MARKET ECONOMY. NEW CHALLENGES TO LITHUANIA’S ECONOMIC AND SOCIAL FUTURE

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ABSTRACT. The article analyzes new challenges to Lithuania’s economic and social future. It provides a detailed analysis of the problems regarding Lithuania’s economic development and assessment of the present economic situation. A lot of attention is paid to analysis of Lithuania’s economic reserves and potentials. The article may be of interest to those who are not indifferent to the economic and social issues in Lithuania.

New challenges of Lithuania economical and social future are analyzed in this article. Problems concerning the development of Lithuania economics are thoroughly described and the evaluation of present economic situation is portrayed. Much effort is put into development of Lithuania economics reserves and capabilities. The article is orientated for those who are interested in questions involving Lithuania economics and social life.

1. MARKET MECHANISM AND GOVERNMENT’S ROLE PURSUING MONETARY AND FISCAL POLICY.

The system of a country’s economy consists of: companies, households, state institutions, banks and communications, goods, services and money. Productivity of an economic system is described by the value of final goods produced within a certain period, i.e. gross domestic product (GDP) per capita in the country.

Productivity of an economic system depends a lot on its management. The common worldwide view is that the most reliable economic system, which is also self-regulating, is market. Usually this system is called market economy.


The practice has shown, however, that market economy in its pure form, does not always act as self-regulating instrument, as market economy tends to fluctuate. Recession is followed by unemployment. Economic crisis may last for quite a long period. (see Fig. 1).
J. M. Keynes, an English economist, created a theory on reasons of crisis, which is presented in his work “The General Theory of Employment, Interests and Money”, 1936. In his opinion, the main reason of a crisis is money, the “blood circulation” of an economic system, which, by going from hands to hands disturb the balance between the savings and investments. If savings are not employed, production is hampered and starts declining. At the same time unemployment starts growing. Income of the population starts decreasing and so does their purchase power. That means that savings decrease too.

It is government who has to find a way out of this vicious circle and to regulate the situation. It has to make investments by itself and, moreover, to encourage other investments.

Although investments are seen as a major factor for economic development, too much investment may trigger another problem – inflation, which is at the opposite end of the scale than unemployment.

Consequently, market economy has to be mildly regulated by the government. At present, two major means are employed to regulate market economy:

1. monetary policy;
2. fiscal policy (taxes, budget) (see Fig. 2).
Market economy is an open system. Once principles of open market economy are realized, there are no serious restrictions for trade with foreign countries. Results of trade with foreign countries, i.e. export-import ratio, gain significant importance. Today, only export of top quality production and strategic raw materials is economically useful. The latter, unfortunately, are not found in Lithuania. That’s why it is essential that we specialize in one or another field and concentrate all scientific potential and applied research in that particular field. That requires investments. Individual companies lack such resources; so targeted state support is absolutely necessary.

Furthermore, it should be emphasized, that the concept of public welfare includes not only material prosperity. Cultural values are equally important. Competition-driven market mechanism does not accept any principles of morality. Competition dooms the weak. Only the state can humanize economic relations. “No society can be really happy and prosperous if the greater part of it is the poor and miserable”, says A. Smith in the above-mentioned book.

In the theory and practice of economy two extreme approaches to state economy management are observed: socialism and liberalism. Most debates arise because of the understanding of social justice. Socialists understand is as unification of income, while liberals understand it as unification of possibilities. The first argue, that the main cause of all social injustices is private means of production (private capital) and unlimited meanness of businessmen. The latter see private property as something that encourages responsibility, initiative and creativity. So, the first are for maximum state interference and the others are for maximum freedom for activity. The truth, as always, is in the “golden middle”.

Fig. 2. Essence of monetary and fiscal policy
At present, in practically all countries of the world we observe market systems that are more or less regulated by state. Lithuania is no exception in this aspect.

The right market economy system has to create not only material, but also social welfare. In today’s world, efficiency of market economy systems is estimated by many criteria, namely:
1. GDP and tempo of its growth
2. unemployment level
3. inflation level
4. real income of the population, family budget
5. social security
6. environmental protection
7. poverty level and percentage of the poor
8. ratio of export and import
9. state debt, etc.

At present the welfare of different countries of the world is compared in three aspects and using three factors: GDP, education and average life expectancy. Arguably, only a rich country may achieve high economic indicators and at the same time successfully tackle social problems.

The Government of the Republic of Lithuania, by its decision No.1645 of 22 December 2003, approved a High Technology Program. This program is oriented to the development of 5 industries (biotechnology, mechatronics, laser technologies, information technologies and nanotechnologies, and electronics). Lithuania develops these industries and produces competitive products. Implementation of this program will require concentration of funds and specialist efforts, development of the already existing in the world competitive high-tech production, creation of jobs for high qualification specialists and encourage investments into high-tech production.

Moreover, the Government of the Republic of Lithuania by decision No.1656 of 22 December 2003 approved a long-term strategy of scientific research and experimental development. The strategy aims at improving the country’s scientific – technical potential and ensuring that it is efficiently used for increasing company competitiveness. The long-term strategy of scientific research and experimental development set forth the following major strategic goals:
- by 2015 Lithuania has to become a knowledge society;
- Within the forthcoming 7 years Lithuania has to achieve, that interaction between science and production would match the European practice of innovativeness.
- By 2010 expenses for scientific research and experimental development from all sources of financing should reach up to 3% of GDP, and private expenses for scientific research and experimental development should amount to 2% of GDP;
- Within the forthcoming 10 years the high-tech production should reach about 20% of GDP.
Sixteen years ago Lithuania regained its independence and since then it has been successfully employing principles of free market – market economy.

The year 2004 was very significant to Lithuania, since it became a member of NATO and acceded to the European Union (EU) as a full-pledged member. During the past decade Lithuania has managed to restructure its economy and got ready to compete with the other countries of the EU. However, decisive measures taken to reform the country’s economy were very costly in terms of social welfare. The positive achievements were overshadowed by such shortcomings as small foreign investments, low average wage, emigration of the population, lack of qualified labor force, miserable pensions, superficial reforms in education and health care, ever-increasing discrepancy between the poorest and the richest.

The worst situation is, probably, in the field of education. During all these years of Lithuania’s independence, the system of education has been undergoing constant modifications, one reform followed another. Employees in the system of education can hardly adapt to the ever-changing requirements. Their workload has been increasing. In order to earn more, many people took up several jobs. In such situation, what quality of their direct responsibilities or scientific work can we talk about? People simply do not have time for that. The 2004 Study of Lithuania’s investment climate, conducted by the World Bank, states that at present the reformed system of education seeks quantity but not quality.

Economic development has been observed in all sectors of economy, and first of all in those of industry, construction, transport and hotels.

The country’s average monthly wage at the end of 2004 was 1144LT/month, in Latvia – 1018LT/month, in Estonia – 1531LT/month. For the sake of comparison we may look at the average monthly wage of the same period in Germany. It amounted to 12072LT/month. Thus, the average monthly wage of Germans was more than 10 times higher than the average monthly wage of a Lithuanian. And the average monthly wage in Denmark is 19448LT/month and exceeds the average monthly wage of Lithuanians even 17 times. According to the forecast for 2005, the average wage should grow by 8% and reach 1235LT/month.

As to the purchase power, in 2004 the GDP per capita in Lithuania made up only 39.3% of the EU average and was one of the lowest among the newcomers of the EU. A sudden increase in the export to the EU countries, forecasted by the specialists of the Lithuanian Free Market Institute for the period of 2002-2004, was not observed. In 2004 Lithuania’s total trade deficit was 8.6bn. Litas, and trade deficit with the EU countries amounted to 4.4bn. Litas. At the end of 2004, export to the EU countries made up 66% of the total export of Lithuania.

Since similar processed were also observed in other post-socialist countries, it may be assumed, that such social phenomena as unemployment, low wages and pensions, are unavoidable when old production technologies and management methods are being radically changed. Positive effects of reforms for the country’s economy and growth of income of different social groups are only observed after some time. Rapid growth of Lithuania’s GDP, which in 2001-2004 exceeded the average of the EU countries more than 4 times, and growth of labor productivity by 6.1% on average show, that the restructured economy has created preconditions for rapid growth of national income. That offered new possibilities for a greater number of people and fostered growth of standard of life, especially in cities.
Unfortunately, it has to be noted, that Lithuania today does not have its niche in the international market and operates in the fields that offer low added value. Growth of Lithuania’s economy is based on traditional activities – processing locally grown production (agricultural production, fishery, and forestry), processing imported raw materials and export of traditional production (furniture, oil refinery products, textiles, transport). In the context of the EU economy, such activities have no prospect, as competition in this market sector is extremely high because of production made in Asian countries, which enjoy much cheaper labor force. [6]

Economy must be oriented to production that gives big added value, and it had to be done five or six years ago. Today we already have a national country development strategy, which envisages ways of efficient usage of the country’s intellectual activity. Foreign experience shows, that high-tech production and intellectual services guarantee the highest added value. Moreover, not only new products give high added value, but also they gain competitive advantage, which, due to information technologies, determine development of those products and their penetration into absolutely all economic sectors. And all this create favorable conditions for growth of the country’s GDP.

In 2005, the World Economic Forum announced new data on global competitiveness. The data reveals one, at the first sight quite controversial and hard to understand phenomenon: three out of six leading (in terms of competitiveness) countries are Northern countries: Finland is number 1, Sweden is number 3 and Denmark takes the 4th position. The other countries of the top six countries are: USA (2nd position), Taiwan (5th position) and Singapore (6th position). Lithuania, in terms of competitiveness, overtakes only a few newcomers of the EU. According to the index of competitiveness, in 2005 Lithuania took the 43rd position (in 2004 it was in the 36th position), overtaking such neighboring countries as Latvia (44th) and Poland (51st), which, although lagging behind, have not worsened their situation if compared with 2004 – in 2004 Latvia was also 44th, while Poland was 60th. [13]

As we see from the above data, Lithuania has not improved its competitiveness; on the contrary, during the last three years it has worsened. Today Lithuania’s position is determined by good macroeconomic indicators. However, taking into consideration negative tendencies of the recent years, the government should pay more attention to the problems with public administration, revealed by the research, such as a high rate of crimes and corruption, too slow and inefficient reform of the systems of education and health care.

How can we explain such success of the Northern countries? The authors of the research point out the following factors determining the economic success of the Northern countries: strong macroeconomic management, good legal environment and efficient institutions, rapid implementation of new technologies in the private sector. Besides, their economies are oriented to long-term programs. Therefore, it is obvious, that the main factors determining development and competitiveness of a modern economy of information society are ideas, innovations and long-term programs, but not labor, capital and short-term objectives. [3]

With a view to gaining advantage from innovations, it is necessary to change one’s way of thinking, to improve macroeconomic management and, through long-term programs, influence development of new technologies in the private sector. Usually, changes in the country’s economic management are very painful, especially to the labor force. Introduction of innovations sometimes triggers a situation, when skills of labor force do not correspond to the new working conditions and people have to change their qualifications, adapt to the new situation, to acquire
new skills. Although it is hard, but it is time to understand, that life in the new and ever-changing market environment requires constant change and life-long learning, as only then we will be able to participate fully and productively in the constantly renewing production processes and compete with the employees of the EU countries.

Very often the concept of knowledge economy is understood as information technologies business and education. Actually, as Margarita Starkeviciute, an economist, points out, successful functioning of knowledge economy is determined not only by economic activities, the main factor of which is knowledge and creativity, but also activities, which disseminate and actively use information – brochures, popular articles and various scientific publications. [9, 45p.]

Today, the input of knowledge economy in GDP generation is growing. That is basically determined by the growth of high-tech industry, communications and financial services. In 2004, traditional businesses accounted for a greater part of GDP. They accounted for 71.2% of the GDP, while knowledge economy accounted for 28.8% only. It is noteworthy, that high-tech industry accounts for a really insignificant part in the general economic structure and at the end of 2004 it was only 1.1%.

In 2004, expenses for research and investment accounted for 5.9% on average of all company’s expenditure. The forecast for 2005 is that expenses for research and investment will reach 6.5%. [13]

With a view to ever-increasing significance of knowledge economy, it is necessary to mention, that the main factor of the growth of knowledge economy is intellectual capital. Intellectual capital – knowledge and creativity – highly affect the outcome of the economic development. Creative energy tries to find ways how to use more efficiently insufficient resources, how to invent or create resource replacements or find other alternatives.

It is obvious, that in the future only those EU countries will create powerful knowledge economies, which will manage to encourage creative potential of the population and create favorable conditions of that. That is why one of priorities of modern economic policy is to develop and nurture culture as a foundation for creativity. Only people of high culture are capable of developing service sector that guarantees new quality life. The following figures could be used for the sake of comparison: at present, Lithuania’s service sector accounts for 63% of GDP, while in the European Union the input of service sector into GDP is about 72%.

3. RESERVES, POTENTIAL AND HESITATIONS

Comparison of the added values of different sectors of economy, i.e. products and services created per 1 hour, with those in the EU countries shows, that traditional sectors – agriculture, hunting and fishery – have the lowest growth potential. The added value of these sectors is 54% of GDP per capita. But this result can be explained by a high number of people working in these sectors, as productivity of these traditional economic activities is only 15% of the EU average. That means, that sectors of agriculture, hunting and fishery have a high potential for introduction of advanced technologies with a view to increasing productivity.
At the moment, 18% of all the country’s labor force is employed in the agricultural sector. It is obvious, that innovations will have a negative effect on employment. Those who remain jobless will have to find work in the sectors of services or new high technologies.

The added value per capita generated in industrial and energy sectors is below 25% of the EU average. This again means, that these sectors have a high potential for innovations and advancement.

The sector of production is dominated by low added value products, while intellectual products with high added value account for just a tiny portion of all production. Export of high technologies, as analytics claim, makes up only about 5-6% of total export.

According to this indicator, Lithuania and Latvia are at the bottom of the list among all the EU newcomers. [6] Only by increasing production of products that generate high added value, Lithuania may expect to increase income per capita and gain a chance within the nearest 20 years to get closer to the average indicators of the EU countries.

The Ministry of finance of the Republic of Lithuania forecasts, that in 2005 the country’s GDP will reach 7%, in 2006 – up to 6%, and in 2007 – up to 5.3.

Lithuania has under-developed sector of services, which already today is giving 2-3 times higher added value. For example, post and communications generate 72LT, and financial services and insurance – 50LT of added value per 1 hour.

At the same time it should be noted, that Lithuania is overtaking all neighboring post-soviet countries by its rates of production growth in the traditional sectors of activity. However, the added value generated in these sectors is low. For example, production of motor vehicles, trailers generate about 26LT, and production of electric and optic equipment generates 25LT of added value per hour.

It should noted, that during the past three years the service sector of our Baltic neighbors, Latvia and Estonia, has been developing much more rapidly. Latvians exceeded the average EU indicator by almost two times, and indicators of Estonia were also better than those of Lithuania.

One of the main reasons why the service sector in Lithuania is so poor and why we are so lagging behind in implementing new information technologies is that both employees and employers have paid too little attention to acquisition of new knowledge.

To keep pace with technological advancement, organizations and institutions of modern economies regularly hold qualification improvement courses, in which employees gain knowledge from the increasingly growing worldwide knowledge fund. In such courses trainees not only acquire some information, but also learn to adjust it to local needs as well as for creation of innovations generation of ideas.

Investment of Lithuanian companies and their employees into qualification improvement was one of the lowest among all newcomers of the EU. Fewer funds for increase of labor force efficiency were allocated only in Romania. Expenses for qualification improvement in Lithuania account for less than 1% of total labor cost. In Denmark, for example, such expenses account for more than 3% [9, 47p] Scandinavian countries (Sweden, Denmark) realized a long time ago that countries without extensive natural resources can take a decent place in the global market only on the condition that they have high quality human and social capital. Therefore, for more than half a century they have been investing into education, science and institutions [3].

Last year in Lithuania most funds for employee training were allocated in the sector of financial services – 1.6% of labor cost; in the sector of real estate and rent – 1.1%, in processing industry – 0.6%, in trade – 0.5%, in social sphere – just 0.2%.
Today, in order to reach the level of the leading EU economies, proper and efficient usage of the EU structural funds for restructuring the country’s economy gains vital role.

According to the European Commission’s directives on funds allocation, in 2005-2008 Lithuania is to receive over 10bn.Lt. That is quite a significant amount of money that almost equals the yearly expenditure of the state. [4] Long-term results and efficiency of absorption of these funds depend on how properly the state will design its expenditure policy and on its priorities. It is necessary to use effective methods of project selection with a view to providing financial support only to those projects, which will generate high added value. The state, taking such decisions, should be oriented not to resolving short-term objectives, but to long-term state programme goals, which would ensure efficient economic development that would lead to decreasing regional differences. Therefore, following the provisions of the General programming document, which establishes directions of the EU fund absorption in Lithuania, it is necessary to encourage development of knowledge economy, ensure efficient usage of the allocated funds and proper administration.

Rational usage of financial resources is possible only in the situation of transparency, which excludes corruption. Efficient usage of the EU structural funds for the development of knowledge economy depends very much on principles and criteria of selection, which ensure optimal state expenses for separate programmes. However, the problem is that criteria of efficiency in social sphere are very hard to define, and it is employees of that sphere, who usually, with rare exceptions, represent interests of their professional groups, define them. And this, naturally, creates preconditions for improper usage of the funds, which eventually will lead to poor results and people’s disappointment.
REFERENCES