1. Introduction

> *"Usually, the IMF or World Bank seem very radical on reforms. Not for us. For us they were always too mild."*

This is how Mart Laar[1], a key architect of Estonia's economic transition, characterised the nature of Estonia's post-socialist transformation. Estonian policy makers have been steadfastly following neoliberal economic policies since the country's regaining of independence in 1991. Firm belief in the virtues of the market, the strong monetarist and supply-side orientation of economic policies, the minimalist, and non-interventionist state are all a testament to the ultraliberal nature of the Estonian economy.

Larner (2000: 9) assumes a "critical distance from the tenets of neoliberalism" on the part of governments when she asks "how is it that such a massive transformation in the policy-making agenda has been achieved"? However, Estonian policy makers, a senior advisor to the President of the Republic of Estonia included, make no secret of their endorsement of neoliberal policies. Enn Listra[2] proudly declares that "I am a supporter of neoliberal fields in economy" placing Estonia's post-socialist administrations among the "very few, that explicitly identify themselves as neoliberal" (Larner, 2000: 8).

In this paper I briefly demonstrate that the neoliberal virtues of small government, *laissez-faire* macroeconomic policies and international openness are all reflected in the economy of post-socialist Estonia. I acknowledge the successes of the transformation of Estonia's economy, such as reorientation of trade from East to West, fast economic growth and high levels of foreign direct investment (FDI). However, I question the socio-economic costs of its transition and argue that Estonian politicians have confused economic growth with economic development. At the beginning of the country's transition the volatile geopolitical environment and uncertainty regarding the economic and political survival of the nation required policies that were speedy and simple to implement. However, for a country with a stable economy and guaranteed political sovereignty continued ultra-liberalism is not justified. Estonia's neoliberal policies have resulted in grave socio-economic disparities in terms of income levels and employment opportunities. The *laissez-faire* economic management of the successive administrations has rendered the country's economy vulnerable to global economic fluctuations and adversely affected the state of Estonia's intangible and tangible infrastructure. From a developmental perspective, Estonian transition has been pursued at significant costs.

This paper integrates existing literature on Estonian transition with information gained from key participants of the country's post-socialist transformation. I conducted 21 face-to-face, semi-structured interviews with leading policy makers who had a major influence on policy choices and/or were first-hand witnesses to decision-making in the early years of Estonia's economic transition in the late 1980s and early 1990s. Despite the well-documented difficulties arising from gaining access to and establishing rapport with elite interviewees (Harvey, 2011; Ostrander, 1995; Thuesen, 2011; *inter alia*), the success rate was seventy percent out of a total population of thirty key decision makers, excluding those who have

1 Prime Minister of Estonia 1990-1992 and 1995-1997

2 Member of the Supervisory Board of the Bank of Estonia

passed away since the events took place. The interviews took place between 2008 and 2012. Over thirty hours of recording has been transcribed and subsequently analysed with the aid of NVivo software, which facilitated the organisation of the interview content along the various themes that emerged. In order to ensure trustworthiness of the findings, member checking, self-critical reflection and triangulation was used. The information gained from the interviews was compared with documentary evidence, including the official databases and documents of national and international organisations.

I use a large number of quotes in my analysis in order to underline the key arguments. I reveal the name of the source (only those who agreed to be named and quoted) where I think it enhances my point.

The structure of the paper is as follows. First I briefly critique neoliberal theory in view of its achievements and shortcomings. In section 2, I demonstrate the neoliberal features of the Estonian economy, which is followed by an examination of their adverse socio-economic impact.

2. A brief critique of the neoliberal ideology

2.1 In praise of the free market

The significance of the freedom of individuals to participate in economic transactions and the achievements of the market mechanism are undeniable. “The market provides economic freedom” (Friedman, 1962: 15). Yet, the importance of free transactions, and “the development of free markets in general and of free seeking of employment… is often overlooked precisely because we take them for granted”. The uninhibited operation of the market forces relies on voluntary participation, which precludes “labour bondage” and the “persistent denial of basic freedom to seek wage employment”, such as prohibiting women “to seek employment outside the family” (Sen, 1999: 112-115).

A striking example of the accomplishments of free market economies is India, which pursued “inward-looking development” aided by protectionist policies with the result that “growth in incomes per head had ground virtually to a halt”. Following economic liberalisation in the 1980s and 1990s, the country’s “GDP per head more than doubled” between 1980 and 2000 (Wolf, 2005: 140-141).

According to the Human Development Index (HDI)

> *“…progress around the world has been impressive… The world average HDI rose to 0.68 in 2010 from 0.57 in 1990, continuing the upward trend from 1970, when it stood at 0.48… Advances in the HDI have occurred across all regions and almost all countries”*
>
> (United Nations Development Programme, 2010: 26-27)

The Report (p. 29-30) also emphasises the convergence between poor and rich countries in terms of HDI. Only ten developing countries experienced no improvement in their HDI. Wolf (2005: 142) attributes these improvements to the achievements of the diffusion of liberal economic policies.

In the centrally planned economies, the “denial of opportunities of transaction” by restricting economic activities was a source of “unfreedom”, as people were “prevented from doing what can be taken to be… something that is within their right to do” (Sen, 1999: 25). In the communist economies, the coordination tasks of the economy – what and how to produce and for whom – were centrally decided by the planning authorities instead of producers. As opposed to buyers’ markets prevalent in capitalist economies, the centrally planned economies were sellers’ markets where buyers were significantly constrained in their purchasing decisions by the lack of variety and endemic shortages (Kornai, 1992: 272-278). The socialist economies were geared towards the accumulation of the means of production at the expense of consumption (Verdery, 1996). “Markets were simply ruled out in many fields” rendering prices ineffective (Sen, 1999: 114) to perform their functions of transmitting information about demand and supply, providing incentives to improve production methods and quality of output, and distributing income. The inherent inefficiencies of central planning ultimately “resulted in a debâcle” of the system (Gros and Steinherr, 1995: 54).

2.2 The neoliberal confusion between economic growth and economic development

Economic growth is widely used as proof of economic development. Wolf (2005: 142) credits economic growth with falling global inequality and declining poverty – “it is the growth, stupid.” However, assessing development in terms of economic growth rates is a very narrow view of progress because GDP includes goods and services that are exchanged in contractual transactions only. As value is determined in terms of price, which do not reflect social and environmental costs (Peet, 2007), measuring living standards and quality of life by a country’s GDP levels is misleading because it excludes crucial factors, such as leisure, quality of the environment, the underground economy, crime rate, life expectancy, access to and quality of education and healthcare, the sale and purchase of second-hand goods and the upbringing of children. Voluntary jobs and work carried out outside of the workplace, such as do-it-yourself activities are not counted as productive activity.

Economic growth and economic development are not synonymous concepts. Economic growth is essential, as it creates opportunities but it is insufficient as its effects are contingent on how its results are utilised (Sen, 1999). Per capita income levels do not guarantee a long and prosperous life. Hayami (2001) and Sen (1999), consider life expectancy a better reflection of standard of living, as it depends on health, which is greatly influenced by the level of and access to health care and the quality of education. Higher rates of economic growth extend life expectancy mainly through improvements in health care and poverty removal.

Proponents of neoliberal policies underline a “strong and robust trend towards catch-up starting in the late 1980s and continuing till today” (Wade, 2009: 149). However, “the pronounced convergence of economic policy toward “openness” worldwide over the past 20 years has gone with divergence of economic performance… With 38 percent of the world’s population, China and India shape world trends in poverty and inequality” (Wade, 2004: 579 and 577). Although China’s economic growth rates have been extraordinary over the past three decades, its impressive economic growth and successful poverty reduction must not be attributed to neoliberal policies, as its “policy regime is too heavily managed to score well by globalisation or Washington Consensus criteria”. Once China is excluded from global income inequality measurements, income inequality indicators show a significant rise. “In short, no China, no overall catch-up" (p. 150). If India is also excluded, the gap is even bigger, denying the neoliberal claim of decreasing income inequalities. Between 1950 and 2001, global PPP-adjusted income inequality, as well as between-country global PPP-adjusted income inequality, increased, which is inconsistent with the "argument that a general process of globalisation has driven a general process of catch-up growth" (p. 149-150).

Advocates of neoliberal theory point to the theorem of Pareto-efficiency not only to underline the fully efficient nature of the self-regulating economy but also "to cut out the need for distributional judgements" (Ingham, 1995: 223). According to them, the free market achieves advancement in overall living standards through the 'trickle-down effect' rendering social protection by state intervention unnecessary. Income equality and efficiency are regarded as incompatible because equality of outcome removes the incentive to work and to improve performance. A free-market system with deregulated markets dominated by private enterprises is perceived as the remedy for social problems. Lower taxes and less regulation supposedly stimulate entrepreneurship and investment creating employment opportunities and increasing income levels (Harvey, 2005).

However, I agree with Stiglitz's (2002: 78) assessment of 'trickle-down economics':

> "…trickle-down economics was never much more than just a belief, an article of faith… While it is true that sustained reductions in poverty cannot be attained without robust economic growth, the converse is not true: growth need not benefit all."

3 Estonia's road to capitalism: 'the shock without the therapy'

Estonia's post-socialist transition has been characterised by the 'big bang approach' (Lauristin and Vihalemm, 1997), which Kolodko (2005) labels the "shock without the therapy". The literature praising Estonia's post-socialist economic transformation is vast (Hoag and Kasoff, 1999; Panagiotou, 2001, Norkus, 2007; inter alia). As Feldmann and Sally (2002: 79) put it, "since its restoration of independence in 1991 Estonia has undergone the swiftest, most comprehensive transformation of a national economy in modern times". They applaud Estonia's fast-growing economy based on flat taxes, free trade, low inflation rate and low level of government debt (European Central Bank). Indeed, when examining economic indicators, such as growth rates, competitiveness levels and reorientation of trade, the nation's economy outperformed most transition countries (Feldmann and Sally, 2002; Gros and Steinherr, 2004). Estonian economic growth rates with the exception of the recession of 2008-2009 have been among the highest in the world (Statistical Office of Estonia). By 2004, it had the most competitive economy among the nations that have recently joined the European Union (Global Competitiveness Report, 2014).

Numerous authors (Lauristin and Vihalemm, 1997; Hoag and Kasoff, 1999; *inter alia*) characterise Estonian economic policies as 'shock therapy', while the IMF has repeatedly praised the nation's "disciplined ... Thatcherite economic policies" (Raun, 2001: 24). For credit rating analysts Moody's (2007) "the country's success in economic stabilisation and structural transformation is unparalleled among transition nations". As recently as 2014, the country's economy had the highest ranking (11) among the Central and Eastern European countries (CEEC) on the Index of Economic Freedom (The Heritage Foundation).

On August 20, 1991, Estonia declared the end to Soviet power in Estonia and the restoration of the pre-war Estonian Republic along the 'principle of legal continuity' (Riigikogu[3]). During the first year of independence, the most important tasks were to establish a democratic constitutional order, to achieve financial sustainability, and to consolidate full sovereignty over Estonian territory (Lauristin and Vihalemm, 1997). On the political side, it had to create a new democratic constitution. On the economic level, the transformation from a centralised to a market economy included decentralisation, liberalisation and macroeconomic stabilisation. The country's production system had to undergo substantial changes to suit the needs of a market-oriented national economy (Mygind, 1997).

Estonian elites proactively discarded the legacy of central planning in favour of a free market economy by emphasising values compatible with neoliberal theory, such as individual initiative, self-reliance, accountability, and a minimalistic state, that they claimed were the view of the good life that Estonians widely shared. The "all too visible hands of the party" were replaced by the invisible hand of the market (Verdery, 1996: 181) overnight. The country's first freely elected government in 1992 spearheaded a quick break with the Soviet past, as they claimed that the benefits offered by the paternalistic socialist state such as guaranteed employment and subsidised provisions came at too high a price. In the words of Mart Laar, *"the overall goal was to return Estonia to Europe"*. The priorities of the new government were recovering national sovereignty: the withdrawal of Russian troops from Estonian soil, reorganisation of the defence forces, westernisation of the Estonian Economy, EU membership and cooperation with NATO. Economic policies were characterised by a radical transformation, which Mart Laar summed up as a 'Just Do It' philosophy, named after the slogan of the Nike corporation. His strategy of 'maximum liberalisation' was based on 'four no-s' – no trade barriers, no subsidies, no progressive taxes and no extensive income transfers. Estonia's first post-socialist administration completely opened up Estonia's internal market to foreign producers by eliminating all trade barriers – visible and invisible alike in one stroke. By steadfastly adhering to maintaining a balanced budget state subsidies were phased out (Lauristin and Vihalemm, 1997 and 2009; Smith, 2001). The immediate implementation of free trade measures without gradually decreasing tariffs and converting non-tariff barriers to tariffs distinguished Estonian reformers as the most liberal ever in any economy (Feldmann and Sally, 2002). Estonian policy makers strongly argued for the necessity of 'shock therapy' over a more gradual approach. Andres Tarand[4] offers an explanation:

> *"…the reason was to make all these reforms as quickly as possible. If you wait, you will not have development. It was right, in my mind. It is like a body – if you want to get rid of a sick part, it is better to do it quickly than wait…"*

The features of Estonian economic development since 1991 exhibit classic, even fundamentalist, neoliberal features. The overarching objective of currency stability is achieved by strict monetarist policies. A cornerstone of Estonia's liberal economy is its tax regime. The current tax legislation, which is one of the most liberal tax systems in the world, places more emphasis on

3 The national assembly of Estonia

4 Prime Minister of Estonia, 1994 – 1995

indirect, rather than direct taxation. Personal incomes and distributed corporate profits are subject to a proportional tax rate of 21 percent. All corporate reinvested profits are tax exempt (Estonian Investment Agency), reflecting Friedman's (1962: 174) recommendations of the introduction of flat-rate tax and the "abolition of the corporate income tax".

Prior to the country's EU accession Estonian policies were ultra-liberal to such an extent that international organisations, such as the World Bank and the EU, advised Estonia to 'de-liberalise' them. Indeed, Estonia's adjustment to the EU *acquis communitaire* actually de-neoliberalised its economy to a certain extent through the adoption of measures (Adam, et al. 2009), such as introduction of trade barriers and labour market regulations. Urmas Varblane[5] expains the process of de-neoliberalisation:

> *"…when we started to negotiate joining EU, then suddenly we discovered that when we join EU, we should implement tariffs. It is a very interesting paradox. Estonia is a unique country in the world. Joining the EU does not mean the growth of liberalisation of trade but the growth of protectionism against third countries."*

The influence of the international organisations have actually introduced concepts of economic management, such as the formulation of a national development plan recommended by the World Bank, and the adoption of protectionist policies required by the EU accession criteria.

Market attractiveness in order to attract foreign capital has played an important role in the Estonian economy from the very beginning of transition. Currency stability, low proportional tax rates, equal treatment of foreign and domestic capital, protection against expropriation and a guarantee of unrestricted transfer of profits have brought in significant amounts of FDI into Estonia. Their positive impact was manifold: they partially compensated for the collapse of Estonian industrial production, they improved the variety and quality of services, and they brought with them technology, know-how and managerial skills. 50 percent of all FDI was directed to industry in 1994, which had suffered greatly from the disappearance of SOEs (Liuhto, 1996; Faggio and Konings, 2003). Although initially Estonia's very low labour costs attracted mainly labour-intensive production, FDI represented a large portion of investment. In 2007, foreign investors were responsible for 78 percent of the nation's GDP, which is a significant figure considering the EU average of 40.9 percent. The same year Estonia ranked number 8 on the country rankings of Inward FDI Performance Index, which measures an economy's relative success in attracting FDI (UNCTAD). The stable macroeconomic environment and business-friendly climate made Estonia a very attractive destination for foreign investment within a few years of regaining independence (Raun, 2001).

Larner emphasises the neoliberal conceptualisation of people as "entrepreneurial, enterprising and innovative … political subjects" as opposed to passive subjects of a paternalistic dictatorship:

> "Neoliberal strategies of rule, found in diverse realms including workplaces, educational institutions and health and welfare agencies, encourage people to see themselves as individualised and active subjects responsible for enhancing their own well being." (2000:12-13)

5 Member of the Supervisory Board of the Bank of Estonia

Having endured half a century of restrictions of central planning, many Estonians were eager to engage with this characterisation of human motivation. According to Rein Ruutso[6] "*the totally liberal discourse*" was accepted implicitly that "*proof of freedom is that the individual is able to take care of himself*". Estonia experienced a fast growth of entrepreneurial activity, which partially offset the job losses from the fast decline of heavy industry. While in 1991, 35,000 businesses were registered, the country had 83,000 enterprises the following year. The share of labour force employed by small and medium enterprises (SMEs) increased from 26 percent in 1992 to 40 percent in 1994 (Liuhto, 1996), and this was crucial in absorbing much of the surplus labour due to the fast contraction of output of state-owned organisations. Between 1989 and 1994 full-time employment in agriculture fell by 45 percent, in manufacturing by 25 percent, contributing to a 16 percent decrease in national employment levels (Saar and Unt, 2006). Although the inaccuracy of unemployment figures of the times and the lack of incentives for the unemployed to apply for benefits also contributed to lowering the official unemployment rate (Harter and Jaakson, 1997), the dismantling of SOEs should have resulted in a 15-20 percent unemployment rate, as opposed to official figures of between 2 percent (Liuhto, 1996) and 7 and 8 percent (Smith, 2000). Erik Terk[7] remembers:

> *"…because the SMEs started to develop very quickly, people had a possibility to find new jobs and unemployment didn't rise very high. I remember when I worked as Deputy Minister of Economy, then I did some kind of prognosis about unemployment and we had such a black scenario that we would have maybe some 30 percent unemployment rate in Estonia. In reality it was less than 10. The reason was mainly that this new entrepreneurship started very quickly."*

Estonian policy makers applied shock therapy in order to transform the country's economy quickly and irreversibly. These neoliberal policies consisted of the complete liberalisation of trade, excessively restrictive fiscal policies and the removal of all protection on output, as well as input markets, including the labour market. Between 1991 and 2013 post-socialist Estonia had eleven administrations pursuing economic reform through ultra-liberal policies. However, unlike other Central and Eastern European countries (CEEC), where right- and left-wing parties frequently replaced one another (for example, Poland, Slovakia, the Czech Republic and Hungary) Estonian governments have been continuously following neoliberal economic programmes carrying out as many reforms as possible in the shortest possible time giving social welfare policies a low priority (Lauristin and Vihalemm, 1997 and 2009).

The relatively frequent changes in administration were not accompanied by economic policy shifts but, according to Raun (2001: 25), were caused by various personal "scandals" involving leading Estonian politicians. In essence, due to strongly popular anti-leftist sentiments, there is no significant political left in Estonia. The Estonian Communist Party disintegrated, unlike in other CEEC where the former communist parties survived in some 'rejuvenated' form (Raun, 2001; Adam et al. 2009). Although policy alternation seems to have greatly contributed to the most successful transitions in Central and Eastern Europe (Orenstein, 2001), Estonia's unwavering neoliberal trajectory also resulted in a successful economic transformation.

6 Former dissident, member of the Estonian Popular Front in the late 1980s and early 1990s

7 Deputy Minister of Economy 1989 – 1992

The neoliberal agenda with its ‘the market got it right’ and ‘wealth-destroying government’ principles (North, 2006) seemed the optimal policy choice for Estonian policy makers. Anticommunism went hand-in-hand with liberal reforms in Estonia, bearing striking similarity to right-wing politicians of other CEE countries (Bockman and Eyal, 2002; Frye, 2010). The only difference was the lack of left-wing voices. The Estonian will of “no way to return to the Soviet Union” and to “get as fast and as far away as possible” led to a situation where “everybody wanted liberal policies”. Their goal to achieve the utopia of ‘total freedom’ was reflected in the economic objective of “let’s just liberalise…” (interviews). Having endured half a century of restrictive paternalistic rule, decision makers viewed the neoliberal paradigm as utopian, as expressed by this interview excerpt below:

> *“There is also, some kind of a background feeling in Estonia that if I am going to be a protectionist, then I make myself as some outstanding fool. The main line is liberal and now behave like that and I am not like some Frenchman who is fighting for government and statehood.”*

Jaak Leimann explains:

> *“Friedman and such kind of freedom was very popular here. It is understandable because we had so regulated system for a long time, so regulated from Moscow. So we decided to go from this ‘very regulated’ to ‘minimum regulated’… It was easier to chop this other world. Even such kind of half-regulated was, for us, too regulated.”*

Estonian policy makers unequivocally agree that Estonia’s transition was a “big success”. On a scale of 1 to 5, with 1 representing a failure, none of them rated it worse than 4 minus. According to them, the transformation from a Soviet republic to an independent state “has been extremely successful” (interview).

Ardo Hansson[8] offers his assessment of the country’s transition:

> *“I think it was a big success in the sense that in the end things really took off. Especially if you think that the idea was to kind of integrate with Europe, to raise living standards. I mean Estonia these days is ranked at least by the World Bank as a high-income country and all this, you know, EU membership, NATO membership, exchange rate stability, and so on…”*

Various economists (Feldmann and Sally, 2002; Gillies et al, 2002; Rajasalu, et al, 2003) point to Estonia’s exceptionally high economic growth rate as proof of the nation’s success (Statistical Office of Estonia), despite the limited usefulness of that indicator. An economist reflects on the nation’s economic achievements:

> *“…in the late ‘80s, the GDP per capita of Poland was about 10 percent above that of Estonia. Now I think Estonia’s GDP per capita is above that of Poland, Croatia, Slovakia, Hungary, and so on… I think it has been a pretty solid performance.”*

8 Advisor to the Estonian government 1991 - 1997

4 Growth without prosperity

4.1 Highly uneven regional development

Lagerspetz (2001: 409) acknowledges the success of Estonia's speedy economic transformation but argues that it was "reached at the cost of worsening economic conditions for large segments of the population". Lauristin and Vihalemm (2009: 1) lament that "beneath the surface of extraordinarily high economic growth, society is tormented by unresolved political, economic and social problems." They also highlight the serious problems of inadequate and inefficient social spending and high levels of "social diseases, such as crime, drugs and suicides". Refuting the Hayekian tenet of the 'trickle-down effect' that a growing economy reduces poverty Estonia's high growth rates did not decrease poverty (Macours and Swinnen, 2008). Andres Tarand criticises the priority of economic growth by providing an analogy:

> *"The main criteria all the time – only growth. You know, economic growth. It is stupid to look only for that… I compare it with a 15 year-old boy. He is growing faster than we all but can we suppose that he is responsible? We cannot. It is just like our state now…"*

Estonia's socio-economic indicators support his statement. Continued neoliberal policies left the country's economy vulnerable to global fluctuations resulting in volatile economic growth rates with relatively high levels of unemployment even in years of fast growth. For illustration, I show GDP per capita figures in purchasing power parity (PPS), economic growth rates and unemployment levels. As a comparison, I include other Central European countries, which gained EU membership at the same time with Estonia but followed more gradual transitions.

Table 1 Real GDP growth rate

	1996	**2000**	**2007**	**2009**	**2012**
Czech Republic	4.0	3.6	5.7	-4.5	-1.0
Estonia	5.7	10.0	7.5	-14.1	3.9
Hungary	0.7	4.9	0.1	-6.8	-1.7
Poland	6.2	4.3	6.8	1.6	2.0

Source: Eurostat

Table 2 GDP per capita in PPS. EU average=100

	1996	**2000**	**2007**	**2009**	**2012**
Czech Republic	73	68	83	83	81
Estonia	36	45	70	64	71
Hungary	52	55	62	65	67
Poland	43	48	55	61	67

Source: Eurostat

Table 3 Unemployment rate

	1996	**2000**	**2007**	**2009**	**2012**
Czech Republic	4.8	8.7	5.3	6.7	7.0
Estonia	9.6	12.5	4.6	13.8	10.0
Hungary	9.0	6.3	7.4	10.0	10.9
Poland	10.9	16.4	9.6	8.2	10.1

Source: Eurostat

Although “the size and nature of the problems in the FSU are incommensurable with those in Central Europe” (Gros and Steinherr, 1999: 231), Estonian GDP per capita income has reached a level similar to that in Hungary and Poland, as seen in Table 2. Estonian households, overall, have been enjoying an improvement in their living standards (Statistical Office of Estonia). However, income does not seem to measure adequately economic development, as the fruits of economic transformation have not been shared equally by all segments of Estonia’s population. Economic shock therapy, fast-paced privatisation, and restructuring have put an enormous strain on society. Although the country’s development has been impressive from a strictly output-oriented view, from a socio-economic perspective, the achievements have been much more modest. The country’s development model has been excessively competition oriented (Lauristin and Vihalemm, 2009).

Smith’s (2000: 136) argument that transition “has created a zero-sum game in which regions win and lose on the basis of the ability of their existing economic structures and the particular strategies developed post-1989 to compete for scarce resources" applies to Estonia's post-socialist regional development, as substantial disparities can be observed between rural and urban areas despite the country's small geographic area. Almost two decades of neoliberal policies have led to significant spatial disparities in terms of income levels and employment opportunities, especially between Northern Estonia, which includes the capital, Tallinn and its hinterland Harju county, and the rest of the country. In Northern Estonia all economic and social indicators are high above the national average. Over 80 percent of the region's added value originates from the tertiary sector. By 2008, these fields attracted around 81 percent of total foreign investment stock in the country (Estonian Investment Agency).

Kaia Jäppinen[9] defends the government's position on welfare reminiscent of the Hayekian paradigm of those who can do make provisions for themselves**:**

> *"The economic and social policies of the governments have been moderate through the changes in government. We have not witnessed or experienced extreme differentiations in the population. Surely they are there but the majority of the population manage themselves."*

Mart Laar echoes the liberal view of egalitarian policies to be based on the envy of the 'have-nots':

> *"…when the reforms started life became significantly better for everybody. The problem for the people is that very often they see people who became winners, who became more successful than other people and that has created the problem."*

However, evidence contradicts these assertions. Northern Estonia enjoys much higher employment rates and disposable income levels compared to other areas of the country. As part of macroeconomic restructuring, a significant structural shift has taken place, leaving vast labour surpluses in regions with a concentration of heavy industry, such as the North-eastern part of the country. On the one hand, the Tallinn metropolitan area enjoys a concentration of investment and development. On the other hand, North-eastern Estonia is suffering from a serious decline due to skewed economic development and a lack of appropriate infrastructure. Regional disparities in income levels have not decreased but slightly increased (Jauhiainen, 2002, Statistical Office of Estonia).

The share of the primary sector has declined in all counties, which follows the pattern of economic development. However, the contribution of the service sector has only increased in Harju county, where Tallinn is located. In all other counties, it has either remained the same or has actually decreased. Northern Estonia is undoubtedly the powerhouse of Estonia. The capital, Tallinn, is the country's economic and political centre. Here economic output, employment rates and standards of living are higher than anywhere else in the country. Regional disparities in terms of the contribution of regions to national output have been continuously increasing between the countryside and Estonia's largest cities of Tallinn, the capital, and Tartu, along with their hinterland of Harju and Tartu counties (Statistical Office of Estonia). The inhabitants of Estonia's two biggest cities, Tallinn and Tartu, are on average better educated, tend to speak foreign languages, use more advanced technology and earn

---

9 Senior Consultant, State Chancellery of the Republic of Estonia, 1990 - 1994

increasingly better wages. The population of rural areas, especially in small settlements, have been excluded from Estonia's transformation. They remain in low-paid jobs with little, if any, prospect of improving their standard of living (Heinonen and Emmert, 2006).

Taagepera's (1993: 230) predictions that "in the long run, social issues are likely to crystallise into three 'issue dimensions'" of growing socio-economic divergence between the poor and wealthy, city and countryside, and Estonians versus Russians have become reality.

Two decades of neoliberal policies in Estonia have led to exceptionally high – and volatile - economic growth rates, and vast segments of the population lacking what Sen (p. 3) calls "gainful employment, or economic or social security". Economic growth is not synonymous with economic development, as the latter includes a very important dimension, economic security. Economic insecurity, including unstable employment,

> "…is not merely a deficiency of income that can be made up through transfers by the state (at heavy fiscal cost that in itself can be a very serious burden); it is also a source of far-reaching debilitating effects on individual freedom, initiative, and skills." (Sen, 1999: 21).

Poverty must be defined not only in terms of "the resources or income that a person commands" but in terms of access to economic opportunities, which affects "quality of life… the way human life goes" (Sen, 1999: 3 and 20). By focusing on achieving and maintaining the neoliberal utopia of 'total freedom', they in fact deny the very freedom they hold in such high esteem to masses of the population because freedom "involves both the *processes* that allow freedom of actions and decisions, and the actual *opportunities* that people have". Inadequate processes and/or inadequate opportunities, "including the absence of such elementary opportunities as premature mortality", causes unfreedoms (Sen, 1999: 15-17).

4.2 **'The way human life goes' in Estonia**

In 2008, 46.5 percent of households were in persistent-at-risk of poverty (Statistical Office of Estonia). Average life expectancy at birth in Estonia only reached 1989 levels by 2000, when it was the lowest in Europe. In 2007, it was still the third lowest in the EU (Eurostat). The same year, the at-risk-poverty-rate after social transfers was 19 – in other words, 19 percent of the population had disposable income less than 60 percent of the national median income even after receiving social benefits (Eurostat). However, this figure varied greatly across the country from as low as 11.3 percent in Northern Estonia to as high as 23 percent in the mainly agrarian Southern Estonia and 30 percent in the predominantly ethnic Russian populated North-eastern Estonia (Statistical Office of Estonia).

Throughout the 1990s, birthrates declined by about one-third; average life expectancy fell by 3.5 years for men and 1.5 years for women. The deteriorating living conditions were reflected in fertility rates, which dropped from 2.05 in 1990 to 1.38 in 1995 (Statistical Office of Estonia). According to the Estonian Human Development Report (2002), Estonia has suffered an average annual human resource loss of 120 000 people due to social exclusion in the first decade of transition. The economic situation of families has stagnated or worsened and proved very painful for much of the country's population by increasing income, wealth and social disparities. In 1980, the ESSR ranked 26 on the Human Development Index (HDI). By comparison, in 2006 Estonia was 42 on the same ranking (UNDP, 2010).

Levels of social inequality have risen; the economic situation of families stagnated or worsened and proved very painful for much of the country's population by increasing income, wealth and social disparities (Adam et al., 2009). Despite the harsh socio-economic conditions, Estonia's total expenditure on social protection has consistently been among the lowest in the EU. In 2011 it was the second lowest at 16.1 percent of GDP as opposed to an EU average of 29 percent (Eurostat).

Estonia's ethnic Russian population has paid a high price for the country's neoliberal transformation, which is particularly pronounced in the predominantly Russian Ida-Viru County where 96 percent of the population are of Russian origin (Statistical Office of Estonia). A study conducted in 2004 confirmed the dissatisfaction of ethnic Russians in terms of employment opportunities, access to education and political participation, and found an increasing socio-economic gap between the Estonian and Russian populations (Smith, 2008; Vihalemm and Kalmus, 2009). However, their dissatisfaction has not translated into political polarisation. Of Estonia's 283,000 ethnic Russians (Statistical Office of Estonia) 165,000 are stateless with the status of 'citizenship undetermined'. They have the right to vote in local elections but they cannot participate in referenda and in parliamentary elections. The Russian Party in Estonia, established in 1994, received only 0.9 percent of the 2011 national parliamentary elections and subsequently merged into the Social Democratic Party (Riigikogu).

5. Confusing the means with the ends

Whereas public funds have been used to create the infrastructure needed for the development of certain industries, such as information technology, telecommunications, and finance, investments in areas of basic physical and social infrastructure have been insufficient in Estonia (Eurostat). In addition to healthcare and education being under-funded, the physical infrastructure is also underdeveloped.

Erik Terk portrays the priorities of policy makers reflecting the neoliberal 'market knows best' paradigm:

> *"This new generation started from trade and services and for these people, research and development and technical universities are not a priority. They say that you just must do business. Now we have the results; we invested very small amounts of money in technology and technical universities... It is good that joining the EU we got additional financing possibilities. If you speak about the infrastructure, we've invested very, very small amounts in the infrastructure before joining the EU. Because all the time there was this idea that you must have a balanced budget and the taxation level must not be high and in this case you just don't have money for infrastructure."*

Egle Käärats[10] echoes concerns regarding the country's poor state of infrastructure:

> *"We had a discussion yesterday with top civil servants, people from tax board, Ministry of Justice, Ministry of Economy, Finance and also business people, Estonian Chamber of Commerce, Employers' Association and one thing came*

10 Deputy Secretary General on Labour Policy, Ministry of Social Affairs

up repeatedly, and that was logistics. Estonia is in the middle of nowhere. We say we have railway, we have actually railway connection outside Estonia... to Russia, to the East, not to the European Union."

The administration's hands-off approach to business development has become an impediment, as attested by another passage:

"…the size of Estonia, location where we are on the map and nobody knows us. Lack of knowledge abroad. Ok, Europe knows us. We had an entrepreneur with us yesterday who sells construction foams to insulate buildings and said that.... It's really a pain to go and to take on a new market. They entered Brazil now but he said that it took them 3 years... and they said that one thing besides logistics they miss is the state or business association assistance in going to foreign markets because you need some knowledge, you need quite a long preparation period to enter foreign markets."

The restrictions on counter-cyclical instruments leave the Estonian economy crisis-prone through wide exposure to global economic fluctuations (Hoag and Kasoff, 1999). Indeed, the effects of the recent global depression caused a severe economic downturn in Estonia (European Central Bank), as attested by table 1. However, the government's response to the recent global recession was a further example of its continued commitment to neoliberal policies. The current economic crisis hit Estonia particularly hard. Unemployment rate increased from 5.5 percent in 2008 to 20 percent in 2010, which was among the highest rises in the EU (Arpaia and Curci, 2010). The country's GDP contracted by 16 percent and industrial production shrank by one-third during the same period. Whereas governments around the world "struggled to generate enough spending to keep their workers and factories employed" (Krugman, 2008: 181), the Estonian government actually cut its expenditure by 10 percent in 2009 (Statistical Office of Estonia), despite the small size of government debt. Urmas Varblane underlines the priority of the country's administration to minimise government debt.

"Our government debt is 3 percent of GDP. I guess it is one of the smallest in the world… last year we had a budget surplus."

The commitment of the successive administrations to maintain a balanced budget, a requirement anchored in the country's constitution, restricts their social expenditures and spending on infrastructure. It seems that Estonian policy makers have lost sight of the forest from the trees.

5. Conclusion

Whereas neoliberal policies steered the Estonian economy on track in the early years of its transition, continued neoliberalism has had significantly adverse effects over the nation's economic development. The proportional tax regime and the strict adherence to a balanced budget seriously limit the government's expenditure on infrastructure development and social welfare. The socio-economic costs of Estonia's neoliberal transition have been immense in terms of life expectancy, health care and vast social and spatial disparities in investment levels, employment opportunities, job security and living standards. Whereas the country's accomplishments have been respectable in terms of economic growth rates and income per capita levels, from a developmental point of view it is lagging behind. Socio-economic indicators show a picture of economic insecurity and increasing disparities between the various strata of society.

Estonian policy makers have been confusing economic growth with economic development.

References

Adam, F, et al. (2009) *Varieties of capitalism in Eastern Europe (with special emphasis on Estonia and Slovenia).* Communist and Post-Communist Studies, Vol. 42, pp. 65-81.

Arpaia, A. and Curci, N. (2010) *EU labour market behaviour during the Great Recession.* Economic Papers 405. European Commission

European Central Bank (2010) *Convergence Report.* http://www.ecb.int/pub/pdf/conrep/cr201005en.pdf

European Commission (2008) *Eurobarometer 70.* http://ec.europa.eu/public_opinion/archives/eb/eb70/eb70_en.htm

Eurostat - Statistical Office of The European Union http://epp.eurostat.ec.europa.eu

Faggio, G. and Konings, J. (2003) *Job creation, job destruction and employment growth in transition countries in the 90s.* Economic Systems, 27 pp. 129-154

Feldmann, M. and Sally, R. (2002) *From the Soviet Union to the European Union: Estonian Trade Policy, 1991-2000.* The World Economy, Vol. 25, 1. pp. 79-106.

Friedman M. (1962) *Capitalism and Freedom.* 4th Edition, The University of Chicago Press

Frye, T. (2010) *Building States and Markets after Communism.* Cambridge University Press

Gros, D. and Steinherr, A. (1995) *Winds of Change - Economic Transition in Central and Eastern Europe.* Prentice Hall

Gros, D. and Steinherr, A. (2004) *Economic Transition in Central and Eastern Europe – Planting the Seeds.* Cambridge University Press

Harter, M. and Jaakson, R. (1997) *Economic success in Estonia: The centre versus periphery pattern of regional inequality.* Post-Communist Economies, 9:4, 469-490.

Harvey, W. (2011) *Strategies for conducting elite interviews.* Qualitative Research. Vol. 11 (4) pp. 431-441.

Hayami, Y. (2001) *Development Economics. From the Poverty to the Wealth of Nations.* Oxford University Press

Heinonen, J. and Emmert, F. (2006) *Sustainability of Estonian Competitiveness.* Social Science Research Network.

Hoag and Kasoff (1999) *Estonia in Transition.* Journal of Economic Issues (Association for Evolutionary Economics)**,** Vol. 33 Issue 4, pp. 919-931.

Jauhiainen, J., (2002) *Industry and Support for Industrial Development in Estonia. Feasibility of the Scheme "Support for Industrial Infrastructure Development".* University of Oulu.

Kolodko, G. (2005) *Seven lessons the emerging markets can learn from Poland's transition.* in Kolodko, G. (ed.) *The Polish Miracle: Lessons for the Emerging Markets.* Aldershot: Ashgate, 1-2.

Kornai J. (1992) *A Szocialista rendszer: Kritikai politikai gazdaságtan.* Heti Világgazdaság Kiadói Rt.

Krugman, P. (2008) *The Return to Depression Economics and the Crisis of 2008.* Penguin Books

Lagerspetz, M. (2001) *Consolidation as hegemonization: The Case of Estonia.* Journal of Baltic Studies. 32:4, 402-420.

Larner, W. (2000) *Neo-liberalism: Policy, Ideology, Governmentality.* Studies in Political Economy, 63, p. 5-25.

Lauristin, M. (1997) *Contexts of Transition.* in Lauristin et al. (eds.) *Return to the Western World – Cultural and Political Perspectives on the Estonian Post-Communist Transtion'* . Tartu University Press

Lauristin M. and Vihalemm, P. (1997) *Recent Historical Developments in Estonia: Three Stages of Transition.* in Lauristin et al. (eds.) *Return to the Western World – Cultural and Political Perspectives on the Estonian Post-Communist Transtion'* . Tartu University Press

Lauristin, M. and Vihalemm, P. (2009) *The Political Agenda During Different Period of Estonian Transformation: External and Internal Factors.* Journal of Baltic Studies, 40:1, 1-28

Liuhto, K. (1996) *Entrepreneurial Transition in Post-Soviet Republics: The Estonian Path.* Europe-Asia Studies. Vol. 48, No. 1. pp. 121-140.

Macours, K. and Swinnen, J. (2008) *Rural-Urban Poverty Differences in Transition Countries.* World Development Vol. 36, No. 11, pp. 2170-2187.

Moody's Investors Service (2007) *Estonia Country Analysis.*

Mygind, N. (1997) *A Comparative Analysis of the Economic Transition in the Baltic Countries – Barriers, Strategies, Perspectives.* in Haavisto, T. (ed.) *The Transition to a Market Economy – Transformation and Reform in the Baltic States.* Edward Elgar

Norkus, Z. (2007) *Why Did Estonia Perform Best? The North-South Gap in the Post-Socialist Economic Transition of the Baltic States.* Journal of Baltic Studies. 38:1, 21-42.

North, P. (2006) *Constructing civil society? Green money in transition Hungary.* Review of International Political Economy. Vol. 13 (1), pp. 28-52.

Ostrander, S. (1995) *"Surely You're Not in This Just to Be Helpful": Access, Rapport, and Interviews in Three Studies of Elites.* in Hertz, Rosanna and Imber, Jonathan (Eds.) *Studying Elites Using Qualitative Methods.* Sage Publications

Panagiotou (2001) *Estonia's success: prescription or legacy?* Communist and Post-Communist Studies. 34 pp.261-277.

Peet, R. (2007) *Geography of Power - The Making of Global Economic Policy.* Zed Books

Raun, T. (2001) *Estonia in the 1990s.* Journal of Baltic Studies. 32:1, pp. 19-43.

Statistical Office of Estonia www.stat.ee

Sen, A. (1999) *Development as Freedom.* Oxford University Press

Smith, D. (2001) *Estonia – Independence and European Integration.* Routledge

Smith, D. (2008) *'Woe from Stones': Commemoration, Identity Politics and Estonia's War of Monuments.* Journal of Baltic Studies, 39:4, 419-430.

Thuesen, F., 2011. Navigating Between Dialogue and Confrontation: Phronesis and Emotions in Interviewing Elites on Ethnic Discrimination. Qualitative Inquiry 17 (7), 613-622.

United Nations Conference on Trade and Development (2008) *World Investment Report.* www.unctad.org

United Nations Development Programme (2010) *Human Development Report* http://www.undp.org

Verdery, K., 1996. What Was Socialism and What Comes Next? Princeton University Press.

Vihalemm, T. and Kalmus, V. (2009) *Cultural Differentiation of the Russian Minority.* Journal of Baltic Studies, 40:1, 95-119.

World Economic Forum (2014) The Global Competitiveness Report http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf