while in urban area this indicator is about 50%. Although the highest risk group for falling into poverty is families with three or more children, age remains a factor that can increase a person's risk of falling into poverty. Discrimination in the labour market based on age can be a serious obstacle for people in forties and fifties seeking employment. A study on the relationship between ethnicity and poverty has concluded that ethnicity is not of major relevance regarding the distribution of poverty in Latvia. Other personal characteristics, such as education, and rural/urban settlement, are much more important in explaining differences in poverty level in Latvia (Poverty Reduction ..., UNDP, Riga, 2000, pp.31-32).

In calculation Lithuania's absolute poverty line indices of a Minimal Subsistence Level (MSL) and State-Supported income (SSI) have been in use since the beginning of 1990s. The SSI is approximately 10% higher than the MSL. Despite of its progressive loss of value in relation to the initial consumption basket, the MSL is still applied in developing social policy in Lithuania and it is also referred as political and social poverty line. It represents the minimal income guaranteed by the government and the state-supported income (SSI). The absolute poverty line is about two MSL. The Lithuania's Statistical Office calculates also relative poverty line, which forms an amount equivalent to 50% of average consumption expenditure. The relative poverty line in Lithuania is almost equal to the average social insurance pension and it covers 40% of the Lithuanian average wage (after taxes). Poverty tends to be more widespread among certain segments of the Lithuanian population and it is more likely appearing among those who are only marginally participating in the active

economic life, or those who have dependent family members. Pensioners have higher poverty rates than the average, with almost 21% living in poverty. 30% of farmers and 40% of the unemployed or people who for other reasons were not working were also poor. The lack of good education is also serious risk factor of poverty in Lithuania. The distribution of poverty among people with university education, and those with only basic or secondary education differs by as much as six or seven times (Poverty Reduction ..., UNDP, Riga, 2000, pp.17-18).

There is no doubt that the level of economic development of the Baltic economies has had a major impact on the scale of poverty in these countries. During the first period of reforms (1991-1995) the Baltic States' economies experienced a significant downturn. In 1996, 21.4% of Latvians had per capita income below the 50% of the average per capita income, 18% of the Lithuanians lived below the relative consumption poverty line (50% of average expenditures), and 12% of Estonians lived below the 50% of per capita median income (18% below the 60% median income – the officially stated income poverty line in EU) (Lantz-de Bernardis, 2002; Household Living Niveau ...,2002). In the EU member states the average share of population living below the poverty line was 17% in 1996.

At the same time inequality significantly increased in the Baltic States during the recent decade. The Baltic States belongs to the countries with high inequality: the Gini index is around 0.34-0.36. In Estonia the Gini index jumped even to 0.39 in 1993 and 1994. The previous studies have showed that the people from the post-socialist countries are less willing to tolerate existing income inequalities, even after the actual level of income inequality and other determinants of attitudes are taken into account (see Suhrcke 2001). Consequently, additionally to absolute poverty people seriously suffer from the consequences of inadequate social participation and integration due to rapid changes in their households' economic life and a rupture of social bonds between the individual and society.

In conclusion, despite some cross-country differences in developing methodological approaches for exploring poverty issues, it is possible to summarize

- 1) The concept of poverty and indicators used for indirect assessment of poverty in all three Baltic States are closed to those used in EU and OECD countries.
- 2) The majority of the Baltic States' population was significantly suffered from the transition processes, especially during the first years of transition. The main risk groups for poverty are the families with small children, people with low education, unemployed, elderly people and people from rural areas.
- 3) The differences in using methodological approaches and statistical indicators for assessing poverty in the Baltic States complicate direct comparison of poverty situation between these countries. In Lithuania the share of people who were living under the relative poverty line (50% of average consumption expenditure) was around 16% in the end of 1990s. In Estonia 17% of population lived below the relative poverty line (60% of national median income per capita) in 2001. These indicators are roughly in accordance with the average share of population living below the poverty line in the EU member states.
- 4) Using additionally information about economic and social environment of the Baltic States (see also Gassmann, 2000) it is possible to suggest, that the share of population that suffers from poverty is the biggest in Latvia.

In order to analyze the results of indirect and direct poverty assessment it is possible to compare households' actual income per capita and the households' self-evaluation of their

economic situation and the income per capita considered necessary to have a normal life. In the Estonian Household Income and Expenditures Survey developed by the Statistical Office of Estonia since 1995, the households have five options for assessment of economic situations:

- 1) consume without any restrictions;
- 2) afford everything needed for a normal life;
- 3) manage generally;
- 4) make both ends meet;
- 5) live in very poor conditions.

The self-assessment results of the Estonian households' economic situation support the statement that not all people have shared the economic success of the country. But surprising is that the share of households cannot manage generally is so remarkable: more than 50% of the households (table 3). This share is more than three times bigger than the share of population living under the poverty line stated according to the EU rules.

**Table 3.** The self-assessment of the Estonian households' economic situation in 2001 (EUROS per household member)

Options for assessment	Share of the households (%)	Necessary income	Actual income	Ratio of necessary and actual income (
1) Can consume without any restrictions	0.4	428	422	1.01
2) Can afford everything needed for a normal life	7.0	340	301	1.13
3) Can manage generally	35.7	278	194	1.43
4) Can make both ends meet	50.1	228	115	1.98
5) Living in very poor conditions.	6.8	206	72	2.87
Average	100	253	155	1.63

*Source:* Estonian Household Income and Expenditure Survey, Statistical Office of Estonia; Paas and Võrk, 2003.

More than a half of the Estonian households consider that their economic situation in 2001 was much or somewhat worse than it was five years ago. These results are also quite surprising. In 1996, the Estonian economy had only started to grow from the very bottom where it was in 1993-1994. During the period 1996-2001 the GDP per capita increased about two times and average salaries about 1.8 times. Thus, it seems that the Estonian households are very critical about their own economic life and their expectations regarding improvement of households' economic situation have probably been higher than it has happen in reality despite rather quick economic development of the country. The assessment results also indicate that there is some rupture of relationship between individual and society. People suffer from the social exclusion as the relational issues expressed by inadequate social participation and integration. In the case of Estonia social exclusion can also be explained by the failure of institutions, particularly by the labour market institutions. Estonian labour market is very flexible, especially in comparison with the EU member states' average (see also Paas, *et al*, 2003). Trade unions are small and weak. Labour market policy is insufficiently funded and the share of active measures is relatively low: 28% of the overall employment policy budget. The expenditures on the active labour market measures accounted only for 0.06% of GDP in Estonia. This is a very small fraction compared to the respective



average rate of 1.12% in the EU. The low level of expenditure on the active labour market measures leads to the exclusion of some part of the unemployed people from the labour force.

In order to study the self-assessed current economic situation of the Estonian households with respect to the households' socio-demographic characteristics we estimate ordered probit and linear regression models. We consider two dependent variables: a) self-assessed poverty (in the ordered probit model), b) the necessary monthly income per household member for normal life (in the linear regression model). Explanatory variables are the socio-demographic characteristics of the household and household's head, and actual income per household member. The modeling results are presented in the table 4.

Table 4. Empirical results of the regression models<sup>+</sup>

Variables	Dependent variables and method	
	Self-assessed economic situation (ordered probit model)	Required income per capita (1000s) (OLS with robust standard errors)
Head is Estonian	0.172 (6.32)***	0.116 (1.79)*
Head is male	0.231 (10.55)***	0.295 (5.42)***
Age	-0.016 (3.87)***	0.030 (3.18)***
Age squared	0.011 (2.85)***	-0.051 (5.99)***
Kids aged 3 years	0.007 (0.17)	-0.681 (4.74)***
Kids aged 4-8 years	0.109 (3.53)***	-0.612 (11.15)***
Kids aged 9-16 years	0.058 (3.20)***	-0.589 (17.95)***
Adults	0.187 (14.35)***	-0.439 (13.50)***
Secondary education level	0.256 (9.28)***	0.230 (4.71)***
Higher education level	0.721 (19.65)***	0.687 (7.14)***
Income per capita (1000s)	0.245 (40.25)***	0.463 (13.12)***
Constant		3.577 (8.88)***
Observations (n)	11806	11777
(Pseudo) R-squared	0.15	0.38

Source: Paas and Võrk, 2003

<sup>+</sup> Dummies for time periods and for counties were also included. Absolute value of t statistics are in parentheses; \* significant at 10%; \*\* significant at 5%; \*\*\* significant at 1%. Positive coefficients in the ordered probit model can be interpreted so that corresponding variable improves households' satisfaction with the economic situation.

We see that even after controlling for actual income per capita, considerable differences remain in direct assessment of economic situation. The estimation results allow us to conclude that other factors than just income per capita is relevant for household welfare and their perception of normal life.

How can we evaluate the current situation in Estonia in the sense of successfulness of people's adjustment to transition and European integration processes? According Wolfgang Zapf (1984), who expresses the German notion of quality of life, there are objective living conditions and subjective well-being evaluations which together create a typology of welfare positions (see also Berger-Schmitt 2000, p.11). The objective living conditions are ordinarily the ascertainable living circumstances, such as material aspects, working conditions, state of health and social relations. Subjective well-being expresses evaluations of living conditions including also cognitive and affective components caused by the peoples' position in the society. The combination of good living conditions and bad subjective well-being represents a dissonance. Poor objective living conditions coinciding with bad subjective well-being represents a situation of deprivation. Poor living conditions in combination with high well-being can be described as adaptation (Figure1).

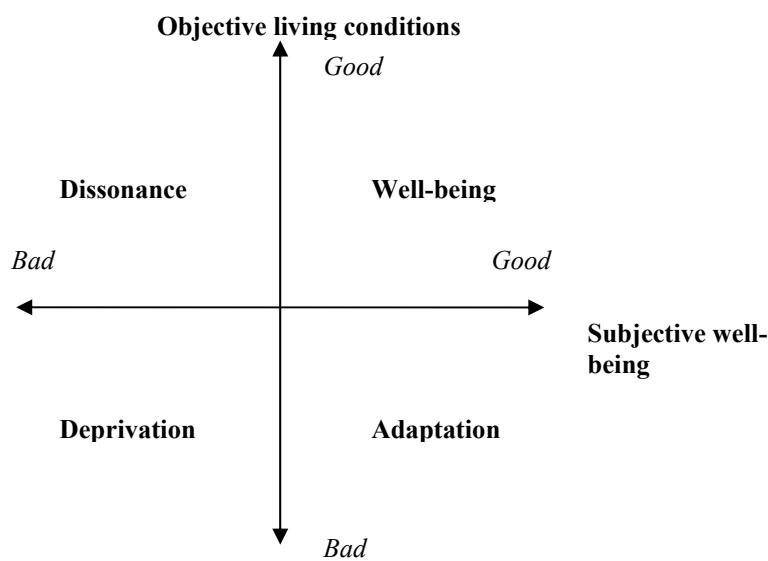


Figure1. Assessment of living conditions (Based on welfare typology of Wolfgang Zapf, 1984)

Despite the quick economic growth and significant increase of salaries during the recent years, the objective living conditions cannot be described as good in Estonia, particularly in the European context. The level of Estonian per capita GDP (PPP adjusted) is only about one third of the EU countries respective indicator (Straubhaar, 2001). Estonian institutions are still rather weak in order to support people in their adjustment processes. Thus, self-assessment of households' economic situation indicates that both objective living conditions and subjective well-being of majority of the Estonian households are bad. The self-assessment results also characterize the adjustment of people to the changes in the labor market and to the new social protection system. Important task of the social protection system is to avoid serious social exclusion and to create conditions for sustainable social development. We can conclude that at the present time Estonian society is still characterized by the deprivation and the people's adjustment to the quick changes caused by the transition and integration processes is not finished yet.

### **3. HOW TO OVERCOME THE NEGATIVE SOCIAL CONSEQUENCES**

The poverty issues assumed new urgency in Western Europe with the slowing of economic growth and rising unemployment in the 1980s. At the beginning of the 1990s nearly 50 million Europeans were living under the poverty line. Toward the end of the decade this number had already risen to 60 million Europeans (Sainsbury and Morissens, 2002, p.3). Therefore, the problems of increasing poverty and social exclusion are at the centre of the studies and policy debates of the European Commission.

In 2001 the European Union endorsed a policy document on poverty and social exclusion and inclusion (Joint Report on Social Inclusion, 2001), which analyses the situation across the member states and identifies the key challenges for the future in order to strengthen the European social model. It is thus a significant advance towards the achievement of the EU's strategic goal of greater social cohesion in the Union during the period 2001-2010; thus, including also the period of adjustment with the EU eastward enlargement.

There is an overall agreement that economic growth is a pre-requisite for poverty reduction. While many studies have proven a correlation between economic growth and poverty reduction, there are also some findings, which indicate that economic growth alone is not enough to ensure broad-based improvement in people's welfare. The UNDP study conducted in 1996-1997 examined the relationship between growth and the share of people living in income poverty in 38 countries; most of them were developing countries. The results of the study showed that growth in countries with high degree of inequality had less effect on poverty reduction, since the increases in income are channelled disproportionately to the more advanced groups (see Lantz-de Bernadis, 2002).

The poverty reduction strategies are playing an important role in widening people's choices and their access to opportunities. The role of the social protection system in reducing poverty is manifold. It has to support the most vulnerable groups of population, to reduce poverty risk and social exclusion and to encourage people to improve their human capital. That is important precondition for achieving sustainable human development and stable economic growth.

The increasing inequality and officially recognized existence of poverty and unemployment are the new phenomena for the post-socialist societies. Therefore, it took some time to recognize the existence of poverty also in the Baltic States. Estonia, Latvia and Lithuania started tackling the issue of poverty and elaborating the poverty reduction strategies only in the second half of the 1990s. The UNDP, World Bank, EC and ILO had a remarkable influence on dealing with this issue and implementing measures in order to alleviate the consequences of poverty in the Baltic States.

The Baltic States have elaborated their National Strategies for Poverty Reduction with the support of the UNDP Poverty Strategies Initiative Programme. All three strategies stress the importance of the following three elements in poverty reduction:

- 1) promoting economic growth;
- 2) investing in human capital;
- 3) strengthening the social protection system.

The main tasks of the poverty reduction in the Baltic States are settled according to the requirements of the international organizations. The poverty reduction initiatives are directed to guaranteeing a basic coping capacity for those groups of the population living below the poverty line, and to preventing and reducing the risk of poverty. A great emphasis is given on strengthening labour market policies in order to promote employment and income generation

activities. The main poverty reduction targets emphasized in the poverty reduction strategies of the Baltic States are resumed in the Table 4.

Table 4. Poverty reduction targets in the Baltic States

Country	The basic areas for poverty reduction or/and main targets
Estonia	General increase in the population's material resources. Better access to opportunities provided by the community and guaranteed participation in policies (regional policy, labour policy, social policy). Vertical redistribution of community resources (social policy, tax policy). Development of human resources (culture; education and health policies). Formation and mobilization of public opinion (information and media policies).
Latvia	Reduction of the number of people with low income to 10% of the population by 2015. Reduction of the total number of low-income and poor people to 25% of the population by 2015.
Lithuania	Eliminating extreme poverty by 2003. Reduction of relative poverty to 10% of the population by 2005. Reduction of the level of poverty suffered by the poorest social groups to 15% of the population by 2005.

*Sources:* National Poverty Reduction Strategies of the Baltic States; Poverty Reduction in Estonia, Latvia, and Lithuania, UNDP, Riga, 2000

Latvia's and Lithuania's poverty reduction strategies consist of concrete tasks and deadlines for eliminating poverty and reducing the number of people with very low income. In Estonia's strategy paper the basic areas of poverty reduction are presented giving attention to the target groups for poverty reduction strategies. These target groups are:

- 1) young families with children;
- 2) the unemployed and job-seekers, in particular long-term unemployed;
- 3) individuals with low incomes (underemployed, involuntary part-time workers, underpaid qualified employees, workers with low professional qualifications);
- 4) individuals with special needs and their households (people with disabilities and/or chronically ill);
- 5) elderly people (people over 60 years of age); 6) marginal groups: individuals insufficiently integrated into societal structures (around 50 000 – 70 000 persons).

The role of the social protection system in reducing poverty is rather modest in the Baltic States. The real value of social protection costs has been declining in all three Baltic States since regaining independence in 1991. The share of social protection costs in GDP has declined in Latvia and Estonia and there was only a small increase of this share in Lithuania during the recent decade. As a consequence, people are not receiving fully acceptable social support in order to adjust with all tremendous changes of transitional societies, to avoid a rapid increase of inequality and poverty and to support social cohesion as a necessary precondition for economic growth.

The European Union social protection system is not universal. It does not offer clear positive experience for the new member countries in order to develop the social protection system that supports population's adjustment processes with the new economic and political systems. There are four models of social protection systems developed in the EU current member countries (Anglo-Saxon or liberal welfare regime, continental or conservative corporatist regime, Scandinavian or social democratic regime and Southern-European regime) which conceptions and policy measures have experienced both success and failure.

The social protection systems of the Baltic States are not homogenous and they do not exactly follow any of the four social protection models used in the EU member countries. They can currently be described as rather liberal and therefore it can be argued that the Baltic States' social protection systems are most similar to the Anglo-American system. The Baltic social protection systems have more contributed to the economic efficiency than to the social cohesion of society. The changes in the Baltic labour markets and their institutions have contributed to rises in wage inequality and also in overall inequality.

Accession of the Baltic States to European Union requires development of elaborated strategies giving continuing emphasis to social protection of people and at the same time improving the flexibility of the labour markets. In some sense these are controversial tasks. In the case of the Baltic States as small transitional societies, the controversial role of social protection system, particularly of institutions and labour policies in reducing poverty could be overcome by increasing productivity of labour force. The key issues are the development of more innovative skills at lower school levels and of the complex problem-solving techniques at higher school levels, improving the quality of vocational education and increasing the amount of workplace training, as well as expanding the active labour market programs and creating better conditions for lifelong learning. The development of labour market policy measures in the Baltic States has to ensure the fulfilment of the main labour policy goals like improvement of allocative (matching supply and demand) and dynamic efficiency (increasing the quality of the labour force) and supporting the sense of equity and social justice among labour force participants. It is important to ensure higher levels of employment and labour flexibility that at the micro level could reduce social exclusion, and at the macro level improve the ability to finance social expenditure.

In conclusion, by elaborating and implementing strategies for development of the Baltic States both components of welfare – economic, social – should be taken into account. The determinants of economic development are intensive internalization, innovation and development of new technologies. The role of the human factor increases in step with the role played by know-how, innovation, organization and management, and other quality factors in global competitiveness. The content of the human factor is changing: individual characteristics such as level of education and health (the human capital) are accompanied by the growing importance of social relations shaped by interaction between people (social capital). The social protection measures should be more targeted on the most vulnerable groups of population in order to avoid social exclusion and to support social cohesion. The improvement of information system about the real economic situation of households and their welfare perceptions is necessary in order to implement targeted social protection measures.

## **CONCLUSIONS**

More than decade-lasting economic reforms and structural adjustment have had serious social consequences and costs that may have negative impact on the Baltic States reintegration into Europe and joining the EU. The main social consequences of the transition and EU integration

processes are unemployment (particularly structural unemployment) as a new phenomenon for the post-socialist societies, increasing inequality, poverty and social exclusion.

Under the former central planning regime the Baltic States like the other post-socialist countries was characterized by more egalitarian income distribution than western market economies. This situation has changed dramatically after the onset of transition; as a consequence the income inequality has been rising much faster than in any of the established market economies during the same period. Consequently, additionally to absolute and relative poverty people seriously suffer from the feeling of social exclusion. That also partly explains significant differences in results of indirect and direct assessment of poverty. For instance, according to indirect assessment of poverty 17% of Estonian population is living below the relative poverty line. But according to the household self-assessment of their economic situation around 57% of families found that they are living in very poor conditions (6.8%) or can make both ends meet (50.1%) in 2001. Thus, Estonian households are critical about their own economic situation. Despite the quick development of Estonian economy in recent years, only 24% of households indicate that their economic situation has improved in 2001 comparing to 1996. Consequently, the expectations of the population regarding improvement of their households' economic situation have evidently been higher than the real development can fulfill.

The households' low self-assessment of their economic situation is probably also influenced by the fact that the Estonians like the people from other post-socialist countries are less willing to tolerate income inequalities than people from the western market economies. The reason for this low tolerance is also social exclusion as relational issue, which is caused by the weak social bonds between individual and society. The speed of transition processes has often been quicker than expected and people cannot adjust with big changes so rapidly.

Thus, increasing inequality, poverty and social exclusion are serious issues creating social tensions and having a negative impact on human capital formation and economic growth of the Baltic States. Therefore the development of social protection measures and poverty reduction strategies are playing an important role in economic and social development widening people's choices and their access to opportunities. The role of the social protection system in reducing poverty is manifold. It has to support the most vulnerable groups of population, to reduce poverty risk and social exclusion and to encourage people to improve their human capital. The unavoidable precondition for European integration euro-zone enlargement is the increase of labour market flexibility. At the same time the accession of the Baltic States into EU requires the development of employment protection regulations and the increase of minimum wages, social benefits and pensions. New labour market institutions and strict labour regulations may reduce labour flexibility and increase unemployment. Thus, the Baltic States have to solve contradictory tasks – to increase labour flexibility and at the same time to follow the rather strict EU labour regulations.

In summary, solving possible negative social consequences of the rapid transition and EU eastward enlargement processes needs big investments into human capital (education, training and health of people) and development of the social protection systems according to the national strategies oriented to sustainable development. The latter ensures that the needs of current generations are met without impeding future generations. The enrichment of current generations is acceptable only if it strengthens welfare resources and improves the factors of development by investing in infrastructure, technological development and human resources. This should improve the position of current generations and, at the same time, increase the development potential of future generations.

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