



The Neoliberalisation of Estonia: Agency Does Matter

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Abstract

The goal of this research is to prove the significance of active local agency in the spatial diffusion of the neoliberal ideology. By examining Estonia's post-socialist economic transformation I demonstrate the domestic origin of the country's neoliberal economic policies. I contest the hegemonic view of neoliberalisation and argue that neoliberalism has progressive aspects.

Although post-socialist transition and the impact of neoliberal policies have been studied extensively, there is a gap in literature regarding the motives of local decision makers in policy choices. The main research question is why Estonian policy makers chose the neoliberal trajectory in the country's post-socialist transition. By analysing data obtained from key decision makers and advisors in the form of face-to-face, semi-structured interviews, I argue that Estonian leaders proactively exercised active agency within the confines of structure. Structure in the form of place, the country's precarious geopolitical situation and history has instilled a sense of 'historical injustice' and a self-image in Estonians that emphasises the virtues of self-reliance and individualism, which are compatible with neoliberal values. The country's grave geopolitical and economic situation in the early 1990s required simple policies that can be implemented quickly and neoliberal policies were fit for purpose due to their simplicity. However, although neoliberal policies have outlived their use as the country's geopolitical and economic situation consolidated, Estonian policy makers have been willingly pursuing an ultraliberal trajectory for the past two decades out of ideological conviction and in defiance of the explicit advice of international organisations, such as the IMF and the World Bank, to introduce '*more government and less market*'.

Estonian policy makers are not 'victims' but 'champions' of neoliberal policies. Agency does matter.

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Acronyms

CEE	Central and Eastern Europe
CEEC	Central and Eastern European Countries
EBRD	European Bank for Reconstruction and Development
EC	Economic Competence
ESSR	Estonian Soviet Socialist Republic
EU	European Union
FDI	Foreign Direct Investment
FSU	Former Soviet Union
GDP	Gross Domestic Product
IMF	International Monetary Fund
NEM	New Economic Mechanism
NEP	New Economic Policies
PPP	Purchasing Power Parity
SME	Small and Medium Enterprises
SOE	State-owned Enterprises

Chapter 1. Introduction

1.1 Journey to the Thesis

The choice of this topic came naturally to me; I have never had to consciously search for one. Being a Hungarian I have first-hand experience of the post-socialist transition in Central and Eastern Europe (CEE). I witnessed the changes personally as an undergraduate university student, although neither me, nor my friends were active politically. We were the first student intake in 1988 to study neoclassical economics at the Karl Marx University of Economic Sciences instead of Marxist-Leninist ideology. When Hungary's border with Austria was opened, some of my friends went there to collect pieces of the barbed wire, which subsequently they sold off to Western tourists, as 'pieces of the Iron Curtain'. Others sold sealed but empty jars labelled 'air from the socialist era'. By 1991, my university was renamed Budapest University of Economic Sciences and Public Administration. Street names were changed back to their pre-socialist original; Felszabadulás tér (Liberation square) became Ferenciek tere, Népköztársaság ut (People's Republic road) was renamed Andrásy ut (Andrásy road), Vörös Hadsereg utja (Road of the Red Army) was called Üllői ut (the Road to Üllö) again. Officially the 'counter-revolution' of 1956 became a 'revolution' and October 23 replaced April 4 as a national holiday, which had marked the liberation of Hungary by the Red Army in the socialist era. Whereas many were afraid of losing their job and livelihood, many were also hoping to gain from privatisation and restitution. Transition did not seem black and white, black representing the 'grim communist past' and white the 'bright capitalist future', but had the shades of grey. Grave economic and political uncertainty prevailed.

My interest in this topic was further aroused when I moved to Estonia in 1998, a mere seven years after it regained its independence. During the seven years that I spent there I made a lot of acquaintances and friends, including my wife. I taught as a full-time faculty member at Concordia International University and regularly trained corporate executives at the Estonian Business Centre. Many of the students were senior managers, corporate executives and government officials, which helped me to become familiar with the country's political and socio-economic landscape. It also allowed me to have an insight into the etiquette, norms and values of the Estonian elite, which subsequently proved invaluable in my research. In Estonia academics enjoy a relatively high status

and occupational prestige, which helped me to establish valuable contacts. During our conversations I was able to gain an inside view to the workings of the Estonian economy. This insight has also enabled me to identify the key players in the country's political and economic arena.

While living in Estonia I had the opportunity to witness the enormous changes in the country first hand. Some people were grateful for the changes and some were reminiscing about the 'good old days'. While some of my students were very wealthy, others were struggling just to feed themselves; the disparities seemed enormous. As an avid photographer, I travelled and took pictures all over the country and could not help but notice the vastly unequal development between the various regions of such a small country. Gradually, I was taking a keen interest in Estonia's political, economic and social transformation.

Estonian policymakers are very proud of the country's subsequent achievements highlighting impressive rankings on economic league tables. I heard countless stories about its triple transformation – from a totalitarian one-party system to pluralistic democracy, from a centrally administered economy to a market economy, and from Soviet imperial hegemony to fully independent statehood. The successive post-socialist governments have succeeded in creating an ultra-liberal environment. However, they have confused economic growth with economic development.

Although there is ample literature (Lieven, 1993; Taagepera, 1993; Liuhto, 1996; Kahk and Tarvel, 1997; Terk, 2000; Heinonen and Emmert, 2001; Jauhiainen, 2002; Raun, 2001; Smith, 2001; inter alia) discussing Estonia's economic transformation, a critical qualitative evaluation of the motives behind the country's neoliberal transformation has not taken place.

1.2 Key arguments

I am not a geographer. This thesis offers an interdisciplinary critique of neoliberalism and the diffusion of neoliberal policies. By examining the neoliberalisation of Estonia in a politico-economic and socio-economic framework, I prove the significance of local agency refuting the hegemonic view of the neoliberal policies.

The literature on neoliberalism is divided. Barnett (2005) and Wolf (2005) fundamentally question its very existence as a discrete concept worthy of analysis in its own right. There is also disagreement about whether neoliberalisation is a top-down hegemonic project or a multifaceted, more complex process shaped by its context (Larner, 2002). Harvey (2005 and 2006), Giroux (2004), Duménil and Lévy (2005), Tickell and Peck (2003), inter alia, view neoliberalism as a supranational political 'hegemonic project', which externally imposes neoliberal policies on national economies. The universal nature of standard macroeconomic policies originating from the 'ideological heartlands' of the USA and the UK (Larner, 2003) with their emphasis on decentralisation and a minimalist government is seen by many as the transfer of power from democratically elected governments towards private capital (Larner, 2000), leading to a loss of national sovereignty. According to the hegemonic view of neoliberalisation, the quick diffusion of neoliberal policies was aided by international financial institutions resulting in neoliberalism's ideological hegemony (Peck and Tickell, 2002).

I argue that neoliberalism 'exists' and that specifically 'neoliberal' policies can be clearly identified: they can be characterised by an unconditional support of the self-correcting free market assuming rational individualism, the commodification of man and nature (Polanyi, 1944), support for the unimpeded mobility of inputs and outputs, and the reliance on monetarist and supply-side oriented economic policies (Peck, and Tickell, 2002). At the core of neoliberal policies is the supremacy of the free market achieving optimal allocation of resources. In order to maximise welfare, currency stability, financial austerity in the form of low levels of tax rates and public expenditures, free trade in goods and services, and flexible labour markets are considered essential (Tickell and Peck, 2003). The Keynesian goal of full employment has been replaced with the objectives of economic efficiency and competitiveness. The provision of many public goods has been gradually taken over by the private sector. The withdrawal of the state from economic activities has been accompanied by commodification and privatisation over the past thirty years (Larner, 2000).

Using Estonia's recent post-socialist economic transformation as an empirical case, my aim is to engage in the debate regarding the nature of neoliberalism. I contend that

neoliberalism does not only take many forms but also new neoliberal ‘heartlands’ emerge. I agree that “neoliberalism cannot only be seen as a project constructed through the powerful institutions of the global economy” (Smith, 2007: 1164) and support Larner’s (2000, 2002 and 2003) view of neoliberalism as a multi-faceted concept constructed in many forms. By critically analysing the nature of post-socialist Estonia’s policy choices in its formative years, I take this debate beyond its current binary core vs. periphery dichotomy and argue that neoliberalism can emerge indigenously through pro-active agency. I emphasise the complex interconnectedness of multiple centres and peripheries rather than passivism on the part of the ‘periphery’ (England and Ward, 2007).

Estonian policies could serve as textbook examples of neoliberal economic principles applied in real life. 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 neoliberal nature of the Estonian economy. It would be tempting to blame external pressure and the powerful influence of international financial institutions, such as the International Monetary Fund (IMF) and the World Bank, for the neoliberalisation of Estonia. However, I argue that Estonian neoliberal policies were devised and implemented proactively and endogenously.

The hegemonic narrative of neoliberalism does not take account of its contingency and its multiplicity. It assumes that people are victims on whom the neoliberal agenda was imposed in a top-down manner, rather than active agents (Larner, 2000). Nor does it explain the variety of capitalisms emerging in post-socialist Central and Eastern Europe, including “disciplined” Estonia with its “Thatcherite economic policies” (Raun, 2001: 24), “prickly” Poland and “sleazy” Hungary (The Economist, 16.11.2006.) with its ‘wobbly’ economy.

I agree with Larner’s (2003) emphasis on the variegated nature of neoliberalism working on many levels. I underline the importance of active agency within the confines of structure by demonstrating that openness to the adoption of neoliberal policies must be in place for neoliberal policies to be implemented successfully. Populations and their leaders can and do willingly choose neoliberal policies. It can take

on many forms shaped by internal and external factors, as well as economic and political objectives.

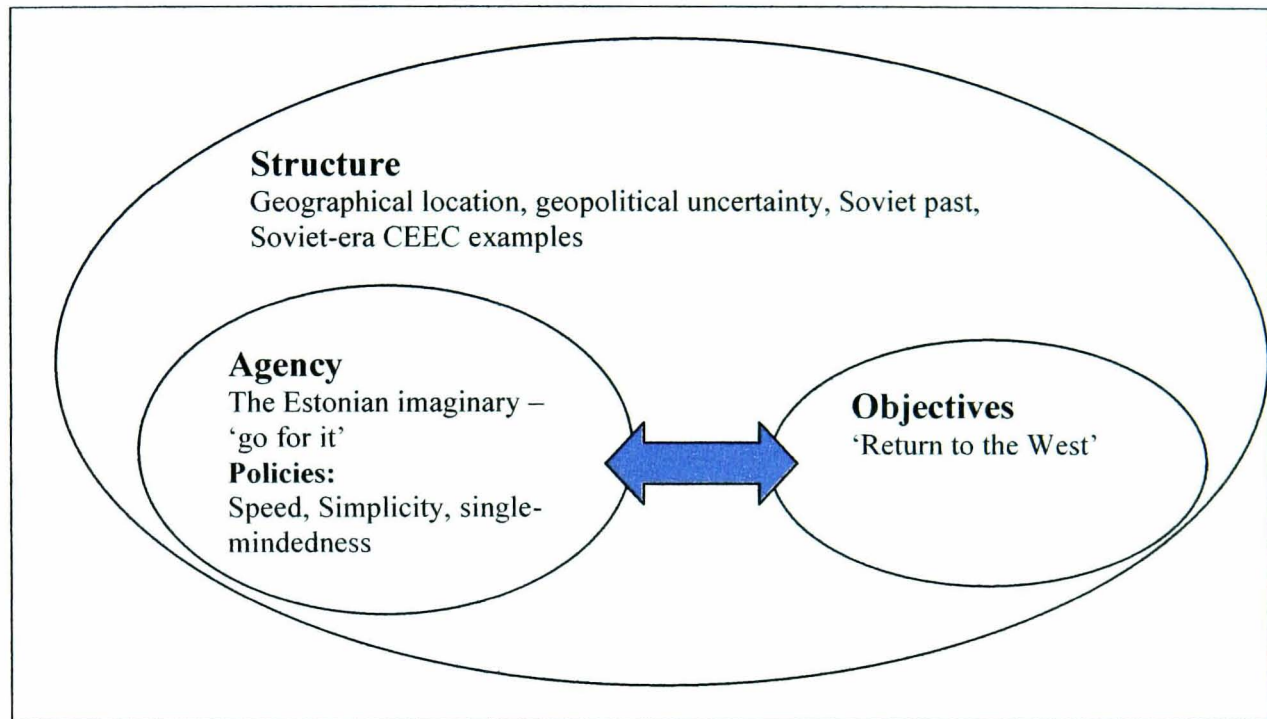
This thesis investigates the origins of the decisions made by Estonia's policy makers and shapers. Based on my findings, I argue that the spatial diffusion of neoliberal ideology is not a linear top-down process exported from its centres of origin in the West to reluctant recipients on the periphery. Instead, it is reproduced locally with certain elements of the neoliberal doctrine proactively imported and implanted. Estonian policy makers intentionally and willingly opted for neoliberal policies. Agency does matter.

Neoliberalism in Estonia is uniquely 'Estonian' in nature. Neoliberal policies were not forced upon the country by exogenous forces; Estonian policy makers not only voluntarily adopted such radical policies but they also played a proactive role in creating an indigenous Estonian version of neoliberalism. It is insufficient to search the origins of Estonian neoliberalism in the post-socialist era, as they can be traced back to the Soviet era, the pre-Soviet years and as far as the pre-independence era. As Lauristin (1997: 26) argues, transition is not a sum of 'positive changes' emanating from the West but is a process full of "tension between structures and agencies" with an outcome contingent on the "interplay between various social and political actors in the political, cultural and economic fields". Although dissatisfaction with the socialist system was widespread in Estonia during Soviet occupation (Taagepera, 1993; Kukk, 1993; Lauristin, 1997; inter alia), the country's transition along neoliberal lines was driven by a small Estonian elite group. The neoliberal policies were not hegemonically imposed upon Estonia but were devised locally in an elitist, top-down manner.

Estonia's policy choices in the early 1990s were more than a mere economic dilemma. The lenses through which policy makers viewed their options were shaped and chiselled by history and more specifically by their national struggle for survival. Neoliberalism was one of the choices available to them. To quote Larner (2002: 418) "(c)ontext remains of paramount importance." Estonia's post-socialist transformation has been a sum of historical, social and cultural factors affected by the common experience of successful as well as unsuccessful efforts of gaining and preserving statehood. The sheer complexity of the origins of Estonian neoliberalism requires a detailed analysis of

the various factors shaping it. Figure 1.1 provides an outline of structures constraining agency, which shaped post-socialist socio-economic policies as well as objectives along with the pressing goal of reaching western standards of living. Estonian policy makers exercised agency in light of their self-image, the Estonian imaginary. Estonians characterise themselves in terms of values, such as individualism and self-reliance that are compatible with the value system of neoliberalism.

Figure 1.1 Structure and agency in the formation of Estonian neoliberalism.



Geography has been pivotal in forming the Estonian imaginary, which has a central role in understanding the consistent pursuit of neoliberal policies of post-socialist Estonian governments with the population's tacit agreement. Due to its geographical location in the Northeastern corner of Europe on the shores of the Baltic Sea bordering Russia, as seen in Figure 1.2, throughout history Estonia faced an ambiguous geopolitical situation between Russia and the rest of Europe.

Figure 1.2 Estonia's geographical location in Europe.



Source: *The University of Liverpool Map Room*

Regional cooperation has a long history between Estonia and Scandinavia. Estonia and Finland share a common Finno-Ugric heritage; they consider one another 'sisters'. The small distance (80 kilometers) between Helsinki and Tallinn makes it possible for Estonians to follow Finnish media, which served as a 'window to the west' during the Soviet era (Lieven, 1993; Smith, 2001).

Over the past centuries the country's fate was beyond the control of Estonians. The territory inhabited by ethnic Estonians and now known as 'Estonia' was ruled by the neighbouring European powers of Denmark, Germany, Sweden and Russia for over seven hundred years shaping the Estonian imaginary that Estonians describe as a mix of stubbornness, suspicion, individualism, single-mindedness and an aversion of outside influence. Having endured seven centuries of foreign rule, Estonia became an independent nation in 1918. The significance of the First Estonian Republic, which Soviet invasion ended in 1940, must not be underestimated. It served as living memory of the country's statehood and its ability to function as a democratic market economy in the Soviet era.

The excessive repression of the Soviet era, which meant the nation's full integration into the USSR, fuelled anticommunism and a fear of external dominance. "Liberal economic ideas were therefore already constituted through resistance to the communist experience of ECE¹" (Smith, and Rochovská, 2007: 1167-1168). Although an integral part of the USSR, Estonia was able to carry out economic experiments (Miljan, 1989; Panagiotou, 2001), which familiarised the population with entrepreneurship and the workings of the market forces. The Estonian imaginary shaped by history, tradition and place have a significant impact on the country's policy choices. Estonian history, particularly the living memory of the First Estonian Republic in the interwar era and the subsequent Soviet occupation defined Estonian policy makers' and shapers' perception of a 'market economy' in the 1990s.

I argue that Estonia's neoliberal policies were not externally imposed but were developed endogenously on Estonian initiative. Of the international organisations, the European Union (EU) had by far the greatest influence on Estonian policies. Aspirations to become a full EU member, which were realised on 1 May 2004, imposed constraints on the country in both the pre-accession and post-accession periods (Feldmann and Sally, 2002; Rajasalu, et al, 2003). The influence of other international organisations, such as the International Monetary Fund (IMF) and the World Bank, which have been repeatedly blamed for the hegemonic diffusion of the neoliberal agenda (Kelsey 1995 and 1997; Harvey, 2005 and 2006; Giroux, 2004; Tickell and Peck, 2003; Peet, 2007) is markedly less. Indeed, as I argue in Chapter Seven, post-socialist Estonian economic policies were ultra-liberal to the point that even the international financial organisations advised Estonian policy-makers to 'de-liberalise' them by increasing the role of the state in economic management.

This research indicates that post-socialist Estonian policies have three salient features: speed, simplicity and single-mindedness. Speed was dictated by the desperate economic conditions of the early 1990s and the desire to reach western European levels of living standards, which many Estonians describe as 'return to the West' and 'catching up with the West'. The political uncertainty prevailing in the early 1990s due to the unpredictability of the survival or failure of the USSR and of Soviet/Russian policies,

¹ Eastern and Central Europe

and the ambivalent attitude of western powers to Estonian independence further amplified the need for speedy decision making and policy implementation. Simplicity was required because of the immense task of state-building that the country was facing and the lack of local expertise in the workings of a pluralistic free-market economy and its institutions. Newly independent Estonia found itself in a crisis, which called for policies that are simple to design and can be implemented fast. Speed was also essential to demonstrate a “clean break with the past” and to “consolidate post-communist power” (Sachs, 1993: 42). Despite the frequent changes of administration, Estonian policies have remained on the neoliberal path. Single-mindedness refers to local agency on the part of the Estonian political elite to voluntarily and willingly choose to follow neoliberal policies and stay the course.

1.3 The structure of the thesis

My thesis is organised into nine chapters. Chapter Two provides a comprehensive critique of neoliberal theory. I provide a brief history of economic thinking and the emergence of the neoliberal ideology. I examine neoliberal theory’s weaknesses, such as its reliance on faulty unrealistic assumptions, as well as strengths, like its emphasis on the utopian ideal of perfect liberty, which seemed irresistible to the Estonian population living under alien Soviet domination.

In Chapter Three I provide an overview of the socialist centrally planned economic system and critically analyse post-socialist socio-economic transition in the CEEC. I demonstrate the heterogeneity of the former socialist states, which contributed to their divergent transformation. I contend that post-socialist transition is not a linear process with a given positive outcome but a multi-faceted change affected by the socialist, as well as pre-socialist past of these countries.

Chapter Four details the research design. This qualitative and interpretive research is of the realist epistemology. I use in-depth semi-structured personal interviews with key decision makers and shapers in order to find the answer to why and how Estonia’s post-socialist policies were formulated. I clarify the elite nature of this study and argue that my positionality was instrumental in gaining access to the interviewees and gaining their trust. A key finding stemming from this research is that the researcher’s

positionality evolves over time. Over the course of my research I began to feel empathy towards my interview subjects, which subsequently turned into sympathy.

In Chapter Four I emphasise the central role of the Estonian imaginary and trace its origins back to Estonia's pre-Soviet history. I argue that Estonians' self-image of individualism and self-dependence agrees with the value system of neoliberal ideology. Furthermore, by examining Western attitudes to the creation of the First Estonian state in 1918, to its subsequent annexation by the USSR in 1940, and to its secession from the Soviet Union in 1991, I contend that Estonians have developed a sense of historical injustice leading to an aversion of external influence.

Chapter Six discusses the Soviet era, including the consequences of Soviet domination on Estonia's economy and its population. I argue that the external imposition of collectivist central planning resulted in the deterioration of living standards and strengthened aversion to dependence on a paternalistic state. Also, by discussing Estonian socialist-era economic experiments I prove the existence of active local agency within the constraints of Soviet structure.

By providing an analysis of policy making in Estonia's post-socialist transition in Chapter Seven, I refute the theory of hegemonic diffusion of neoliberal policies by proving the domestic origin of the country's neoliberalism. I demonstrate that Estonia's post-socialist policies were neither designed, nor consciously selected; they were the result of local agency doing its best in a crisis situation.

Last but not least, in Chapter Eight I analyse the impact of two decades of neoliberal policies and demonstrate their long-term adverse effects over socio-economic development. I argue that whereas the implementation of neoliberal policies were justifiable in the early years of transition due to the country's grave geo-political and economic situation, continued reliance on them is unwarranted and harmful from a socio-economic perspective.

I conclude the thesis in Chapter Nine by highlighting the theoretical, methodological and empirical contributions.

Chapter 2. The Philosophy of Neoliberalism: Theory and Practice

A critical evaluation of the choice by Estonia's leadership of neoliberal policies requires a comprehensive understanding of neoliberal thinking. In this chapter I examine the origins of neoliberal philosophy, critically analyse its arguments and evaluate its socio-economic impact. I highlight the shortcomings of the neoliberal ideology, such as the assumption of the fully rational 'economic man', long-term market equilibria, the eventual convergence of national economies, and its confusion of economic growth with economic development. I also point out its more positive aspects, like its emphasis on a society based on the "active, self-directing individual" (Wolf, 2005: 24), which held great appeal particularly to populations living under totalitarian rule.

2.1 A brief history of economic thinking and the emergence of neoliberalism

Milton Friedman's (2002) criticism of President Kennedy's line "(a)sk not what your country can do for you – ask what you can do for your country" captures the essence of neoliberalism.

"The paternalistic "what your country can do for you" implies that government is the patron, the citizen the ward, a view that is at odds with the free man's belief in his own responsibility for his own destiny. The organicist, "what you can do for your country" implies that government is the master or the deity, the citizen, the servant or the votary. To the free man, the country is the collection of individuals who compose it, not something over and above them." (Friedman, 1962: 1)

2.1.1 Classical economics

The roots of neoliberal economic thinking can be traced back to classical economics in the 18th and 19th centuries. "Neoliberalism is merely liberal economics exaggerated" (Peet, 2007: 192). "The intellectual basis for all classical economics is found in Adam Smith's *Wealth of Nations* of 1776", as it "set the agenda for the whole classical era" (O'Brien, 2003: 112, 113). The concept of the '*invisible hand*', the self-interested voluntary and free cooperation of individuals leading to the betterment of society takes central place.

"...and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention." (Smith, 1776: 292)

Unlike earlier economic thinkers, classical economists held a consumption-oriented view representing a drastic shift in the history of economic thought. Their model of the economy was based on three forms of activity: agriculture, manufacture and trade. They classified land, labour, and capital, as inputs for production, and identified wages, profit, and rent as the “three original sources of all revenue” (Smith, 1776: 50).

Classical economics focused mostly on the distribution of income among the factors of production and the determinants of international trade patterns. By using formal models, they laid down the foundations of modern economic methods and argued that markets emerge automatically (Gilpin, 2001). Smith (1776) had stressed the superior role of capitalists - entrepreneurs, merchants and manufacturers – in a nation’s economy. While consumption and demand for commonly bought goods is considered important, it is entrepreneurs’ thrift and ‘good conduct’ that determine national wealth. Since producers know their own circumstances best, they ought to be left to their own devices; it is through their profit motive and their desire to improve their business that they promote society. As the market forces of demand and supply determine prices, any interference with the workings of the market forces would lead to a violation of ‘natural liberty’ of economic agents with adverse effects on national wealth. The key to national wealth creation is free trade and free competition (Smith, 1776).

Smith (1776) placed emphasis on the influence of special interests on government and their adverse effects. Undue government intervention, such as regulation of prices and production, and restrictions imposed on the mobility of capital and labour, were strongly criticised because of their adverse effects on the economy. Government bureaucracy is not productive, therefore its size, as well as its role, should be minimised. The functions of the state must be limited to maintaining law and order, to the provision of public goods, which private industry is unable to supply, and external defence (Hoover and Plant, 1989).

Although numerous economists (Samuelson and Nordhaus, 1985; Friedman and Friedman, 1990; Taylor, 2004; inter alia) interpret the works of Smith and his contemporaries mostly as arguments for a *laissez-faire* economy, classical economics was not entirely *laissez-faire*; the pursuit of self-interest was to be channelled by a system of laws and regulations in order to ensure the contribution of economic activities

to social welfare (Medama, 2003). Classical thinkers, such as Locke and Mill, also gave ample thought to the role of community and distributional equity by pointing out that the pursuit of individual self-interest must be constrained by concern for its social consequences (Hoover and Plant, 1989). The interests of producers coincide with consumers in the case of market size, as larger markets are favoured by both consumers and producers. However, they have conflicting interests when it comes to competition. Whereas fair competition is in consumers' and thus in society's interest, entrepreneurs are in favour of reduced competition, as it results in higher profits. Classical economists underlined the responsibility of the government in maintaining the 'public defence of society', 'the administration of justice', and the provision of public goods. The maintenance and improvement of the transportation and communication infrastructure by the state was regarded as essential, as it facilitates commerce (Smith, 1776). They recognised the need to regulate uncompetitive practices, such as cartels and monopolies, but cautioned against excessive intervention.

Smith made his socio-economic predictions and constructed his theories in the preindustrial age when the level of tolerance for inequalities was much higher. There was no tax on profits; capital gains tax did not exist. Inequality of property and income were taken for granted. They believed that differences in wealth necessitated the protection of property rights because "the affluence of the rich excites the imagination of the poor, who are often both driven by want, and prompted by envy, to invade his possessions" (Smith, 1776: 408).

2.1.2 *Marxism*

As opposed to classical economists, who by emphasising the positive role of capitalists were critical of government intervention in the economy and regarded advancement as a result of the voluntary cooperation of individuals through the 'invisible hand', Marx and Engels (1849) provided a radically different view of society and economic thinking. "The history of all hitherto existing society is the history of class struggles" (Marx and Engels, 1849: 2). They divide "(m)odern bourgeois society... into two great hostile camps, into two great classes directly facing one another: Bourgeoisie and Proletariat" (p. 2-3). Whereas classical economists considered self-interest the engine of economic development, Marx and Engels criticised (p. 5 and 6) self-interest as "the only remaining ... bond between man and man" reducing "personal worth into exchange

value” with free trade becoming the only freedom. Marx acknowledged the achievements of capitalism, which he referred to as ‘big industry’, its uprooting of feudal society, technological advancement and organisation (Kornai, 1992: 50). However, he argued that the “bourgeoisie cannot exist without constantly revolutionising the instruments of production” (Marx and Engels, 1849: p. 7). Technological and industrial advancement over time necessitate “a constantly expanding market for its products”, which “chases the bourgeoisie over the whole surface of the globe... It must nestle everywhere, settle everywhere, establish connections everywhere.” Indeed, “modern industry has established the world market...” (p. 4). However, whereas

“...big industry in its earliest stage created free competition, it has now outgrown free competition; that for big industry competition and generally the individualistic organisation of production have become a fetter which it must and will shatter; that so long as big industry remains on its present footing it can be maintained only at the cost of general crises...”
(Engels, 1848: 73)

Capitalism is crisis ridden threatening “the existence of the entire bourgeois society” (Marx and Engels, 1849: 12).

Capital accumulation is accompanied by the exploitation of workers (Kornai, 1992). The industrial revolution - the “introduction of the factory system” - led to a division of labour making it possible to “produce things faster and cheaper” (Engels, 1848: 68), leading to the “existence of classes” (p. 79). Due to industrial development, the “extensive use of machinery” and specialisation “the work of the proletariat has lost all individual character” becoming an “appendage of the machine”. While ‘big industry’ impoverished the working people by “rendering entirely worthless the meagre property of the workers” (p. 68), the cost of labour became “restricted, almost entirely, to the means of subsistence that he requires for his maintenance” (Marx and Engels, 1849: p. 13-14). “The Bourgeoisie has torn away the family its sentimental veil and has reduced the family relation to a mere money relation” (p. 6). The “proletariat, the modern working class... a class of labourers... live only so long as they find work, and who find work only so long as their labour increases capital”. The proletariat is “without property” (p. 21), living “entirely from its sale of labour and does not draw profit from any kind of capital”, thus its “existence depends on the demand for labour”. The only difference between a slave and a proletarian is that “the slave is sold once and for all;

the proletariat must sell himself daily and hourly” (Engels, 1848: 67-69). In “bourgeois society... those of its members who work, acquire nothing, and those who acquire anything do not work” (Marx and Engels, 1849: p. 31).

Marx and Engels (1849: p. 27-28) argue that the bourgeois class depends on capital, which is contingent on wage labour, even though wage labour does not create “property for the labourer”. Therefore, capital is not a private but “collective product... not a personal but a social power” necessitating the “abolition of private property” (Engels, 1848: 75). Their conclusion is that “a new social order” must arise because the existing social order “no longer corresponds to the requirements of the real situation” (p: 74). Capitalism through its emphasis on capital accumulation, modern technology and organisational management prepares the grounds for a more advanced mode of social organisation. Thus it would appear in the most advanced capitalist countries first (Kornai, 1992: 50-51). “The bourgeoisie itself... supplies the proletariat with its own elements of political and general education...” Through impoverishment of the ‘petit bourgeoisie’, peasantry and middle classes “the proletariat is recruited from all classes of the population”. “Entire sections of the ruling classes are, by the advance of industry, precipitated into the proletariat” (Marx and Engels, 1849: 16). Thus the fall of the bourgeoisie and the “victory of the proletariat are equally inevitable” (p. 23).

“Big industry has brought all the people of the earth into contact with each other... and has thus ensured that whatever happens in the civilised countries will have repercussions in all other countries. It follows that if the workers in England or France now liberate themselves, this must set off revolutions in all other countries – revolutions which sooner or later must accomplish the liberation of their respective working classes.”(Engels, 1848: 71)

These revolutions will lead to the emergence of a new society, which

“...will take all the forces of production and means of commerce, as well as the exchange and distribution of products out of the hands of private capitalists and will manage them in accordance with a plan based on the availability of resources and the needs of the whole society.” (p. 78)

Whereas Kornai (1992) emphasises the scientific value of Marxist analysis of capitalism, Gros and Steinherr (2004: 2) acknowledge that “the Marxist vision gave hope to large fractions of society of both developed and developing countries, a hope that capitalism was unable to provide”. Marx and Engels provide a straightforward view of central planning, in which production decisions are not hampered by the chaos of competition and the profit motive. Although Marx critiqued capitalism in detail but

provided little on the organisation of the communist state, 'Marxism' later became a theoretical pillar of the Soviet Union and other socialist states (Kornai, 1992).

2.1.3 Keynesianism

The Great Depression of the 1930s and the turbulent years of the first half of the 20th century led to significant changes in economic thinking and policy formulation. The years following World War II brought along a 'new world order' based on a compromise between capital and labour. Policy makers in Western Europe were greatly worried that the demobilisation of millions of soldiers would lead to a post-war recession, if not revolution, and were ready to fight it by stimulating demand (Hoover, 2003). In addition, the existence of the centrally planned economy in the Soviet Union provided evidence of a viable alternative; socialism was an "ideal for the Western left" (Lavigne, 1999: 4). Since "the anarchic nature of the capitalist economy generated enormous waste", many argued that "the socialisation of the means of production... would be better employed under the direction of economic planners in the service of the state". British socialists went as far as calling for planning at the micro-level, public ownership of the factors of production, as well as Keynesian economic management in order to correct the "three fundamental flaws of capitalist economies... unemployment, inequality and monopoly" (King, 2003: 187-188). The election manifesto of the British Labour Party in 1945 entitled 'Let us face the future' claimed that "governments would have to accept greater responsibility for achieving full employment", which reflected a shift of public sentiment in economic matters towards higher levels of state intervention in economic affairs (Aldcroft, 2001: 149).

"The Beveridge Report of 1942 in Great Britain and the Employment Act of 1946 in the United States provided blueprints for government involvement in the macroeconomy along Keynesian lines" (Hoover, 2003: 412). New institutions, such as the United Nations, the World Bank, and the International Monetary Fund (IMF) were founded with the objective of stabilising international relations. The General Agreement on Trade and Tariffs rounds of negotiation were aimed at encouraging free trade of goods. In the Bretton Woods agreement a system of fixed exchange rates were established with the US dollar as the global reserve currency (Hoover and Plant, 1989).

Keynesian fiscal and monetary principles rely on the core assumption that government has the responsibility, competence and instruments to positively interfere in the economy. Keynes (1936: 376) strongly criticised classical economics and “its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes”. He argued that output depends on aggregate demand – “(a)ll production is for the purpose of ultimately satisfying a consumer” - which in turn is contingent upon investors’ expectations of future profit rates.

“...the volume of employment (and consequently of output and real income) is fixed by the entrepreneur under the motive of seeking to maximise his present and prospective profits... while the volume of employment which will maximise his profit depends on the aggregate demand function given by his expectations...” (p. 46 and 77)

He stressed that the “actual results of an investment over a long term of years very seldom agree with the initial expectations” because “all sorts of considerations enter into the market valuation which are in no way relevant to the prospective yield”. Keynes argued that investors’ expectations of future profit rates are not fully rational; “our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be taken as a result of animal spirits” (1936: 152). Keynes had diagnosed the Great Depression of the 1930s as a “massive failure of aggregate demand” (Hoover, 2003: 412) and blamed the Great Depression on a drastic decrease in aggregate demand caused by pessimistic expectations of profit rates by investors. He brought attention to the possibility that aggregate supply and aggregate demand can determine levels of output at which factors of production are not fully employed and provided explanations for the emergence of involuntary unemployment by pointing out that “the economy has multiple equilibria, only one of which involves full employment” and even if we assume only one equilibrium, the “economic system is unstable without the assistance of policy, so it cannot reach full equilibrium on its own” (Scarth, 1996: 55).

Keynes (1936: 378) considered macroeconomic management a central responsibility of the government in order to stimulate demand by encouraging both consumption and investment with the means at its disposal, as a “somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment”. He (1936: 382-383) advocated the crucial role of active government

intervention in order to achieve the economic objective of full employment, which he considered essential.

“...if nations can learn to provide themselves with full employment by their domestic policy... there need be no important economic forces calculated to set the interest of one country against that of its neighbours... International trade would cease to be what it is, namely, a desperate expedient to maintain employment at home by forcing sales on foreign markets and restricting purchases, which, if successful, will merely shift the problem of unemployment to the neighbour which is worsted in the struggle, but a willing and unimpeded exchange of goods and services in conditions of mutual advantage.”

In essence, Keynesianism is “counter-cyclical macroeconomic management by an interventionist state committed to achieving full employment and high incomes for everyone” (Peet, 2007: 6).

“For at least 25 years after the end of World War II, mainstream macroeconomics was predominantly Keynesian” (Hoover, 2003: 412) and was characterised by high rates of economic growth, welfare state building, redistributive politics, restricted capital mobility with moderately high levels of capital accumulation and adequate profit rates in the developed capitalist economies. The state played an active interventionist role in the economy; collective bargaining was supported, mobility of capital was controlled, public expenditures were expanding, and economic development was planned to a certain extent (Harvey, 2005). This was an era of sustained economic expansion, rapid technological progress, high levels of employment and continuously growing real incomes. Although poverty and income inequality were not eradicated, economic growth rates were high with low levels of unemployment (Aldcroft, 2001; Lapavitsas, 2005). To borrow Aldcroft’s (2001: 205) summation, “it would be difficult to deny that the first two post-war decades were the most successful in terms of economic growth and stability in human history”. Indeed, Harvey (2007: 27) describes the 1950s and 1960s as the “golden age of capitalism”.

2.1.4 Neoliberalism

Sharp oil price rises, high inflation rates, stagnating output, declining productivity growth and increasing budget deficits in the 1970s put an end to the fast economic expansion of the previous decades. “The 1970s and early 1980s were an era of nasty shocks – of inflation and unemployment rates that went into double digits, of the worst

economic slumps since the Great Depression” (Krugman, 2008: 140). Real interest rates became negative discouraging saving. Due to diminishing levels of productivity growth, profit rates declined decreasing tax revenues, which became insufficient to cover increasing levels of public expenditures leading to a fiscal crisis (Harvey, 2006). The advanced capitalist economies experienced stagflation, as high unemployment rates were coupled with high inflation rates leading many to doubt the viability of Keynesian economic policies. By 1971, the Bretton Woods system of fixed exchange rates was abandoned in favour of flexible rates. One alternative, advocated by European socialist and communist parties, was a turn to a more open market-socialism with the expansion of state control and more regulation over the economy (Harvey, 2005). Harvey’s (2007: 27) assesses the era:

“The crisis of capital accumulation of the 1970s affected everyone through the combination of rising unemployment and accelerating inflation. Discontent was widespread, and the conjoining of labour and urban socialist movements throughout much of the advanced capitalist world augured a socialist alternative to the social compromise between capital and labour...”

Another option was to deregulate the economy and to substantially decrease state intervention (Harvey, 2005). From the perspective of the proponents of neoliberal ideas the economic crisis of the 1970s helped the spread of monetarism giving rise to the perception of the market as a self-adjusting mechanism rendering state intervention unnecessary and harmful. As Wolf (2005: XVII) puts it

“The naïve Keynesian faith in the ability to fine-tune economies to achieve given social outcomes had been shattered by the stagflationary 1970s.”

Critics of active economic management assessed the impact of government policy on economic growth as negligible (Aldcroft, 2001). The University of Chicago with Milton Friedman as one of its most prominent members has remained unimpressed by Keynesian theories. Their focus, instead, was the role of money, giving rise to monetarist principles that emphasise the flexibility of wages and prices and the economy’s self-correction to full-employment equilibrium. According to the monetarist view, unemployment levels are determined by productivity and wage levels, (im)mobility of the labour force, profitability of businesses and world trade. Governments’ attempts to maintain full employment are labelled counterproductive, as its inflationary effects adversely affect employment rates (Hoover and Plant, 1989). Full employment was replaced by currency stability, and internal and external balances as

the primary macroeconomic objectives. Unemployment came to be recognised as the necessary price for stabilising the capitalist economies (Lapavitsas, 2005).

Another main source of neoliberal economic theory was Friedrich von Hayek and the ‘Mont Pelerin Society’ founded in 1947. Whereas the neoliberal movement remained largely marginal for the following two decades, in the 1970s it gained significant influence both in economic policy making and in academic circles. Its impact was symbolised with the establishments of various liberal think tanks, such as the Adam Smith Institute and the Institute of Economic Affairs in the UK, the Cato Institute and the Heritage Foundation in the USA. In 1974, Friedrich von Hayek, in 1976 Milton Friedman won the Nobel Prize in economics. International institutions, such as the IMF and the World Bank have increasingly adopted neoliberal policies since the 1970s to the extent that the IMF’s current pro-market policies contradict its original mission to safeguard global economic stability in the face of market imperfections. Whereas its original instruments were expansionary policies, today it is a promoter of the supremacy of the free market and fiscal and monetary austerity (Stiglitz, 2002).

“...advocates of the neoliberal mindset now occupy positions of considerable influence in education (universities and many “think tanks”), in the media, in corporate board rooms and financial institutions, in key state institutions (treasury departments, central banks), and also in those international institutions such as the IMF and the WTO” (Harvey, 2007: 23)

“The first great experiment with neoliberal state formation was Chile after Pinochet’s coup” on September 11, 1973, which, following guidance by a “group of economists known as ‘the Chicago boys’ because of their attachment to the theories of Milton Friedman”, consisted of the deregulation of labour markets, the replacement of import substitution policies with export-led growth, privatisation of public assets and trade liberalisation (Harvey, 2006: 12). While “it violently repressed all left-of-centre social movements and political organisations and dismantled all forms of popular organisation...”, eliminated import substitution policies and deregulated labour markets, “the subsequent revival of the Chilean economy in terms of growth, capital accumulation, and high rates of return on foreign investments provided evidence upon which the subsequent turn to more open neoliberal policies in both Britain (under Thatcher) and the United States (under Reagan) could be modelled” (Harvey, 2007: 26). The neoliberal ideology was wholeheartedly adopted by the administrations of Ronald

Reagan in the United States and Margaret Thatcher in the United Kingdom in the 1980s. Both advocated a ‘cold turkey’ approach, arguing the stimulating effect of non-interventionism over productivity and economic growth (Samuelson & Nordhaus, 1985). Britain in the 1980s witnessed a clampdown on union power, the rolling back of the welfare state, privatisation of state-owned enterprises (SOEs), tax cuts, and the creation of a business-friendly climate to stimulate foreign as well as domestic investment. In similar fashion, the Reagan administration in the United States substantially deregulated labour and financial markets, privatised state assets, decreased tax rates, cut government welfare expenditures and relaxed labour laws (Harvey, 2006).

The end of the Cold War and the collapse of the centrally planned economic system, along with the unsuccessful import-substitution strategies of many developing countries and the relative success of the US economy in the 1990s, have significantly strengthened acceptance and support of neoliberal ideas (Kelsey, 1995). The failure of the centrally planned economies and the end of the socialist era in Central and Eastern Europe (CEE) have been interpreted by many as the victory of the self-healing free-market economy (Stiglitz, 2002), proof of the malfunctioning of government intervention in the market (Peet, 2007) that “encouraged acceptance of unrestricted markets as the solution to the economic ills of modern society” (Gilpin, 2001: 8). As Wolf (2005: XIII) puts it, “the death of socialism has killed all sane people’s belief in the planned economy and state ownership.” Chang (2002: 15) summarises the neoliberal assessment of the end of the socialist era:

“Crowning glory of this trend towards liberalisation and opening up was the fall of communism in 1989, which finally ended the ‘historical anomaly’ of a closed world trading system that had prevailed in the early post-war years.”

As demonstrated in the empirical chapters, to Estonians communism was indeed a ‘historical anomaly’ that, unlike neoliberalism, was imposed upon them externally.

2.2 The pillars of neoliberal theory

2.2.1 Rationalistic and utilitarian individualism

Classical economists emphasised the benefits of competition but did not provide an in-depth analysis of market transactions. They focused on production and costs, neglecting

consumer preferences and demand. Neoclassical economics, which is considered mainstream economics today, “provided the missing link in a complete theory of the market mechanism”. Neoclassical economists “discovered how to analyse the economy as a whole – a simultaneous general equilibrium of labour, land, and product markets” (Samuelson and Nordhaus, 1985: 762).

Smith’s (1776) ideal of self-interest leading to the betterment of society by the guidance of the ‘invisible hand’ is shared by contemporary neoliberal thinkers. “Self-interest, coordinated through the market, motivates people to invent, produce and sell a vast array of goods, services and assets” (Wolf, 2005: 45) and leads to a division of labour and specialisation improving productivity and output quality. The aim in a market economy is to increase material welfare and produce a profit. Each person by working to his own goal with his interest at heart contributes to the welfare of society. Economic liberalism focuses on consumers who are considered rational utility maximisers seeking the best value for money. The sole goal of producers is profit maximisation, therefore, businesses produce those goods and services which consumers are willing and able to buy (Samuelson and Nordhaus, 1985; Gilpin, 2001).

“...there is only one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it... engages in open and free competition, without deception and fraud.”
(Friedman, 1962: 133)

The economy consists of a number of markets driven by the decisions of millions of price-taking consumers and producers. Inability or unwillingness of organisations to respond to market signals ultimately leads to failure (Samuelson and Nordhaus, 1985).

A central axiom in economic thinking is the assumption of rational behaviour (Mayer, 1993) that forms the basis of optimal decision making. Klein (2002: 103) defines optimisation as “the attempt to find the best option out of a set of potential courses of action”. According to the full rationality theory, every person, consumer and producer, is a fully informed rational economic agent guided by self-interest living in a self-regulating and self-contained economy making fully rational decisions in response to changing prices and quantities of inputs and outputs. People are optimisers; they try to get the most out of what they have and possess the knowledge and time necessary to compare the current and potential costs and benefits of the various options. They make

choices according to their preferences and choose the best option available to them. Every person is a *homo economicus*² (Gravelle and Rees, 1992; Klein, 2002).

The optimal outcome, “the option with the highest expected utility” (Klein, 2002: 104), is contingent upon the methods of optimal decision analysis. An optimising individual has well-defined and stable goals, values, tastes and beliefs, according to which he/she has a clear and consistent preference between clearly defined choices. Each person is aware of all the options available to him/her, has all the relevant information needed to construct alternative options and is able to evaluate the consequences of the various courses of action. Having compared the options, the decision-maker selects the one that offers the maximum set of benefits. Consumers and producers all thrive to maximise return on their scarce resources. Individuals’ value systems and the environment are stable and non-dynamic (Klein, 2002). Producers’ expectations are static with technology as a constant variable (Scarth, 1996).

Neoclassical economics takes a utilitarian approach. The value of a certain input or output is determined by how much economic agents are willing and able to sacrifice for it, which necessitates the commodification of all inputs and outputs, as only then can we calculate the potential gains or losses from the various courses of action available to us. This involves, “in effect, no less a transformation than that of the natural and human substance of society into commodities” (Polanyi, 1944: 42). Everything, including land, the natural environment, manpower, etc., is treated as a commodity that can be bought and sold at a price determined by the market through voluntary contractual transactions. “Accordingly, there are markets for all elements of industry, not only for goods... but also for labour, land and money” (p. 69). Their value is measured by their productivity, in other words, the extent of their usefulness to production. Individual success does not depend on the righteousness of a person’s intentions but the value others attach to them, which might not be compatible with our perceived distributive equity. Thus social considerations are taken over by a self-regulating market, as value is defined by scarcity. As Polanyi (1944: 75) writes “human society had become an accessory of the economic system”. Harvey (2005: 165) assesses the emergence of a ‘market-driven society’.

² Economic man

“To presume that markets and market signals can best determine all allocative decisions is to presume that everything can in principle be treated as a commodity. Commodification presumes the existence of property rights over processes, things, and social relations, that a price can be put on them, and that they can be traded subject to legal contract. The market is presumed to work as an appropriate guide – an ethic – for all human action.”

2.2.2 The virtues of ‘perfect liberty’

As demonstrated in the empirical chapters, the “utopian endeavour of economic liberalism” (Polanyi, 1944: 29) and the “ideal of freedom” (Hayek, 1960: 1) held immense appeal to Estonians during Soviet occupation biasing their policy choices in the post-socialist era. The ideal of liberalism, as expressed by Friedman (1962: 195) below, has been repeatedly echoed by Estonian policy makers.

“The heart of the liberal philosophy is a belief in the dignity of the individual, in his freedom to make the most of his capacities and opportunities according to his own lights, subject only to the proviso that he not interfere with the freedom of other individuals to do the same... Each man has an equal right to freedom.”

In neoliberalism the self-regulating free market is perceived as the key to economic development. It is a “moralising effect”, as by encouraging people to be proactive problem solvers it installs the virtues of punctuality, frugality, and probity (Ingham, 1995: 154). Markets “require, reward and reinforce valuable moral qualities: trustworthiness, reliability, effort, civility, self-reliance and self-restraint” (Wolf, 2005: 55). Neoliberals argue that no group of people or agency has integrated and perfect knowledge of every individual’s mind in society. This knowledge is not knowledge in the scientific sense; it represents the skills, abilities, resources, efforts and circumstances of members of society; it is the cumulative, unorganised and tacit knowledge of individuals and their awareness of their options and limitations. In their view the advancement of knowledge and social progress did not grow out of deliberate and organised action. Hayek (1944: 37) stresses the central role of free individual effort - “a complex civilisation like ours is necessarily based on the individual adjusting himself to changes”.

As Hayek (1960: 41) asserts “(p)rogress by its very nature cannot be planned”. Friedman (1962: 3) similarly states that the “great advances of civilisation... have never come from centralised government”. Historical breakthroughs have been made possible by the efforts of individuals trying to achieve their own goals, which took creativity and

experimentation, as well as imitation of the more successful members of society. They point to the continuous effort each person trying to achieve his/her objectives and constant adaptation to changing situations as the cause of improved welfare (Hayek, 1976). In their view our society and all social phenomena are a culmination of the voluntary cooperation of many separate rational minds. Since any attempt to centrally plan and organise individual efforts and knowledge hinders progress, government should not interfere in the efforts of private individuals. The role of our institutions should be the protection of the freedom of individual action and thought (Hayek, 1960; Peet, 2007). As Hayek (1944: 56) argues:

“The state should confine itself to establishing rules applying to general types of situations, and should allow the individuals freedom in everything which depends on the circumstances of time and place, because only the individuals concerned in each instance can fully know these circumstances and adapt their actions to them.”

Individualism does not assume that people live in isolation in their own reality; it is concerned with the individual pursuing his/her self-selected goal given his/her own motives thereby contributing to the common good. The idea of unintended social consequences of self-regulating individual action renders the existence of free markets unimpeded from government interference essential for government cannot reproduce the diversity of individual achievements (Friedman, 1962). In neoliberal theory division of labour and specialisation, which are prerequisites for economic growth, are not the outcomes of human foresight or a conscious ‘consequence of human wisdom’ of the collective. They are the result of a slow and gradual process originating from individuals’ voluntary collaboration, which is more effective and more efficient than deliberate direction (Smith, 1776). To quote Hayek (1944: 151) again, “it was men’s submission to the impersonal forces of the market that in the past has made possible the growth of a civilisation...” Each person can apply his talent, knowledge and resources in the best way he/she sees fit given his/her particular situation. Even if none of the available alternatives are desirable, the market provides the freedom to choose the least unattractive course of action (Hayek, 1976). Neoliberals argue that the engine of economic development is the self-regulating market completely free from government intervention, in which people are at full liberty to pursue their own goals through their preferred course of action culminating in the “coincidence of private and public satisfaction” (O’Brien, 2003: 113). Hayek (1944: 158) vehemently argues against ‘collective action’:

“...independence, self-reliance, and the willingness to bear risks, the readiness to back one’s own conviction against a majority, and the willingness to voluntary co-operation with one’s neighbours – are essentially those on which an individualist society rests. Collectivism has nothing to put in their place, and in so far as it already has destroyed them it has left a void filled by nothing but the demand for obedience and the convulsion of the individual to do what is collectively decided to be good.”

Both Hayek and Friedman warn against the synonymous use of the terms *homo economicus* and *self-interested man*, arguing that the pursuit of material goods or rewards is not about “myopic selfishness” but “whatever it is that interests the participants, whatever they value, whatever goals they pursue” (Friedman and Friedman, 1980: 27). ‘Rationalistic individualism’ allows individuals to pursue their goals, whatever they are, as long as they are aware of the consequences. The emphasis is not on the nature of individuals’ goal but the freedom to desire it and the liberty to achieve it without coercion (Hayek, 1976), which is an essential ingredient in achieving political freedom (Friedman, 1962). Hayek (1960: 79) cautions against judging other people’s values stating that “each person has his own scale of values, which we ought to respect, even if we do not approve of it...” People have the right to make mistakes and to take the wrong course of action. “Liberty is an opportunity for doing good, but this is so only when it is also an opportunity for doing wrong”. The actions of the individual do not depend entirely on natural causes thus man must be held responsible for his own action (Hayek, 1960).

In the neoliberal paradigm the onus is clearly on the individual. “Liberty and responsibility are inseparable” (Hayek, 1960: 71). A person chooses a course of action determined by his/her preference of the payoffs of the various alternatives, which are defined by other members of society. Every person should be responsible for her/his own welfare and standard of living through personal success or failure. All economic agents ought to be aware of the consequences of their actions. By assigning responsibility to the person we presume that person’s ability for rational action (Hayek, 1960).

To traditionally individualistic societies upon which collectivism was forced upon, as in the case of Estonia, the idea(l) of the accountable individual free to choose his/her course of action seems especially attractive.

2.3 Market and government

2.3.1 *The need for a 'government by rules'*

Discussions about the appropriate roles of the state and the market take centre stage in economic development (Gilpin, 2001). Friedman (1962: 38) summarises the neoliberal view of government - "what we urgently need, for both economic stability and growth, is a reduction of government intervention not an increase". The axiomatically held superiority of the free market, in which the profit motive and rational individual decision making ensure efficiency, necessitates private ownership. An efficient market reflects utilitarian and not necessarily social value, the measurement of which requires the commodification of everything, so that prices replicate scarcity and allocate resources accordingly. Because barter is cumbersome as it incurs large transaction costs due to its requirement of double coincidence of needs and wants, the existence of money that functions as means of payment, store of value and unit of account (Baumol and Blinder, 1998) is essential. In a free-market system

"All transactions are turned into money transactions, and these in turn require that a medium of exchange be introduced into every articulation of industrial life. All incomes must derive from the sale of something or other, and whatever the actual source of a person's income, it must be regarded as resulting from sale." (Polanyi, 1944: 41)

Consequently, in a free-market economy there must be a freely functioning market for everything used in the economy eliminating non-contractual relations between individuals over time. "Instead of the economy being embedded in social relations, social relations are embedded in the economic system" (p: 57).

At the very centre of neoliberal thinking is the relation between economic freedom and political freedom. "A self-regulating market demands nothing less than the institutional separation of society into an economic and political sphere" (Polanyi, 1944: 71). As Friedman (1944: 152) argues, "the only alternative to submission to the impersonal and seemingly irrational forces of the market is submission to an equally uncontrollable and therefore arbitrary power of other men". Neoliberals perceive government intervention through regulations, such as restrictions on international trade, price fixing, and high tax burdens, as the major inhibitor to economic growth because it demotivates entrepreneurship and leads to misallocation of resources. As government replaces the market's voluntary cooperation with coercion, any increase in the role of government is a threat to freedom. Whereas actions through "political channels... tend to require or

enforce substantial conformity”, markets permit “unanimity without conformity” (Friedman, 1962: 23). According to them the state should not carry out any functions that can be performed by the market.

Unlike political power, economic power can be widely distributed. Friedman (1962) and Hayek (1976) consider the basic problem of social organisation a trade-off between two choices: central administration using coercion, as in totalitarian states, or coordination without coercion, as in a free market economy based on economic freedom and the voluntary cooperation of individuals. They distinguish between government determining the “rules of the game” acting as an “umpire to interpret and enforce the rules decided on” (Friedman, 1962: 15), and ‘government by orders’, which assigns specific tasks to individuals. A person must be freely directed in his actions by his awareness of the rules and the consequences of not complying with them. “A society that does not recognise that each individual has values of his own which he is entitled to follow can have no respect for the dignity of the individual and cannot really know freedom” (Hayek, 1960: 79). This is a powerful argument to populations, including Estonians, with experience of totalitarian regimes.

The central assumption of neoclassical economics of efficient market and inefficient government implies that government must refrain from conscious economic development (Saad-Filho, 2005). The neoliberal view of the role of government is perhaps best explained by the public choice theory, which questions the ability of the state to meet its responsibilities, including the maintenance and enforcement of the rule of the law, the provision of public goods, and the correction of market failures. “Politicians are motivated by increasing their chances of getting themselves or the members of their party elected or reelected”. Thus governments, due to their political campaign funding needs, are susceptible to succumb to the disproportionate influence of special interests causing overinvestment of resources in some industries and underinvestment in others (Taylor, 2004: 392). While the benefits are concentrated to a small minority, the costs are dispersed among the population (Friedman, 1993). “Public servants are no different from any other economic agent in seeking to maximise their individual self-interest”, which makes them vulnerable to bribes and pressure from

special interest groups. The overall effect is a diversion from wealth-producing entrepreneurship to rent-seeking (Fukuyama, 2004: 66).

“Special interest groups are subsets of the general population that hold intense preferences for or against a particular government service, activity, or policy” (Arnold, 1998: 407) and “use tariffs and other protectionist measures to increase their incomes at the expense of others” (Stiglitz, 2002: 13). They exercise disproportionate influence over government through their campaign funding and lobbying. For instance, producers in regulated industries enjoy protection from intense competition in the form of entry barriers, which increase the price of their outputs and thus their profits. Therefore, it is in the interest of these organisations to lobby for continued regulation (Samuelson and Nordhaus, 1985 and 2001). Rent-seeking behaviour is costly. Rent-seeking producers incur the expenses of lobbying, advertising campaigns aimed to influence the public and its elected representatives, and legal defence in case of anti-trust accusations. It also imposes additional costs on society because consumers have to pay higher prices for the outputs of protected producers than under competitive conditions (Tirole, 1988).

Public choice theory views the behaviour of politicians and government officials as driven by the desire to promote their own self-interest under the influence of powerful groups at the expense of national welfare. Rent seeking is an important argument for privatisation as it reduces the opportunities for government officials to “skin off the profits of government enterprises or award contracts and jobs to their friends” (Stiglitz, 2002: 58).

Advocats of neoliberalism place the blame for the underdevelopment of many economies in the world on mistaken government policies, which interfere with the operations of the market and distort economic incentives (Tirole, 1988; Friedman, 1993; Gilpin, 2001). The depiction of state employees as self-serving bureaucrats who put their own interests ahead of the public precludes their diverse responsibilities and professionalism (Kelsey, 1995; Fukuyama, 2004). In the words of Hayek (1960: 262), “the greatest danger to liberty today comes from the men who are most needed and most powerful in modern government, namely, the efficient expert administrators exclusively concerned with what they regard as public good”.

Government is the agency that possesses a monopoly on the legitimate use of force, through which some members of society can coerce others. The challenge, therefore, is to ensure that these monopoly powers of the state do not threaten freedom (Friedman, 1993). While the combination of economic power and political power in the same hands is dangerous, as it leads to totalitarianism, their separation provides the necessary checks and balances for political freedom. Concentration of power is the gravest threat to individual freedom, therefore, “government power must be dispersed” (Friedman, 1962: 3). The market and economic organisation restrict the number of decisions faced by government, so competitive capitalism and freedom are consequently considered inseparable. In the market place proportional representation without conformity is possible, unlike in the political arena. Economic freedom reduces the range of decisions for which political power is needed. The more decisions are made in the marketplace, the fewer political decisions are needed rendering conformity unnecessary, which reduces the strain on society (Friedman, 1962; Friedman and Friedman, 1980).

Under neoliberalism politics and economics are interwoven; democracy and unimpeded free markets are considered inseparable (Giroux, 2004). Neoliberal ideology is presented as the champion, the exclusive guarantor of individual freedom, in the promotion of which the market is deemed instrumental (Ingham, 1995). “Neoliberalism is... an economic project but it is also a moral one – a project of individual ethics” (Smith and Rochovská, 2007: 1166). As such, neoliberal theory easily lends itself to political movements that attach high values to individual liberty.

Indeed, as I argue in chapters six and seven, these ideals greatly contributed to the utopian image of neoliberalism holding immense appeal to Estonian decision makers. “Good markets need good governments” (Wolf, 2005: 73). Liberalism does not mean that “government should never concern itself with any economic matters” (Hayek, 1960: 220) but freedom under the law. A democratic state must be led by general principles. “The consistent liberal is not an anarchist” (Friedman, 1962: 34) but intervention in economic affairs must be evaluated carefully on a case by case basis. In Wolf’s (2005: 67) words, “the mechanism of the state is at least as defective as that of the market.” Hayek (1960) prefers an inactive government to an active one stating that erroneous interference does more harm than good even if it is for the right reason.

Overall, neoliberal ideology considers the free market the best regulator of monopolies and anticompetitive practices in the long term. The theory of contestable markets is used as a safeguard against market consolidation. Industries with above-average profits attract investors, which increases output and drives profit levels down. Thus, over the long term the market retains its competitive nature (Samuelson and Nordhaus, 1985: 480-488).

2.3.2 The mechanism of the self-regulating market

The concept of general market equilibrium is central in neoclassical economics. It is argued that the forces of the free market, demand and supply, lead to a state of equilibrium in the long term, where maximum efficiency is achieved by fully utilising all the resources of the economy. The price system has a built in self-correcting mechanism; surpluses are eliminated by a fall in price and shortages are eradicated through an increase in price. High unemployment levels cause the price of labour, wages and salaries, to fall until full employment is restored (Ingham, 1995). In a multimarket equilibrium, where each industry is in equilibrium, allocative efficiency is achieved and social welfare is optimised. “General equilibrium analysis can show that free-market exchange achieves economic efficiency” (Lapavitsas, 2005: 35).

“The market mechanism simultaneously solves the What, How and For Whom for many interdependent markets by allowing supply and demand curves to determine all the prices and quantities. This interdependent set of equilibrium prices and quantities is the general equilibrium of markets determined by supply and demand.” (Samuelson and Nordhaus, 1985: 69).

In neoclassical economics external changes result in a temporary state of disequilibrium but over the long term, the market automatically returns to long-term equilibrium, where real output equals potential output leaving no resources – including labour – unemployed. Thus, economic development is viewed as a process of equilibria and disequilibria not requiring outside interference (Gilpin, 2001; Saad-Filho, 2005). It is not the function of the government to provide goods and services because the

“...general-equilibrium set of interdependent markets solves the problems posed in the basic definition of economics. It is through prices and markets that (1) scarce resources with alternative uses... are allocated, and that (2) the economy achieves its ends and goals...”
(Samuelson and Nordhaus, 1985: 70)

In a free market economy market equilibria through efficient allocation of resources leave everyone better off, creating a 'Pareto-efficient' outcome, in which no individual or business can improve welfare without making someone else worse off. "Under conditions of efficiency... one person's utility can be increased only by lowering someone else's utility". Thus "redistributional programmes reduce the total size of real national income" (Samuelson and Nordhaus, 1985: 483 and 750) by misallocating resources into non-productive activities, diminishing the incentive to work and increasing administrative costs. The welfare of society can be best advanced by motivating free enterprise in neoliberal thinking because "on the whole, market competition, when it is permitted to work, protects the consumer better than do alternative government mechanisms..." (Friedman and Friedman, 1980: 222). Since in neoliberal theory the self-regulating market ensures optimal social outcomes and maximises welfare, the role of the state must be limited to providing the preconditions for economic growth and the proper functioning of the market (Friedman, 1962; Taylor, 2004). Neoliberals warn against government interventions in order to protect the market's ability to transmit correct signals about demand and supply through price, (Ingham, 1995).

Economic phenomena are explained by neoclassical economists using abstract mathematical models, which are applied to analyse specific problems. The actions of consumers and producers are represented as numerous interdependent equations, which are solved continuously at the same time. The extensive use of calculus and modelling is used as proof of the objective and universal nature of the economic science, which is assumed to apply to all societies and economies, even though economic theories cannot be tested empirically. Although fundamental economic issues affecting social welfare are treated as purely technical problems and problems that cannot be modelled tend to be ignored (Gilpin, 2001), the outcomes of these calculations form the basis of economic advice and policies, which have become orthodox, mainstream macroeconomic management over the past thirty years (Tickell and Peck, 2003). Economics has become "universalised, centralised, naturalised and normalised as a scientifically true discourse valid for all people" (Peet, 2007: 82). Samuelson and Nordhaus (1985: 6) stress the role of economists in our society:

"Economists have in recent years become the counsellors of presidents and prime ministers... Leaders must have economic advisors on hand to make

sure their political instincts will not lead the country astray. It is sometimes said that the nineteenth century was the time of the clergy, and that in the first half of the twentieth century government was dominated by lawyers. Today, economists often are in the middle of political analysis, debate and evaluation."

Free-market economy "implies a self-regulating system of markets... it is an economy directed by market prices and nothing but market prices" rendering the organisation of society and its institutions subordinate to the requirements of the market economy. A market-driven society is organised on the principle of profit and gain with social relations functioning within the framework of the market (Polanyi, 1944: 43).

2.4 Neoliberal Economic Policies

The literature on neoliberalism is divided. According to Wolf the term 'neoliberalism' is "an incomprehensible piece of neo-Marxist jargon" (2005: 7). Barnett argues that "(t)here is no such thing as neoliberalism" (2005: 9) because the term 'neoliberalism' is just a "muddled set of *ad hoc*, opportunistic accommodations to these unstable dynamics of social change" (2005: 10). In contrast, Harvey (2005 and 2007), Peck and Tickell (2002 and 2003) argue that neoliberal policies can be clearly distinguished due to their relentless pursuit of the self-correcting free market through the means of rational individualism, flexible labour, unimpeded mobility of inputs and outputs, and monetarist and supply-side oriented economic policies. I agree with Harvey's (2007: 22) definition that

"(n)eoliberalism is a theory of political economic practices proposing that human well-being can best be advanced by the maximisation of entrepreneurial freedoms within an institutional framework characterised by private property rights, individual liberty, unencumbered markets and free trade. The role of the state is to create and preserve an institutional framework appropriate to such practices."

Neoliberal theory emphasises the rationality of the market over that of the government and warns against government interference in the market place. Friedman (1962) regards the governments' objectives of full employment and economic growth as excuses for intervention in economic affairs. Under neoliberal policy prescriptions, instead of a continuous engagement in fine-tuning the economy, the government becomes much less intrusive by consistently following an economic policy that is not "being subject to the day-by-day whim of political authorities" (p: 51).

Neoliberal economic theory rests on the pillars of monetarism and supply-side economics. Monetarists outright reject Keynesian economics and consider the market to be automatically self-adjusting, claiming that “most of the efforts of policy makers to smooth out the economy’s ups and downs actually make things worse” (Krugman and Wells, 2006: 823). Monetarism consists of three components:

“(1) a penchant for small government, and free markets; (2) greater emphasis on containing inflation than on reducing unemployment; and (3) a desire to avoid active government policies, preferring ‘rules of law’ rather than ‘discretion of men’.” (Samuelson and Nordhaus, 1985: 329)

Monetarists deem demand management by the state authorities inflationary and a principal cause for unemployment arguing that due to the difficulties in measuring real output levels relative to potential or full-employment output levels, discretionary government policies further destabilise the economy (Hoover and Plant, 1989). Higher levels of government expenditure raise interest rates “making it more expensive and more difficult for individuals to get mortgages on new homes and for businesses to borrow money”. They point out that policies aimed at achieving full employment increase budget deficits. In addition, they “have not succeeded in producing full employment but they have produced inflation” (Friedman and Friedman, 1980: 264-266). Overall, neoliberals argue that “economies automatically self-adjust to full employment, so that use of monetary and fiscal policy to permanently raise full employment merely generates inflation” (Palley, 2005: 20).

Monetarism emphasises the importance of labour market flexibility in fighting unemployment. The flow of labour should be free, as outside interference, such as labour market regulations, decreases efficiency by distorting market forces. Since in perfectly competitive input markets the price of a factor of production is equal to its productivity (Krugman and Wells, 2006), unemployment is caused by a mismatch between productivity and wage levels. Therefore, in order to protect the adaptability and self-regulating nature of the economy, workers should accept wages equalling their level of productivity. According to monetarists the effect of minimum wage laws is “clearly to increase poverty” because it is not within the interest of employers “to hire at that minimum all who were formerly employed at wages below the minimum” (Friedman, 1962: 180). In their view collective bargaining increases unemployment

rates by pushing the price of labour above the equilibrium level. Friedman (1962: 124) underlines the adverse effects of trade unions.

“Unions have... not only harmed the public at large and workers as a whole by distorting the use of labour; they have also made the incomes of the working class more unequal by reducing opportunities available to the most disadvantaged workers.”

Neoliberals point to workers' unwillingness to offer their labour at the going wage rate and/or their refusal to move to locations with higher demand for their skills as the cause of unemployment. Laid off workers should not be offered compensation, instead they should relocate to areas with better employment opportunities. Friedman and Friedman (1980: 246) argue that involuntary unemployment only exists in an overregulated economy because “(t)he most reliable and effective protection for most workers is provided by the existence of many employers”. Supposedly, free markets do “not let valuable factors of production (including labour) go to waste. Instead, prices will adjust to ensure that demand is forthcoming and all factors are employed” (Palley, 2005: 20).

Monetarists underline the pivotal role of “appropriate monetary policy” (Hayek, 1960: 302) in maintaining currency stability and reducing unemployment. Monetarism is based on the notion that shifts in the money supply are the cause of the business cycle. Therefore, decreasing the quantity of money in the economy would result in a recession, increasing it would lead to an expansion. Thus the central bank has a crucial role in the economy; its responsibility is to maintain a slow and gradual increase of the money supply in order to achieve stable prices, output and employment levels (Mankiw, 2000). Since inflation is regarded to create unemployment in the long term, the maintenance of a stable monetary structure and control of the price level is considered the economic priority of the state. Monetarists do not dwell much on fiscal matters, such as public spending. They underline the government's responsibility in maintaining a stable and predictable business environment by consistently pursuing a money-supply target regardless of interest-group pressures. However, monetarism still leaves room for discretionary fiscal policies and it does not specify whether the budget deficit should be eliminated by cutting expenditure or by raising taxes (Hoover and Plant, 1989).

The other pillar of neoliberal economic policy is supply-side economics. ‘*Supply-siders*’ warn that the “stabilising effects of fiscal policy are dampened because the impact on

private investment (and other interest-sensitive sectors) tends to offset the effects of fiscal policy” (Samuelson and Nordhaus, 1985: 352). They claim that higher levels of government expenditure have an adverse effect on private investment by increasing interest rates. Supply-side economics abandons the Keynesian view of active demand stimulation by government and focuses on encouraging output through lower tax rates. Arguably, workers taking home a higher portion of their income would be motivated to work more leading to higher output and faster economic growth (Mankiw, 2000). Lower tax rates thus benefit individual incentives and productivity ascertaining a rise in economic growth rates and government tax revenues. Friedman (1962: 132) argues that the “corporate tax should be abolished”. As for personal income taxes, a “low flat rate – less than 20 percent – on all income... would yield more revenue” than progressive taxes (Friedman and Friedman, 1980: 306).

As argued in the empirical chapters, it is not a coincidence that Estonia today has no corporate taxes on reinvested profits and has a proportional personal income tax regime of 20 percent.

Supply-side proponents consider current levels of public expenditure in the developed economies excessively high. Increases in government expenditure and budget deficits are perceived to have adverse economic and social effects as they impose a higher tax burden on the private sector, decrease productivity by demotivating workers, and crowd out private investment by increasing interest rates leading to lower private investment. As “crowding out is associated with the impact of a structural deficit, one arising from discretionary increases in government expenditure or cuts in taxes”, the maintenance of a balanced budget is considered to be of primary importance (Samuelson and Nordhaus, 1985: 353).

2.5. Equity considerations

The neoliberalist principle of income distribution is best illustrated with a quote from Milton Friedman (1962: 160): “(t)o each according to what he and the instruments he owns produce.” Unlike equality of outcome or material equality, equality of opportunity is deemed an essential part of liberty. Individuals must have the freedom to make the

most of their abilities and opportunities with no arbitrary obstacles preventing them to achieve their goals. In Hayek's (1944: 59) words,

"...formal equality before the law is in conflict, and in fact incompatible, with any activity of the government deliberately aiming at material or substantive equality of different people, and ... any policy aiming at a substantive ideal of distributive justice must lead to the destruction of the Rule of the Law. To produce the same result for different people it is necessary to treat them differently."

Neoliberalism perceives inequality of income, ability, skills and status as necessary in a competitive world, where the best will succeed at everyone's benefit (Hayek, 1960).

Progress is viewed not as a deliberately designed process but an advance in knowledge.

The neoliberal paradigm "suggests raising human capital, through training and education, in order to raise productivity and as a result decrease poverty" (Brady, 2003: 377). As factors of production are rewarded according to their productivity, owners of resources are encouraged to focus on increasing their productivity levels in order to raise their living standards (Hayek, 1960). In the neoliberal world

"Individual success or failure are interpreted in terms of entrepreneurial virtues or personal failings (such as not investing significantly enough in one's own human capital through education) rather than being attributed to any systemic poverty (such as the class exclusion usually attributed to poverty)." (Harvey, 2005: 65-66)

However, there is no guarantee that progress will be equally satisfying to everyone, as new knowledge and its benefits diffuse slowly and unevenly causing inequality.

Through trial, error and experimentation we discover new ways to make better things. In Hayek's (1960: 44) words it is through knowledge "acquired by the experiments of some members of society that general progress is made possible". They regard the rich as experimenters taking on risks to the benefit of society as a whole. Since new goods produced in small quantities are pricy, only the more affluent can afford the financial and psychological risks included in acquiring them.

"If today... the relatively poor can have a car or a refrigerator, an airplane trip or a radio, at the cost of a reasonable part of their income, this was made possible because in the past others with larger incomes were able to spend on what was then a luxury... The path of advance is greatly eased by the fact that it has been trodden before." (Hayek, 1960: 44)

Neoliberal theory claims that since through large-scale production the luxuries of today will be inexpensive, available to everyone, the less affluent owe their relative material well-being to the experimentations of the wealthy who take leadership in trying out new

ideas, goods, services, and styles of living. They create lifestyles that the less well-off will want to imitate (Hayek, 1960). Over time, the position of the lower classes is supposed to improve reducing inequality between the various layers of society. Friedman (1962: 170) also regards progress as the liberation of masses from hardship and access to goods and services that in the past had been the privileges of upper classes. He contends that “the advances in technology have for the most part simply made available to the masses of the people luxuries that were available in one form or another to the truly wealthy.”

Neoliberals argue that poverty is relative. Not all new ideas, products and experiments are successful; high payoffs are not guaranteed to everyone. People base their decisions on the relative attractiveness of the outcomes of the choices they make. Some attach higher values to leisure; some are more hard-working than others. Some jobs are more attractive than others and “naturally more gruelling, physically intensive or intellectually demanding work would pay higher wages” (Brady, 2003: 377). “Individuals choose occupations, investments, and the like in accordance with their taste for uncertainty” (Friedman and Friedman, 1980: 163).

The neoliberal paradigm points to the opportunities available for mankind to explore and develop their skills and abilities as one of capitalism’s greatest achievements. In their view, income differentials are a reflection of individuals’ decisions regarding the allocation of their resources, time and the extent of their risk aversion. They regard inequality as mostly a result of differences in returns to people’s choices of occupation, investments and preferences of work versus leisure. “Payment in accordance with product may be necessary to achieve true equality of treatment” (Friedman, 1962: 162). Investment opportunities involving above average risks, unattractive occupations and jobs requiring long years of training necessarily offer higher than average payoffs to compensate for above average hardship and uncertainty. Friedman (1962: 162) explains:

“One man may prefer a routine job with much time for basking in the sun to a more exacting job paying a higher salary; another man may prefer the opposite. If both were paid equally in money, their incomes in a more fundamental sense would be unequal.”

Neoliberal theory considers failure personal; if the conditions of some people deteriorate it is because of their inadequate investment in their own human capital. An

increased gap between rich and poor is regarded as unavoidable and necessary to encourage entrepreneurial risk and innovation. “Each individual is held responsible and accountable for his or her own actions and well-being” (Harvey, 2005: 65). Friedman (1962) and Hayek (1960) view inequality of outcome as a necessary and inevitable result of the differences in individual efforts, abilities, performances and the willingness to take risks. Therefore, as each decision, including career choices, investments, involves risks, every person must be allowed to decide freely and bear the consequences of his/her decision.

“Free markets should be preserved and government intervention should be minimised if poverty reduction is the goal” (Brady, 2003: 374). Deliberate redistribution of income is unjustifiable in neoliberal theory because it diminishes the motive to experiment. In the short term it would improve the situation of the poorer at the expense of the better off. In the long term, however, “it may actually worsen and deepen poverty” (p. 375). People are different; they have different values, talents, abilities, values and desires. In a neoliberal world performance is reflected in wealth accumulation, thus equality of outcome is incompatible with freedom and individualism. Considerations of equity and fairness are relative concepts; they are “in the eyes of the beholder”. Instead of getting what others consider ‘fair’, people are entitled to receive the fruits of their own efforts (Friedman and Friedman, 1980: 135). Capitalist ethics is instrumental. As a free market economy is based on the principle of collaboration through voluntary transactions, individuals’ returns depend not on distributive equity considerations but on merit. As income distribution is impersonal in a free market economy, intervention by authority is entirely unnecessary (Friedman, 1962).

This ‘some win, some lose’ paradigm is also used to explain differences in levels of economic development between nations. The neoliberal paradigm sees “government as the problem. Free markets were the solution to the problems of developing countries” (Stiglitz, 2002: 13). Lack of competitiveness, inflexible markets, personal, cultural and political problems, and people’s failure to improve their own human capital are listed as causes of slow economic growth. Thus, in line with neoliberal principles, “the core solution for lagging regions, Africa above all, is freer domestic and international trade

and more open financial markets, leading to deeper integration into the world economy” (Wade, 2003: 567).

According to the neoliberal philosophy “(b)ecause prosperity and economic growth are the best mechanisms to combat poverty, free market capitalism is the best system for reducing poverty in the long term”. Economic growth is necessary for increasing living standards for everyone, including the poor. “What is good for the nation is naturally good for the nation’s poor” (Brady, 2003: 372). Arguably, 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).

“The welfare state is counterproductive and inefficiently hinders the free market from achieving its full potential” (Brady, 2003: 375). According to neoliberal theory the state deprives people of the choice of helping themselves by the compulsory system of social security. Welfare induces dependency, as it impedes the ability of the poor to spot and seize available opportunities. “Generous welfare programmes discourage work, provide incentives for deviant behaviour and single parenthood, and lead to dependency” (p. 375). Neoliberals claim that state welfare expenditures are financed from tax revenue, therefore they constitute a threat to individual freedom, as they restrict individuals’ freedom to spend their income as they see fit. In addition to its high costs, welfare spending has a long-term inflationary impact with an adverse effect on the very people it is supposed to help. State-funded expenditure on welfare is a major contributor to the growth of government, as it can become an ‘open-ended’ commitment. “Once people get on relief, it is very hard to get off” (Friedman and Friedman, 1980: 107). Neoliberals also view the effects of price supports and minimum wage laws as negative because they are costly and reduce the incentive for people to help themselves (Samuelson and Nordhaus, 1985).

Friedman (1962: 169) states that “capitalism leads to less inequality than alternative systems of organisation and that the development of capitalism has greatly lessened the extent of inequality”. He argues that non-capitalist economic systems have more permanent income inequalities and lower levels of social mobility than developed free market economies. Wolf (2005: 53) agrees – “among sophisticated societies with an elaborate division of labour, societies with market economies have been the least unequal...” Neoliberals claim that the increased integration of national economies and the accompanying improvement in resource allocation has decreased global income inequality and the size of the world’s population living in extreme poverty has declined for the first time since the 1980s over the past two centuries. Between-country purchasing power parity (PPP) adjusted income inequality has been steady or decreasing (Wade, 2004).

Friedman and Friedman (1980:144) argue that government measures aimed at redistributing income and alleviating poverty, such as progressive taxation and inheritance taxes, have ambiguous effects over income inequality, as “the end result is not an equitable distribution. A vast reshuffling of income and wealth, yes; greater equity, hardly.” They claim that graduated taxation adversely affects allocation of resources into higher risk activities, encourages tax evasion and tax avoidance, and violates the principle of individual freedom, as it gives some people more by forcibly taking away from others. Hayek (1976) contends that the effects of progressive taxation are only justified by misled egalitarian beliefs. He considers it harmful for society, as it reinforces social immobility by making it harder to accumulate income. Due to the seriously impractical implications of unanimous voting rules, democratic states are governed by the principle of majority rule, which may lead to ‘majority tyranny’ over minorities through discrimination and income redistribution (Samuelson and Nordhaus, 1985). Hayek (1960: 316-317) states that progressive taxation “offends against what is probably the only recognised principle of economic justice, that of “equal pay for equal work””, misallocates resources by diverting “energies to activities where they are less useful than they might be” and “discriminates against those risky ventures which are worthwhile only because, in case of success, they will bring a return big enough to compensate for the great risk of total loss”. The resulting improvement in economic performance and employment

would be to the advantage of everyone, including the poor. Friedman and Friedman (1980: 306) point out that progressive taxation violates the pay for performance principle, as those receiving higher pay for more work may end up earning less than those getting smaller pay for less work. They underline the advantages of proportional taxation of simplicity and lower disincentive effect.

In neoliberalism the notion of the freedom of choice of the free and responsible individual conflicts with the institution of the welfare state with its supposedly paternalistic feature. Neoliberal ideology draws a parallel between socialism and aristocracy in the sense that both are based on rule by command. “Believers in aristocracy and socialism share a faith in centralised rule, in the rule by command rather than by voluntary cooperation” (Friedman and Friedman, 1980: 97). It likens this to the welfare state, as in the name of ‘public interest’ a small group of individuals decide what is good for the majority. It criticises public pension schemes because they are financed not from one’s savings but by workers paying taxes today, not leaving them enough disposable income to be able to save for retirement. In essence, this is considered a mandatory and impersonal transfer from the young to the old. The problem in is aggravated by the tendency of children of poorer background joining the labour force at an earlier age; thereby they are taxed for a longer period of time than the better-off. Public assistance is viewed as a “transfer from the less well-off to the better-off” dividing society into “two classes of citizens, one receiving relief and the other paying for it” (Friedman and Friedman, 1980: 106-107). Neoliberals claim that the welfare state has created impersonal and involuntary benefit schemes, in which government bureaucrats decide about spending of someone else’s money. Much of the funds aimed at the poor do not reach them, as this system encourages benefit fraud. The welfare state thus creates waste, weakens the family, provides disincentives to work and save, and restricts individual freedom (Friedman and Friedman, 1980).

The recommended alternatives to government administered welfare measures are based on the existence of self-reliant rational and responsible individuals, who are able to help themselves. Those who cannot would be cared for by charities. Private charities consist entirely of not compulsory but voluntary actions, therefore. they are perfectly

compatible with neoliberal philosophy (Friedman, 1962). Neoliberals argue that a decrease in state support motivates households to become more efficient. They urge the shift of responsibility onto the family from the welfare state and encourage people to seek alternatives, such as private pension plans, to provide for their own retirement (Kelsey, 1997 and 1999).

Friedman (1962) recommends the introduction of the negative income tax, which would guarantee a minimum income threshold. Once a person's income rises above that level, the extra income is taxed at a certain rate. He considers it less costly due to its relative simplicity and efficiency and more humane as it leaves the incentive to work intact.

2.6. 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, which determines prices in a free market, 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). Demand is defined as the amount of a good or service, that "buyers are *willing* and able to purchase" and supply is explained as the amount of a good or service that "sellers are *willing* and able to sell". At the market-clearing equilibrium price "everyone in the market has been satisfied: buyers have bought all they want to buy, and sellers have sold all they want to sell". Thus, "markets are usually a good way to organise economic activity" (Mankiw and Taylor, 2006: 65-81).

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 1990, 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). “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, which will be elaborated further in Chapter Three, ultimately “resulted in a débâcle” of the system (Gros and Steinherr, 1995: 54).

Indeed, it was a higher quality of life as well as the ability to decide freely for oneself that Estonians aspired to achieve. Their intention of not settling for anything less than ‘perfect liberty’ will be discussed extensively in the empirical chapters.

2.7 Critique of the neoliberal ideology

In this part I highlight the errors in the foundations of neoliberal ideology – the assumption of a utilitarian, fully rational economic individual who bases his decisions

on self-interest, its central hypothesis of a self-regulating market, and the preoccupation of monetarism and supply-side economics with deflationary policies and fiscal austerity.

2.7.1. The assumption of the rational utility-maximising Economic Man

Critiques of neoliberalism argue that “(m)odern mainstream economic theory is largely based on an unrealistic picture of human decision making...” (Selten, 2002: 13).

Empirical evidence deviates from the full rationality assumption to a great extent.

Economic decisions are not determined solely by incentives and the knowledgeability of individuals of their own circumstances. Rationality has cognitive as well as affective bounds. “Conclusions reached by rational deliberations may be overridden by emotional impulses”. People do not have unlimited cognitive abilities, nor do they have access to all the information needed to make a decision due to time and cost constraints. In many cases, decision makers are not even aware of the kind of information required, let alone the consequences of their actions (p: 14-15).

Asymmetry of information, which according to Stiglitz (2002: xi) is “pervasive in all economies”, also impedes rational decision making. It arises from unequal access to information whereby the better informed can benefit disproportionately at the expense of others leading to inefficient outcomes. Such asymmetries of information can occur between employer and employee, borrower and lender, and buyer and seller (Stiglitz, 2002; Lapavitsas, 2005).

The bounded rationality theorem questions the validity of the full rationality assumption by examining the “nonoptimising behaviour of real people” (Selten, 2002: 15). It argues that

“(f)ull rationality requires unlimited cognitive capabilities. Fully rational man is a mythical hero who knows the solutions to all mathematical problems and can immediately perform all computations, regardless of how difficult they are. Human beings are in reality very different. Their cognitive capabilities are quite limited. For this reason alone, the decision-making behaviour of human beings cannot conform to the ideal of full rationality.”
(p. 14)

The prioritisation of goals can have multiple outcomes depending on the evaluation criteria. Urgency can lead to a trade-off between long-term and short-term objectives. Many everyday dilemmas involve incomplete searches and unclear choices. In today’s

complex dynamic environment, decision makers virtually never encounter perfect conditions for optimisation. They have to make important decisions under changing circumstances; time and cost constraints limit their ability to find the optimal solution. “A truly optimising approach to unfamiliar decision problems with constrained decision time is not feasible” (Selten, 2002: 17). Often, a ‘reasonable’ examination of the situation must suffice, leading to suboptimal decisions. Human decision making does not necessarily produce fully rational outcomes due to physiological limitations and the existence of non-utility-maximising motives. The rationality of individuals is bounded in various ways and degrees; people’s decisions are based on goals and evaluative criteria that take ecological, ethical, and altruistic considerations into account. (Pelikan, 1997; Baranyi, 2002). As Keynes (1936: 153) argues, “the motives of human individuals are only exceptionally determined by the needs of material want-satisfaction”.

Krugman and Wells (2006: 231) define utility as “a measure of the satisfaction the consumer derives from consumption of goods and services”. Utilitarianism assumes that we prefer to consume more than less, favour consumption today to consumption in the future (Scarth, 1996), and a rise in a bundle of commodities increases a person’s well being automatically, regardless of how those goods or services can enhance quality of life. The treatment of people as homogeneous decision makers ignores personal differences in demographics, life style, climatic conditions, social circumstances, cultural aspects, and distributional considerations. It supposes that everyone has the same utility function and that the same bundle of commodities yields equal utility to everyone. By perceiving individuals as utility maximisers, the consumption theory of neoclassical economics equates value with pleasure derived from possessions neglecting community relations, political and human rights, and living conditions. Personal possessions transmit little information about an individual’s quality of life due to differences in people’s circumstances and preferences (Sen, 1999: 62-63). Personal satisfaction is contextual and cannot be decoupled from one’s socio-economic circumstances.

“The utility calculus can be deeply unfair to those who are persistently deprived... The deprived people tend to come to terms with their deprivation because of the sheer necessity to of survival, and they may, as a result, lack the courage to demand any radical change, and may even adjust their desires and expectations to what they unambitiously see as feasible... (p: 62-63)

2.7.2 Labour as a commodity

Polanyi (1944: 37-38) strongly questions the natural and automatic emergence of markets arguing that the “market economy is an institutional structure which... has been present at no time except our own, and even then it was only partially present”. He contests the existence of “Economic Man... Adam Smith’s suggestions about the economic psychology of early man” and argues that the “alleged propensity of man to barter, truck and exchange is almost entirely apocryphal”. There never was a self-regulating market economy, as “never before our time were markets more than accessories of economic life” (p. 68). He criticises the “essentially confused” classical economists for drawing a “parallelism between wealth and value” and placing the “laws governing a market economy... under the authority of Nature herself” with far reaching consequences.

*“Essentially, economic society was founded on the grim realities of Nature...
The laws of a competitive society were put under the sanction of the jungle.”*
(p. 124-125)

Neoclassical economic theory regards labour as a mere commodity that earns its return according to its productivity. Thus, the price of labour, wage, is determined by the “extra output you get when you add one unit of labour, holding all other inputs constant” (Samuelson and Nordaus, 1985: 581). Similarly, rent, which is defined as the price of land, is the equivalent of the change in output “resulting from one additional unit of land, with all other inputs held constant...” (p. 581). In the free market a human being is “a mere factor of production” (Harvey, 2005: 167). The “neoclassical model of labour-leisure choice” tells a “simple story” by focusing on an individual’s utility function and relying on the assumption that a person chooses either work to increase consumption of goods or non-work to increase consumption of leisure (Borjas, 2010: 27). This approach ignores people’s drive for self-actualisation, professionalism and self-fulfilment which play an important role in people’s motivation to work (Kelsey, 1995).

The self-regulating market economy does not treat employment in a socially acceptable manner. Stiglitz (2002: 84) simply equates the term “labour market flexibility” with “lower wages and less job protection”. As Polanyi (1944: 71) argues, complete dependence of the labour force on the market would inevitably lead to very unstable job

prospects and incomes, and social dislocation. Treating labour as a commodity “means to subordinate the substance of society itself to the laws of the market”.

“To allow the market mechanism to be sole director of the fate of human beings and their natural environment, indeed, would result in the demolition of society. For the alleged commodity “labour power” cannot be shoved about, used indiscriminately, or even left unused, without affecting also the human individual who happens to be the bearer of this peculiar commodity.”
(Polanyi, 1944: 73)

Thus, the “natural aim of all social protection was to destroy such an institution and make its existence impossible” (Polanyi, 1944: 177). Friedman (1962) argues that the costs of labour market interventions outweigh their usefulness to society. Krugman (2007: 262) disagrees:

“Unions raise the wages of their members, who tend to be in the middle of the wage distribution; they also tend to equalise wages among members. Perhaps most important, they act as a countervailing force to management, enforcing social norms that limit very high and very low pay even among people who aren’t union members.”

In Polanyi’s (1944: 231) words, “the function of trade unions becomes morally and culturally vital to the maintenance of minimum standards for the majority of the people”.

2.7.3 The myth of the self-regulating market

Keynes (1936: 32 and 378) argues that the “completeness of the Ricardian victory is something of a curiosity and a mystery” because “its tacit assumptions are seldom or never satisfied, with the result that it cannot solve the economic problems of the actual world”. The neoclassical economic principles of the efficient market mechanism work only under highly restrictive conditions. The use of modelling to assess real-life economic problems imposes unrealistic constraints of precision (Mayer, 1993). As these models are based on the static ‘*ceteris paribus*’³ principle, many of these models tend to reflect reality in an oversimplified manner ignoring numerous exogenous variables, such as culture, political movements, technological advancement, social forces, etc. Although often these economic models have no social relevance (Gilpin, 2001), conclusions drawn from them are treated as facts based on empirical evidence. As a result, the economics profession has been accused of concentrating on rigorous, step-by-

³ Other things being constant.

step derivation of models neglecting the interpretation of conclusions (Mayer, 1993). The unrealistic *homo economicus* and *ceteris paribus* assumptions enable economists to “simplify complex subjectivities into objective means of behaviour and strip away the environment of economic action, so that the economic world became a sterile plain populated by clockwork people” (Peet, 2007: 66).

For instance, the real business cycle theory posits an automatically clearing labour market in which involuntary unemployment does not exist because workers “make a choice concerning the best time to work. If something happens to make working today more valuable workers make an intertemporal substitution; they work more today and take a longer vacation tomorrow” (Scarth, 1996: 221). In other words, they are flexible economic agents making conscious decisions regarding when to work and for how much. Labour is a commodity sold at the ‘right price’. Scarth (1996: 227) provides an interesting criticism of this theory.

“In its simplest terms, it suggests that the Great Depression of the 1930s was the result of agents anticipating World War II and deciding to withhold their labour services for a decade until that high-demand period arrived.”

Nevertheless, this theory appeals to many economists due to its firm grounding in microeconomics (Scarth, 1996) underlining the priority of rigour over relevance in neoclassical economics.

The concept of a self-correcting market achieving long-term equilibrium ignores market failures, such as transaction costs, asymmetry of information, and entry and exit barriers to markets, rendering many markets less than contestable.

“In reality, markets involving risk and uncertainty are plagued by market failures... When these are present, markets may give the wrong signals, incentives may get distorted, and sometimes markets may simply not exist.”
(Samuelson and Nordhaus, 2001: 210)

As argued previously, a free-market economy is not an entirely *laissez faire* system. Rather, “the liberal argument is in favour of making the best possible use of the forces of competition as a means of coordinating human efforts, not an argument for leaving things just as they are” (Hayek, 1944: 27). As Keynes (1936: 149) argues

“...economic liberalism cannot be identified with laissez-faire... Strictly, economic liberalism is the organising principle of a society in which industry is based on the institution of a self-regulating market. True, once such a system is approximately achieved, less intervention of one type is needed.”

However, this is far from saying that market system and intervention are mutually exclusive terms. For as long as that system is not established, economic liberals will unhesitatingly call for the intervention of the state to establish it, and once established, in order to maintain it.”

Thus, “(n)eoliberal policies are not self-correcting” (Saad-Filho, 2005: 116). This has been proven by the past three decades of neoliberal policies. Although the state has withdrawn significantly from welfare provision and control of much of the productive capacity, neoliberal economic policies ended in unprecedented levels of government intervention. The prediction of supply-side economics that lower taxes generate higher tax revenues by stimulating private investment proved wrong. The fiscal deficits of the Reagan administration were among the highest in US history (Peet, 2007). “...state expenditure as a proportion of gross domestic product (GDP) has remained substantial in all developed capitalist countries” (Lapavitsas, 2005: 35). Krugman (2008: 182) simply calls supply-side economics a “specific set of foolish ideas” and a “crank doctrine that would have had little influence if it did not appeal to the prejudices of editors and wealthy men”. According to Mankiw (2001: 172-173) “(s)ubsequent history failed to confirm... that lower tax rates would raise tax revenue”.

In addition to the divergence between neoliberal theory and practice, maintaining a balanced budget at all costs has serious socio-economic consequences in the form of reduced growth. Taylor (2004: 494) questions the significance of the crowding-out effect of budget deficits over private investment because as “net exports and consumption also fall, the crowding out of investment is not as large as it otherwise would be”. The size of crowding out is put into doubt by the Barro-Ricardo effect as well, which argues that the interest rate increase resulting from higher government expenditures is partially offset by rational savers, as higher interest rates encourage people to save more (Parkin, 2000).

Furthermore, “(w)hat is important is what government spends its money on, whether on defence or health, on social services or prisons” (MacGregor, 2005: 143).

Macroeconomic stability is not the ends but the means towards achieving social objectives (Sen, 1999). Supply side economics has failed to deliver high rates of economic growth. Insufficient aggregate demand has led to surplus productive capacity and slackening economic growth rates restraining prosperity. After three decades of

neoliberal economics, “for the first time in two generations, failures on the demand side of the economy – insufficient private spending to make use of the available productive capacity – have become the clear and present limitation on prosperity for a large part of the world”. It is the result of a “steady drift in emphasis in economic thinking away from the demand side to the supply side of the economy” (Krugman, 2008: 182). Overall, “the results of such policies have been disappointing in terms of growth and income per capita throughout the 1980s and 1990s.” (Lapavitsas, 2005: 8).

As for the second pillar of neoliberal economics, monetarism, its results were “mixed”, as it “proved quite difficult to control money. Moreover, interest rates proved to be extremely volatile...” (Samualson and Nordhaus, 1985: 330). Saad-Filho (2005: 116-117) argues that the monetarist obsession with inflation hinders economic development. As Sen (1999: 139-140) points out, “anti-inflationary radicalism” - the wisdom of focusing on one macroeconomic objective, inflation prevention, while tolerating high unemployment levels is highly questionable. It is important “to keep in view the likely costs of tolerating inflation against the costs of reducing it, or of eliminating it altogether”. The costs of tolerating moderate levels of inflation must be balanced against the costs of deflationary policies (Sen, 1999). Overly restrictive deflationary policies hinder economic growth through lower levels of private investment while there is little empirical evidence supporting the benefits of pushing inflation rates below moderate levels. Paying attention to financial variables, such as inflation rates, instead of real variables, such as real incomes, employment and economic expansion, “led to high interest rates and high exchange rates, creating unemployment and not growth” (Stiglitz, 2002: 81-82).

2.7.4 Economic growth versus 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.” Krugman and Wells (2006: 25) define economic growth as “the growing ability of the economy to produce goods and services.” A common measurement of national income is Gross Domestic Product (GDP), an “aggregate output”, that is the equivalent of “the total value of all final goods and services produced in the economy during a given year” (p. G-6). 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 (Parkin, 2000: 126-127).

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. Sen (1999: 21 and 23) stresses the inadequacy of per capita income levels in reflecting living standards by demonstrating the weakness of the link between economic growth rate and average life expectancy.

“...in the United States, African Americans as a group have no higher – indeed have a lower – chance of reaching advanced ages than do people born in the immensely poorer economies of China or the Indian state of Kerala (or in Sri Lanka, Jamaica or Costa Rica)... for example, Bangladeshi men have a better chance of living to ages beyond forty years than African American men from the Harlem district of the prosperous city of New York”.

Hayami (2001: 47) sees a “causal relationships between economic growth and human capital accumulation, operating in a mutually reinforcing manner”. Higher investment levels in human capital lead to improved productivity and better economic performance, which in turn increases per capita incomes allowing people to spend more on health care and education. However, as Sen (1999) points out, higher per capita income raises average life expectancy only through the rising income of the poor and through public spending, especially on health care. When public expenditure on health care and

declining levels of poverty are removed as explanatory variables the correlation between per capita income levels and life expectancy breaks down.

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 (Dicken, 2011), 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” (Wade, 2009: 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). The theorem of Pareto-efficiency is used in neoclassical economics 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). In Stiglitz’s (2002: 78) assessment,

“...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.”

Wolf (2005: 53) argues that “among sophisticated societies with an elaborate division of labour, societies with market economies have been the least unequal and the inequality they generate has been the least harmful”. He claims that the centrally planned socialist regimes were among the most unequal societies in the last century, as opposed to market economies. This statement is not supported by empirical evidence. The following table demonstrates the dispersion of earnings, as measured by the Gini

coefficient in a number of Central and Eastern European countries (CEEC) and the United Kingdom.

Table 2.1 Gini coefficients in CEEC in 1986.

Country	Gini coefficient
Czechoslovakia	19.7
Hungary	22.1
Poland	24.2
Russia	27.6
United Kingdom	26.7

Source: Gros and Steinherr, 2004

Data based on income levels and consumption patterns show that the distribution of income was less uneven in centrally planned economies than in market economies (Gros and Steinherr, 2004). Firstly, “the system was able to generate full employment rapidly and maintain it over time”. Secondly, income distribution was “not as egalitarian as claimed by communist ideology but still less skewed than in market economies” (p. 50). Despite its gross inefficiencies, the socialist system did meet the basic needs of the population by guaranteeing full employment based on the principles of right and duty to work (MacGregor, 2005).

Brady’s (2003: 388) findings refute the neoliberal thesis that “poverty is dependent on the harmonious progress of economic growth, free market capitalism, worker productivity, and the supply and demand of labour”. Empirical evidence suggests that “the rising tide of economic prosperity... does not distribute evenly to the bottom of the income distribution”. In fact, “nations with more productive workers – and ostensibly with more human capital, education, skills and training – do not have less market-generated poverty” (p. 388). His analyses of data demonstrate that

“...liberal economics provides a weak and ineffective model of poverty, and many of its precepts are wholly unsupported... a central finding emerges that the size of the state has a large and significant negative effect on poverty after taxes and transfers... In sum, liberal economic expectations about growth, productivity and unemployment are not confirmed.”
(Brady, 2003: 369 and 395)

The majority of the workforce has not benefited much from economic growth since the 1970s. In the USA, the real wage per hour of an average worker is just slightly above than what it was thirty years ago. Between 1973 and 2005, inflation adjusted

productivity levels rose by around 50 percent, whereas median household income increased by only 16 percent (Krugman, 2007: 126). This in part has been accomplished through longer working hours and higher participation rates of women. Today's typical jobs require much higher levels of skills than before diminishing the need for unskilled or low-skilled labour. Although the returns from education have increased, wage gains have been trailing increases in productivity (Krugman, 2007: 261).

Instead of fast economic growth, increased trade, deregulation and weaker trade unions led to an upward redistribution of income with a much higher portion of national income going to corporate profits and high salary earners (Baker, 2007). Unemployment rates and income inequality levels are high and rising in most OECD countries. The elimination of welfare for single parents has not decreased poverty rates, instead, the welfare poor became working poor. However, higher levels and more targeted government expenditure to the poor do lower poverty rates (Smeeding, 2005). Brady (2003: 395) confirms these findings, arguing that "a larger government budget massively decreases national poverty", reflecting "the valuable role of the state in reducing poverty". The USA has the highest inequality rates among the developed nations. Between the 1980s and 2005, the number of families filing for bankruptcy in the United States has increased 5 fold. Today's average American family spends more on housing and less on luxuries than in the 1970s (Krugman, 2007).

The picture is very similar in the UK, where labour market polarisation is most marked in Europe with the reappearance of low-paid, low-quality work. Both relative poverty and inequality have increased. The poorest 10 percent of the population witnessed a decrease of 17 percent in their real incomes during the 1990s. While average incomes rose by 36 percent, the richest 10 percent saw an increase of 62 percent during the same decade. Overall, "key indicators show an increase in relative poverty and inequality" (McGregor, 2005 144-145). In the words of Castree et al. (2009: 1),

"(u)neven development" is, today, extreme in both social and geographical terms. Equality of opportunity (never mind outcome) is still an idealist dream in most of the twenty-first century world."

In terms of economic growth, "Keynesianism vastly outperformed neoliberalism" (Peet, 2007: 7). Deflationary policies, due to the constant neoliberal obsession with inflation.

have caused lower economic growth rates, higher levels of unemployment and a redistribution of income from owners of labour to owners of capital (Stiglitz, 2002: 82).

The obsession with deflationary policies and adherence to a budget surplus has constrained economic growth (Sen, 1999; Kelsey, 1995 and Saad-Filho, 2005), as demonstrated by the following table.

Table 2.2 Aggregate global economic growth rate

Years	Percentage
1970s	5.5
1980s	2.3
1990s	1.1

Source: International Monetary Fund

Neoliberalism survived the first economic crisis at the beginning of our century, which Peck and Tickell (2002: 399) assessed as its “sternest test of credibility and legitimacy”. Less than a decade later, in the face of the gravest economic crisis since the Great Depression (Kenc and Dibooglu, 2009) neoliberalism seems very much sustainable. As Peck and Tickell (2002: 387) stated “these economic crises proved to be important moments in its ongoing transformation”. It seems that Polanyi’s (1944: 148) obituary of the self-regulating market was premature:

“Undoubtedly, our age will have been credited with having seen the end of the self-regulating market. The 1920s saw the prestige of economic liberalism at its height.”

I agree with Peck et al. (2009: 95) that neoliberalism has not, as many have suggested, encountered its own “Berlin Wall moment of irretrievable collapse”.

“The present crisis is clearly placing considerable pressure on the neoliberal operating system itself. At the same time, the world that this system has wrought... is clearly far more profoundly entrenched than any particular facet of neoliberal governance.” (p. 110)

2.8 No alternatives?

As Harvey (2005: 181) contends, to accept that there are no alternatives to a neoliberal world is “to accept that we have no alternative except to live under a regime of endless capital accumulation and economic growth no matter what the social, ecological, or political consequences”.

Markets are instrumental in creating prospects and opportunities but they need to be supplemented with efficient and effective government institutions, in order to solve the problems arising from its imperfections (Stiglitz, 2002: 139). On its own, a self-regulating market does not ensure optimal outcomes due to the existence of market failures, such as economies of scale and asymmetric information.

The accomplishments of the market depend on political as well as social arrangements. Throughout their development, the economies of today's rich countries have been aided with active interventionist policies dealing with land reforms, education, health care, promotion of new technologies, etc. respectively. Although capitalism is perceived to be based on greed, its efficient operation has been contingent on the firm foundation of institutions, and behavioural ethics. By promoting cooperative behaviour, social capital is essential to the successful operation of the market economy. "Successful operation of an exchange economy depends on mutual trust and the use of norms – explicit and implicit" (Sen, 1999: 263).

Neoclassical economists assert the superiority of the free-market economy and its principles regardless of its location. Due to economic interdependence, economic growth rates, performance and productivity levels are expected to eventually converge. The forces of economic globalisation are supposed to eliminate national differences; all countries will adopt similar domestic institutions and practices converging towards the neoclassical economic model. However, these policies do not take account of the cultural, institutional and geographical differences between national economies (Kelsey, 1995). Political economists, such as Gilpin (2001: 149-168), identify three main systems: the American (Anglo-Saxon), the Germanic and the East Asian. The following figure illustrates the main features of the various systems.

Figure 2.1 Differences among national economies

	American system of market-oriented 'managerial' capitalism	East-Asian system of developmental capitalism	Germanic system of "social market" capitalism
Purpose of economic activity of the nation	Utility / profit maximisation. Pro-consumption, pro-competition policies.	Economy subordinate to the social and political objectives of society. National economic policy: 'neomercantilism'.	Balance between social welfare and market efficiency.
Economic role of the state	Fragmented structure, divided authority. Tension between private and public sectors. Non-interventionist at microeconomic level. Industrial policies targeted at sectors and firms in order to improve productivity.	Interventionist, central role in national economic development. Public responsibilities taken on by the private sector. Government support for favoured industries. Protectionist policies.	Indirect contribution: encouragement of high saving rates, rapid capital accumulation and economic growth. Heavy government spending on research and development but no significant intervention in the economy.
Corporate governance and private business practices	Primary obligation to shareholders. Fragmented, policies to prevent concentration of corporate power. Industry and finance more separated.	Primary responsibility to stakeholders: employees and subcontractors. Close cooperation among government, the private sector and labour.	Long-term ties between banks and corporations. Well-organised labour. Prominent role of the 'Mittelstand'.

Source: Gilpin (2001)

These economies are distinguished according to the main objective of the nation's economic activity, the role of the state in the economy, and the system of corporate governance and private business practices. Although certain preconditions need to be in place for long-term economic development to happen, as the failure of the centrally planned economic systems demonstrated, the same economic function can be carried out via different institutional arrangements across societies. Whereas the American system carries unmistakable signs of neoclassical economic thinking with its goal of consumer satisfaction and adaptability to change, the social burden of these policies in other countries is perceived too high (Gilpin, 2001). As Sen (1999: 265) argues,

"While capitalism has been very successful in radically enhancing output and raising productivity in the modern world, it is still the case that the experiences of different countries are quite diverse. The successes of East Asian economies... raise important questions about the modelling of capitalism on traditional economic theory."

The experience of the East-Asian economies, in which "the economy is subordinate to the social and political objectives of society" (Gilpin, 2001: 157), is living proof that

there are alternatives to neoliberal economic policies, as their development has taken place under state-directed industrial policy. With the exception of the crisis of 1997, the East Asian economies “had not only grown faster and done better at reducing poverty rates than any other region of the world, developed or less developed, but had also been more stable” (Stiglitz, 2002: 90). These economies, which experienced high rates of economic growth in the second half of the 20th century, only gradually opened their economies to the outside world. Foreign direct investment (FDI) had no part in the development of South Korea and Japan and Singapore. Malaysia kept a close eye on FDI and took advantage of the access to technology and markets. Their fast economic development was based on exceptionally high saving rates unaccompanied by large increases in inequality (Stiglitz, 2002). Japan, South Korea and Taiwan liberalised their trade gradually as they became richer. Domestic production replaced imports of consumption goods and the share of capital goods and intermediate products took up an increasingly larger portion of their imports (Wade, 2004).

In the 1980s, the high inflation rates were lowered at the cost of sharp increases in unemployment in the market-oriented economies. In the meantime, Japan, the East Asian economies and West Germany followed economic policies with significant success, which significantly deviated from the neoliberal doctrine. “The 1980s in fact belonged to Japan, the East Asian “tiger” economies and West Germany as powerhouses of the global economy” (Harvey, 2006: 30).

By placing heavy emphasis on export promotion but not on the removal of import barriers, trade was liberalised in a gradual manner. They argued that the key to catching up with the Western economies was to close the technology gap. In order to achieve that, their governments took an active role in expanding educational opportunities to all members of society and directed investment to areas with long-term growth potential. They have shown that high levels of inequality are not an unavoidable by-product of high savings rate and that fast economic growth can be accomplished while keeping income inequalities in bounds. They view social cohesion as a necessary ingredient in maintaining investment and growth (Stiglitz, 2002).

2.9 Conclusion

Neoliberal theory relies on the self-interested action of responsible and rational individuals who through voluntary transactions in the market place contribute to the common good. Value is measured in terms of scarcity necessitating the commodification of everything, including land, nature, and people. Any interference in the market distorts efficient allocation of income. Neoliberal theory emphasises values of individualism, entrepreneurship and competition and views progress in terms of enhanced material wealth. Currency stability takes centre stage, as one of its main pillar, monetarism, views fluctuations in the money supply as the cause of the business cycle. Its other pillar, supply-side economics, hypothesises that low tax rates yield higher levels of tax revenue. A proportional tax regime is preferred, as progressive taxation demotivates entrepreneurship by forcibly reallocating income.

Neoliberal thinking views income inequality as the inevitable outcome of differences in abilities and efforts. The market stands for meritocracy by rewarding those who provide what people are willing and able to pay for. Equality of opportunities is essential to promote hard work; equality of outcome serves as a disincentive. Thus redistribution of income deprives the more willing of the fruits of his/her efforts and encourages people's reliance on welfare.

Neoliberal theory relies on highly unrealistic assumptions; it ignores asymmetry of information, transaction costs, scale economies and individuals' physiological constraints, as well as unselfish motives. The effectiveness of the policies of supply-side economics and monetarism has been highly questionable. Market imperfections resulted in numerous unintended and inefficient outcomes, such as environmental degradation, industry consolidation and social deprivation. Blind reliance on the impersonal market has caused repeated economic and financial crises requiring unprecedented levels of government intervention and spending. Neoliberal policies have not only failed to achieve higher rates of economic development and improving living standards globally but also impoverished entire communities, reallocated income from owners of labour to owners of capital and increased income inequalities both within nations and between nations.

However, the neoliberal ideology's emphasis on the utopian vision of perfect liberty and an active society based on self-reliant, accountable and self-motivated individuals and its rejection of paternalism has lifted millions of people out of poverty around the world and has provided an ideal for populations, including Estonians, living under totalitarian rule.

Chapter 3. The Economics of Transition

I begin this chapter by analysing the salient features of the socialist economic system and stress its main differences from market economies. I emphasise the enormity and uniqueness of post-socialist transition and examine the supposed remedy, the policies of Washington Consensus, recommended by the international financial organisations. I argue that the Washington Consensus failed in its mission to lead a successful transformation by neglecting the diverse historical, socio-economic and political contexts of these countries. I discuss the geographical debate regarding neoliberalisation and, using the diversity of post-socialist transition experiences as an example, I support Lerner (2000, 2002 and 2003) that neoliberalism is not a ‘coherent, top-down’ philosophy but a complex and diverse model, in which agents play an active role.

3.1 Socialism defined

In 1987, 26 countries belonged to the ‘communist bloc’, including 34.4 percent of the world’s population, covering 30.7 percent of our globe (Kornai, 1992: 38-39). However, as Kornai (1992), Smith and Pickles (1998) and Swain and Swain (2009) point out, socialism was not uniform but differed across countries due to the diverse legacies inherited from the pre-socialist era and the varying degrees of the implementation of the socialist principles.

“The experience of Stalinism and neo-Stalinism had produced different degrees of industrialisation, urbanisation and cultural development, despite all the attempts by communists to achieve economic integration and uniformity.” (Swain and Swain, 2009: 6)

For instance, small private enterprise was tolerated in certain communist nations but not in others. The heterogeneity of the socialist states is demonstrated by numerous examples of one socialist country accusing another one of deviation from or the abandonment of socialist principles, such as Stalin’s denunciation of the Yugoslav leader Tito and the Albanian leadership’s labelling of most of the leaders of the other socialist states as ‘traitors’ (Kornai, 1992). “Yet, throughout this century, historians have consistently written about them as a single unit, as if they did, after all have a great deal in common” (Swain and Swain, 2009: 1).

As Swain and Swain (2009: 1) argue, the socialist states “despite their manifest differences, faced similar social, economic and political problems”. I use the term ‘socialism’ as a synonym to the terms ‘centrally-planned economy’, ‘command economy’ or ‘communism’, as they all share numerous characteristics, which I elaborate further in this chapter.

In order to realise the significant challenges of post-socialist economic transition we must understand the nature of the socialist system. Ironically, the fundamentals of the centrally planned economy were not planned *per se*, as the Bolsheviks “proceeded largely by trial and error” during the early years of the Soviet Union between 1917 and 1921, but were born out of War Communism in an effort to stay in power in the civil war and an “attempt to reach full communism as fast as possible” (Sutela, 2003: 13). Indeed, in 1917 “there was no existing socialist system to use as a model, and only vague guidelines in the theory available on socialism” (Bater: 1996: 43). The devastation of World War I and years of civil war necessitated the introduction of the New Economic Policies (NEP) between 1921 and 1928, which allowed for limited liberalisation of the economy. They were ended by Stalin, who saw NEP as a necessary and temporary step in the wrong direction. The principles of the centrally-planned economic system were laid out in 1928, which marked the beginning of the first five-year plan. The architects of the socialist system looked at the works of Marx and pre-revolutionary ideologists, the ideas of the revolutionary movement and their own early experiences of building socialism, including Stalinism, as its most influential part. Due to the failure of communist uprisings in European states, such as Germany, Soviet leaders were faced with the outcome of socialism in one country, which partly caused the Soviet Union to become a fairly closed economy. Following the end of World War II, to Russians the Great Patriotic War, communism was forced upon the Central and Eastern European countries (CEEC). Despite numerous reform attempts, the fundamentals of the socialist system remained largely unchanged until the late 1980s (Kornai, 1992; Bater, 1996; Lavigne, 1999; Sutela, 2003; Swain and Swain, 1998 and 2009).

The following figure compares and contrasts the salient features of the capitalist and ‘actually existing’ socialist systems.

Figure 3.1 Comparison of the socialist and capitalist systems

	Political power	Property rights	Coordination mechanism	Cost constraints	Economic sphere
Socialist system	Complete control of the state by the ruling communist party	Primary role of state	Mostly bureaucratic	Soft budget constraints, weak responsiveness to price	Chronic shortages, sellers' market
Capitalist system	Private-enterprise friendly environment	Primary role of private property	Mostly based on market coordination	Hard budget constraint, strong responsiveness to price	Chronic unemployment, buyers' market

Source: Kornai (2000)

The socialist countries were a one-party political system with the monopoly of the communist party over all political initiative and decision making, all forms of social organisation, as well as all channels of communication. There were no real legal limitations on state power (Gros and Steinherr, 2004). Swain and Swain (2009: 117) use the label “actually existing socialism” in order to distinguish the socialist system’s Marxist-Leninist theoretical underpinnings from reality. According to Doder and Branson (1990: 145), socialism “had degenerated, after Lenin’s death in 1924... There was no public opinion, only the party’s command.” As Lavigne (1999: 4) argues

“...the ideology of the ‘really existing socialism’ had little to do with Marx or Lenin, from which only a few standard quotations were borrowed. It was a set of norms and codes of speech and conduct, which were defined by the leaders, and were not subject to discussion or critique.”

As Stalin argued that in socialism “economic policy is not for economists” (Sutela, 2003: 47), investment decisions were heavily influenced by political considerations. Fundamental economic “policy decisions were the prerogative of the Politburo”, the “small, inner group of the Communist party hierarchy”, which “usually bore the personal stamp of approval of the leader” (Bater, 1996: 61).

The centrally planned economic system relied on three pillars. The first one was autarky, “national self-sufficiency in order to become independent of the capitalist class enemies”. The second pillar was “to allocate resources by using the price mechanism only as a secondary support instrument” (Gros and Steinherr, 1995: 42-43). Instead of the market forces of demand and supply, in socialism prices were determined artificially by the central administration based on ‘average production costs’. Domestic prices did not reflect international prices. Unlike in market economies, use of land and capital

were not included in total costs, thus rent and interest were excluded from economic calculations (Kornai, 1992). Thirdly, economic growth, fuelled by the desire to catch up with Western standards of living, was the top priority for planners. The socialist objective was a state providing its citizens with standards of living similar to that of the developed countries. Indeed, in 1961 Nikita Khrushchev, General Secretary of the Soviet Communist Party, publicly declared that “the socialist states, whose economies were based on rational planning, would soon be outstripping the economies of the west” (Swain and Swain, 1998: 93). The means to fast growth were heavy industry to speed up industrialisation, collectivisation of agriculture to extract its surplus and five-year planning (Kornai, 1992; Lavigne, 1999).

Whereas in capitalism businesses and households make decentralised autonomous decisions regarding what to buy, what to produce, in what quantity and how, in socialism the state takes over all production decisions and influence many consumption choices through limited availability of goods, services and outlets. As such, the socialist states had ‘quasi-markets’ where both demand and supply were artificial (Kornai, 2000; Sutela, 2003). Bator (1996: 61) summarises the workings of the centrally-planned economic system:

“Plan-instructions were customarily issued for five-year time periods, and theoretically determined for each year what was to be produced, how and by what means, when and to whom it was to be delivered, and at what price it would be sold.”

In the socialist system “production for use” replaced “production for profit” (Hayek, 1944: 25). Rejection of the market necessitated alternative means of value measurement and estimation of social needs and preferences. Hence an economic system was created, in which the central authorities - under the leadership of the Communist Party representing the interests of the working class, thus the population – estimated the needs of the population and planned production accordingly in non-market units. All enterprises were subordinated to a hierarchical chain of command that issued mandatory targets in quantitative terms (Swain, and Swain, 1998). Successful fulfilment of the plan resulted in economic rewards, such as bonuses, and non-economic incentives, like better career opportunities. Failure to meet a target would inevitably be followed by measures that would adversely affect a person’s career and financial status, as almost all personal income originated from fixed wages and salaries determined by the authorities

(Dmitrieva, 1996). These predominantly quantitative targets were virtual commands, the achievement or over-achievement of which had highest priority in the eyes of all economic agents. The lack of competitive conditions, the absence of markets for services and constraints on wage differentials seriously inhibited improvements in labour skills. Although material incentives were tied to the expansion of physical production targets, the link between performance, qualification and pay was quite weak (Gregory and Stuart, 2001). There is ample empirical evidence (Kornai, 1992; Lavigne, 1999; Gros and Steinherr, 1995) that illustrate the inefficiency of socialist organisations, many of which were led by less than competent managers. Nepotistic hiring practices and corruption aggravated the situation. Socialist job requirements, performance targets and measurement criteria were all different from those in a market economy (Pelikan, 1997).

Overall, the post-socialist CEEC inherited economies, which were lacking the prerequisites of a developed post-industrial economy. Figure 3.2 includes the system's defining characteristics.

Figure 3.2 The salient features of centrally-planned economic system.

State ownership of all factors of production.
Centralised control by high level authorities over prices, allocation of resources and outputs targets resulting in the elimination of both input and output markets.
Priority of industry, heavy industry in particular, and neglect of light industries and the service sector.
Obsession with economic growth leading to high rates of investment in both physical and human capital.
Central allocation of savings to investment rendering the financial system redundant.
Absence of a legal and institutional framework characteristic of a market economy.
Non-market determined currency exchange rates.
Artificial trade patterns.
Soft budget constraints.

Source: Gros and Steinherr (2004)

The structure of these economies differed greatly from that of market economies. The USSR was characterised by overinvestment in industries that increased the economy's

productive capacity and underinvestment in industries producing consumer goods. Decreasing effectiveness of investment, autarky, complete lack of domestic competition and slow technological advancement presented insurmountable problems. Investment goods, such as heavy machinery, were considered key strategic products with heavy industry seen as the engine of economic development. Agriculture came second with services a distant third (Gros and Steinherr, 2004). The priority development of extractive and heavy industries was supported by the reallocation of resources from agriculture and the light industries (Dmitrieva, 1996). Consumption and living standard of the population suffered, as only a small share of investment was directed toward the non-productive sector. Dmitrieva (1996: 25) explains:

“Because ultimately social allocations were managed by... branch ministries who were mainly interested in the fulfilment of production targets, the input of material and financial resources was concentrated in favour of production purposes. One of the consequences of such a system was the escalation of industrial investment to the detriment of social facilities and housing.”

Soviet economic development relied on extensive growth, based on the accumulation of inputs, instead of intensive growth relying on improved productivity. Managers “in order to meet output targets... tended to bring under their control as many inputs as possible” (Bater, 1996: 61), which resulted in abnormally fast diminishing returns. Low productivity rates were an inherent weakness of the command economy. Since the basic economic decisions of what to produce, how and for whom were determined by the authorities, bankruptcy was not an option. Producers, whose expenditures exceeded their revenues, could apply for direct subsidies, negotiate a lower tax rate, request a bank loan on highly favourable conditions or ask the central authorities to increase the prices of their outputs. The resulting ‘soft budget constraint’ encouraged hoarding of resources creating chronic shortages (Kornai, 1992; Sutela, 2003). As centrally administered prices did not reflect relative scarcities, managers were unable to make informed decisions. The negative interest rates prevailing in the Soviet era further encouraged hoarding of inputs with little consideration paid to costs. The pressure to fulfil the plan’s targets led to endemic inefficiency and waste (Mygind, 1997). Kornai (2000) points to the dismal levels of productivity as one of the main reasons for the failure of the centrally-planned economies.

Both in socialism and capitalism organisations have a tendency to grow. Socialist planners recognised the advantages of size for reasons of scale economies and because it was easier to control fewer organisations. Factory managers were motivated to expand organisational size, hire more employees and hoard resources in order to ascertain the fulfilment of compulsory production quotas. The relentless drive to expand output coupled with soft budget constraints led to high rates of investment in fixed assets, such as new factories and equipment. The result of extensive methods of production was resource shortages. Thus, whereas capitalist production is ‘demand-constrained’, the socialist economies were ‘supply-constrained’ (Kornai, 2000; Sutela, 2003). Due to resource shortages all along the supply chain, the outcome was a

“...cascading, multiplier effect within the system, since output from one production facility was frequently an input for another. Production bottlenecks were... endemic to the planning system.” (Bater, 1996: 61)

Throughout its history, the Soviet economy was never able to tackle the problems of inefficiency, low quality and technological obsolescence. The centralisation of economic decisions in reality meant that most organizations “produced from year to year the same products from the same materials for the same users” (Sutela, 2003: 30). Although the socialist system managed to accomplish significant scientific achievements, they failed to integrate them into production processes. The diffusion of technological advancement was always problematic in the socialist era (Offe, 1996).

The ‘anti-Schumpeterian inertia’ essentially prevented technological advancement and a transfer from extensive to intensive production methods. Due to the extensive nature of growth, relative technological backwardness and inefficient production methods, output growth levels and productivity rates started to slow down in the mid-1970s. Living standards rose quickly throughout the 1950s and ‘60s but began to decline in the mid-70s. By the late 1980s output was at the same level as that of Turkey, a mere 10 percent of the United States (Sutela, 2003; Aldcroft, 2001; Gros and Steinherr, 2004). In the words of Kolodko (2009: 181-182), the centrally-planned economic system

“...had used up its development capacity... the system was clearly creating more problems than it was able to solve, the material fatigue was so great that the system was bound to collapse under the weight of its own disfunctionality”.

As Swain and Swain (2009: 5) argue:

“The planning system that had achieved some success in dragging the East European economies out of their peasant backwardness, proved incapable of adapting to the demands of an urban consumer society.”

The centrally-planned economies produced less but used more resources than market economies. Soviet reformist economist, Abel Aganbegyan, summed up the situation, as “we use extra funds to run bad enterprises” (Doder and Branson, 1990: 243). Table 3.1 below illustrates the divergence between socialist and capitalist economies in terms of outputs and inputs.

Table 3.1 Economic growth and labour input, 1950-1989

	<i>GDP per capita</i>		<i>1989/1959, in percentages</i>	<i>Annual no. of hours worked per capita, 1987</i>
	<i>1950</i>	<i>1989</i>		
Czechoslovakia	3,465	8,538	246.4	936
Hungary	2,481	6,722	270.9	839
Soviet Union	2,647	6,970	263.3	933
Greece	1,456	7,564	519.5	657
Ireland	2,600	8,285	318.7	524
Portugal	1,608	7,383	459.1	738
Spain	2,405	10,081	419.2	591

Source: Maddison (1994, pp.22 and 43)

The slow improvements in productivity were aggravated by the self-imposed autarky, which inhibited the transfer of ideas, know-how and technology, vocational and managerial skills, as well as transmission of signals about the real value of resources. The absence of competition and protection from international trade hindered economic development (Gros and Steinherr, 2004). The symptoms of the weaknesses of the Soviet economy were recognised as early as 1983. The Novosibirsk Report, cited by Gros and Steinherr (2004: 30), stated that “(t)he origins of crises lay in the system’s inability to make efficient use of the human and intellectual potential of Soviet Society.”

In 1985, when Mikhail Gorbachev became General Secretary of the Communist Party of the Soviet Union, he found himself in charge of an economy lagging far behind the developed countries. Whereas the USSR was still in the industrial age, the rest of the world was already in the information age (Gorbachev, 2000). His policies of *glasnost* (openness) and *perestroika* (restructuring) were in stark contrast with the policies of previous Soviet leaders. Gorbachev’s objective was to reform Soviet society, to restore economic growth and restructure the Soviet economy through managed top-down

changes, which were necessitated by the 'supercentralised' management of the system (Gorbachev, 2000). *Perestroika* transferred significant amounts of power from central to local levels, attempted to encourage competition between producers and introduced economic management of organisations (Sutela, 2003). It was a "specific blueprint for economic reforms", aimed to improve the socialist system. As he put it in a speech in 1987, the objective of *perestroika* was the "reconstruction of a socialist house, which had solid foundations and good walls, but its flooded basement, leaky roof, and broken windows needed repair" (Doder and Branson, 1990: 115). The term '*glasnost*' was first used by Alexander Solzhenitsyn in an open letter that he wrote in protest of his expulsion from the Soviet Writers' Union in 1969. Gorbachev borrowed it in his quest for "greater openness and candor in government affairs" and for an "interplay of different and sometimes conflicting views in political debates" (p. 375 and 143). In the political arena, certain civic freedoms were partially restored. Decentralisation left a lot of room for radical experimentation. As of 1986, private ownership of small businesses became possible (Smith, 2001). However, although Gorbachev realised the need for fundamental changes in the Soviet social and political arena, his reforms in essence were crisis management because the basic problems of a centrally administered economy were not addressed. Prices remained fixed and the soft budget constraints were not hardened leaving the system deficient and uncompetitive (Sutela, 2003; Gros and Steinherr, 2004).

3.2 The meaning of 'transition' from a socialist to a capitalist system

The objectives of *perestroika* in the USSR were to improve the existing system and not to reject it. In the case of the socialist states of the CEEC, discarding the one-party system and the principles of communism were out of the question until the late 1980s when it became clear that the Soviet leadership would not interfere in their internal affairs. The meaning of the terms 'transition' or 'transformation' differ to a large extent from the concepts of 'reform'. The purpose of a reform is to improve radically the effectiveness and efficiency of an existing system. Reforms do not challenge the existence of the system but attempt to change it for the better. Transformation, and its synonym transition, on the other hand, is the creation of a new system. Post-socialist transformation means the elimination of the former socialist system and its replacement

with a capitalist market economy (Kornai, 1992; Swain and Swain, 2009; Kolodko, 2009). Lavigne (1999: 96) discusses the beginning of transition in the CEEC:

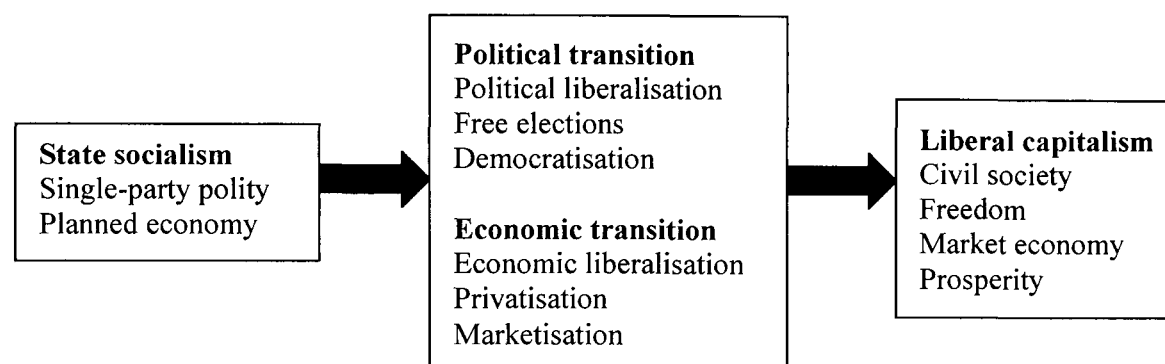
“...the process began with a double abstention. The Soviet party did not condemn the so-called ‘Round Table’ negotiations, which opened in February 1989, between the Polish leadership and the opposition represented by Lech Walesa, the president of Solidarity. It did not block the progress toward multipartism in Hungary which had begun in the first months of 1989. The transition could start... The Soviet communist party was no longer interested in its economic domination of Eastern Europe because the situation in the USSR had become economically and politically critical.”

The transition of the CEEC was unprecedented in history both in its magnitude and nature. As Lavigne (1999: 91) argues, the collapse of socialism took everybody by “surprise, even those who anticipated the ultimate outcome.” These countries faced the “dramatic and unparalleled transformations” (Swain and Swain, 2009: 233) of political transition from a totalitarian one-party system to pluralistic democracy, motivated by the ideals of freedom and ‘civic society’. The prevailing confidence of the populations of the CEEC stimulated the transition from a centrally planned economy to a market economy, supported by a popular belief in the “quick and smooth closure of the wealth gap with the West” (Sokol, 2001: 645). The collapse of the centrally planned economies of Central and Eastern Europe was sudden. On the eve of transition none of these countries had a politically and economically independent middle class (Piirimäe, 1997), which are crucial to building a society based on the rule of law and democratic values (Stiglitz, 2002). For guidance, economists looked at similar events, among them the post-war reconstruction of Western Europe, developmental problems of emerging economies, and Latin America’s economic restructuring (Smith, 2001).

To some, transition means a change from an undesirable state of affairs (for example, dictatorship) to a positive outcome (democracy). To many observers of the process, transition implies “some sort of ‘catching up’ effort made by the people who want to achieve the established standards of the ‘developed’ nations” (Lauristin, 1997: 25). Policy-makers and their advisors appeared to have an ideal outcome in mind, using phrases, such as “Western democracy” and “open market economy”. The transition of the societies of Central and Eastern Europe has been highly concentrated in time and space coinciding with the “all European process of political and economic integration and the growing impact of liberal ideas” (p: 26).

Transition in the CEEC was optimistically expected to happen in a linear fashion, which is demonstrated by the figure below.

Figure 3.3 The 'linear model' of transition



Source: Sokol (2001)

The challenges facing the CEEC have been enormous. In order to create a market economy, its preconditions must be established. They had to convert the centrally administered fixed prices into a market price system, establish markets and the institutional infrastructure, stimulate entrepreneurship, create efficient enterprises (Stiglitz, 2002), and open their relatively closed economies to international trade. Economic agents must be provided with the incentives and the means to respond to these signals, which requires allowing private ownership of the factors of production, protection of property rights, and the formation of properly functioning input and output markets (Lavigne, 1999). Swain and Swain (2009: 236) stress the immense challenges of post-socialist transition in the CEEC:

“...how do you create a market when prices have been systematically distorted for 40 years? How can you sell assets to new private owners when you do not know the real price of what you are selling? Who can you sell assets to when private savings are minimal because most saving was social? How do you create the institutions to facilitate horizontal information flows, when they have been vertical for four decades? How do you create responsibility and autonomy when for 40 years the safest strategy was to demur and ‘protect one’s backside’? How do you create openness and transparency when, in an economy of shortage, the most effective way of obtaining goods was by exploiting patronage or resorting to the ‘second economy’?”

The international community was involved in the transition to a great extent. The reform packages devised for the CEEC were fairly uniform; they consisted of economic stabilisation, which meant correction of imbalances in the government budget.

international payments and the money supply, and structural adjustment. Figure 3.4 details the measures.

Figure 3.4 Economic stabilisation package in the CEEC

Price liberalisation, abolition of consumer and producer price subsidies.
Liberalisation of domestic and international trade.
Balancing the government budget.
Disciplined monetary and fiscal policies.
Privatisation of state-owned enterprises.
Creation of a financial and banking sector, along with tax reform.
Development of a social safety net

Source: Lavigne (1999).

3.3 Critique of the ‘Washington Consensus’

Smith and Rochovská (2007: 1163) rate the “transition from communism to capitalism” of the CEEC as “one of the boldest social, economic and political experiments with neoliberal ideas in the world today”. The post-socialist reform programmes were heavily influenced by the principles of the ‘Washington Consensus’, which is a consensus in the sense that it was the “lowest common denominator of the reforms” (Marangos, 2009: 197) that were recommended to remedy the economic problems of Latin America, which struggled with a serious debt crisis and high inflation rates in the 1980s. The name ‘Washington’ in this context refers to the “conventional wisdom of the day among the economically influential bits of Washington, meaning the US government and the international financial institutions” (Williamson, 1993: 1329).

The alternative name for this programme suggested was “universal convergence, which to Williamson, the author of the Washington Consensus, is the equivalent of “economic good sense”, the promotion of which “must be a political priority” (Williamson, 1993: 1329 and 1330). These policies stem from neoclassical economic theory underlining the convergence of national economies regardless of their historical, geographical and cultural context. They do not address distributional concerns, resource endowment or availability of domestic capital or skilled labour but view economic development as a function of the implementation of these policies. Because of its content, which by and

large reflects the economic orthodoxy of the Reagan administration, the Washington Consensus has been labelled the “neoliberal manifesto” (Marangos, 2009: 197). It consists of 10 policy instruments needed to achieve sustainable economic growth, as demonstrated below.

Figure 3.5 The principles of the Washington Consensus

1. Fiscal discipline
2. Reorientation of public expenditures
3. Tax reform
4. Financial liberalisation
5. Unified and competitive exchange rates
6. Trade liberalisation
7. Openness to FDI
8. Privatisation
9. Deregulation
10. Secure property rights

Source: Williamson, 1993

The policies of the Washington Consensus were derived from neoclassical competitive equilibrium models and were based on the four pillars of privatisation, stabilisation, liberalisation and internationalisation (Stenning, et al. 2010). They were constructed on the assumption that the withdrawal of government from the economy automatically leads to the quick emergence of a competitive private sector and the creation of markets. These policies lead to believe that the establishment of property rights is sufficient and the emergence of institutional and legal framework will follow naturally. Whereas Keynesianism emphasised the role of the government in creating jobs, the Washington Consensus policies are mostly concerned with inflation and budget deficits. They ignore the issues of sequencing, which adversely affect social welfare

“...forcing liberalisation before safety nets were put in place, before there was adequate regulatory framework, before the countries could withstand the adverse consequences of the sudden changes in market sentiment that are part and parcel of modern capitalism; forcing policies that led to job destruction before essentials for job creation were put in place, forcing privatisation before there were adequate competition and regulatory framework.” (Stiglitz, 2002: 73)

When job destruction outpaces job creation, privatisation has significant social costs: social and political unrest, stress among workers still in employment and their families, increasing alienation and disenfranchisement. The Washington Consensus addresses poverty by relying on the trickle-down effect that results from economic growth, whereby income is supposed to reach the poor and deprived reducing poverty. Because the rich can save more than the poor, capital accumulation, which is essential for

economic growth, increases inequality. However, this assumption contradicts evidence from East-Asian economies, where the high saving rates of the population did not require high levels of inequality (Stiglitz, 2002). More egalitarian societies benefit from larger portions of the population sharing the benefits of growth (McCleery and De Paolis, 2008).

Low tax revenues, coupled with the need to maintain the physical and social infrastructure and aggravated by the debt inherited from the socialist era, put the transition states under intense pressure to comply with the recommended neoliberal measures, as privatisation of state-owned enterprises, which had been a major source of government revenue, caused a serious output decline in the CEEC, especially in the early 1990s (Gros and Steinherr, 2004).

The Washington Consensus policies, based on the concept of ‘invisible hand’, work only under highly restricted and unrealistic conditions. The appropriateness of these policies for underdeveloped economies, such as the CEEC, is especially questionable because “whenever information is imperfect and markets incomplete, which is to say always, and especially in developing countries, then the invisible hand works most imperfectly.” These policies assume the automatic emergence of “institutions and the kinds of legal structures that make the market economies work” (Stiglitz, 2002: 73). However, many of the institutions in the CEEC that were inherited from the socialist era were similar only in their names to those in the west and served different purposes. Although banks did exist in centrally planned economies, the banking system was very primitive; banks merely followed the orders of the planning agency in allocating funds with little consideration to returns. Due to the weak competitiveness and productivity of producers in these economies, rapid trade liberalisation led to disproportionate levels of job destruction with serious socio-economic consequences (Stiglitz, 2002). The liberalisation of input and output markets on its own does not guarantee fast economic growth. An economy can only enjoy the benefits of liberalisation if the fundamentals of economic growth – human capital, good governance and macroeconomic stability (Wolf, 2005) - and strong institutions are in place (Fukuyama, 2004). As Hayek (1944: 29) argues, “an effective competitive system needs an intelligently designed and continuously adjusted legal framework as much as any other”.

Foreign direct investment should benefit the domestic economy through direct and indirect job creation, transfer of skills, knowledge, technology and capital. However, the fruits of FDI are contingent on many factors. Foreign investment “can help create a dual economy, in which there are pockets of wealth. But a dual economy is not a developed economy” (Stiglitz, 2002: 72). Foreign investors can repatriate their profits from the host country. Inflow of FDI can distort the economy because large inflows of resources cause the currency to appreciate making exports expensive and imports cheap. If foreign producers raise the capital required for their operation in the host country, they crowd out domestic businesses by increasing demand for funds, which raises interest rates. Foreign firms also tend to dominate the primary labour market in underdeveloped economies with their ability to offer above-average ‘efficiency wages’ to attract highly skilled labour leaving domestic businesses at a disadvantage. Without the enforcement of effective competition laws, foreign enterprises may drive local producers out of business (Stiglitz, 2002: 68-72). Overall, when compared with the developed economies, the CEEC have attracted low levels of FDI. In fact, empirical evidence has shown a net flow of surplus from East to West (Sokol, 2001).

In the words of Rodrik (2006: 974), “(t)here was more privatisation, deregulation, and trade liberalisation in Latin America and Eastern Europe than probably anywhere else at any point in economic history”. Privatisation had multiple goals in the post-socialist economies. The political objective was to create a class of entrepreneurs by taking away property from the state and handing it over to private hands. Equity considerations played a part in restitution. Last but not least, privatisation served as an important instrument of economic stabilisation by serving the need to increase productive and allocative efficiency (Lavigne, 1999).

Entrepreneurship and capital are essential for job creation, which were in limited supply in the CEEC in the 1990s. A stable and liberal market economy based on private enterprise is assumed to provide an attractive environment for domestic and foreign investment leading to economic growth and job creation. The argument for privatisation is that it opens up previously untapped fields for capital accumulation because profit maximising owners exert all effort to allocate resources efficiently (Harvey, 2006). Advocates of privatisation argue that organisations can be made more efficient by

shedding unproductive assets, including laying off unneeded workers, neglecting the social costs of unemployment (Stiglitz, 2002).

The Washington Consensus neglected the contributions of good governance and state capacity to economic development. Fukuyama (2004: 25) quotes Friedman, who admitted that his advice to the CEEC to “privatise, privatise, privatise” had been wrong, as “it turns out that the rule of law is probably more basic than privatisation”.

The theoretical weaknesses of the Washington Consensus soon became apparent in the countries of Latin America, which closely followed its strongly recommended policies. The privatisation of state-owned enterprises produced a brief rise in FDI and stock market indices. However, these measures failed to produce long-term economic growth with the economic crises of Mexico in 1995 and Argentina in 2002 ending their recovery (Stiglitz, 2002). Harvey (2005: 88) assesses the outcome of implementation of the policies of the Washington Consensus in South America, as an “awkward mix of low growth and increasing income inequality... a whole ‘lost decade’ of economic stagnation and political turmoil.”

The deep and prolonged recession of the CEEC in the first half of the 1990s and the failed economic reform attempts of numerous Sub-Saharan countries added further proof of the ineffectiveness of the policies of the Washington Consensus. Furthermore, the successes of China in achieving high economic growth rates and subsequently reducing the number of people living in absolute poverty contradicted the policies of the Washington Consensus, as the country used unorthodox economic measures, like protectionism, active government-led industrial policies, and lax fiscal policies (Rodrik, 2006). Unlike many countries of CEE, China largely ignored Western pressure and advice and chose instead to combine the “invisible hand of the market and a visible head of the state” (Kolodko, 2009: 178). As a comparison, over the past twenty years, average production levels have only increased by 20 percent in the CEEC, averaging an annual growth rate of a mere 0.9 percent. During the same period of time, GDP per capita in China has increased by more than 420 percent (p. 178). Stiglitz (2002: 6) compares the performance of the Russian economy that wholly adopted the Washington

Consensus with China's economic performance: "(w)hile in 1990 China's GDP was 60 percent of that of Russia, by the end of the decade the numbers had been reversed."

The assessments of global economic development by the international financial institutions have been diverse. Whereas the World Bank has recognised that blanket policies cannot be uniformly applied to all countries and there is a need for "policy diversity, for selective and modest reforms, and for experimentation" (Rodrik, 2006: 974), the IMF took a very different approach by blaming the failure of its policies on inadequate implementation. As a response to criticism, a list of 'second generation' measures has been added to the original principles underlining the importance of institutional reform, which Rodrik (2006) describes as the "augmented Washington Consensus, which proves to be largely a dead-end upon closer look" (p. 979). In Peet's opinion (2007: 118) the new set of reforms is no more than a mere reflection of the "guilty conscience about the misery of miscellaneous policies". This is a reference to the obsession of the Washington Consensus with exclusively market-based economic growth and its neglect of social development and living standards. These policies take the success of the 'holy trinity' of marketisation, deregulation and privatisation for granted, regardless of the conditions of the specific countries (Marangos, 2009). The following figure lists the added reforms along with the original version.

Figure 3.6 The augmented Washington Consensus

Original Washington Consensus	The added reforms:
1. Fiscal discipline	11. Corporate governance
2. Reorientation of public expenditures	12. Anti-corruption
3. Tax reform	13. Flexible labour markets
4. Financial liberalization	14. WTO agreements
5. Unified and competitive exchange rates	15. Financial codes and standards
6. Trade liberalization	16. Prudent capital-account opening
7. Openness to FDI	17. Non-intermediate exchange rate regimes
8. Privatisation	18. Independent central banks / inflation targeting
9. Deregulation	19. Social safety nets
10. Secure property rights	20. Targeted poverty reduction

Source: Rodrik, 2006

The inclusion of institutional reform is recognition of the importance of the protection of property rights, to the extent that critics labelled them 'institution fundamentalism', as opposed to the 'market fundamentalism' of the original ten reforms (Rodrik, 2006). However, they still exhibit the same shortcoming; they ignore the importance of context

and fail to distinguish between institutional function and form. McCleery and De Paolis (2008: 439) deem these policies as “fatally flawed” and compare their advocates to “snake oil salesmen peddling a miracle cure for whatever ails you” arguing that an examination of a country’s institutional and economic development needs to take place to allow for policies tailor-made to the specific geographic, cultural and historical circumstances.

3.4 The geographical debate on the diffusion of neoliberal policies

“While neoliberalism has become one of the central motifs for thinking about the changing nature of the global political economy for the past 15-20 years, there remain several fundamental problems associated with the ways in which neoliberalism is thought.” (Smith, 2007: 1164)

The Washington Consensus with its trickle-down approach to poverty is prevailing thinking today and has become ‘standard’ policy recommendation to developing countries by the IMF, World Bank and credit rating agencies alike. Bank loans provided by international financial institutions and development banks are conditional upon their implementation (Kelsey, 1995; McCleery and De Paolis, 2008). Deviation from them can have dire consequences to nations in need of foreign capital, as access to loans depends on it. Governments are expected to adopt these recommendations to the extent that disapproval by the IMF and credit rating agencies can lead to higher interest rates or refusal of loans (Stiglitz, 2002).

Private investors and financial institutions base their strategies and assess risk of a national economy on evaluations carried out by international organisations, such as the IMF, the WTO, and credit rating agencies. These annually upgraded ratings are considered objective, although Standard & Poor and Moody, which dominate the credit rating industry are commercial, private and profit-oriented firms offering advisory services and research for financial and economic analyses on stocks, bonds, and financial risk management. Historically, these agencies have advocated policies, which were favourable to international investors. High credit rating of an economy is a reflection of low risk of default on its debt obligations. Countries with favourable ratings can borrow funds at low interest rates. Good ratings also serve as a signal for potential investors about the competitiveness and attractiveness of national economies (Kelsey, 1999). Negative assessment of a country’s liberalisation, privatisation, or

deregulation can seriously hamper that nation's chances to attract funds by increasing the costs of borrowing (interest rates) and exert indirect influence on a government's economic policy. It can send a "highly negative signal to the markets", which would "at best lead to higher interest rates and at worst a total cut-off from private funds" (Stiglitz, 2002: 42-43). As few nations have sufficient domestic savings, the competition to attract foreign capital puts pressure on nations not in need of loans as well. The requirements of foreign investors have a strong influence on the economic development of national economies in their effort to attract capital. Countries not deemed sufficiently 'investor friendly' will face a less-than favourable assessment of their credit rating and thus lower demand for their bonds. As an outcome, "elected governments are pressured by capital markets to adopt 'pro-investor' economic policies... as investors retain a strong and broad influence on governmental policy" (Peet, 2007: 36).

Thus the important question arises as to who is actually in charge of a nation's economic management. The electorate indirectly chooses the set of policies desired by them at the ballot box and subsequently elect the party with the set of policies they agree with the most. Democratically elected governments face a grim decision if their policy direction deviates from the 'recommendations' of the international financial institutions as to whether to stand by their policies based on which they were elected or to change course and follow the advice of the international financial organisations. Not abiding by these 'recommendations' faces the risk of 'investment strikes' through which foreign capital can exercise control over sovereign states (Peet, 2007).

There is an ongoing debate regarding the extent of freedom national governments have in choosing their economic policy. Do they have alternatives to adopting the policy 'recommendations' of international financial organisations? Are these policies recommendations or diktats?

According to one view, the neoliberal paradigm emerging from its Western heartland has been hegemonically imposed upon the rest of the world. "Neoliberalism has been seen as a political economy that has been institutionalised through a wide-ranging, global network of political intervention" (Smith and Rochovská, 2007: 1166). Harvey (2007: 23) labels the policies spelled out in the Washington Consensus as "the rules of

engagement”, “a global set of rules”, by which “all states that sign to the WTO and the IMF... agree to abide... or face severe penalties”. He defines neoliberalism as “hegemonic as a mode of discourse”, aimed at the restoration of class power to the “ruling elites, as in the case of the United States or Britain, or created conditions for capitalist class formation, as in China, India, Russia and elsewhere”. The means to achieve the restoration of “class power to capitalist elites” are “an ongoing process of accumulation by dispossession”. He equates the process of neoliberalisation with “class struggle” (2007: 34, 35 and 41), “which results in a reinforcing, even an exacerbation, of class inequalities globally, nationally and locally” (Stenning et al. 2010: 35).

The global diffusion of the neoliberal dogma has been facilitated by the economics schools of many US universities with neoliberal curricula, which “were training grounds for many foreigners who take what they learn back to their countries of origin... as well as into international institutions, such as the IMF, the World Bank, and the UN” (Harvey, 2005: 54). Thus neoliberalism is exported through graduates of these universities who subsequently become change agents in the transformation of their national economies along neoliberal lines completely eradicating Keynesian policies.

Similarly, Peck and Tickell (2009: 104) view neoliberalisation as a “hegemonic restructuring ethos”, which has been “manufactured in Chicago and vigorously marketed through principal sales offices in Washington D.C., New York, and London” (2002: 380), which Harvey (2007: 38) describes as the ‘Chicago boys’ working through the “Wall Street/Treasury/IMF complex”. However, Peck and Tickell (2002: 387-388) emphasise that neoliberalism is “variegated in character”, calling for the recognition of “local peculiarities” along with the “generic forces of neoliberalism”. They identify “historical shifts in the constitution of the neoliberal project in this transnational space”. The first shift took place in the 1970s when neoliberalism transformed itself from ““proto”- to “roll-back” neoliberalism”, whereby Keynesianism was replaced with monetarism and supply-side economics, thus significantly curtailing the role of the state in economic management. Thus the state was ‘rolled back’. The second phase happened in the 1990s when “the neoliberal project... gradually metamorphosed into more socially interventionist and ameliorative forms”. Triggered by manifestations of market imperfections, such as increasing income inequalities, pollution and crises in the

financial and labour markets, neoliberalism was ‘rolled out’ whereby “new forms of institution-building and governmental intervention have been licenced within the neoliberal project”. In effect, this meant “extensions of national state power” and the imposition of “metaregulatory frameworks” (Peck and Tickell, 2002: 388-391).

They acknowledge the geographically variegated, complex and hybrid nature of neoliberalism (Stenning et al. 2010), that it has not been “reproduced homogeneously across space” (Peck and Tickell, 2002: 392) and that “establishing “market rules” was never a matter of imposing, from above, a singular regulatory template” (2009: 107). However, they stress the significance of “extralocal regime of rules and routines, pressures and penalties” as well as “the causally substantial connections and telling family resemblances between different forms of neoliberalisation”. They define neoliberalism as a “system of diffused power” (pp. 392 and 400). The hegemonic view of neoliberalisation labels the Washington Consensus an “ideological effort to impose neoliberalism and market fundamentalism on developing nations” (Rodrik, 2006: 974) and an instrument in the hands of neoliberal policymakers in the USA to force their right-wing ideology on the world (Peet, 2007). Stenning et al. (2010: 36) that, “this perspective tends to focus on national differentiations and institutional sources of variation and fails to deal with the ways in which neoliberalism is constituted at other scales and in other spaces”.

Kelsey (1995: 17) discusses the alternatives faced by governments, as to whether to pursue their own policies or follow the ‘recommendations’ of international financial organisations in the context of the economic restructuring of New Zealand along neoliberal lines. It is a

“...stark choice between the promotion of profit through the free market, and the protection of the welfare state through government intervention. Pressure and encouragement from international economic interests made the latter increasingly difficult, even for governments of a social democratic stamp. The neoliberal model implemented through structural adjustment became dominant. Attributing this solely to the hegemony of international capital is too easy. Governments of individual countries, especially those with ‘conditionalities’ attached to loans, still had policy choices about which path to take and how far and how fast to move.”

Larner (2003: 509) contests the perception of neoliberalisation as a “monolithic project emanating from the ‘ideological heartlands’ of the United States and the United

Kingdom” (2002: 416) arguing that “too many analyses of neoliberalism, no matter what their theoretical inclination, continue to assume that ideas and influences flow either from the Global North to the Global South (for example, from Chicago to Chile, from the United States to Eastern Europe) or between the neoliberal hegemons (from London to Washington)” (2008: 1578). Neoliberalism is not a “unified set of policies or political ideology”, in which the “state ‘forces’ people to act in these ways”. She stresses neoliberalism’s “contradictory consequences”, and the “multiple and contradictory aspects of neoliberal spaces, techniques, and subjects” by highlighting the process’s positive outcomes, such as “important feminist victories”, as well as “attempts to institutionalise bi-culturalism” whereby “neoliberals and some Maori found themselves in unexpected agreement on a key theme: namely, the dangers of continued dependency on the state” in New Zealand (2000: 18). Economic liberalisation and deregulation by New Zealand’s Labour government in the 1980s was “positively welcomed” by Maori entrepreneurs and the “urban Maori... who saw deregulation as a means to advance pan-Maori socio-economic well-being” (Kelsey, 1999: 20-22). Many Maori identified *tino rangatiratanga* (sovereign authority) (p.44), “the central objective of most Maori political discourse”, with economic security and backed “new economic arrangements that will free them from colonial government control over their decisions and economic activities”. They viewed economic liberalisation as reduced reliance on the state facilitating the establishment of “their own arrangements for internal governance” (pp. 52).

Smith et al. (2008), Smith and Rochovská (2007) and Stenning et al. (2010: 37) “support a theorisation of neoliberalism as a process, neoliberalisation, which is geographically and historically differentiated, hybrid, constructed at a variety of scales”. By taking a ‘grass-roots’ perspective, they draw attention to how neoliberalism is embedded, “domesticated”, how “‘ordinary’ people in their daily lives” adapt to the “neoliberal policies and practices in everyday life” (p. 37 and 38). They argue that neoliberalism in the CEEC is neither hegemonic, nor the result of local agency but arose through institutional and networked structures. They focus on the “domestication” of neoliberalism “through the ways in which economic knowledge and claims over the supremacy of the market flow and are constructed through networks” (Smith and Rochovská, 2007: 1167).

By investigating the impact of neoliberalisation on everyday life in Nowa Huta in Poland and the Petržalka district of Bratislava in Slovakia, Stenning et al. (2010) focus on household “survival strategies”; how people “attempt to create the conditions for their social reproduction in the context of rapidly changing economic circumstances and neoliberalising contexts” and how they try to “make it more tolerable” (p. 7). In the post-socialist CEEC the responsibilities and expenses of welfare have been transferred from the state to households. The authors argue that by engaging in a diverse range of economic practices to try to “create the means to survive”, households “have enabled neoliberalism to work” (p. 220); they domesticated neoliberalism. The domestication of neoliberalism involves both proactive strategies providing evidence of agency and practices of adaptation. Stenning et al. (2010) emphasise the differentiated processes of neoliberalisation in Poland and Slovakia, although the reform programmes in both countries have been implemented along neoliberal lines. These differences point to the importance of path dependence; post-socialist practices were not created in a vacuum but were built on the remnants of socialism. They conclude that neoliberalism is “historically and geographically contingent” (p. 220). Thus neoliberalism “should not be seen as a global, externally imposed project, but as one part of the construction of ‘economics’ not only in ECE but also in the West” (Smith and Rochovská, 2007: 1168).

Although the focus of my thesis is not how ordinary people survive in post-socialist Estonia but why and how policies were formulated in the early years of transition, my findings support the theory of path dependence and provide strong evidence against the view of hegemonic external imposition of neoliberal policies.

Bockmann and Eyal (2002) also argue against the theory of externally imposed neoliberalism in the CEEC. They contend that the rapid implementation of neoliberal policies cannot be explained by hegemonic pressure from international financial organisations in the North-Atlantic heartlands of neoliberalism. They argue that the reform policies “were not simply the dictate of Western advisors but reflected the experience and interests of a specific group of Eastern European economists” (2002: 317). They underline the expertise that Eastern European

economists had, particularly in the areas of mathematical economics, and the existence of the centrally planned economic system as an opportunity for Western economists to study alternative economic systems. They highlight the significance of transnational dialogues in the form of academic collaboration between Eastern European and Western economists that facilitated the rapid diffusion of neoliberal theory in the CEEC. They argue that by the 1980s Eastern European economists “reached the conclusion that the socialist system was bankrupt” (338) and “were neoliberals at heart” (p. 332).

As demonstrated in the empirical chapters, this was also the case in the post-socialist transformation of Estonia. However, it was not only economists that were convinced of the bankruptcy of the socialist system but the whole leadership of the country.

Swain (2006) examines the emergence of capitalism in the Ukraine. By analysing the unsuccessful neoliberal restructuring of the coal industry in the Ukraine he underlines the importance of local context in the process of neoliberalisation. He identifies the emergence of a ‘transition industry’ consisting of academics, advisors, journalists local as well as Western European and North American, who were “involved in the production, acquisition, accumulation, storage, geographical transfer and management of knowledge to realising transition “ (p. 208). Through an investigation of extra-local and local processes he concludes that “neoliberal ideas could not be grafted *in toto* onto the ruins of the soviet system because state power could not be allied to the neoliberal project” (p. 210). In line with Swain’s conclusion, my findings underline the significance of local context as well as agency.

Barnett (2005: 10-11) criticises the hegemonic narrative of neoliberalism as a “simplistic image of the world divided between the forces of hegemony and the spirits of subversion”, draws attention to the vast diversity in the processes of neoliberalisation across space and asserts that “stories about “neoliberalism” pay little attention to the pro-active role of socio-cultural processes in provoking change in modes of governance, policy, and regulation”. He stresses the influences of a “combination of different factors”, such as “changing consumer expectations” and “the refusal of the

subordinated, referring to the emergence of anti-paternalistic attitudes...” As mentioned in Chapter Two, he goes as far as denying the existence of neoliberalism as a unifying concept due to its very heterogeneous manifestations.

Strong ‘anti-paternalistic attitudes’ have clearly manifested themselves in the socialist countries as a backlash against the omnipresent state under socialism, which I elaborate in chapters six and seven. I disagree that “we should try to do without the concept of neoliberalism altogether” but support Barnett’s argument that

“The political re-alignments of the last three or four decades cannot therefore be adequately understood in terms of a straightforward shift from the left to the right, from values of collectivism to values of individualism, or as a re-imposition of class power. The emergence and generalisation of this populist ethos has much longer, deeper, and wider roots than those ascribed to “hegemonic neoliberalism.”” (2005: 10)

Larner (2003: 509-511) calls for a “more careful tracing of the intellectual, policy, and practitioner networks that underpin the global expansion of neoliberal ideas, and their manifestation in government policies and programmes”. This is exactly what I intend to do in my thesis. By analysing the post-socialist transformation of the Estonian economy along neoliberal lines, I acknowledge the roles of ‘empowerment’ and ‘choice’ in neoliberalisation and argue that Estonians were not victims but “active agents in the process of political-economic change” (Larner, 2000: 17). I support her argument for the need to “give agency some space, acknowledge that participation may be fluid, informed, motivated, intentional, aspirational...” (2002: 416). I also agree with Stenning et al. (2010: 39) that “neoliberalism was domesticated in ECE from the outset”, as neoliberal policies “were not simply imposed from outside”, even though “key external actors were critical for the plan’s success” (p. 40-41).

My argument is that the neoliberalisation of Estonia was not an externally imposed hegemonic project but an indigenous, locally driven undertaking in which agency was ‘motivated, intentional and aspirational’, although not well informed. Unlike in the post-socialist transitions of other countries, for example Poland and Slovakia, external agents in Estonia played a minor role. Moreover, whereas in Poland and Slovakia “(f)ew within the political mainstream of either country have promoted policies that contest the foundation of neoliberalism” (Stenning et al. 2010: 56), in Estonia neoliberal policies had full support, as demonstrated in the empirical chapters.

Neoliberalism is not a homogeneous ideology consisting solely of regressive policies that was imposed upon populations around the world with dire consequences. Calling the past thirty years of neoliberal domination the ‘dark ages of neoliberalism’ and discarding all its elements would be a mistake. The ideology’s call for an active society along with its rejection of dependence on a paternalistic state has played a progressive role in motivating people to proactively improve their own fate. As argued in the empirical chapters, neoliberal policies were instrumental in the transformation of Estonia’s centrally planned economy to a market economy. Indeed, as Smith and Rochovská (2007: 1166) put it, “we should not expect *a priori* resistance to and protest against neoliberalism”.

3.5 The diversity of post-socialist economies and transitions

Reality significantly deviated from the expectations of post-socialist transition.

“...experience stands in stark contrast to the basic premise of the neoliberal structural adjustment model as applied to ECE by international agencies such as the World Bank and Western advisors; that the unleashing of market forces would result in the reallocation of labour towards ‘rational’ economic activities that ‘made sense’ in the free market.” (Smith, 2000: 1759-1760)

The decline in output in the early 1990s and the subsequent increase in unemployment and poverty greatly varied across the region, which took the populations of the CEEC as well as economists by surprise (Lavigen, 1999; Gros and Steinherr, 2004; Rodrik, 2006; Berend, 2007; Kolodko, 2009). The economies of the CEEC reflect “profoundly fragmented patterns of development” (Smith, 1996: 136). Table 3.2 illustrates the dramatic post-socialist recession of the 1990s.

Table 3.2 National income levels in 1997, as a percentage of 1989 levels in CEEC

Countries	Years of GDP decline	1997 GDP index (1989 = 100)
Poland	2	111.8
Slovenia	3	99.3
Czech Republic	3	95.8
Slovakia	4	95.6
Hungary	4	90.4
Romania	4	82.4
Estonia	5	77.9
Croatia	4	73.3
Latvia	4	56.8
Russia	7	52.2
Lithuania	5	42.8
Ukraine	8	38.3

Source: Kolodko (1999)

The diversity of transition paths of the various CEEC refutes the view of neoliberalisation as a hegemonic process, the “outcome of highly coherent political-ideological projects” (Barnett, 2005: 10). Despite the uniformity of economic policy advice, the post-socialist economic transformations “did not produce identical programmes” (Stenning et al. 2010: 39). The economic decline varied greatly across the CEEC contradicting the neoclassical assumption of convergence. The neoliberal hypothesis of linear post-socialist transition (Sokol, 2001) ignores the “multicoloured” nature of the CEEC. “Rather than following a simple transition from socialism to capitalism, post-socialist economies have ‘gone wild’” (Smith and Stenning, 2006: 193 and 205). The Washington Consensus overlooks the specific economic, social, political, geographical and historical contexts of these countries, which led to significant deviations in economic performance, political reforms, as well as standard of living (Sokol, 2001; Kolodko, 2009). Smith and Pickles (1998: 2) highlight the shortcomings of neoliberal expectations.

“...the conventional, neoliberal view of transition wielded by western multilateral agencies and advisors to governments in ECE, that transition is a relatively unproblematic implementation of a set of policies involving economic liberalisation and marketisation alongside democratisation, enabling the creation of a market economy and a liberal polity, relies on an under-theorised understanding of change in post-communism. Such claims tend to reduce the complexity of political economic change in Eastern and Central Europe and fail to provide us with an adequate basis on which to move beyond policy prescriptions of transition as a set of end-points.”

Gros and Steinherr (2004) explain the variations across the CEEC in economic performance with four factors: the reliance on intra-socialist bloc trade, the level of economic development, macroeconomic distortions inherited from the socialist era and geographical proximity to Western Europe. The longer a nation stayed in the socialist system, the more damaged its economy. Thus, member countries of the FSU experienced a larger drop in output. Geographical proximity to Western Europe is positively related to economic success. They also draw a parallel between advancement in transition and the implementation of reforms. In the words of Sokol (2001: 649), “quick and full implementation of the ‘transition to market’ equals good economic performance”.

The neoclassical economic convergence assumption ignores path-dependence altogether. Pickles (1998: 173-174) questions the validity of “general statements that

apply equally to all parts of the region” emphasising that “transition that is occurring in this post-socialist era is not one of epochal ‘breaks’, but a transformation of social relations, forms, and practices that carries traces of the legacy of the previous forty years”. The countries making up the former socialist bloc greatly differ in their levels of economic and political context; they also have “very different cultural traditions and backgrounds” (Swain and Swain, 2009: 1).

Furthermore, the ‘socialist revolutions’ did not happen in a vacuum. Although decades of communist rule was adequate time for the socialist system to cement and had defined the lives of millions in the CEEC, its consolidation is a relative concept that happened during a short period of time in terms of a nation’s history (Kornai, 1992). The following table demonstrates the diversity of the CEEC at the end of the communist era.

Table 3.3 A select list of socialist states, 1987.

Country	Population 1986 (million)	Area (1000 km ²)	GNP/head 1985 (USA=100)	Proportion of labour force in agriculture
Albania	3.0	29	-	50
Yugoslavia	23.3	256	40.4	30
Bulgaria	9.0	111	40.8	23
Czechoslovakia	15.5	128	59.2	12
Hungary	10.6	93	46.0	20
Poland	37.5	313	39.2	30
Romania	20.9	121	-	48

Source: Kornai (1992)

These figures, however, do not reflect path-dependence and historical continuity. “There is a high degree of national path-dependence in the ‘transition’, leading to a complex mosaic of national and regional pathways” (Smith, 1996: 136). Berend (2007: 276) emphasises the significance of “continuity and centuries-long legacies” and the diversity of “customs and values”, which state socialism inherited and which “became amalgamated into the socialist attitude and value systems under state socialism”.

The values of individualism, self-reliance and entrepreneurship prevalent in Estonia, which are discussed in detail in the following chapters, stand in stark contrast with the collectivist communal societies of some of the Slavic nations, which survived well into the twentieth century. Anti-entrepreneurial and anti-capitalist attitudes were characteristic among the Hungarian, Polish and Romanian nobilities. Even the poorer

segments of the nobility condemned entrepreneurship and sought employment exclusively in public administration or joined the army despite the relatively low pay. This 'gentry' culture permeated the lower layers of society, as spending beyond one's means became typical of peasant households as well. "Thrifty was not elegant" (Berend, 2007: 276). These discourses refute the neoliberal ethos of competition, utilitarianism and rational *homo economicus* and support Peet's (2007) criticism of mainstream economics as an 'imaginary', a 'pure make-believe'.

As Smith and Pickles (1998: 10) argue "(t)he diversity of historical experiences was replicated under state socialism..." Sokol (2001) also highlights the crucial role of different historical legacies by linking the progress of political and economic post-socialist transition and the quality of capitalist political and economic structures of the individual countries to their pre-socialist level of economic and political development. These countries' "diverging economic trajectories should be understood in the light of the structural legacies of both the state-socialist and pre-socialist past" (p. 645). He distinguishes four tiers representing different economic and political arrangements at the beginning of post-socialist transition. The first one consists of Slovenia and the Czech Republic, which were well integrated with Western economies already in the first half of the 20th century. The second tier includes countries where industrialisation took place relatively late, such as Hungary, Poland, Slovakia and the Baltic States. The third group comprises the Eastern European pre-dominantly agricultural periphery including Russia, Belarus and the Ukraine. The last tier includes the underdeveloped states of Central Asia. After decades of central planning, the countries of the former Soviet bloc exhibit significant variations in their economies, political systems and governance. Sokol explains the relative transitional success of the first two groups by their return to capitalism. The pre-socialist existence and experience of a market economy and multi-party political system gave these countries a significant head-start over the others. Thus the "significant divergence within Eastern Europe" clearly refutes the "neoclassical assumption... of economic convergence under market conditions". The "historical legacies" of these countries "deserve attention as one of the important factors shaping developmental trajectories in post-socialist Eastern Europe" (Sokol, 2001: 647-649). Smith (2000: 1759) also underlines the "importance of national differences which belie neoliberal notions of a unidimensional transition".

Berend (2007), drawing on Polanyi (1944), compares the consequences of the British industrial revolution and the impact of the colonisation of Africa with the post-socialist transition experience of the populations of the CEEC. In all these cases people had to learn new 'life strategies', which Stenning et al. (2010: 58) label "household survival strategies". Socialism eliminated the pre-socialist ruling classes, firmly established the CEEC among the industrialised economies with urbanisation and industrialisation becoming dominant processes. Half a century later, post-socialist transition brought on the need to adjust to a new social environment with new values. Employment security, free education and medical care, and guaranteed pensions were replaced by uncertainty, risk taking, competition and the incessant search for better opportunities (Berend, 2007: 277). However, just as pre-socialist informal networks had been preserved and strengthened as important means of survival during the socialist era due to endemic shortages and scarcity, the kinships of the socialist years became crucial in post-socialism (Berend, 2007). As Smith (2000: 1760) argues,

"...by positing the centrality of a linear transition to capitalism... neoliberalism fails to be open to the possibility both that the legacies of practice under state socialism and that the process of 'transition' are set alongside a whole series of noncapitalist practices constituted quite separately from the capitalisms of transition".

The policy recommendations of the Washington Consensus also failed to take account of the socialist era reform experiments, such as the ones in Estonia and Hungary, which positively affected their starting position on the road to a market economy. The significance of these experiments has been discussed extensively by Lieven (1993), Liuhto (1996), Kornai (2000), Smith (2001), Panagiotou (2001), Sokol (2001), inter alia. Such experimentations with a 'third way market-oriented socialism' familiarised the population with the concepts and workings of the market. This was subsequently translated into political capital in the form of greater courage to carry out the reform measures required in the transition to a market economy, upon which the political leadership of these countries was able to rely.

The pre-socialist legacy and socialist-era reform experiments explain the diversity in post-socialist economic performance negating the neoclassical convergence theorem and the hypothesis of neoliberalism "as a coherent hegemonic project" (Barnett, 2005: 9). The differences in their progress prevail despite ten of them gaining EU

membership, a development that accelerated economic integration through compulsory compliance with the ‘*acquis communautaire*’, a set of EU laws and regulations, which candidate states are required to fully implement (Gros and Steinherr, 2004).

Indeed, assumptions of the hegemonic imposition of neoliberal policies on the CEEC emanating from its centres in the West and the neoliberal view of these economies have a common characteristic: they both underestimate local context and agency. The implementation of policies of the Washington Consensus differed across the CEEC, depending on the administrative machinery inherited, the political situation and popular support for reforms.

Empirical evidence accumulated over two decades of economic transition also underlines the importance of the political and social context (Gros and Steinherr, 2004). Table 3.4 illustrates the differences in income levels among the Central and Eastern European EU member states as a percentage of EU average.

Table 3.4 GDP per capita in Purchasing Power Standards (PPS) (EU-27 = 100)

Country	1997	2008
Bulgaria	26.4	41.3
Czech Republic	72.9	80.3
Estonia	41.9	67.4
Latvia	34.6	57.3
Lithuania	38.6	61.9
Hungary	53.1	64.4
Poland	46.8	56.4
Romania	-	41.6 (2007 figure)
Slovenia	77.7	90.9
Slovakia	51.3	67.7 (2007 figure)

Source: Eurostat

The speed of implementation of reforms aimed at economic stabilisation and restructuring varied across the CEEC. Proponents of the gradualist approach emphasised the need for ‘sequencing’, reforms at a ‘reasonable’ speed, due to the impossibility to carry out structural reforms, such as privatisation, overnight. They also feared the significant social costs of the ‘big bang’ approach (Lavigne, 1999). Stiglitz (2002: 162) criticises shock therapy arguing that “haste makes waste”. Shock therapy proponents stressed that carrying out reforms at a slow pace risked reversal to communism. Speed is essential for reform-minded governments to take advantage of

the 'honeymoon' period, which ensues immediately after gaining power and is characterised by a patient population and the chance to put the blame for any hardship on the previous administration. As the public's patience may not last forever, the need to reach a point of no return fast is crucial in order to maintain commitment to reforms (Marangos, 2009).

Hungary and Slovenia chose the slower, gradualist approach (Stiglitz, 2002). "Poland's stabilisation programme was introduced on January 1, 1990", which "soon became known as "the big bang"" (Sachs, 1993: 48) but subsequently slowed down (Stiglitz, 2002), as the country's "political economic transformation" along neoliberal lines was "not uncontested" (Stenning, et al. 2010: 42). Although Russia did not have any of the needed market institutions, radical reforms were fully implemented in the early 1990s, ignoring the dynamics of change. Fast paced privatisation went ahead before the institutional infrastructure was in place, which led to asset stripping. Many of the formerly state-owned enterprises ended up in the hands of their former managers for fire-sale prices. The overnight liberalisation of the capital market made it easy to channel funds abroad. Excessively restrictive monetary policies resulted in the widespread use of barter. The outcome was a grave decline in output and a sharp increase in inequality to South American levels. Although in 1989 only 2 percent of the Russian population lived in poverty, that figure reached 23.8 percent by 1998. Russian output in 2000 was a mere two-third of that in 1989 (Stiglitz, 2002).

Unemployment and mortality rates in post-socialist states following speedy mass privatisation were much higher than in those with a gradual approach. The higher unemployment rates were strongly related with high mortality levels in the FSU. The sudden disruption of the existing social order resulted in high levels of social stress. The implementation of shock therapy measures had significant human costs.

Impoverishment, lower quality and less available medical care due to spending cuts and the disappearance of state-owned enterprises, many of which had provided medical care to their employees, psychosocial stress, rising unemployment, increasing social inequalities, corruption and the erosion of social capital all contributed to climbing mortality rates (Stuckler, et al. 2009). As Stiglitz (2002: 133) evaluates the impact of Russia's post-socialist transition, "(f)or the majority of those living in the former Soviet

Union (FSU), economic life under capitalism has been even worse than the old Communist leaders had said it would be.”

3.6 Conclusion

Socialism was a one-party political regime and a centrally planned economic system with no limitations on state power. All factors of production were state-owned. Enterprises were driven by central planners setting quantitative targets. The absence of competitive pressure coupled with ‘soft budget constraint’ resulted in endemic inefficiencies, skewed economic development favouring heavy industry and chronic shortages. By failing to address the fundamental problems, reform attempts, such as the policies of *perestroika* and *glasnost*, were unable to reverse the eventual breakdown of the socialist system.

Post-socialist transition is unique and unprecedented, as it includes the political transformation from a one-party rule to a multi-party democracy and the economic transformation from a centrally planned to a market oriented economy. Economists and international financial organisations offered guidance and advice in the form of the Washington Consensus that were based on orthodox neoclassical economic theory emphasising fiscal and monetary austerity, minimal state involvement in economic affairs and international economic convergence. These policies, including their ‘augmented’ version, however, mistakenly assume the automatic emergence of the required legal and institutional framework and ignore the diverse socialist as well as pre-socialist legacies. Countries that closely followed these policies paid dearly in terms of socio-economic costs.

Two decades of political and economic transition in the CEEC provide ample evidence to deny the theory of neoliberalisation as a hegemonic process and the neoclassical economic assumption of the convergence of national economies. Their respective pre-socialist and socialist legacies, the varying degrees of compliance with the neoliberal policies of the Washington Consensus led to divergent outcomes. Indeed, just as it is misleading to address neoliberalism as a unified hegemonic project, it is mistaken to treat the post-socialist states as a homogeneous group.

Estonia is a telling example of active local agency contesting the hegemonic treatment of people as neoliberal subjects or victims, as argued in Chapters Five to Eight.

Chapter 4. Research Design

4.1 The research question

This thesis focuses on the origins of post-socialist socio-economic transformation of Estonia.

There is a tendency to view the pressure applied by international financial institutions as the main cause of the diffusion of neoliberal doctrine to the Central and Eastern European countries (Giroux, 2004; Harvey, 2005). In the words of Peck et al. (2010: 102) the “ideological vacuum” created by the “fatal rapture of the pre-existing social order” was filled in by the “strategic promotion of favoured institutional and ideological designs” of “multilateral banks, powerful donor nations, and their various epistemic communities”. Opposing the view of neoliberalisation as a “hegemonic restructuring ethos” (Peck et al. (2010: 104) I take a stand in support of Larner (2000, 2002 and 2003) who sees a multi-centred and multi-faceted neoliberalism. By using Estonia’s post-socialist transition as an example, I argue that as the advice of international institutions, such as the World Bank and the IMF, was fairly uniform to all the former centrally planned economies, putting the blame solely on them would be a mistake. Estonia’s policies were markedly more liberal than of other transition economies of the CEE. The central argument of this thesis is that local agency was a determining factor in the emergence of neoliberalism in Estonia.

When I first started work on my PhD at the Turku School of Economics and Business Administration in Finland in 2004, my supervisor recommended a quantitative approach in order to analyse the long-term socio-economic impact of Estonia’s ultra-liberal economic development, which – from what I have seen during my studies there - is the dominant research method in Finland. However, upon transferring to the University of Liverpool, I decided on a different focus requiring a qualitative method. Although numerous economic studies have been carried out examining Estonia’s post-socialist transition, not one article or book attempted to look ‘behind the scenes’ to explain the reasons for the neoliberal course of the country. Whereas there are many accounts of Estonia’s transition (Lieven, 1993; Misiunas and Taagepera, 1993; Taagepera, 1993; Lauristin and Vihalemm, 1997, inter alia), none examines Estonia’s neoliberalisation from a qualitative perspective. I have a great interest in the discourse of the diffusion of

neoliberal policies. Thus the principal research question of ‘what’ has been replaced by the ‘why’ and the ‘how’ – why did Estonian policy makers decide to pursue the neoliberal trajectory and how did they make those decisions? This includes two subquestions. To what extent was Estonia’s transformation 1. an Estonian project and 2. an elitist process?

4.2 Methodology

This thesis is grounded in international political economy, which unlike economics, addresses the impact of the global economy on the political autonomy and social values of nations that govern production and income distribution. I integrate economic and geo-political approaches in order to improve “comprehension of the implications of new developments for... domestic economic affairs” (Gilpin, 2001:12).

In this research a qualitative, interpretive approach has been chosen because I argue that facts cannot be decoupled from individuals’ value systems and perception of reality. Through investigating the subjective realities of the respondents and presenting as well as interpreting the perspectives of their experiences (Creswell, 2007), my aim is deeper understanding of the causes and reasons of the policy choices of Estonia’s leaders. Qualitative research constructs social reality underlining the human factor in the events and actions examined and concentrating on interactive processes and situationally constrained events. First-hand knowledge and personal insight provide the researcher with a better understanding of social life (Golafshani, 2003). In the words of Whitemore et al. (2001: 524), “qualitative research seeks depth over breadth and attempts to learn subtle nuances of life experiences as opposed to aggregate evidence” and is “contextual and subjective”.

The interpretive approach looks into what people deem to be true and what they consider relevant assuming that ordinary individuals rely on common sense in their everyday life, guided by often affective and not necessarily rational motives (Newmann, 2000). I interpret the meanings that the respondents attach to what happened around them and how they chose these courses of action based on their perceptions of their environment and events. By viewing human action as purposeful and meaningful

instead of being driven by exogenous circumstances, my goal is to uncover how the participants made sense of the events (Gill and Johnson, 1997).

As I focus on local agency, it would be tempting to describe the epistemology of this non-participatory research project as constructivist. As opposed to structuralism, which concentrates on structures determining human behaviour, the constructivist epistemology emphasises agency and process (Spivey, 1997). Social constructivism implies the existence of diverse constructions of reality in people's minds. Each person has his/her own comprehension of his/her own world developing subjective meanings of experiences. Facts and ideas are interdependent; the same events can have various meanings in different social contexts. Evidence about social action cannot be separated from its context, as facts are embedded in a non-neutral, partial and subjective system of meanings (Newmann, 2000; Creswell, 2007).

Rather than taking this approach, I argue that ideas and perceptions are important but, as Gilpin (2001: 20) points out, "the world is composed of many economic, technological, and other powerful constraints that limit the wisdom and practicality of certain ideas and social constructions". As elaborated in the following chapters, Estonian policy makers acted under significant geopolitical and economic constraints. The First Estonian Republic rose out of the ashes of Czarist Russia and was ended by the invasion of the Red Army. Soviet hegemony stifled economic and political autonomy for half a century. The regaining of Estonian independence was largely possible due to a failed coup attempt in Moscow and sympathetic nationalistic forces in other parts of the Soviet Union. Social constructs must be examined in the light of wider social forces beyond the control, perhaps even the comprehension, of individuals.

Thus my philosophical position is of the realist thought. I explain the emergence of neoliberal policies in Estonia in terms of its causes and the forces that produced it. Standing on the domains of the empirical (individuals' perceived experiences of the world), the actual (individuals' different interpretations of events), and the real (structures containing mechanisms leading to events and their empirical perceptions), decisions feed "forward even if the external milieu does not change" (Johnston, 1997: 218). However, the "external milieu" is dynamic and people's actions within the

constraints of their structures are continually changing. I focus on the “world of lived experience” of “knowing actors operating within the structural constraints” (p. 228 and 221). I acknowledge the significance of economic and geopolitical limitations on human behaviour and the importance of human agency.

I use grounded theory, which is inductive in nature with theory developing as a result of systematic empirical research enhancing its usefulness and plausibility (Glaser and Strauss, 1968). I inductively develop a theory, “an abstract analytical schema of a process”, which is “grounded in data from participants who have experienced the process”. In my research I emphasise the “diverse local worlds, multiple realities, and the complexities of particular worlds, views and actions” (Creswell, 2007: 63 and 65).

4.3 Research method

Through directed but open-ended exchange, the aim is to elicit the interviewees’ own accounts of their experiences and perspectives. The objective is to hear about the interviewees’ beliefs, attitudes and motives, in other words, the kind of information, which would be very hard, if not impossible, to obtain through surveys. Thus, the main data collection method in this study is semi-structured, face-to-face interviews. Surveys are widely used research methods, due to ease in explanation and understanding, as they allow the collection of an ample amount of data with very reasonable costs. Although the survey strategy enhances the generation of findings that are representative of the overall population, it also poses the critical disadvantage of not being able to be as comprehensive as those collected by other research strategies (Saunders, et.al. 2007). Surveys are easily replicable and therefore considered reliable. However, they are highly structured, which leaves little room for the researcher to communicate how he/she personally understands the issue at hand (Gill and Johnson, 1997). Surveys, unlike interviews are a ‘one-way’ form of communication. The researcher has low degree of control over how the respondents complete the questionnaire. Unless the researcher is present while the respondent fills in the questionnaire, it is impossible to observe nuances, such as non-verbal clues, facial expressions, intonation, which can be crucial in interpreting information.

As the events under examination happened in the past, observation in this research is impossible. Focus groups are appropriate collection techniques when the respondents cooperate with one another facilitating information collection and exchange. Some participants may also feel more encouraged to speak up in a group setting (Creswell, 2007). However, I excluded the use of focus groups for two reasons. First of all, it would have been highly improbable to find one particular date and venue that would suit several Estonian elite interviewees who are dispersed all over the world with hectic schedules. Second of all, having acquired an insight into their culture through years spent in Estonia, I thought that Estonians do not willingly open up in front of one another and prefer one-to-one interviews. To verify my 'gut-feeling', I did ask some of the interviewees if they were willing to participate in a focus group but they politely declined. Upon reflection, in the course of one-to-one interviews I managed to gain their trust and obtained invaluable in-depth information. I agree with Stephens (2007: 205) that "semi-structured interviews provide(d) the best window into the norms and values experienced by the participants".

Although interviews are time consuming, they have several advantages. It makes it easier to probe for lengthier and more detailed answers. In telephone interviews it is harder to establish trust and it is easier for the interviewees to finish the interview than in face-to-face interviews (Healey and Rawlinson, 1993). Interviews tend to have a higher response rate compared to surveys; however, this is of questionable comparative value due to the difficulties in gaining access to elite interviewees. Semi-structured interviews provide the interviewer with more discretion over the conduct of the interview than unstructured interviews (Newmann, 2000). I have collected the necessary information by talking to the participants individually, with a set of specific questions in hand, and carefully listening to their stories. My intention was to construct a consistent picture by talking to several people, comparing one person's version with that of others, by tackling important issues from different angles, by careful probing and triangulating with the literature. My objective was to obtain the interviewees' own perception of events. Having a specific set of questions in hand helped me to cover all the necessary topics and left room for the interviewees to express their own thoughts. Also, as gaining access to elites is hard, I intended to use my time efficiently.

4.4 The challenges of researching Estonian elites

The nature of the research question has defined this research as an elite study because it investigates the decisions of Estonia's political and economic leaders in the country's post-socialist transition. The respondents are those individuals who were either key decision makers, and/or 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.

Smith (2006), disputes the segregation of people into elite and non-elite groups, stating that some marginalised groups can be just as hard to penetrate as those in powerful positions. I consider this research an elite study because the people I study personally made or greatly influenced decisions, which have affected the life and well-being of the whole population of Estonia. Furthermore, these individuals have been highly visible; they have been occupying powerful positions in government institutions and organisations, such as ministries and the Central Bank of Estonia. Many still exert considerable influence over policy making today. They enjoy high status and have access to data and information that is inaccessible to the public. They are also in a position to manipulate information and to deny access to it. Elites can command significant resources and exert influence over others. They are hard to reach and are surrounded by numerous gatekeepers. Elites are visible but not necessarily accessible.

Hunter (1995) states that elites are 'relatively unstudied' because of their power and ability to protect themselves from intrusion and criticism. Studies using elites – business, political or social – are quite rare; most research in social sciences involve 'ordinary' individuals leading to an asymmetry in the distribution of knowledge, as they provide information about the 'masses' to the elites (Ostrander, 1995). Elite-oriented studies aim to lessen this asymmetry by providing a flow of knowledge the other way. Whereas in non-elite studies the researchers have the position of 'expert', in elite studies those who are studied are 'in the know'. Due to the social status of elite research participants, elite studies are also referred to as 'studying up' (Hunter, 1995).

Elite studies, such as this one, pose specific difficulties. 'Studying up' presents different methodological and ethical challenges from researching non-elite groups. Elites consist

of a small number of people with specialised knowledge (Cormode, 1999). They purposefully erect barriers, which set them apart from the rest of society. Gaining access to elites has to be carefully negotiated, which can take much longer time and higher costs than non-elite studies (Welch, et al, 2002). The researcher depends on their cooperation but they are very hard to access. Cochrane (1998) suggests that elites are powerful not only because they are used to running things but also because of the researcher's dependence on their cooperation. They have very rigorous time schedules, which makes it hard to meet with them, let alone get the time essential for a meaningful interview. "Without gaining access, there can be no research" (p: 2124).

As my aim is to understand the motives of Estonian policy makers behind their policy decisions, participants were selected by purposive sampling using specific criteria from a hard-to-reach, specialised population. The interviewees can be characterised as political and economic elites. Given the very limited number and the influential position of these individuals, random sampling was inappropriate. Although there have been eleven governments in post-socialist Estonia, the various positions – let it be in government or in opposition – tend to be filled by the same people, as the same individuals kept circulating among the various leadership positions, as elaborated in Chapter Eight. The population under investigation was small, of a size of approximately 25-30, some of whom have passed away since.

My Estonian experience was crucial in gaining access to interviewees and obtaining their trust, without which my research would have been impossible. The institutions where I taught - Concordia International University, Estonia (CIUE, currently part of the Tallinn School of Economics and Business Administration) and the Estonian Business School – are considered elite schools not only in Estonia but also in all three Baltic States and are also well-known in Scandinavia. Many of my colleagues had important roles in Estonian society. For instance, a former colleague and friend is a member of the Estonian Rotary Club, which has significant prestige in Estonia. Another close friend was a top executive at a Finnish-Estonian media firm. Numerous prominent politicians lectured at these schools as part-time or guest lecturers. For example, the country's current President, Thomas Hendrik Ilves, taught political science at CIUE. Kristiina Ojuland, who was foreign minister from 2002 until 2005, repeatedly delivered

guest lectures at the school. As part of the Executive MBA programme of the Estonian Business School, I taught cross-cultural business communication to Estonian corporate executives. These elite students took me seriously as a foreign academic. When Hungarian President Ferenc Mádl visited Estonia in December 2000, I was an invited guest at the state banquet hosted by the Estonian President, Lennart Meri. Through such contacts I learned who the key personalities are. I saw their willingness to cooperate and realised that they perceive social research as something to be gained from. They did not shy away from opportunities to voice their views. It was not so much knowing them personally that proved precious but the knowledge that accessing them and gaining their trust is possible. Inside knowledge was crucial for my research.

Making the right contacts and using my own circles, which I detailed above, helped me get in touch with the participants. I relied on connections, networks, as well as luck. One of the reasons for selecting Estonia's transition for my research is that I moved there just seven years after the country regained its independence and lived there for seven years. In addition to becoming interested in the country's economic development, my Estonian experience has equipped me with the ability not only to identify the required sources of information but also the knowledge of how to reach them. I became familiar with Estonian culture, which proved invaluable when approaching my interviewees. For instance, knowing that stubbornness and perseverance are not considered impolite by Estonians was crucial in obtaining contacts and interview appointments. I also relied on friends, former colleagues and acquaintances to 'point me in the right direction'. Perseverance and flexibility on the part of the researcher are essential.

I found Estonian society very closed and ethnocentric. Although I lived in the same apartment block during my stay in Tallinn and regularly greeted my neighbours in the corridors, they would start returning my greetings only after two years. In my fourth year, when one of my neighbours gave me a bag of apples from his garden I knew I was in! Such episodes had an important part in the formulation of my research idea, as I was realising that perseverance and familiarity with their values and norms 'pays off'.

As elite interviews are very difficult, if not virtually impossible, to repeat, careful planning and getting in touch with the respondents well in advance are essential in order to make the most of the event. “Doing your homework helps in the creation of contacts with individual informants” (Laurila, 1997: 411). In order to facilitate the process, I had to use my contacts and connections not only to ‘put a foot in the door’ but also to establish trust. The researcher must identify the respondents as well as find the right media to reach them. As elite interviewees are not willing to travel to the interview and are not likely to adapt to the researcher’s schedule, the researcher must be prepared to be flexible, which costs time and money. Once the interview is set, the interviewer needs to be familiar with the interviewees’ norms of behaviour and etiquette in order to gain their trust (Conti and O’Neal, 2007; Stephens, 2007), which requires the researcher to present him/herself in a respectable manner, as expected by elite interviewees (Cochrane, 1998). For example, I wore a suit and a necktie at each interview, as this is the norm among Estonian civil servants. Dressing in a suitable manner helps the interviewer to ‘blend in’ more, while inappropriate clothes may adversely affect the interview. Overall, the interviewer’s social skills are an important determinant of a successful elite interview (Healey and Rawlinson, 1993).

Finding the respondents’ contact details was relatively easy; in most cases I was able to obtain telephone numbers, email as well as postal addresses. From my experience I found that Estonians prefer written over oral communication with strangers. Although literature (Conti and O’Neal, 2007; Stephens, 2007) suggests sending formal letters to be followed up by phone calls, I decided to establish contact through emails. Again, knowing the local culture proved invaluable. Estonian is a high-context culture with emphasis on non-verbal communication. Estonians do not think aloud. Their tight-lipped characteristic is expressed through their high rate of internet usage and their preference of written communication. Estonian people are very high-tech oriented; they pride themselves on using the latest technology. According to a survey conducted in 2007, 65 percent of 6-74 year olds, including almost every 10-24 year old, are regular users of the Internet with 49 percent of households having home access (Vihalemm and Kalmus, 2009). The whole country is wi-fi covered (Estonian Ministry of Foreign Affairs). Choosing electronic media when contacting them proved right; my no-response rate was below twenty percent.

Scheduling the interviews was an important decision. Being a full-time lecturer with teaching commitments, interviews had to be conducted on a 'piecemeal' basis. I did not contact all the participants at the same time, nor did I start with the most important ones, in order to gain experience and confidence. I contacted the respondents three-four months in advance. Giving them a choice of dates far in advance proved very helpful, as none of them declined due to lack of time or a busy schedule. I never scheduled two interviews for the same day to allow room for last minute changes or in case the interview lasts longer. This proved useful, as one interviewee had to postpone our meeting by several hours. Another interview took much longer than I had expected and I was intent on taking full advantage of the interviewee's willingness to talk.

Altogether I interviewed eighteen people with two follow-up interviews. I have interviewed the vast majority of the figureheads in Estonia's transition, including every prime minister between 1991 and 1997, the President of the Central Bank who spearheaded Estonia's monetary reform, along with two members of the Central Bank's Supervisory Board, various economic and finance ministers, leading former dissidents, as well as lead consultants and advisors. The full list of interviewees is detailed in Appendix A. Although Creswell (2007) suggests twenty to thirty interviews for grounded theory research, I believe I have reached theory saturation point with this many interviews because the same distinct themes and names kept emerging, although from different angles. Having triangulated with the literature, I am fully confident in the solid nature of my data because I gained first hand accounts of the events, circumstances and decisions that took place in the time period under discussion in Estonia from the key decision makers and advisors themselves. This was confirmed by a member of staff of the Office of the President of Estonia when upon enquiring about whom I had interviewed, she responded: "is there anyone you have not interviewed?"

There is. I intended to interview Edgar Savisaar, Vice-Chairman of the Council of Ministers of Estonian SSR, Prime Minister between 1990 and 1992, but he does not provide interviews due to ill health. I also would have liked to talk with Arnold Rüütel, Chairman of the Supreme Soviet of the Estonian Soviet Socialist Republic (ESSR), 1990-1992, and President of the Republic of Estonia 2001-2006. Again, his frail health

and old age - he is over 80 years old - has prevented me from interviewing him.

However, I did manage to speak with their close associates in both cases.

The location of the interview can have considerable influence on the interview process. The setting of the front stage, such as the person's office, reflects the bureaucratic position and the power of elites. Responses obtained in an office can represent the official, public relation version. It is the 'back stages' where negotiations take place, issues are discussed in earnest and decisions are made but they are carefully protected from outsiders. Although they are not necessarily constrained to one physical location, most back-stage activities take place in informal environments, such as exclusive clubs. Finding them can be a challenge, as they are only known to insiders. "To know where it is is to belong; not to know is to be an outsider" (Hunter, 1995: 152).

Ostrander (1995) suggests that interviews take place at public places. Meeting at neutral locations minimises distraction and interruptions and enables the researcher to claim some control over the setting. Arriving early and getting familiar with the environment is also helpful. However, meeting them outside of their office may be problematic due to various reasons, such as personal security (Thomas, 1995). If the interview does take place in the interviewee's office, it is advisable not to behave like a guest, such as getting into 'socialising' and commenting on the surroundings. There is the danger of being taken aback and impressed by the interviewee and his/her environment and overestimating the significance of the interviewee's knowledge (Ostrander, 1995). The researcher should not take everything the interviewee says at 'face value'; critical judgment is important. However, the interviewees must be allowed to speak for themselves and their stories have to be taken seriously (Cochrane, 1998).

Flexibility was the key word when choosing the venue and time for the interviews. My interviews took place in six cities in four countries – I conducted one interview in Liverpool, London, Brussels, Riga and Tartu each, the rest took place in Tallinn. Being a full-time lecturer posed some serious time constraints. Also, as my research was funded entirely by myself, travelling extensively was a financial burden. However, in light of the advantages of face-to-face interviews over telephone interviews I was willing to sacrifice both time – I had to use my annual leave days – and money.

Although according to Stephens (2007: 203) telephone interviewing is “both a productive and valid research option”, I opted to conduct all my interviews in person because I wanted to familiarise myself with the interviewees’ environment in order to acquire an insight into their surroundings. Face-to-face contact also allowed me to pay attention to non-verbal clues, which are particularly important in a high-context culture, such as the Estonian. I had to resort to telephone interview with one participant, as he is currently working in China.

My experience refutes Thomas (1995) recommendation of neutral locations. One interview took place in a café, two in restaurants, which had three major disadvantages – noise, interruptions and the neutral nature of the location itself. The noise level made it harder to focus and affected the quality of the recording thus it took me longer to transcribe these interviews than those recorded in offices. Despite these difficulties I gained high quality data and invaluable information from these interviews as well.

Holding the interviews in the interviewees’ own environment proved consequential, as it provided me with additional insight into the participants’ setting. I agree with Creswell (2007) that it is important not to separate what people say from their context and to listen to the participants’ stories in their own environment, in order to gain a detailed understanding of the problem. Every office that I have been in had not just a desk but also a table with chairs around it, which were used for the interview. I found Estonian offices unobtrusive, practical and uncluttered; they almost looked austere not reflecting the high level position of their occupiers. I had the full attention of my interviewees on every occasion and not once were we disrupted. I disagree with Thomas (1995) because conducting a face-to-face interview at a neutral location removes the respondent from his/her own environment thus depriving the researcher of a crucial element of context.

One of the challenges is to get the respondents’ honest opinions, however subjective or emotional they are. Beginning the interview on the ‘right note’ is important. The researcher must be open and straightforward about his/her personal involvement and must make the goals and conditions for the research clear at the very beginning (Ostrander, 1995; Laurila, 1997). Healey and Rawlinson (1993) suggest that the

researcher start the interview with an open question so that the content does not influence the response. This also provides the interviewer with more time to build up trust and confidence. Summarising what has been discussed and its interpretation by the researcher helps to avoid misunderstanding of the answers. Ending the interview with an open-ended discussion can be a useful way to check the completeness of the information acquired (Healey and Rawlinson, 1993).

Many elite subjects have the ability and the power to protect themselves from exposure to criticism. Elites can influence the interview situation as well as the quality of information in various ways. Establishing rapport is a critical issue; gaining access and trust are not identical. Unlike non-elite studies, in which researchers are advised not to use complicated terminology, elite interviewees are knowledgeable. Elite interviewees can be tempted to dominate the interview and even challenge the researcher's views. Many have excellent communication skills. On occasions, the researcher may easily find him/herself in a situation of being patronised (Welch, et al, 2002). Elites are used to being in charge and being asked about their opinion; they have the ability to converse easily, 'just talk' and get into monologues instead of answering the hard questions. In addition, many of the elite research subjects are trained in how to represent their organisation to the outside world. It is not uncommon for researchers to hear the 'public relations' version of events instead of the 'real story'. The researcher must be prepared for such situations with strategies to tackle them successfully (Laurila, 1997). Thomas (1995) suggests that presenting the questions in personal terms and showing interest in what they personally think tends to open up elite interviewees. It indicates that the researcher is after their own insight, which they may find flattering. Demonstrating eagerness to learn from them may lead to a role-reversal, whereby the elite interviewee will have the opportunity to teach the researcher. I have repeatedly come across such instances during my fieldwork. Assurances, like the interview excerpt below, have invariably led to valuable information:

*“Interviewee: This will be my personal comment now.
Interviewer: That's exactly what I want.”*

In order to avoid journalistic answers, it may be necessary to 'recalibrate' the interview by rephrasing the question. If this does not work, shifting to a completely different line of questioning is an option (Thomas, 1995). Ostrander (1995) recommends that

researchers do not shy away from asking inappropriate questions even if it stretches the bounds of etiquette. This also reduces the perceived status gap between the researcher and the elite interviewee. Maintaining control over the flow of the interview is another reason why I chose semi-structured interview. It allows the researcher to decide when to interrupt and change the direction of the line of conversation.

4.5 The central question of positionality

Due to the influential and powerful positions of most participants in this study, the positionality of the researcher is crucial. Elite research subjects tend to enjoy higher status than the researcher. The background characteristics of the researcher and the researched have a significant impact on the dynamics of the interview. As Okumus et al. (2007: 15) argue, self-promotion “contribute(s) to gaining formal and personal access and fostering individual rapport”. In order to gain credibility and reduce the status imbalance, it is important for the researcher to emphasise his/her academic and professional credentials and institutional affiliations (Welch, et al, 2002). The status inconsistency in elite studies between researched and researcher is widely perceived to present a problem (Hunter, 1995; Ostrander, 1995; Thomas, 1995). However, as Herod (1999) suggests, this may not always be the case. Elites may perceive the interview as an opportunity to have an informed discussion.

Due to the power, privileges, and knowledge of elites, self-presentation is crucial (McDowell, 1998). Welch et al. (2002) consider the position of the ‘informed outsider’, which describes a neutral outsider with an inside view, effective. According to Sabot (1999), local elites respond differently to fellow compatriots and to foreign researchers. Her findings show that foreign researchers are trusted more, as they are not perceived to pose any threat to the interviewees’ status and position, especially if the results are published in a different country. This places the outsider at an advantage at obtaining information. It makes it easier for them to get access and ask blunt questions. Foreign researchers seem to get more leeway in their conduct. At the same time they are not as well placed as local ones to understand and interpret the obtained information, due to their lack of ‘inside view’ (Sabot, 1999). However, according to Welch et al. (2002), foreigners can benefit from the cultural gap by maintaining a critical view.

I am Hungarian, which greatly benefited my research. Estonians have a strong ethnographic interest in the Finno-Ugric peoples and highly value links with them. Their strong national identity is deeply rooted in their language. Lennart Meri, President of Estonia 1992-2001, was an anthropologist searching for Estonian ‘relatives’ in Siberia and traces of the ancient Estonian religion in their ‘shamanistic’ practices (Lieven, 1993; Taagepera, 1973 and 1993). I have repeatedly come across the enthusiasm of Estonians regarding Finno-Ugric contacts. An example, which ironically underlines their Finno-Ugric affinity, is that many Estonians refer to Hungarians as “Estonians who for some reason call themselves Hungarians”. Upon learning my Hungarian nationality, many Estonians would draw my attention to the few words that sound similar and have the same meaning in both languages.

I speak some Estonian but my knowledge is insufficient to carry out in-depth academic conversations. I taught at an international university where Estonians – faculty and students alike – were a minority and the language of instruction was English. A common assumption is that because Hungarian and Estonian languages both belong to the Finno-Ugric family these languages are very similar. This is not the case. The grammar and the intonation of the languages are similar but the words are completely different with the exception of a very few. In addition, despite living in the country I found that my chances to practice Estonian were quite limited. Whenever I spoke Estonian, my accent gave me away as a foreigner and Estonians regarded these occasions as an excellent opportunity to practice their English.

I have given a lot of thought to my positionality in the research. It would be impossible to fit my position into the simplistic ‘insider’ versus ‘outsider’ dichotomy. Being a full-time lecturer and a PhD candidate at a UK university makes me an outsider but also gives me important status, as academics are highly valued in Estonian society. However, being a Hungarian who grew up in the socialist era in Hungary, lived in Estonia for a relatively long period of time and married an Estonian puts me in the light of an insider. Having had Estonian elites as colleagues and students gave me respectability. My Estonian experience, coupled with my Hungarian nationality, has defined my positionality to a great extent and significantly aided my ability to gain access and trust.

Overall, it was due to my positionality, personal contacts, inside knowledge of Estonian culture and etiquette, and perseverance that I got excellent access and succeeded in conducting lengthy and in-depth face-to-face interviews with the key policy makers and shapers of Estonia's post-socialist transition.

Instead of a black-and-white dualism, my positionality has been somewhere in the middle on the insider-outsider continuum. Perhaps the term 'concerned foreign friend' would describe my position in this research best. I am not perceived as a local but I am not viewed as an outsider either. As Herod (1995) and Sabot (1999) suggest, being an insider does not necessarily translate to benefits. Estonians are more willing to share potentially sensitive information with outsiders, such as foreigners, because they are perceived to be harmless. Outsiders are also considered neutral and impartial (Herod, 1995). Being a non-Estonian not working in Estonia presents me as non-threatening to them. This is underlined with the fact that out of eighteen interviewees fourteen agreed to be quoted and their names to be revealed. Those who refused to be recorded and insisted on remaining anonymous said their refusal was not out of caution but they just did not like to be recorded. This, however, does not explain their request of anonymity. On the other hand, all are near retirement age, which can explain their caution.

It was very interesting to experience the progress of the interviews. Every interview started off on a courteous but 'cool' note. I began the interviews enquiring about their background and I only revealed my personal relationship with Estonia during the interview. The following quote by one of the interviewees is a good representation of the resulting rapport between the researcher and the researched:

"You have witnessed the everyday struggle in life, so you have a very deep insight... So you understand what I am talking about."

Revealing my personal connection with Estonia has helped to gain their trust, as the official, public relations lines were replaced with candid in-depth conversation. I was very careful to observe etiquette. Although on occasions I had to redirect the discussion, I did not have to resort to interrupting the interviewees.

The importance of the researcher's positionality throughout the research process must not be underestimated. It strongly affects the researcher's success to establish contact

and gain trust. As the research progresses, the researcher's 'track record' of interviews serves as proof of trustworthiness. Upon reflection of my interviews with Estonian elites I realise that my positionality has evolved over time. Having personally seen the socio-economic consequences of the country's ultra-liberal policies, I was not an unbiased researcher to start with. I began my investigation of the origins of Estonia's ultra-liberal economic policies with slight antagonism and curiosity. Over the course of my research I developed empathy, which has gradually turned into sympathy towards my interviewees. Thus on the 'insider-outsider continuum' my positionality has become more of an 'insider'.

Over time I managed to establish rapport. On numerous occasions, they showed me mementos. For instance, Jaak Jõeriüt⁴ brought me an original copy of his father's degree in engineering, which had been awarded almost a hundred years ago at the University of Riga. Tiit Vähi⁵ proudly showed me a copy of the country's EU accession document, which he personally signed as Prime Minister of Estonia in 1994. Most of my interviewees asked me about who else I had interviewed. Once I revealed the names – excluding the ones who insisted to remain anonymous – they offered me further contacts. They "became gatekeepers" (Okumus, et al., 2007: 17). Some even shared their personal opinions of those persons with me

4.6 The importance of interview preparation

My experience supports the existing literature on the importance of thorough preparation. It is essential to acquire solid pre-existing knowledge about the research participants prior to the interviews (Hunter, 1995), as it allows the researcher to ask specific questions, to which the answers are not available in public (Welch et al. 2002). A well-informed interviewer is in a better position to check the accuracy of information received. Exhibiting knowledgeability of the topic can be a good defence against interviewees' attempts to patronise the researcher (Healey and Rawlinson, 2002). I supplemented the interviews with alternative forms of data collection. Different sources and forms of evidence were brought together. Some of

⁴ Member of the Supreme Council of the ESSR, Minister of Defence 2004-2005

⁵ Prime Minister of Estonia 1990-1992 and 1995-1997

the best sources were the local media, such as the daily newspapers Äripäev, Postimees, and Eesti Päevaleht, which are the leading national newspapers covering political and economic news. Their articles are available in English language through media portals.

Knowing that Estonians prefer written over oral communication and their 'flair' for technology, I approached my interviewees through emails, which I carefully worded. Estonians tend to be very formal, thus using the proper title, such as Dr. or Professor is crucial. I cannot overemphasise the importance of thorough preparation. Familiarity with their background was essential, as some of them asked me in their reply why I had chosen them. Knowing their life history helped me to spot minor nuances during the interviews, which helped me make efficient use of my time with them by being able to ask very specific questions and also improved their perception of my knowledgeability decreasing the status imbalance between the researched and the researcher.

I cannot underestimate the significance of knowledge of the country and its language. Firstly, as initially I was given one hour by my interviewees, interviewing them with specific questions in hand increased the opportunity to have an 'informed conversation' and improved the efficiency of these meetings, as no time was spent on discussing information that can be obtained from written sources. Secondly, having read articles written not only about them but also by them and all relevant documents enhanced my knowledgeability, which decreased the status imbalance between the researched and the researcher. My knowledgeability has helped me to gain their trust, which is critical for the researcher to receive the interviewee's personal account of events. Although before the interviews the respondents allocated one hour for our meeting, on most occasions our conversation lasted longer than that. One interview continued for over two hours.

I worded the questions carefully trying to be unambiguous and clear. Even though my Estonian language skills are limited, knowing some key words, phrases and abbreviations did help; it made the flow of the interviews much smoother and it contributed to my knowledgeability. All of the interviewees spoke good English, although it was their second or third language. Interpreters were used on two occasions at the request of the interviewees due to the (self-admitted) lack of confidence in their

English language skills. The interpreters were native Estonians, fluent in English. The presence of an interpreter may inhibit some interviewees from giving honest answers (Welch et al. 2002), however, as the interpreters were independent from any commercial or governmental interests, this fear was minimised. The following questions comprised the backbone of the interviews:

Figure 4.1 List of interview questions

- What were the main priorities for Estonia before gaining independence in the late 1980s?
- What were the main priorities for Estonia after gaining independence in the early 1990?
- What were the most important considerations in policy choices?
- What were the objectives of these policies?
- Who was involved in policy making?
- What/who were the main sources of guidance and advice?
- How were the advisors selected?
- Who/what had the main influence over policies?
- To what extent did these policies have outside influence over them?
- What kind of influence did they have?
- What were the main components of these policies?
- Was the socio-economic impact of these policies considered?
- Who were in charge of implementation?
- Who were monitoring the progress of changes?
- What were the main difficulties?
- What role did the trade unions play?
- How would you evaluate Estonia's transition?

These were supplemented with additional questions, depending on the flow and direction of the discussion. Some questions did not have to be asked if an interviewer covered them while answering another question. Due to the differences between the respondents' communication skills, language ability, the interviewing situation and the availability of time I formulated my questions differently, depending on the interview situation. The quality of interview design and the way the questions are asked strongly affect the nature of answers received. Extreme care and attention needs to be paid to the interview process both while it takes place and when analysing the notes and recordings (McDowell, 1998). The manner and wording in which questions are phrased can alter

the interpretation of the question, and thus the response (Healey and Rawlinson, 2002). Due to differences in the participants' background and personality, the questions had to be worded differently in order to get the same meaning across for all respondents. The interviewer-respondent interaction, which is heavily influenced by the attitudes and reaction of interviewees to the questions, can vary greatly across interviews. As my interviews progressed, some of the questions were altered due to new information revealed in previous interviews. The length of interviews was varied between one and two hours, depending on the time constraints of respondents and the interview context.

Age and gender did not play a critical role in conducting the interviews. With three exceptions, all of the interviewees were men, like me. There was a seniority gap with the interviewees but I felt like I was treated as an equal.

Data collection and analysis were carried out following ethical research guidelines. No respondents were subjected to physical or physiological harm, stress or any kind of discomfort whatsoever. This is an overt and independent research project. Interviews were held with the informed consent of the participants. None of the interviewees belonged to any vulnerable groups. Those interviewees who wanted to remained anonymous; their privacy has been respected. I made it clear at the outset that my research is an independent project, not sponsored by any commercial or government sources. This eased concerns about information that could be considered sensitive by the interviewee. There is one issue regarding confidentiality. As my interviewees are prominent members and leaders of the Estonian community, deductive identification is possible. Only two participants asked to be provided with a copy of the transcripts, to check for accuracy of facts. However, the integrity of research and the researcher will be protected by not giving them control over what is written in the thesis and what is published and where.

4.7 Post-interview follow-up

At the end of the interview it is helpful to ask for an opportunity to follow up with questions of clarification after the notes are reviewed. It helps to ask for names of contacts that they think would be able and willing to provide information in the form of an interview (Thomas, 1995). Such snowballing technique helped me to find potentially

useful information. On various occasions, I was given contact details of potential interviewees. Many of the interviewees provided me with additional reading material. Following each interview, I sent each an email thanking them for their cooperation. This gesture not only served as a reminder in case the interviewee offered additional help, such as reports or additional contacts during the interview, but also kept the door open for follow-up interviews. Post-interview cooperation can be helpful, as interviewees can be sent the transcripts to check for accuracy, which can provide additional information and comments to the researcher (Welch, et al. 2002). A thank-you letter to the interviewee leaves a positive impression, which makes further research with them possible (Healey and Rawlinson, 1993).

Post-interview communication has revealed an emotional side to the process. Many of the participants responded to my follow-up emails admitting that they enjoyed our conversation, as it brought back memories from Estonia's post-socialist formative years. Overall, I have been impressed with the cooperation, willingness and openness of my elite interviewees, for which I am grateful.

4.8 Establishing validity and reliability

It is impossible to achieve perfect reliability and validity, although they are very important in social science due to the often-ambiguous nature of social constructions (Newmann, 2000), which makes it essential "to guard against the investigator's conjuring up concepts and theories that do not authentically represent the phenomenon of concern" (Whittemore et al. 2001: 526). Dependability and consistency are common in quantitative methods; they can be improved by increasing the level of measurements, using pretests and retests, pilot studies, replication, and/or using multiple indicators of a variable (Newmann, 2000). In qualitative research the need to incorporate rigour as well as subjectivity into the research process raises difficulties in developing validity standards (Whittemore et al. 2001). Creswell (2007: 204) defines validation as the compilation of "bits and pieces of evidence to formulate a compelling whole". However, evidence is not the equivalent of truth and objectivity because as "we cannot separate ourselves from what we know, our subjectivity is an integral part of our understanding of ourselves, of others, and of the world around us". Thus, validation in

qualitative research is a “judgment of trustworthiness or goodness of a piece of research” (Angen, 2000: 380, 385 and 387).

Whereas in quantitative studies the reliability is instrument specific, reliability of qualitative research is mostly determined by the ability, skills, and efforts of the researcher. Healey and Rawlinson (1993) describe validity in terms of the accuracy of the information. For some researchers, reliability and validity are not considered separate issues in qualitative research; they both refer to the concept of credibility (Golafshani, 2003). Whereas according to Patton (2002) reliability is determined by the study’s validity, Golafshani (2003) views trustworthiness as essential to ensure quality.

Following Creswell’s (2007) recommendations, I used triangulation, member checking and self-critical reflection in order to improve validity and reliability to ascertain a critical evaluation of the findings. Biases may arise in the interviews due to the interviewees’ selective memory or due to self-serving motives, such as post-hoc rationalising of events. I compared and contrasted the interviews with official documents and databases of national and international organisations, such as the Statistical Office of Estonia, the Central Bank of Estonia, the Office of Statistics of the European Union, pre-accession reports prepared by the EU and country evaluations carried out by the IMF, World Bank, the Organisation for Economic Co-operation and Development (OECD), United Nations Conference on Trade and Development (UNCTAD) and the United Nations Development Programme (UNDP). Through post-interview communication, I have asked some of my interviewees to comment on my preliminary findings. Also, reflection and critical discussion of my own perspective, voice and taken-for-granted knowledge was an integral part of the research process.

4.9 Interview analysis

The interviews with two exceptions were recorded and transcribed. I have never been an avid diary writer but this time I ran a research diary, in which I recorded my impressions about the background and the environment of the interviewees. This allowed me to reflect not only over the nuances and particularities of each interview but also on my positionality, emotions, understanding of the stories, as well as my reactions to them, which affected my interpretation of events. I paid special attention to the

interviewees' body language, which was reflected in my notes, as well as in the transcripts. Estonian is a high-context culture; non-verbal communication plays a significant role in interpersonal exchange. Estonians tend not to chat; small talk is considered unnecessary, their purpose of talk is passing on information. Although they tend to get to the business at hand, being very familiar with their culture I did not consider them blunt or rude. Prompting my interviewees was needless. When they were finished with their answer, which could take from a few seconds up to half an hour, they asked for the next question. Sometimes the intonation of the interviewee's voice, his posture and facial expression would express more than his words.

I carried a pocket-size notebook with me. Prior to the meetings I took notes of the exterior and interior of the buildings and offices, in which the interviews took place. After the interviews, I would find a quiet place, for instance a café – and write down my impressions. Probably the most memorable moment was Siim Kallas⁶ vividly recalling the arduous night before his crucial meeting with Michel Camdessus, Managing Director of the International Monetary Fund, where he intended to inform the IMF of defying their advice by leaving the rouble-zone in June 1992. It was not uncommon to detect emotions on the faces of interviewees while they recalled their experiences, which are detailed in chapters Five to Eight.

I used Nvivo software in addition to the pen-and-paper method. Nvivo helped me to organise the interview content along the various themes that emerged and to locate information more easily. I found the two methods complementing one another quite well. I followed McDowell's (1998) recommendation to watch how events unfold, what actually happens and how the story-teller shifts his/her narrative position.

I have been listening to the recordings with my research objective in mind. The main emphasis was not on any individual interview itself but the contribution and impact that each added to the whole picture. I intended to extract themes from the data and examine the motives of Estonian policy makers at the time by taking the views of my

⁶ President of the Bank of Estonia 1991 – 1995, Minister of Foreign Affairs 1995 – 1996, Minister of Finance 1999 – 2002, Prime minister of Estonia 2002 – 2003, currently Vice President, European Commission

interviewees, their interpretation of events and circumstances. I checked their accounts against reality by weaving data and literature – from human geography, economics, international political economy, as well as historical accounts – together to get a full account. I aligned interviewees’ stories with one another and with documentary evidence.

I use a large number of quotes in my analysis in order to underline the key arguments. Confidentiality permitting, I reveal the name of the source where I think it enhances my point. Some of the interviews were ‘cleaned up’ for the purpose of readability. However, the meaning has not been tempered with.

Based on my findings, I have divided the analytical discussion into four chapters. Chapter Five examines the evolution of the Estonian imaginary and Estonians’ collective memory of ‘historical suffering’ that contributed to a sense of ‘go-it alone’. Chapter Six discusses the socio-economic and cultural impact of Soviet domination and Russification, and their legacies in the post-socialist era. Chapter Seven analyses the country’s triple transition from the ESSR to the sovereign Republic of Estonia. By exploring the structures and discourses regarding the emergence of Estonian neoliberalism I prove the crucial role of local agency. Chapter Eight provides an account of the results of neoliberal policies and emphasises that while these policies may have been unavoidable in the early years of Estonian transition, they are no longer suited for the country’s sustainable socio-economic development.

4.10 Conclusion

This chapter examined the methodological framework used in researching the origins of Estonia’s neoliberal policies. This qualitative research is inductive and interpretive aimed at a deeper level of understanding in view of the interviewees’ meaning and interpretation of events. My methodology is based upon the realist epistemology; my research method consists of semi-structured, in-depth face-to-face interviews. As the participants are key decision makers and influential policy shapers in Estonia’s post-socialist transition, this is categorised as an elite study. Purposive sampling was used to identify respondents. Data was collected through nineteen in-depth, face-to-face interviews and one telephone interview. Semi-structured interview method was chosen,

which allowed me to pose the interviewees specific questions but also left room for the respondents to express their arguments and motives.

The elite nature of this research posed specific difficulties, which were tackled by thorough preparation. Knowledge of the interviewees' backgrounds and preferences, such as their favoured means of communication and their willingness to contribute to academic research, helped in gaining access. In-depth knowledge of the research topic and familiarity with the interviewees' culture and norms of behaviour facilitated gaining their trust, which proved invaluable in obtaining their own perception of events. During the course of data collection the researcher's positionality has evolved and has become a key determinant of the project's success. A critical finding is that the researcher's positionality is not determined externally in the context of an insider/outsider dichotomy but is on a continuum that can be controlled by the researcher to a certain extent. My personal links with Estonia and my knowledgeability make me seen as an insider but my professional and academic affiliations, as well as overseas residence put me in the position of an outsider. Having reflected extensively on the process of interviews, I characterise my positionality as 'concerned foreign friend'.

Data analysis has underlined the significance of context and local agency in policy making. Various discourses and structures have been identified, which explain the emergence of neoliberalism in Estonia and negate the hegemonic view of the diffusion of neoliberal policies.

Chapter 5. The Estonian imaginary and the birth of the Estonian state

5.1 Introduction

My argument is that the formulation of Estonia's economic transition policy has been endogenously driven by local agency within the constraints of structure. Political economists acknowledge the significance of national identity in the formulation of national policies (Gilpin, 2001). However, defining it is no easy task. Anderson (1991) defines nationality and nationalism as a 'cultural artefact', a socio-cultural concept, "an imagined political community – and imagined as both inherently limited and sovereign" (p. 6). It is imagined because people imagine their communion with their fellow compatriots, as they know only a small number of their countrymen. It is limited due to its finite boundaries and it is sovereign because of the tendency of nations to aspire for freedom. Finally, nationality is a community, "conceived as a deep, horizontal comradeship" (p. 6), an imagined fraternity, the roots of which lie in culture and for which people are willing to make serious sacrifices.

I am not stating that national character is biologically or environmentally defined or Estonians are all alike. My argument is that the self-image and culture of the Estonian people, which have been shaped by their turbulent history, are crucial to understand the origins of Estonian neoliberalism. In Taagepera's words (1993: 6), "(n)ational character is a murky field of inquiry that has no easy answers, but some quality in Estonians has enabled them to survive and develop with an extremely small population..." As elaborated further, Estonians self-categorise themselves as an individualistic and self-reliant nation, which they use as justification for the ultra-liberal model that they have chosen.

The central theme of this chapter is path dependence. I focus on 'Estonianness' (the imaginary and culture of Estonians). I trace the nation's history from ancient times to the Soviet annexation in 1940 and examine the themes emerging from this era. I argue that due to centuries of dependence on external geopolitical forces and foreign domination, Estonians developed a perception of 'historical injustice' leading to a sentiment that it is best to 'go it alone', placing emphasis on values of individualism and self-dependence that are compatible with neoliberal values. In section 5.2 I present the

historical events followed by a detailed discussion of the evolution of the Estonian ‘imaginary’ in part 5.3 and the creation of the First Estonian Republic in section 5.4. I base my arguments on evidence in existing literature, information gained from my interviews and my own observations while living in Estonia.

5.2 A brief overview of Estonia’s history until World War II

Present day Estonia had not taken its current shape until the early 20th century either as a unified nation or a single territorial administrative unit. Despite their long presence in Estonia’s present territory, Estonia has been a ‘self-aware nation’ less than a hundred years. The ancestors of Estonians, Finno-Ugric tribes, settled in today’s Estonia two and a half thousand years ago, which makes them one of the longest settled people in Europe (Lieven, 1993). Pre-Christian Estonians lived in a loose decentralised federation divided into clans (Piiramäe, 1997).

Throughout the centuries Russian princes repeatedly attempted to spread their rule over the Baltics. The numerous German efforts to convert pagan Estonians to Christianity were unsuccessful. Indeed, one can view the Soviet occupation of Estonia as yet another foreign endeavour to transform the Estonian people and their culture (Taagepera, 1993). Lieven (1993: 41) describes Estonian history as “straightforward conquest and colonisation”. In the words of Taagepera, (1993: 1) “as a nation with a definite cultural-linguistic identity, Estonia always continued to exist, despite a long period of political submergence”.

The decentralised political organisation of the Estonian clans yielded to a Danish invasion in 1219. The Danes subsequently sold Estland (present-day Northern Estonia) to the Teutonic Knights. During the following centuries Estland was incorporated into Livonia (present-day Latvia and Southern Estonia) and its native population was gradually enserfed by the German nobility. Danish and Germanic rule had left its legacy not only on its medieval architecture but also on its economy. Trade had a significant role in the economies of Estland and Livonia. Tallinn (the name itself originates from the Danish term *taani linn*, meaning Danish town) along with the Northeastern town of Narva were two of the principal ports in the Hanseatic League (Lieven, 1993; Smith,

2001). The smaller Estonian towns of Tartu, Pärnu and Viljandi were also members of the League (Piiramäe, 1997).

The outcome of the Livonian Wars of 1558 - 1561 was a landmark in the history of Estonia. In 1561, following a Russian invasion of Old Livonia (present-day Northern Estonia), the city council of Tallinn applied for protection from the Swedish Crown to prevent Russian looting. The Estonian Duchy was created in the northern part of Old Livonia in 1584. However, the Livonian wars, the Northern Seven-Years War (1563 - 1570), repeated Swedish-Russian conflicts (1570 - 1571 and 1590 - 1595) and Swedish-Polish (1600 - 1629) wars devastated Estonia. In 1620, 75 percent of farms were deserted. The country's population plummeted from 250-280,000 before the wars to 100,000 after they ended, subsequently recovering gradually through natural reproduction and large-scale immigration from Finland and Russia (Piiramäe, 1997).

Estonians today describe Swedish domination as the "happy Swedish time". In the 17th century Estonian trade was booming; in 1682, 384 large seagoing boats left Tallinn. In 1699, 232 boats were recorded to set sail from the port of Narva (Piiramäe, 1997). Under Swedish rule certain rights of the peasantry were guaranteed and the power of nobles to punish their serves was restricted bringing about relative ethnic as well as class harmony (Lieven, 1993). It was under Swedish domination that Lutheran Protestantism was introduced in Estonia, which was instrumental in the development of the Estonian language and laying the foundations of the Estonian education system. Schools were established in the countryside; the University of Dorpat (present-day University of Tartu) was founded in 1632 (Lauristin, 1997; Smith, 2001), which had a significant contribution to the creation of a class of local intellectuals.

Although Estonia became part of the Russian empire during the Great Northern War (1700 - 1721), it remained economically and politically distinct, as the Baltic German nobility was able to retain its privileges (Smith, 2001). Russian rule meant the end of the 'happy Swedish days' for the local population and the beginning of the 'golden age' for the Baltic German nobility, whose control over the local administration was guaranteed by Peter the Great. Rights of the peasantry were significantly curtailed and

Due to the fear of the Russian court of social upheaval in the Baltic provinces during the Napoleonic war between 1816 and 1819, the serfs of Estland and Livonia were liberated. Land distribution to the peasantry was strongly opposed by the Baltic German nobility. Although their emancipation happened forty years before other parts of the Russian empire, they were freed without land, which then they had to buy or lease. Despite these difficulties, advances in agricultural production improved standards of living and healthcare leading to a growth of rural as well as urban populations (Lieven, 1993; Smith, 2001).

Estonia took its current territorial shape only in February 1917 when the provisional government of Russia unified Estland and Northern Livonia into a single administrative unit in response to Estonian demands for increased autonomy (Lieven, 1993; Smith, 2001). As late as October 1917, the majority of Estonian politicians still supported a union with Russia, as traditionally the Estonian population sought protection with the Czar against Baltic German oppression, even though the Russian Duma was in favour of the Baltic German nobility (Raun, 1984; Lagerspetz, 2001). As a result of Estonia's difficult birth as a nation in the years immediately after the Russian revolution, this attitude changed radically for the reasons discussed below.

Following the Russian Revolution in November 1917 the Bolsheviks took over control of much of the Baltic provinces (Lieven, 1993). The Bolshevik promises of peace and autonomy appealed to Estonians but their anti-religious stance also alienated large segments of the population as did the decision to turn the Baltic German estates directly into cooperatives, instead of distributing them among the peasantry. Following the collapse of German-Russian negotiations in 1918, German armies invaded Estonia, along with Latvia and Lithuania. With the approval of the Estonian representative assembly, the Maapäev, the National Salvation Committee proclaimed independence on February 24, 1918. Estonia became an independent self-aware sovereign state for the first time in history. However, Estonian sovereignty remained more of a dream than reality, as German forces invaded just days after Estonia's declaration of independence.

Following the surrender of Germany in November 1918, which led to their “withdrawal from most of the Baltic States” (Lieven, 1993: 58), including Estonia, a provisional government was established in Tallinn (Taagepera, 1993).

Soviet armed forces immediately invaded Estonia in November 1918 and by February next year they were within 35 kilometres of Tallinn. However, aided by supplies and weapons by a British squadron, which was stationed off the shores of Estonia to prevent the Soviet Baltic fleet from landing, Estonian troops drove the Soviet forces out of Estonia. Their struggle was helped by several hundred Scandinavian volunteers. Estonia’s full independence from Russia was subsequently sealed in the Treaty of Tartu the following year. When in 1921 both France and Britain retracted military assistance to the Baltic governments, the presence of which had effectively consolidated the independence of the Baltic States under a ‘British and French umbrella’, uncertainty increased regarding the fate of newly independent Estonia. (Lieven, 1993). These events heightened Estonian sentiments about the necessity to ‘go it alone’, as they view the purpose of their military presence not as aiding Baltic independence movements but preventing the Bolshevik forces from gaining a foothold on Baltic soil. The withdrawal of these naval forces contributed to Estonians’ sense of abandonment, as discussed further in section 5.3.

International recognition of Estonia’s declaration of independence was a slow and cumbersome affair. The Baltic delegations attending the Paris Peace Conference, which they were only allowed to attend unofficially, put their trust in President Woodrow Wilson’s principle of the right to self-determination. Their efforts were rebuffed by ‘White Russian’ and Baltic German interest groups questioning their ability to exist as politically and economically sovereign nations. President Wilson contradicted his own principle of the right to self-determination by insisting on Russia’s indivisibility and giving the Baltic States full recognition only in 1922, four years after Great Britain and two years after France (Trapans, 1994). Such negative attitude towards the independence of the Baltic States discouraged Scandinavian support; they voted against their admission into the League of Nations (Piiramäe, 1997).

Interwar Estonia was an independent democratic republic governed by a 100-member parliament, which was elected by proportional representation. This “ultrademocratic” system stressed “popular initiative at the expense of efficiency” (Taagepera, 1993:53) hindering the implementation of reforms, such as economic stabilisation and advances in education. Between 1919 and 1933 the successive governments lasted an average of eight months until the authoritarian take-over by Konstantin Päts in 1934. However, as Lieven (1993: 69) points out, “the same parties and individuals were represented in many of the governments”, a characteristic that bears strong resemblance to the current Estonian governments, as explained in Chapter Eight. Triggered by the impact of the global depression, “economic fears, especially on the part of the middle classes, encouraged the growth of a fascistic movement, the League of Veterans of the War of Independence”, which was a “general political movement with a uniformed paramilitary wing” with a “strongly nationalist, anti-communist, anti-parliamentary, anti-semitic” ideology (p. 69). In order to prevent the League’s rise to power, which was facilitated by its electoral victories in Estonia’s three largest cities, the prime minister, Konstantin Päts declared a state of emergency on 12 March, 1934, with broad political support. Päts’s intolerance for opposition soon became clear, as public opposition and all political parties were banned and candidates for elections to the national assembly were selected by him. The League was abolished and four hundred of its leading members were expelled from civil service and the army. However, no political executions took place (Lieven, 1993; Taagepera, 1993). From an economic point of view, the Päts administration was characterised by active economic management aimed at stimulating the economy. Measures included the launch of numerous public projects, such as infrastructure development (Kahk and Tarvel, 1997).

It is important to emphasise the indigenous nature of Estonia’s constitution, as it was not a copy of that of western states but an Estonian creation. It surpassed the minimum requirements set by the League of Nations by providing the right of education in their mother tongue along with a pledge of full cultural autonomy to ethnic minorities (Lieven, 1993, Smith, 2001). Their relative tolerance of minority interests can be partly explained by the lack of threat they posed to Estonian culture. In 1935, 87.7 percent of the nation’s population were ethnic Estonians (Smith, 2001), as opposed to 61 percent today (Statistical Office of Estonia).

The brief period of the First Republic served as proof of the nation's ability to function as an independent pluralistic and affluent society. In the 1920s land owned by Baltic Germans was re-distributed among the peasantry greatly enhancing the country's social and political stability. Economic development was fast. Industrial production increased 1.5 fold between 1926 and 1937 (Kahk and Tarvel, 1997). The nation had an open economy with extensive investment and trade links with the West. Its speedy development was aided by foreign capital, mainly from the country's largest trading partners, Britain and Germany. The country's population enjoyed a relatively high level of well-being with GDP per capita levels similar to that of Finland. By the end of the 1930s, Estonia had a well-developed infrastructure and a skilled industrial labour force with average earnings near Western European levels (Arkadie and Karlsson, 1992). Despite the authoritarian rule of the late 1930s, the First Republic is remembered as an era of political sovereignty and economic prosperity (Lieven, 1993).

Estonian independence in the 20th century was ended by Soviet troops in 1940. The secret protocol of the Molotov-Ribbentrop pact of 1939 effectively divided Poland and the Baltic States between the USSR and Germany (Lieven, 1993). In September 1939, all Baltic governments were presented with an ultimatum demanding the foundation of a new government under Soviet supervision, military alliance with the Soviet Union and the establishment of Soviet military bases on their territory. By June 1940, the country was occupied by Soviet troops. In July, parliamentary elections took place with a single list of candidates approved by Soviet authorities. The same month, the new parliament 'requested admission' to the USSR (Lieven, 1993, Smith, 2001). Within a few months, the independent Estonian Republic lost its sovereign statehood and became the Estonian Soviet Socialist Republic (ESSR), an integral part of the Soviet Union.

5.3 The formation of the Estonian imaginary

5.3.1 The collective memory of historical suffering

"Nationalism thinks in terms of historical destinies" (Anderson, 1991: 149). The very first line of the book of the prominent Estonian sociologist, Taagepera (1993), begins with the statement "Estonia exists." The survival of the small Estonian nation, its culture and language in spite of centuries of foreign rule has instilled a strong sense of national identity, as illustrated by an interviewee:

“To be an Estonian is not just to belong to a certain nationality, it is a profession!”

Lieven (1993: 18) cites Enn Soosaar, writer and political analyst:

“For centuries, Balts have had only two choices: to survive as nations or to merge into larger nations. You could say that we decided, subconsciously but collectively, to survive. So for us, nationalism is a mode of existence... To survive, you must be nationalist.”

Resilience is a common element in Estonian consciousness, although in various forms. Up to 1918 there had never been an Estonian state and national awareness was embodied in their constant struggle to nurture and foster the Estonian culture (Lieven, 1993). The prosperous years of the First Republic proved the nation’s ability to function as a modern European state, which had an instrumental role during the Soviet era in preserving Estonianness. Once the nation regained its independence in 1991, the goal was, as several interviewees simply put it, to “return to the West”, which was more than preserving statehood; it was about quickly rejoining the group of developed countries and close the gap in living standards. My respondents were unanimous on the overall success of Estonia’s post-socialist triple transition. The passage below is a typical example of the responses.

“Despite all the mistakes and misunderstandings, it (transition) was very successful... There are some 6,000 languages in the world. How many members does the United Nations have? I think 191 independent states.”

Path dependence is a returning theme, as reflected by their ‘memory of historical suffering’, which has central place in the Estonian imaginary. The nation has survived despite seven hundred years of foreign occupation, most of which were spent in serfdom (Feldman, 2000). I was personally able to observe a certain sense of historical injustice during informal discussions with Estonian acquaintances. During my years in Tallinn, I heard many non-Estonians call Estonians ‘stone-faces’ because they seldom smile. Below is an Estonian response:

“Foreigners don’t understand why we don’t smile much, why we are so serious. With a past like ours, we don’t have much to be cheerful about.”

It is not uncommon to hear statements, like “nobody has ever done any favours for us, we are just fine on our own”. My father-in-law has pinpointed the significance of Estonia having an independence day. Although many nations have a national day, many others do not have a day in the calendar to celebrate their independence *per se*. In his

words, “it is natural for a country like Holland to be independent, they take it for granted”. Estonians cherish their independence. Comparisons to Estonians’ collective memory of historical injustice could be drawn with the impact of the Hungarian revolution of 1848-1849 on the Hungarian imaginary. Allegedly, on October 6, 1849, to celebrate Habsburg victory, the Austrian generals witnessing the execution of the Hungarian revolutionary government said toasts clinking their beer mugs. As a reaction, Hungarians vowed not to clink beer glasses or mugs for the next 150 years. Indeed, until 1999, I do not remember any Hungarian doing that. Despite the expiry of the oath, many still refrain from it.

The concept of ‘living on the border of the Western world’ has imprinted itself on the nation’s imaginary, which has been described as ‘Nordic’, ‘Hanseatic’ or ‘Balto-Scandic’. Numerous writers (Smith, 2001; Kahk and Tarvel 1997) have labelled the country and its economy as provincial, existing on the peripheries of its larger and more powerful neighbours. Taagepera (1993: 18) describes Estonia’s geopolitical and position as “unenviable”.

“The climate left them too marginal to sustain the demographic mass that enabled Lithuanians to assert themselves in favourable time and to survival in bad times. But geopolitically, the Estonians were not sufficiently marginal to be left in relative peace, as the Finns have been... many parties often thought the land of the Latvians and Estonians worth fighting over – and without giving them any say in the matter. Repeatedly, sheer demographic survival became precarious. It still is.” (p. 18)

The following comment by Margus Laidre on the country’s precarious geographical location gives an insight:

“...we have many things to complain, starting from geography but as the Poles said before the Second World War, we will fight geography. Well, we cannot. I proposed my colleague from Luxemburg to change places but he didn’t agree.”

Estonian independence in 1918 as well as the break from the Soviet sphere in the late 20th century were beyond the control of the Estonians. The Bolshevik revolution and Lenin’s realisation that they could not defend Estonia from the German army (Taagepera, 1993) provided a unique opportunity for sovereign statehood, which Estonians successfully exploited with armed struggle (Lieven, 1993). The First Republic ended with the Soviet annexation in 1940. Estonia’s regaining of its independence was facilitated by the collapse of the Soviet Union, paralleling the

situation in the turbulent years of 1917-1920 (Raun, 2001). Tiit Vähi⁸ highlights the significance of exogenous geopolitical forces determining the destiny of Estonians:

“Russia twice supported Estonian independence. Russia was the first to recognise the independence of Estonia on August 24 (in 1991). Initially it was Lenin who gave independence to Estonia in the 1920s. That was the first time when Estonia became independent... That time it was a collapse in Russia. The second time Yeltsin signed the decree. Yeltsin and Rüütel⁹ signed an agreement between Russia and Estonia about independence. At that time already the Soviet Union collapsed.”

Lieven (1993) raises an interesting point. Had the Czarist regime survived World War I in Russia, Estonia along with Latvia may have stayed within Russia. Taking this argument one step further, if the February revolution of 1917 and the Russian Provisional Government had lasted and had the “nascent Russian democracy” (Taagepera, 1993: 42) not been abruptly ended by the Bolshevik revolution in November 1917, Estonia might not have declared independence in 1918 with far reaching consequences seventy years later. As Lieven (1993) argues, the last years of Czarist rule were of prosperity and social progress in the Baltics. Furthermore, even if they had declared independence, if Lenin had insisted on keeping the Baltic provinces within the Soviet Union, their independence would have been short-lived. Without the experience of independent statehood in the First Estonian Republic Estonian aspirations for independence in the late 1980s and early 1990s would have possibly been weaker and the post-socialist Estonian objective of ‘return to the west’ would have sounded hollow. As discussed chapters Six and Seven, the First Republic served as a reference point to policy makers in the country’s post-socialist transition. Structure constrained Estonian agency to a significant degree. Not having control over one’s destiny has imprinted itself on the Estonian imaginary. However, once it loosened Estonians took advantage of their opportunities. The significance of the memory of independent statehood is discussed in section 5.4.

5.3.2 Discourses of the Estonian self-image

As Feldman (2000) states, studies of the Estonian imaginary need to move away from the conventional East/West dichotomy. As a prominent Estonian stresses

⁸ Prime Minister of Estonia 1990-1992 and 1995-1997

⁹ Chairman of the Supreme Soviet of the Estonian Soviet Socialist Republic from March 29, 1990 to October 6, 1992.

“I hate this ‘western’ and ‘eastern’ term – even more, I don’t think that ‘old’ and ‘new’ Europe is relevant.”

An examination of the causes of Estonia’s policy choices must account for the nation’s resources and capabilities, including its ability to convert the geopolitical interests of its powerful neighbours, such as Germany, Scandinavia and Russia, into economic and political stability.

Based on my experience and interviews, I agree with Feldman’s description (2000: 406) of four identity narratives: “Estonia as a reconstructed state and society, Estonia as European, Estonia as Finno-Ugric, and Estonia as Nordic”. These narratives compose a self-image of Estonians as a Nordic nation of Finno-Ugric origin with close historical, cultural and economic links with Scandinavia reflecting European values of ‘civil society’ and a free-market economic orientation, which has been reconstituted following the collapse of the Soviet Union.

Estonia as a Nordic nation

Estonia’s Northwest European self-image is firmly rooted in its millennia-long relations with the Nordic countries, which left its imprint on architecture, culture and mentality (Piiramäe, 1997). Fifty years of Soviet rule is construed as domination by an alien culture over a country of ‘European values’. Collectivism forced upon Estonia significantly enhanced a sense of foreign domination during the Soviet era (Kalmus and Vihalemm, 2006). Estonians managed to keep an inner distance from the norms and values of Soviet life, which was reflected in the low proportion of native Estonian members of the Estonian Communist Party, estimated at around one third of the whole membership in 1970. Indeed, other parts of the USSR viewed the Estonian Soviet Socialist Republic as the ‘near abroad’ and ‘Soviet Scandinavia’ (Taagepera, 1973; Misiunas and Taagepera, 1993; Lauristin, 1997).

Estonians’ self-perceived Nordic identity has been reflected in the objectives of ‘return to Europe’ and ‘closing the income gap with Finland’ of Estonia’s post-socialist administrations. Their economic and cultural links with the Scandinavian countries and Germany throughout the centuries greatly influenced the people of Estonia (Piiramäe,

1997). Numerous respondents cite geographical location as a positive contributor to the country's relative success in transition.

"You can see around the world all rich countries are close to each other... Estonian location with its sea and rich neighbours... The location of Moldova is closed in by Ukraine and Romania, with no sea. The country is the same size as Estonia. It's difficult to have a success story in these surroundings. And maybe history and culture even, because here we had long Baltic German power with its culture for seven hundred years... (interview)

In the eyes of Estonian policy makers, Estonia's rightful place is in developed Northern Europe. My interviewees expressed their aspiration in the simple term of "putting Estonia back on the map of the free world".

Estonians dislike conformity. They do not like to be called Balts despite their geographical location and their recent common struggle against Soviet occupation. To them the term 'Baltic' is merely a geographical term, as their ancestry, language and culture is distinctly different from Latvians and Lithuanians. They resent the label 'post-Soviet'. Despite their geographical location in North-eastern Europe, they distance themselves from the 'East' and associate with the 'West'. They take pride in their Finno-Ugric roots and proximity to Scandinavia (Lieven, 1993; Piirimäe, 1997; Smith, 2001). Their national consciousness is strongly based on their Finno-Ugric language and culture mixing tribal, pagan and Christian elements (Lieven, 1993). When Friedrich Reinhold Kreutzwald wrote Estonia's national epic, *Kalevipoeg*, between 1857 and 1861, he held *Kalevala*, the Finnish epic, as a model. In his work *Kalevipoeg* (son of Kalevi), a central figure in Estonian folk-tales, is a strong but imperfect individual, a symbol of "national redemption" who promises "one day to liberate his people from the evil oppressor" (Clemens, 2009: 173). According to Lieven (1993), *Kalevipoeg* is an 'organic' development of Estonian culture, as it represents Estonian values of non-aggressiveness. Anderson (1991) discusses nationalism in terms of cultural systems and highlights the significance of cultural products, such as novels and newspapers on 'imagined communities', i.e. nations. His description of novels as a "form of imagining" (p. 27) applies to *Kalevipoeg*, as it is embedded in a specific society. Borrowing his assessment of a Mexican novel of 1816, *Kalevipoeg* can be seen as the "national imagination at work in the movement of a solitary hero through a sociological landscape of a fixity that fuses the world inside the novel with the world outside" (p. 30).

Estonian culture is deeply rooted in paganism. The nation was integrated fairly late into the feudal system and Christian culture; some parts of the population were not converted into Christianity until the 17th century. The eastern shores of the Baltic Sea were the last non-Christian area of Europe, west of the river Volga. Nordic traditions greatly influenced Estonian culture and religion. To ancient Scandinavians as well as Estonians Thursday was the most important day of the week, instead of the Christian tradition of Sunday, a tradition that survived well into the 18th century. According to some researchers, the Estonian word for Christmas (*jõulud*) is a manifestation of the cult of the winter solstice, as the word originates from the Swedish word (*hjul*) that depicts the disc of the sun (Lieven, 1993; Piiramäe, 1997). Paganism still manifests itself in Estonian culture with its very tight links with nature. Estonia's mostly urban population maintains close ties with the countryside. Environmental issues were a focus of protests in the late 1980s in Estonia. It was through demonstrations against the expansion of phosphate mining in the north-eastern part of the country that open opposition to Soviet rule began in the late 1980s (Miljan, 1989; Taagepera, 1993; Lieven, 1993; Lauristin, 1997; Anderson and Romani, 2010).

Christianity in Estonia played a secondary and superficial role. The clergy, who were mostly of foreign origin, in the eyes of people were "subordinate to the nobility and served as tools for the maintenance of their privileged class position" (Raun, 1999: 347). Pastors were viewed with suspicion as Estonians suffered at the hands of the foreign nobility. Over centuries of Danish, German, Swedish and Russian domination the local elites had been gradually assimilated or destroyed leaving Estonia with what Lieven (1993) calls an essentially 'peasant culture' with suspiciousness as a salient feature, which manifests itself in the Estonian attitude to hospitality. A guest is not to be trusted and is someone to watch closely (Lieven, 1993; Raun, 1999). An interviewee dwells on the suspiciousness and mistrust of Estonians:

"One characteristic is that we are suspicious. We are listening, listening, sometimes we follow but when we get suspicious, then we stop and choose our own way... and also, the stubbornness. So even if we feel that something is good but is imposed on us, we say 'no, no, no, that's not the way'."

Estonian suspiciousness of outsiders and single-mindedness demonstrated itself in the country's re-introduction of its own national currency and its rapid trade liberalisation,

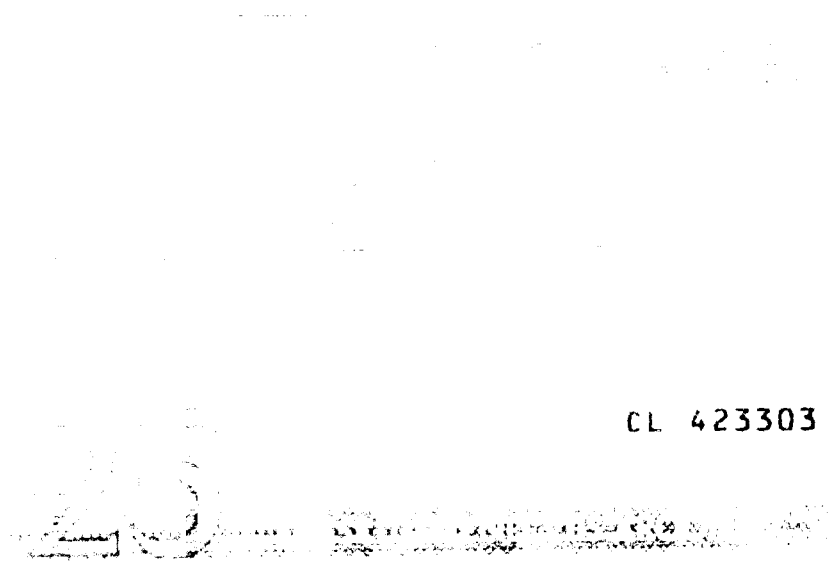
which took place against the explicit advice of international organisations in 1992. These will be detailed in Chapter Seven.

Individualistic Estonians

Their resilient and hard-working nature is coupled with egoism and a large dose of individualism (Lieven, 1993) manifesting itself in their preference of technology over human contact. As Lieven (2002: 254) puts it, “hope for technological-scientific solutions rather than cooperation with fellow humans naturally ties to the belief in hard but individual work”. This statement is supported by such statements - “Estonians are a relatively individualistic nation” (interview). Individualism can be observed in the setup of Estonian villages whereby houses are scattered around and seem inner-oriented. This inner-looking arrangement can be seen on the back of the Estonian 25 Kroon bill.

Figure 5.2 Traditional Estonian village houses

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As one Estonian commented – “we don’t have neighbourhood watch; we do neighbour-watching instead.” Estonia is very scarcely populated; it is the second most sparsely populated country in Europe with an area of Denmark but only one-fifth of its population (Statistical Office of Estonia), which leaves limited opportunities for socialisation. From personal experience I agree with Lieven (1993) that Estonians avoid crowds and cherish personal space. One of the biggest Estonian holidays is Jaanipäev, when Estonians celebrate summer solstice with massive bonfires. On midsummer night the beaches and rural areas are spotted with hundreds of separate fires of the different

groups of families and friends. Kalmus and Vihalemm (2006: 114) refer to this as “pure individualisation” or modern, “atomised” individualisation where the “acknowledgment of mental similarities is not linked with one’s neighbourhood or position in the socio-economic structure and is probably not regarded as a basis for common social activity”. Their ‘radical individualism’ is illustrated in post-socialist Estonia in low levels of trade union membership, which is elaborated further in Chapter Eight.

Numerous interviewees describe Estonian people as “very suspicious”. One respondent goes as far as calling them “masochistic”. An interviewee summarises the Estonian character:

“The character of Estonians is different... When we speak about Estonians, they are very calm people, very sceptical, very ironic people and all this means that since the very beginning, after regaining independence, they were full of enthusiasm and energy but at the same time they were continuously very critical.”

There is a very strong distinction between one’s in-group and out-group. Estonians tend not to accept foreigners into their in-groups, as I learned from my own personal experience. As a newcomer to the country, I asked my local colleagues for guidance about how to spend my free time in Tallinn. In response, a copy of an Estonian-language newspaper was thrown in my way. Asking for advice is rare. A common response to seeking advice is “it’s a free country, do what you want”.

Stubbornness and suspicion were strongly reflected also in the construction of post-socialist Estonia, particularly in their attitude to external help. A leading politician recalls meetings with Westerners who offered unsolicited advice during the early years of independence:

“...we had a huge inflow of different adventurers, bad adventurers but also people who now thought that ‘everybody is so stupid that I can now make academic capital’, for instance. For example, three men wrote a book ‘Monetary Reform for Estonia’ and they were very angry that I refused saying ‘go away with your book’... I was not interested. They all think that we, local decision makers are inferior...”

Calling outsiders offering advice ‘bad adventurers’ demonstrates the closeness of their society and their mistrust of outsiders. Many interviewees stressed the limited participation of external advisors in policy formulation; they relied mostly on local Estonians and the Estonian diaspora. They brought up their sceptical, suspicious and

impassive nature as one reason for their avoidance of external interference in their affairs and for the local origin of the economic policies of the 1990s. My personal Estonian experience confirms these findings. Many of my foreign colleagues tried to work as consultants to Estonian organisations with very little success.

Estonia's national flag with its blue black and white colours captures the essence of the Estonian character with its stoicism, impassivity, restraint and practicality. A common explanation of what these colours represent among Estonians, which is also mentioned by Lieven (1993), is that blue reflects the sky above Estonian land, black symbolises soil and the historic struggle of Estonians and white stands for purity. Blue is also the colour of Estonia's national flower, the cornflower. I have come across another and rather sarcastic version of the interpretation of these colours, according to which white (submission to foreign rule) is the result of blue (repeated beatings) and black (mourning). I find both apt reflections of the Estonian mindset with its qualities of resilience, stubbornness and down-to-earth pragmatism.

Culture and its consequences

Estonian political movements are deeply “rooted in traditions of cultural resistance created by the people who had lived through centuries under foreign rule” (Lauristin, 1997: 74). Their national consciousness has been heavily influenced by the nation's geographical, economic as well as cultural links with the Baltic Sea region. The establishment of widespread literacy and education in Estonia dates back to Swedish domination in the 17th century, which is a recurring theme in conversations today, particularly in the form of wishful thinking - “had the Swedish times lasted...” 160 years of Swedish rule alleviated the lot of Estonians. The Swedish – as well as German – influence fostered the country's development of culture, education, philosophy and science along the lines of West-European enlightenment and helped instil the concepts of individual liberty, accountability and rationalism (Lauristin, 1997). Anderson (1991) underlines the ideological and political significance of the emergence of print media in the strengthening of nationalism in Europe. By 1850, 90 percent of the rural population was literate facilitating the diffusion of national consciousness, as people were urged to think for themselves cultivating a sense of human dignity (Lieven, 1993; Smith, 2001; Clemens, 2009).

Norkus (2007) points to the Pietist cultural legacy as an important determinant of Estonian policies of the late 1980s and 1990s. Although all three Baltic Republics experienced ‘only’ five decades of Soviet rule, as opposed to seventy years in other parts of the USSR, Estonia’s economic performance surpassed those of Latvia and Lithuania. He goes as far as labelling Estonians ‘Baltic Lombardians’ to signify their industrious nature. Miljan (1989) contrasts the work ethic of Lutheran Estonians with the “anti-Protestant work ethic in Russia”, as the main obstacle to Gorbachev’s attempts to reform the Soviet economy in the late 1980s. He cites (p. 150-151) an article written in *The Economist* in 1988:

“Estonia, probably the richest of the 15 Soviet republics, is in the fast lane of perestroika, testing changes before they are introduced in the rest of the country... You do not have to be a sociologist to notice that the Russian attitude toward work is often less than diligent... The real problem of inertia is in the Russian republic, which contains half of the Soviet population. If you have read your Gogol or Goncharov you will know that inertia is no new phenomena there. But it has certainly not improved under Communism.”

However, as Norkus (2007) explains, the Estonian population associated Lutheranism with their German landlords, whom they resented. Protestant pastors, many of whom were Germans with poor command of Estonian, were regarded as representatives of the German landed class. The Pietist ‘Herrnhuter’ or Moravian Brethren movement spread its missions to Estland and Livonia in the 18th century. The ‘Herrnhuters’ were firm believers in piety and virtues. Despite the ban of the Russian government of their community, their influence contributed to a marked decline in drunkenness, petty crime and premarital births. The values of temperance, personal hygiene, choral singing, self-education and hard work were encouraged. While modernisation eradicated the religious roots of the Pietist cultural legacy, Herrnhuters over time gained a reputation for reliability and a no-nonsense mindset and they were more likely to be appointed as managers and public officials (Norkus, 2007). An interviewee discusses the value system of Estonians:

“...Estonians throughout the history have been quite down to earth, quite realistic, stubborn, and even, which I don’t regard as a compliment necessarily, materialistic. Therefore, as it has always been, very important to Estonian to have safe, good home, why not a house, to have a car, etc. materialistic belongings, a good life.”

Norkus (2007) considers their secularised, individualistic and achievement-oriented qualities as significant contributors to Estonian economic development and

urbanisation. By the end of the 19th century over two-thirds of Estonia's population lived in urban areas (Raun, 1984). The increase in urban populations saw the emergence of a new native professional class and intelligentsia which increasingly resented Germanisation as a precondition for social progression. Indeed, Baltic Germans were viewed with mistrust and enmity throughout generations due to their oppression of the Estonian peasantry and their condescending attitude towards Estonians. The University of Dorpat (present-day Tartu University) became a 'champion' of nationalism when it introduced instruction in Estonian replacing German in 1894. The intensified Russification of the late 19th century, which entailed the incremental use of Russian language instruction in schools, met with strong Estonian opposition. They increasingly resented the fact that the language of the state was not the language of the population (Anderson, 1991; Lieven, 1993; Raun, 1999; Smith, 2001).

Due to their small population size, they traditionally expressed their opposition through culture instead of armed resistance (Taagepera, 1993; Lieven, 1993; Raun, 1995). A strong awareness of Estonian cultural identity is embodied in singing. It is a symbolic weapon; 'singing matches' – non-violent singing competitions - have been recorded in Estonian folklore (Lieven, 1993). Annual song festivals have been organised since 1869, which gained special significance during the Soviet era, as this was a form of legal gathering through which they could openly show their national allegiance. The annual singing festivals in Tallinn were a symbol of their fight for independence and opposition to Soviet oppression. There seems to be a contradiction between Estonian individualism and the importance of the annual singing festivals. However, in Lauristin's (1997: 74) words, the song festivals became "open manifestations of national feelings" and a "shared experience of sustaining national identity". The significance of singing festivals in the Estonian imaginary can perhaps be best explained with Anderson's summation of the symbolism national anthems (1991: 145).

"... nothing connects us all but imagined sound... There is a special kind of community which language alone suggests – above all in the form of poetry and songs. No matter how banal the words and mediocre the tunes, there is in this singing an 'experience of simultaneity'. At precisely such moments, people wholly unknown to each other utter the same verses to the same melody. The image: unisonance."

The ‘Singing Revolution’ epitomised the peaceful nature of Estonian resistance to Soviet rule rooted in Estonian tradition. The singing festival in 1988 turned into the ‘Singing Revolution’, an overt expression of defiance and victory against foreign occupation. Indeed, Estonians claim to have ‘sung their way to freedom’ (Lieven, 1993; Lagerspetz, 2001). On August 23, 1989, on the fiftieth anniversary of the Molotov-Ribbentrop pact, 2 million Estonians, Latvians and Lithuanians formed a continuous human chain of roughly 550 kilometers between the capitals of Tallinn, Riga and Vilnius in protest to Soviet occupation (Miljan, 1989; Raun, 1995). Clemens (2009) points to culture and its symbolic expressions, such as singing, as the roots of ‘soft power’ that enabled Estonians, Latvians and Lithuanians “to endure centuries of foreign domination by foreign powers and emerge in 1918-1920 as independent nation states” and facilitated their re-emergence in 1991 as they “skilfully converted to undermine foreign rule and promote self-rule” (p. 170). As Andres Tarand¹⁰, recalls,

“...this powerful machinery of the Soviet Union. They were here and we had to calculate their power and our power and as a result we can say that we were right that we did it not with force but singing.”

Hundreds of years of foreign suppression led to an intense sense of nationalism. Due to Estonia’s small population, small geographical area and flat terrain, armed resistance was futile, giving rise to stoicism, suspicion, pragmatism and a passive but stubborn resistance. As in Finland where rising popularity of folklore and poetry, and the publication of novels and periodicals in the vernacular language led to the emergence of a literary language serving as a vehicle for the advancement of political demands (Anderson, 1991), the Estonian intelligentsia saw the protection of Estonian folk culture and education in the Estonian tongue as the principal factor in national survival, which was the focal point of resistance to Germanisation in the 19th century and to Russification in the 20th century (Lieven, 1993). Estonian leaders saw Estonia more as a cultural community than a territorial unit, to the extent that “political independence was not an issue before 1917” (Taagepera, 1993: 31). Their goal was “autonomy within a democratic Russian Federation” (Lieven, 1993: 55), which was ended by the Bolshevik revolution in 1918.

¹⁰ Prime Minister of Estonia, 1994 – 1995, Member of the Estonian Parliament 1992 - 2004

5.4 The ‘living memory’ of the First Republic

5.4.1 The First Republic as a reference point

The First Republic has enormous economic, political and social significance in Estonian consciousness, memories of which were kept alive in families throughout the Soviet era (Lauristin, 1997). The ‘golden era’ of the First Republic, which existed between 1918 and 1940, is subject of what Lieven calls (1993) ‘un-analysed nostalgia’, as little discourse has taken place regarding its various aspects. The strong desire to ‘catch up with the West’ among Estonians in the post-socialist era was significantly enhanced by the experience of the First Republic in the interwar era when life expectancy in Estonia was higher than in Finland. Between 1925 and 1934, Estonia occupied 12th place on the ranking of national per capita income level in Europe (Arkadie and Karlsson, 1992; Vihalemm, 1997). According to Lieven (1993), western visitors were impressed by the affluence of the population in the 1930s.

Its ‘living memory’ is crucial in understanding Estonia’s post-socialist transition because it is a major force in shaping Estonian thinking and subsequently policy making underlining the significance of path dependence. Unlike the non-Baltic FSU states, Estonians had the experience of independent statehood, which was emphasised by all of my interviewees. Estonia’s declaration of independence on 20 August, 1991, is not regarded as the birth of the Third Republic – the second one being the ESSR - or the Second (independent) Republic but signifies the end to Soviet power in Estonia and the restoration of the Estonian Republic along the ‘principle of legal continuity’. In effect, it is a restitution of the First Republic (Lieven, 1993). Holding Independence Day celebrations on February 24, the anniversary of the birth of sovereign Estonia in 1918, instead of August 20, which marked the declaration of independence from the USSR in 1991, underlines the continuity of the Estonian state and its strong links with the First Republic.

The actual presence of people with first-hand experience of an independent homeland with high standards of living based on a well-functioning market economy and democratic civil society had a major impact on Estonian consciousness. Today’s political parties, their ideologies, work practices as well as state institutions are based on those of the First Republic (Lieven, 1993; Smith, 2001). Its living memory has kept

entrepreneurial spirits alive. According to one interviewee it “reduced uncertainty” in the early 1990s by providing policy makers with some sort of a reference point. Many of the survivors of the First Republic took an active part in devising the experimental policies of the second half of the 1980s, taking advantage of Gorbachev’s policies of *glasnost* and *perestroika*. Due to the limited knowledge of younger Estonians in the functioning of a market economy and lack of access to foreign advisors, they offered much needed expertise. As an economist points out, in the early years of transition

“...there were only two persons in Estonia who knew something about taxation. Two persons for the whole of Estonia!”

To make matters worse, as he recalled, the background of one of these experts was in cybernetics. Tiit Vähi emphasises the significance of the living memory when asked about the involvement of external advisors:

“As you ask, who were the main advisors who assisted and helped... in Estonia before August 1991 we did not have western advisor groups. Where we got this information for us? Very important it is to stress that fifty years ago we already had our independent state, so we had already our experience.”

Survivors of the First Republic had direct experience of entrepreneurship and of a market-economy. In the post-socialist years, policy makers relied mostly on them, such as Rudolf Jalakas who emigrated to Sweden in 1946 and worked as an economist in various senior banking positions, and the descendants of émigrés for advice, like Ardo Hansson, a Harvard PhD and senior economist at the World Bank. They were instrumental in steering the Estonian economy in the first years of post-socialist independence. The reliance on Estonian know-how was an outcome of a combination of the Estonian character with its suspicion of outsiders, self-reliance and the presence of survivors from the First Republic, who in the words of one of the interviewees, “had carried over this memory”. All respondents rate Estonia’s policies more successful than the post-socialist transition of other states and contribute it to the

“...living memory. The Ukraine and Georgia didn’t have such experience that we had. It was in our minds and hearts and soul.” (interview)

The existence of pre-war independent Estonia had not only sentimental but also very practical consequences. The foresight of the Estonian leadership in the 1930s made it

possible for policy makers sixty years later to escape the rouble zone and its hyperinflation by introducing their national currency. Urmas Varblane¹¹ explains:

“... there is another factor, which is important, it is the statehood in the 1920s. It is a social memory. It still existed, this living memory. And it was not simply in an informal way. You know how Estonia was able to execute its currency reform? ...Estonia in the 1930s kept its gold reserves in Sweden, UK, Switzerland and the US... And this money was used in order to execute this currency board type of monetary reform. Otherwise, we had no money.”

Estonia's monetary reform, including the reintroduction of the Kroon as the national currency in June 1992, was made possible by the recovery of the eleven tons of gold bullion reserves of the interwar republic from Britain and other western countries (Smith, 2001). The currency reform is another example of indigenous Estonian policy making, as they went ahead with it despite the explicit disapproval of the IMF. The ensuing stabilisation of prices and the resumption of growth ahead of other CEE economies subsequently vindicated them (Gros and Steinherr, 2004).

The First Republic is relevant from the point of view of continuity of policy formulation as well, which is parallel to that in post-socialist Estonia. Between 1920 and 1934, Estonia had seventeen governments lasting an average of nine months. Despite the frequent changes in the country's administration - the nation has seen eleven governments since 1991 – policy makers have stayed the course of neoliberal policies. Both today and in the interwar era the key personnel within the successive administrations changed very little (Smith, 2001). Mart Laar¹² explains:

“...when we look at the background of these policies, many of them come from history... You always learn from the good things and the mistakes. One thing that we found in Estonian experience is that the 1920s was the fastest time of Estonian development. The governments were changing even faster than currently in Estonia... Nevertheless, the politics stayed very steady and I was greatly interested in how they achieved it. Then we talked with some people, we looked at it and it was very easy to see how they did it and this became the basis of our public administration reform. Even though politicians are changing, we should keep the course. And that was one of the best things that we did. And I must say, looking back, once again, that was one of the most important decisions and it had nothing to do with the economy.”

¹¹ Member of the Supervisory Board of the Bank of Estonia

¹² Prime Minister of Estonia 1992 - 1994 and 1999 - 2002

Although policy makers came and went, the ‘change agents’ in Kelsey’s (1995) words, a group of civil servants responsible for policy implementation stayed. The First Republic is a significant anchor in Estonian politics. It is a crucial reference point for contemporary politicians and advisors, as they look back to those two decades as a template for setting up institutions, forming policies and deciding on issues.

5.4.2 Western attitudes to Estonian independence

Estonian single-mindedness and suspiciousness were aggravated by the ambivalent attitude of the western powers regarding Estonia’s status as an independent nation three times in one century in 1918, 1940 and 1991 (Trapans, 1994). On all these occasions the major geopolitical powers ignored the will of the Estonian people (Piiramäe, 1997). In 1918, the USA was reluctant to officially recognise Estonian sovereignty. Estonia found its interests overshadowed by the West’s ‘Russia first’ policy in 1940 when Soviet invasion led to the incorporation of the Baltic States, including Estonia, into the USSR ending its sovereignty. Although “three member states of the League of Nations suddenly vanished from political existence and came under foreign occupation” (Lange, 1994: 233), western concerns to maintain the anti-Nazi alliance with the Soviet Union during World War II and to preserve the status quo during the Cold War precluded any active support for the Baltic States, including Estonia, leading contemporary radical nationalists to accuse the West of ‘treachery’ and ‘cowardice’ in their Baltic policy. Besides Nazi Germany only the Swedish government gave recognition to the annexation of the Baltic States in the Soviet Union in 1940. They added ‘insult to injury’ by handing over the keys of the Estonian embassy in Stockholm to Soviet representatives and by giving the country’s gold reserves, which was part of what the Estonian Republic had transported to the West for safekeeping, to the Soviet State Bank. The annexation of Estonia, the West’s ‘Russia first’ policy and fifty years of Soviet rule accompanied by Russian immigration on a massive scale stoked nationalistic sentiments and suspiciousness (Lieven, 1993; Piiramäe, 1997; Smith, 2001). Taagepera (2009: 452) describes the West’s perception of the First Republic as a “random vagary of history”, and the Soviet annexation in 1940 as a restoration of “the usual order”. He argues that the West preferred *status quo* and showed little regard to the fate of the Baltic States. An example of this indifference is that the *Encyclopedia Britannica* replaced all headings relevant to ‘Estonia’ with the ‘Estonian SSR’ entry.

which only included a brief description of its economy. In western eyes, Estonia “vanished from the map... No history, no people” (Taagepera, 2009: 452).

Their sense of abandonment and of being let down by the international community has fed their sense of the need to ‘go it alone’, a feeling that was to be resurrected again in the late 1980s and early 1990s. No country aside from Nazi Germany and Sweden recognised the Soviet annexation of Estonia, creating the interesting situation that the Baltic States existed as independent nations *de jure* between 1940 and 1991 but *de facto* they were an integral part of the USSR. The Baltic States were allowed to retain their embassies in some western capitals where Estonian diplomats stayed and continued working. The publication of the secret protocols of the Molotov-Ribbentrop pact in the summer of 1989 greatly encouraged the Baltic States’ aspiration for independence, as it was the equivalent of an admission of the illegitimacy of Soviet rule. The declaration of independence of the Supreme Councils of Lithuania, Latvia and Estonia in the spring of 1990 met with a muted response from western leaders who were preoccupied with gaining Gorbachev’s approval for their policy in the Persian Gulf. In a speech in Kiev in 1990, President George Bush (Senior) advised the Baltic States to ‘soft-pedal’ towards regaining independence (Lange, 1994; Trapans, 1994; Smith 2001; Taagepera, 1993 and 2009). In 1990, the foreign ministers of the Baltic States repeatedly tried to join the Conference on Security and Cooperation (CSCE) in Copenhagen in June, Vienna in July, La Valetta in January and February, and Krakow in May and June 1991 unsuccessfully. In June 1990, they were invited to observe a summit meeting in Paris but were asked to leave at the request of the Soviet delegation. By summer 1991, Estonian officials came to the realisation that the Western powers viewed Baltic aspirations for sovereignty as jeopardising Gorbachev’s reforms (Raun, 1991; Lange, 1994). The cool western reaction to the Baltic independence movements is echoed by Tiit Vähi:

“Frankly speaking, not everybody in ’89 until ’91 supported completely our independence. Sometimes they were not looking at us very friendly.”

In November 1988, Stan Anderson, then Foreign Minister of Sweden, actually advised the Baltic States not to antagonise the Soviet leadership. A year later, during his visit to

Tallinn, he went as far as denying Estonia's annexation by the Soviet Union in 1940 (Piiromäe, 1997).

Margus Laidre recalls the German government's attitude as a telling example of the West's priorities:

"...pretty soon after independence was regained, it was membership in EU and NATO, in order to get on the safe side as soon as possible. And I recall, as I was present myself, how hesitant the then leaders – great Europeans – actually were. To name Helmut Kohl, who said that: "Well, why are you in a hurry to get into EU?" ...for old Helmut it was always a 'Russia first' policy. He even refused to attend the Council of Baltic Sea States summit, which should have taken place in Riga. He delayed and delayed his participation, so the presidency passed from Latvia to Denmark."

Such incidents have strengthened Estonian sentiments of single-mindedness, self-reliance and their sense of living in the shadow of Russia. The lack of western diplomatic recognition and the absence of any political or economic pressure on the Soviet government to withdraw from the Baltic States seriously disappointed the Baltic peoples, Estonians included. Following the Nordic States, Russia, led by Boris Yeltsin, President of the Russian Soviet Federative Socialist Republic, was among the first to recognise Estonia's breakaway from the Soviet Union. Recognition from the western states arrived only after the collapse of the USSR (Lieven, 1993; Trapans, 1994). Rein Ruutso gives an example of the West's approach to Baltic independence:

"It was Yeltsin who recognised us on 24 August and after that everybody did it. If you read Westinghausen's book, Germans suggested to Estonians to start discussions and negotiations with Gorbachev. Germans are Germans! They had special relations with Gorbachev. They got such kind of instructions to suggest such kind of things to Estonians. Westinghausen was the Ambassador here and started to cry – 'you don't realise what is happening in this country and what is the real state of things'!"

Estonia's aspirations to sovereignty over their own affairs have withstood the indifference, and on occasions outright hostility, of the major powers. For over seven hundred years they found their own destiny shaped by external forces with their own agenda, gradually forming a sense of abandonment and self-reliance. If Estonians are victims, it is not of neoliberalism but of geography.

5.5 Conclusion

Path dependence plays a key role in understanding the origins of the Estonian neoliberalism. As recently, as the late 20th century, Estonian sovereignty was decided externally and was overshadowed by the priority of the major geopolitical powers to preserve the *status quo*. Living on the border between ‘East’ and ‘West’ has left its imprint on Estonian consciousness in the form of a collective sense of historical suffering that led to the resentment of external intervention in their affairs.

Over the course of the 20th century, Estonia has undergone a major transformation in national consciousness. Whereas a hundred years ago the aspirations of the nation’s leaders extended to cultural autonomy within Czarist Russia, the existence of the First Republic as a pluralistic society with a relatively well developed economy proved the nation’s ability to function independently. The First Republic provided tangible benefits, such as providing means for post-socialist Estonia’s economic recovery in the form of advisors and the gold reserve, and intangible assets, like the experience of an independent and prosperous state, which proves invaluable in the Estonian imaginary.

History has instilled a need to ‘go it alone’ in Estonians strengthening their resolve and awareness of abandonment and self-dependency. Estonians learned to become self-reliant, which agree with the emphasis of neoliberalism on the responsible individual. Their suspicion of outsiders and aversion of external control defies the theory of hegemonic diffusion of neoliberalism. Having lived in the shadow of neighbouring European powers and having been marginalised repeatedly within the broader ‘Russian question’, the leaders of Estonia were eager to take charge of their own destiny.

Structure restricted Estonian agency. However, when the boundaries of structure expanded, as in 1918, and as elaborated in the following chapters, in the late 1980s and early 1990s, Estonians exercised active agency by deciding to ‘go for it’. Supporting Larner’s (2000: 17) argument, “social movements become visible in these analyses, not simply as victims, but as active agents in the process of political-economic change”.

Chapter 6. The Soviet Era and its Legacy

6.1 Introduction

In the previous chapter I established the importance of path dependence, a theme that continues in this chapter. Seven centuries of foreign domination had instilled self-reliance and individualism in Estonians, which are compatible with the value system of the neoliberal paradigm. The perceived indifference of the major geopolitical powers towards Estonian independence - the belated international recognition of the First Republic and of post-socialist Estonia, and the muted response towards Soviet annexation in 1940 triggered by their preference of *status quo* in the 20th century - led to feelings of abandonment further strengthening Estonians' perception of the need to 'go it alone'.

First I present an overview of half a century of Soviet rule in Estonia then I analyse how Estonian policy-makers interpret Soviet domination. I argue that having experienced half a century of totalitarian and paternalistic Soviet domination, neoliberal theory with its emphasis on liberty, individual responsibility and a minimalistic state made perfect sense to Estonians. Furthermore, the reform experiments of the late 1980s paved the way for the post-Soviet economic policies and prepared the population for the ensuing economic hardship providing post-socialist Estonia's administrations with the 'benefit of the doubt'. Within the strict constraints of structure, reform-minded Estonians exercised agency throughout Soviet occupation. They took full advantage of their cultural and geographical proximity to Finland, providing them with an invaluable 'window to the West'. Soviet-era economic reforms and the country's declaration of independence in 1991 all point to a large extent of active local agency.

The ESSR retained the territory of the First Estonian republic; therefore, I use the terms Estonia and ESSR interchangeably in this chapter. As in Chapter Five, a timeline of historical events will be followed by a detailed discussion of the emerging themes.

6.2 Half a century of Soviet rule

On August 23, 1939, the Molotov-Ribbentrop Pact was signed between Nazi Germany and the Soviet Union with an additional protocol that allocated Estonia, Latvia and subsequently Lithuania to the Soviet sphere of influence. In September, faced with

160,000 Soviet soldiers on its border, Estonia was put under considerable pressure to sign a Pact of Defence and Mutual Assistance with the USSR, which guaranteed Estonian independence, emphasised Soviet non-interference but allowed the establishment of Soviet military bases in Estonia and the movement of 25,000 Soviet troops into the country that outweighed the strength of the Estonian army. On 16 June, 1940, Soviet Foreign Minister Molotov accused the Estonian government of breaking the Pact of Defence and demanded the formation of a new compliant administration. The very next day, the Soviet forces invaded. In July, the sovereign Republic of Estonia became the Estonian Soviet Socialist Republic in the Soviet Union (Misiunas and Taagepera, 1993). On July 22, Konstantin Päts, President of the Estonian Republic, was deported to Ufa in the Soviet Union where he died in a psychiatric clinic run by the NKVD in 1956 (Misiunas and Taagepera, 1993; Lieven, 1993).

In Baltic eyes World War II only ended in 1991. Estonia's population suffered greatly during the Second World War and the following years of Soviet occupation. Approximately 60,000 people were killed and about 100,000 emigrated to the West, including half of all Estonian intellectuals. By the end of World War II, Tartu University lost four-fifth of its pre-war staff. In the late 1940s and early 1950s, the Soviet authorities deported over 60,000 Estonians (Kukk, 1993; Lieven, 1993). "The annexation of Estonia by the USSR in 1940 – and the Second World War – had a disastrous effect...", as the nation's population fell from 1,136,000 in 1939 to 854,000 in 1945 (Kutsar and Trumm, 1993: 129).

By losing control over all of its resources, the ESSR became a provincial economy making up 0.2 percent of the territory and 0.5 percent of the population of the USSR (Dmitrieva, 1996). Soviet rule virtually isolated Estonia from the rest of the world and integrated it into the Soviet Union economically, politically and culturally (Vardys, 1966; Smith, 2001). The ESSR had its own autonomous institutions, such as a parliament, on paper but in reality they were under the hegemony of the Soviet central authorities in Moscow. According to the Constitution of the Soviet Union, each republic had the right to secede. However, this right was more theoretical than real. as the Soviet legal system did not contain any detailed procedures for secession (Dmitrieva, 1996).

The Soviet economic model was imposed on the formerly sovereign Estonian economy, although it was ill suited to its conditions and needs. During the socialist era, Estonian economic output was planned by all-union ministries in accordance with the requirements of the Soviet Union. Estonian industry depended on the USSR for both input supplies and output markets. The decisions and functions of Estonian producers were taken over by a large number of bureaucratic agencies in Moscow (Lavigne, 1999; Gros and Steinherr, 2004). The ESSR was managed in accordance with the Soviet model of socialism based on Lenin's principle of 'democratic centralism' meaning mandatory obedience to central party policy, which was the model for the communist parties in all socialist countries. All political leaders, bureaucrats and economic managers were appointed by or approved by the Communist Party (Swain and Swain, 1998). Estonian organisations were at the lowest level of this strict hierarchy; they were under the control of the central ministries, which were subordinated to *Gosplan*, the central planning authority in the USSR. However, because economic decisions were based on political considerations, *Gosplan* was under the strict control of the highest political authority, the *Politbureau*. Decision-making was "concentrated at the centre, in the upper echelons of the Party bureaucracy in Moscow" (Mettam and Williams, 2001: 137), where investment decisions were taken with the 'colonial interests' of the Soviet central administration in mind, mostly ignoring local requirements and interests (Sutela, 2003; Klesment, 2009). "Local needs were neglected... mainly because of the sectoral administrative structure over the regional one" (Dmitrieva, 1996: 23).

The plight of the Estonian economy invokes Hayek's (1944: 48) assessment of a root problem of central planning:

"It is the essence of the economic problem that the making of an economic plan involves the choice between conflicting or competing ends – different needs for different people... in short, which are the alternatives between which we must choose, can only be known to those who know all the facts; and only they, the experts are in a position to decide which of the different needs are to be given preference. It is inevitable that they should impose their scale of preferences on the community for which they plan."

Essentially, the economy of the First Republic was destroyed (Klesment, 2009). Soviet economic planning, that had been designed for the backwards Russian economy in the 1920s, was implemented in Estonia where the level of economic development was higher than in the USSR. Private property was nationalised without compensation and

brought under the control of ministries and subordinate directories. Commercial banks were dismantled and replaced by banks that performed only one pre-defined task, such as savings or investment or foreign trade. International trade became the sole domain of specialist foreign trade organisations, which had a monopoly over dealing with foreign currency and converted the world prices of imports and exports into domestic prices. All organisations were isolated from external trade by the 'price equalisation system', whereby domestic firms encountered the domestic price of their imports or exports only (Swain and Swain, 1998). Over a thousand enterprises were transferred into state ownership with their former owners simply removed and sometimes deported. Estonia's relatively good infrastructure, oil shale and phosphate deposits received a lot of attention from Soviet planners. Local natural resources were placed at the disposal of all-union industrial producers, which they took full advantage of. Producers located in Estonia received their input from other parts of the Soviet Union, which they used in production of goods not destined for the Estonian market (Miljan, 1989; Klesment, 2009). Soviet regional policy consisted of a 'hub and spoke' system with all organisations subordinated to the central Councils for National Economy, regardless of their location or specialisation. In essence, Soviet regional development was paramount to de-regionalisation caused by the large degree of dependence of organisations on the central authorities and their isolation from each other. The Soviet economy was a vertically integrated system with minimal, if any, horizontal collaboration (Dmitrieva, 1996; Smith and Swain, 1998; Sutela, 2003).

Regardless of whether Estonians wanted or needed heavy industry, the preference of Soviet planners led to fast-paced industrialisation requiring a large workforce, which Estonia did not have. Between 1940 and 1960, Estonia had the highest growth rates of industrial output in the Soviet Union among the republics, as a percentage of the USSR (Dmitrieva, 1996: 43). However, Estonia's massive population losses between 1939 and 1949 decreased its labour force to a level that was insufficient to support industrial development on such a scale necessitating the inflow of workers from other Soviet republics. Approximately 145,000 non-Estonian, mainly Russian, workers moved there between 1945 and 1949 causing significant changes in the country's ethnic composition. Whereas in 1935, 87.7 percent of the nation's population were ethnic Estonians, that ratio decreased to 61 percent by 1989 (Smith, 2001). Mettam and

Williams (2001: 134-135) characterise Soviet industrial development and the accompanying repatriation of large number of non-Estonian labourers to the ESSR as “internal colonialism”, in which industrialisation occurring in the “periphery is typically dependent on and complementary to the core economy”. The Russian-dominated Soviet core aimed to integrate the territories of the USSR into one ‘national economy’. As the non-Russian peripheries were managed by the central authorities in Moscow, Estonia benefited from only a small portion of its own production. For example, 80 percent of Estonian electricity output was used to meet the needs of Leningrad. As a result of Soviet centralisation, by the end of the 1980s, “Moscow controlled more than 90 percent of Estonian industry” (Kutsar and Trumm, 1993: 130).

The economy of the ESSR was dominated by bloated and inefficient industrial enterprises; output was concentrated in a small number of oversized firms. Too few organisations employed too many people resulting in high levels of underemployment and low productivity rates. Regions and entire communities were dependent on a handful of employers (Van Arkadie, Karlsson, 1992). Vertical integration and autarky, which were characteristic of the Soviet economy, inhibited the transfer of ideas, know-how and technology, vocational and managerial skills. Self-sufficient enterprises produced too many goods and carried out too many services leaving little room for specialisation. Prices did not reflect real value because they were determined administratively and not by the market. The absence of competition and protection from international trade hindered economic development (Kornai, 1992; Sutela, 2003; Gros and Steinherr, 2004). The Soviet ‘megalomania’ did not only create large firms but also destroyed small businesses with long-term adverse effects on quality and supply. As a striking comparison, whereas in 1918, newly independent Estonia printed its own postage stamps, 73 years later upon regaining its independence the country had to have them printed in Sweden (Taagepera, 1993).

Economically Estonia fared better than other republics in the USSR; it belonged to the “zone of developed economies” (Privalovskaya, 1984: 43), where output growth rates were “achieved exclusively by growth in productive efficiency” (Dmitrieva, 1996: 159). Due to its geographical location on the Baltic shores in close proximity to Scandinavia, Estonia served as a ‘shop window’ of the Soviet Union to Scandinavian visitors. This

was successfully exploited by Johannes Käbin, the First Secretary of the Estonian Communist Party, who was one of numerous 'Russian Estonians', whose ancestors emigrated to Russia between 1850 and 1920. The Soviet authorities distrusted "anyone who had not undergone twenty years of Sovietisation in the USSR" (Taagepera, 1993: 78) but ethnic Russian officials had serious language difficulties in Estonia. Thus thousands of Estonian Russians moved back to Estonia, Käbin among them in 1941. By 1948 he became a secretary of the Estonian Communist Party (ECP) and was appointed First Secretary in 1951. Käbin, who re-Estonianised his name from Ivan Kebin and over time considerably improved his Estonian language skills, facilitated the advancement of native officials, to whom the needs of the local population came first. He worked relentlessly to achieve the special status of 'experimental republic' for Estonia, which had numerous benefits. Unlike his predecessors, who obediently implemented Moscow's policies, Käbin attempted to keep Estonia's fate in Estonian hands (Vardys, 1966). The ESSR retained Estonian as the language of instruction in education, which discouraged students from other parts of the Soviet Union to study in Estonian schools. Unlike the residents of other republics, Estonian graduates were not required to work elsewhere in the USSR (Kukk, 1993; Misiunas and Taagepera, 1993).

Estonian agency manifested itself in the arts as well. In the 1960s, a new generation of artists, musicians and writers appeared on the Estonian art scene. The Estonian city of Tartu hosted the first ever Soviet jazz festival becoming one of the centres for abstract art in the Soviet Union. Unlike in other parts of the USSR, the avant-garde movement was supported by the local population and accepted by local party bureaucrats. Whereas Estonian avant-garde artists exhibited their works in public galleries, in Russia they could only exhibit in private apartments, as that art form was banned (Misiunas and Taagepera, 1993). Khrushchev's assessment of modern artwork that it "seemed to have been done by a donkey's tail" (Doder and Branson, 1990: 146) stands in stark contrast with the tolerance of Estonian officials, as documented by Misiunas and Taagepera (1993: 160).

"“I don't understand them at all”, Käbin, the ECP First Secretary reportedly said at an “experimental sculpture exhibition” at the library of the Academy of Sciences in 1967. “No, you don't have to remove them, I am not a specialist.””

The ESSR greatly benefited from the introduction of self-management as part of a reform package initiated by Khrushchev. Many cooperatives expanded into food processing and diversified into auxiliary light industries. Estonia was able to preserve its status as a testing ground for economic experiments even during the Brezhnev era with its increased centralised control over the republics. Despite the discouragement of private enterprise by the Soviet authorities, private agricultural production was permitted to alleviate food shortages and became a significant contributor to output. In the 1960s and 1970s, household-farming on small plots produced over one-fifth of the total yield (Taagepera, 1993; Klesment, 2009). As a result, between 1958 and 1968, Estonian per capita income rose by 90 percent as opposed to a Soviet average of 67 percent (Smith, 2001).

Estonia was the richest republic in the Soviet Union (Gregory and Stuart, 2001). The relatively high living standards had two causes. The country's economic structure contained a relatively large share of consumer goods production and service activities. Also, due to political considerations Estonia was subjected to less financial withdrawals by Moscow than other republics of similar levels of economic development because of its 'shop window' status. Soviet spatial policies and regional development were based on the relocation of productive forces and budget transfers from more advanced regions to less developed parts of the country. The budgets of the various republics were coordinated centrally. Whereas the less developed Central Asian republics and Kazakhstan were allowed to keep their revenues, more advanced ones, such as the Ukraine, were left with only a proportion, as part of their income was transferred to poorer republics. Estonia, along with Lithuania, belonged to the so called "intermediate group" that were neither donors, nor recipients of payments (Dmitrieva, 1996: 27).

Overall, the pressure exerted by the authoritarian regime was weaker in the Baltic States than in other parts of the USSR. The 'Soviet West' served as a demonstration of prosperity in the Soviet Union to the mostly Finnish foreign visitors (Lauristin and Vihalemm, 1997) who were "flocking to Estonia" since the early 1960s (interview).

However, standards of living in Estonia were much below those of Western Europe. Unlike in market economies, personal consumption in the centrally planned economies

did not grow in parallel with national income levels, reflecting the low priority of consumer goods and services. The shortages in food products and housing were endemic; per capita consumption levels were approximately half of the west. Inferior product quality, frequent shortages and limited range of goods were commonplace (Miljan, 1989; Gros and Steinherr, 2004). The Estonian population did not benefit from their higher than Soviet average productivity rates and efficient agricultural production because the central authorities were constantly increasing the export quotas, which Estonian producers had no choice but to fulfil. In essence, Estonian farmers were feeding other Soviet republics (Miljan, 1989). Due to endemic shortages, people resorted to buying many necessities on the black market at considerably higher prices (Klesment, 2009). To sum up the damage done to the ESSR's economy and the population's standards of living, "the income and consumption level of the Estonian population had dropped to the level of the year 1920; the living standards hardly ever reached the level of the late 1930s" (Kutsar and Trumm, 1993: 130).

Kornai (1992) extensively documented and analysed the chronic shortages that were endemic in the centrally-planned economies. Forced economic expansion based on extensive methods, the soft budget constraints of producers and the pressure to turn out goods for export to obtain much-needed hard currency all put enormous strain on resources, goods and services, leading to shortages and rationing. Table 6.1 provides examples of rationing in socialist countries.

Table 6.1 Consumer goods rationing in the 1980s in select CEEC

Country	Allotment per person per month
Soviet Union	Rice (9kg), meat (1 kg), sugar (0.7kg)
Poland	Coffee, butter (0,75kg), meat (2,5-8kg), lard (0.375kg), flour (1kg), rice (1kg), sugar, chocolate (20g), cigarettes, alcohol, gasoline (24-36 liters), detergent, soap, shoes
Romania	bread (0.3kg/day), egg (10pcs), chicken (0.5kg) pork or beef (1 kg), butter (0.1kg), rice (0.5kg) flour (0.5kg), sugar, nat. gas, electricity (43kWh)
Yugoslavia	Coffee, cooking oil, gasoline (40 liters)

Source: Kornai, 1992

Quality of life in the ESSR was far below Western levels. Estonian life expectancy rates did not increase between the 1960s and 1988. In 1988, infant mortality rates were half the Soviet average of 24.7 per 1,000 but double the rate of Sweden. Housing quality was poor by Western European standards. While populations of the rural areas stagnated, urban populations increased. The combination of slow housing construction and high rates of immigration caused severe housing shortages, which were one of the main causes of declining fertility rates among Estonians (Van Arkadie and Karlsson, 1992; Smith, 2001). To demonstrate the damage of fifty years of Soviet economic management, if Estonia had been able to develop in a manner similar to Finland, its per capita output could have been four or five times its level at the turn of the 21st century (Klesment, 2009) of €4,500 (Statistical Office of Estonia).

The impact of Soviet domination on the Estonian population is a reminder of Hayek's criticism of central planning (1944: 68-69).

“And whoever controls all economic activity controls the means for all our ends, and therefore must decide which are to be satisfied and which not... Economic control is not merely control of a sector of human life which can be separated from the rest; it is the control of the means for all our ends... Since under modern conditions we are for almost dependent on means which our fellow men provide, economic planning would involve the direction of almost the whole of our life.”

By the end of the Soviet era Estonia was in a much worse shape than before losing its independence. In the words of Taagepera (1993: 89), “all the gains of the period of independence had been undone”. Socialism meant the absence of political and economic sovereignty and central planning failed to generate economic progress.

Mikhail Gorbachev's policies *glasnost* and *perestroika* ended the Brezhnevite years of stagnation and oppression bringing about the opportunity for experimentation that previously had been unthinkable. Estonian frustration with their standard of living and constant shortages gave an enormous stimulus for decentralisation and increased economic autonomy (Miljan, 1989). By the 1980s, Estonia was regarded as the ‘cradle of private entrepreneurship’ in the USSR (Liuhto, 1996). Under the umbrella of ‘Isemajandav Eesti¹³’ (IME) plans were drawn up to regain Estonian control of the economy within the territory of the ESSR. Taking the examples of economic reforms

¹³ Translated to English: economic reform

already under way in Poland and Hungary, these measures went as far as small-scale privatisation, loosening of state-ownership of resources, reorientation of trade, intending to make the rouble a convertible currency and focus on consumer demand, which seriously tested the boundaries of the Soviet economic as well as political system (Miljan, 1989). IME had also acquired symbolic significance, as the acronym IME means ‘miracle’ in Estonian, which is what Estonians were hoping for.

By the end of the 1980s the ESSR had the highest rates of new workers’ cooperatives (small semi-private enterprises), ‘individual employment’ and private sector employment. The ESSR had one workers’ cooperative per 20,000 inhabitants, as opposed the all-union figure of one per 80,000 people in 1987. It also had much higher foreign economic involvement than the rest of the USSR. In 1987, the republic had 26 registered foreign-owned firms, one per 60,000 inhabitants, compared to the Soviet average of one per 800,000 people (Liuhto, 1996).

Open discussion of economic issues and experimentation was possible but the consideration of political alternatives to the one party system, the dominance of the communist party and the secession of republics were strictly off the agenda. Gorbachev’s economic and political reforms were to be implemented within the framework of the USSR. At the 19th Party Conference, he (2000: 92.) clarified the position of the Politburo:

“Despite all the difficulties encountered along our way... the USSR has withstood the test of time. It remains the decisive precondition for further development of all peoples of our country.”

In the remaining of the chapter I analyse Estonian agency within the Soviet structure. In section 6.3 I examine the opportunities for economic reforms in the ESSR and how Estonian policy makers took advantage of their limited autonomy to prepare for independence. In 6.4 I analyse the significance of the geographical and cultural proximity of Finland to Estonia, which serving as a ‘window on the west’ provided Estonia with much needed access to information, markets, resources, and know-how in the 1980s, as well as in the transition years. In sections 6.5 and 6.6 I investigate Russification, the repatriation of hundreds of thousands of Russian workers into Estonia, and its impact on post-socialist policy decisions. Last I turn my attention to the

experience of socialism as a paternalistic ‘soup kitchen’, which Estonians were happy to replace with neoliberalism in 6.7.

6.3 Exploiting the opportunities of *perestroika* and *glasnost*

6.3.1 The ‘Sinatra doctrine’ and its consequences

In the words of Swain and Swain (1998: 173) “(b)y 1989, the era of Soviet control over Eastern Europe had gone”. Whereas previous generations called for a non-Soviet national communist renewal in Hungary in 1956, and a more humane form of socialism in Czechoslovakia in 1968, people in the late 1980s openly expressed their dissatisfaction with the socialist system *per se*, which was permitted by *glasnost*. Chronic shortages, falling living standards and corruption aggravated by the populations’ waning ideological commitment coincided with the realisation that the Soviet Union under the leadership of Gorbachev was no longer intervening in the internal affairs of the CEEC. The ‘Sinatra doctrine’ - a term that Gennady Gerasimov, Gorbachev’s spokesman, invented by making references Frank Sinatra’s song “My Way” – essentially meant that “all satellite countries would be allowed to go their own way” (Doder and Branson, 1990: 387).

In February 1989, the Hungarian Socialist Worker’s Party – i.e. the Communist Party – agreed to the transformation of the country into a multi-party democracy that was followed by free elections in March and April, 1990. On August 20, 1989, following long periods of strikes, demonstrations and subsequent negotiations between leaders of the Communist Party and the opposition, the Polish President invited the opposition movement Solidarity to form a new government based on “broad agreement among Poland’s political and social forces” (Swain and Swain, 1998: 177). Following widespread protests to the regime’s strict grip over the country’ political and economic system, the East German government opened its borders with West Germany and West Berlin on November 9, 1989. Less than a year later, the leaders of the two countries signed a unification treaty that essentially expanded the laws of West Germany to the GDR. Slovenia held free democratic elections in April 1990; Czechoslovakia followed suit two months later. In Romania, the First Secretary of the Romanian Communist Party was executed with his wife after a summary trial on Christmas Day, 1989. By 1990, all references to the ‘leading role of the Communist Party’ were removed from

the constitutions of every satellite state in the CEEC (Swain and Swain, 1998 and 2009).

By the late 1980s, the limits to reform were set by concerns about the intervention of Soviet troops, which was a real threat throughout the Soviet period. Despite the 'Sinatra doctrine' the Soviet invasions of Hungary in 1956, Czechoslovakia in 1968, and the bloody events in Latvia and Lithuania in January 1991, in which twenty protesters died and hundreds were wounded, were grim reminders of political reality and left no illusions about the Soviet leadership's attitude to Baltic independence (Kukk, 1993; Lieven, 1993; Raun, 2001). Relying on Soviet interpretations of the Molotov-Ribbentrop pact, in September 1989 Gorbachev publicly declared that the Baltic States had voluntarily joined the Soviet Union in 1940. Lithuania's declaration of independence in March 1990 was proclaimed illegal by the USSR Congress, followed by an economic blockade lasting three months (Taagepera, 1993).

In defiance of Gorbachev's intent to "preserve the Union" (Gorbachev, 2000: 158) but motivated by the events taking place in Central and Eastern Europe, on November 16, 1988, the Estonian Supreme Council declared sovereignty giving Estonian legislation precedence over all-Union laws. It passed the Language Law with an overwhelming majority on 18 January 1989, which made Estonian the official state language of the ESSR. The same day the Soviet flag was replaced with the Estonian national flag on Hermann castle in Tallinn city centre. The Supreme Soviet of the ESSR proclaimed Soviet annexation illegal and announced Estonia's transition to full independence (Miljan, 1989; Raun, 1991; Lieven, 1993; Smith, 2001).

Estonia's strive for independence was significantly aided by external events. Attempts in other republics to weaken Moscow's control escalated, particularly when Boris Yeltsin became President of the Russian Soviet Federative Socialist Republic Russia in June 1991 (Gorbachev, 2000). Russia's push for a break from the Soviet Union was crucial as Yeltsin, who had been a member of the *nomenklatura* since 1968, did not oppose Baltic separatism (Trapans, 1994). As early as 1989, he assured the Baltic States that unlike Gorbachev he "did not seek their forcible retention" (Service, 1997: 489) within the Soviet Union and reiterated their right to self-determination. The Russian

Supreme Soviet opposed armed intervention in the Baltic States. In January 1991, Yeltsin travelled to the Baltic States during the military intervention in Lithuania and publicly appealed to Russian soldiers not to become “pawns in the hands of dark reactionary forces” (Lieven, 1993: 305), which helped Estonia avoid armed confrontation (Raun, 2001). Defying popular Russian opinion he signed statements of mutual recognition with the Baltic States and condemned the use of military force in the Baltic States (Taagepera, 1993).

The ‘war of laws’ (disputing whether laws set by the individual republics or Moscow had priority) and the ‘war of budgets’ (debating whether the republics or the central authorities in Moscow should collect taxes) substantially weakened the Soviet Union, as enterprises were reluctant to pay taxes and follow regulations leading to deteriorating economic conditions (Sutela, 2003). The coup attempted by hard-line opponents of Gorbachev on August 19, 1991, gravely undermined the position of the central authorities and the push for the disintegration of the USSR gained significant momentum (Gorbachev, 2000). Estonia declared its independence the very next day. As in 1918, through a combination of favourable external situation and local agency, Estonia became a sovereign state. Russia was among the first to recognise Estonia’s breakaway from the Soviet Union (Raun, 1991; Lieven, 1993).

Again, structure sets the parameters to Estonian agency. Estonia’s geopolitical situation would have turned out very differently without Gorbachev’s reform programmes, without his decision not to interfere in the internal affairs of the satellite states of Central and Eastern Europe and without heightened nationalistic movements in other parts of the USSR, particularly Russia. I wonder what turn the course of history would have taken if the coup in Moscow on August 19, 1991 had been successful. However, Gorbachev did become General Secretary of the Soviet Communist Party, he did attempt to reform the socialist system, his reforms did contribute to increased nationalism in the USSR, he did let the CEEC go their own way and the hardliner coup did fail. And as in 1918, Estonian leaders actively exercised agency and took advantage of their opportunity; they saw a gate open and decided ‘to run for it’.

6.3.2 *The ESSR's room for manoeuvre within the USSR*

Smith (2001) argues that Estonia began its “return to Europe” or as an interviewee ironically puts it the “return of Europe to Estonia”, in 1991. However, I agree with Terk (2000) and Panagiotou (2001) that ‘Estonia’s return to the West’ already started during the Gorbachev era manifesting active local agency within the Soviet structure.

By Gorbachev’s time it was clear to Estonian officials that the socialist system was weak. In the words of a respondent, it was obvious that “the apparatus doesn’t work anymore”. However, it was due to the policies of *perestroika* and *glasnost* that Estonians were able to embark on the reformation of their republic’s economy with far-reaching consequences. The significance of the change in climate is well noted by my interviewees, as the following interview quote illustrates:

“Gorbachev’s reforms were something that would never have happened because... it was different from Stalin. Then nobody knew if he was finished; it was physical fear.”

Political oppression was particularly severe during the Brezhnev era. It “was almost treasonous to raise doubts about the perfection of the Soviet way of life” (Doder and Branson, 1990: 145) and people who publicly expressed political demands were prevented from holding any responsible position. In the words of another interviewee, “people couldn’t say outside what they were saying at home”. Hoisting the Estonian national tricolour was the equivalent of subversion, warranting arrest (Miljan, 1989). Production and mere possession of *samizdat*¹⁴ materials were illegal. Typewriters and copy machines were regarded as proof of subversive intent and were confiscated – even from those who needed them for their work. Receiving mail from abroad or listening to foreign radio was illegal (Kukk, 1993).

In 1980, forty Estonian intellectuals sent a public letter to newspapers in Estonia as well as Russia echoing Estonian discontent with the regime and calling for debate instead of repression. The authors of the ‘letter of 40’ drew a comparison between the Soviet occupation of Estonia and the Soviet invasion of Afghanistan. The letter was never published (Kukk, 1993; Taagerpera, 1993; Raun, 1995). I interviewed Rein Ruutso, one of the letter’s authors, who recalls the consequences of dissent:

¹⁴ Written material unapproved by the authorities.

“I belonged to this group of students who protested against the invasion in Czechoslovakia and they didn’t allow me to continue my doctoral studies. After that I was a year in the countryside as a teacher, then I moved to Tallinn and I got this chance to continue my studies at the Institute of History. But I was not allowed to teach. I was marginalised in the sense that I could continue in the academic field but not as a lecturer. Then I wrote on the history of Estonian philosophy and I got my degree in 1978 but then things went wrong in some sense. I belonged to a group, which wrote a ‘letter of 40’... it was finalised and shaped in my house, actually, it means that I was one of the very few who lost the job. I was kicked out from academia and I had to work in a library. It was for 6 years.”

Such draconian measures stifled dissent. These narratives echo Hayek’s (1944: 118-119) assertion of the incompatibility of criticism and socialism:

“...the minority who will retain an inclination to criticise must also be silenced... If the people are to support the common effort without hesitation, they must be convinced that not only the end aimed at but also the means chosen are the right ones... Public criticism or even expression of doubt must be suppressed because they tend to weaken public support...”

Kukk (1993: 376) describes opposition in the Brezhnev-era Soviet Union as the “struggle of Don Quixote”. Enn Listra puts life in the Brezhnev era into perspective:

“We lived under Soviet rule and almost everything was somehow regulated and it carried over to personal relationships. We had at least two layers of personal relationships. One was people you knew and the other was people who you just met, to whom I wouldn’t have spoken everything at least during our first meeting... All these restrictions that you cannot do this, you cannot do that were so forceful that people developed an inside restriction.”

Many interviewees address self-censorship from an ethical perspective, as attested by a blunt respondent:

“Sometimes Westerners have accused us living behind the Iron Curtain that this is a double moral. But quite to the contrary, this is how we could remain humans. And it is possible to have this official face. I had to pass communist party exams, in order to get a diploma from university. I answered them great bulls..t but I hope it didn’t do any bigger damage to my brain.”

One example of this “double moral” was celebrating Christmas that was forbidden by the authorities until 1987. Despite the ban, Estonians still celebrated Christmas at home (interviews). I can add a personal experience of “double moral” in the socialist era. The day after Leonid Brezhnev, the General Secretary of the Soviet Communist Party, passed away in November 1982, we had to observe a minute of silence in school, even though we felt little, if any, sympathy.

Gorbachev's policy of *glasnost* put an end to political persecution. The days of "the standard twenty-five years under Stalin for almost anything" (Taagepera, 1993: 102) were gone. Estonians were able to voice their feelings and convictions leading to a 'political awakening' (Kukk, 1993). "*Glasnost* had encouraged political ferment" (Doder and Branson, 1990: 267). The democratisation process led to the birth of a number of pro-independence political groups, including the Estonian Popular Front and the more radical Estonian National Congress. Although the monopoly of the Communist Party was still intact, many of the Party's leaders in Estonia were also members of the Popular Front and were among the main proponents of reforms (Miljan, 1989; Lieven 1993; Smith, 2001). According to Tiit Vähi:

"Edgar Saavisar, the Prime Minister at the time, did a lot for the restoration of independence".

The popularity of these changes is illustrated by the support of 80-90 percent of Estonians who believed that the "Supreme Council, the Communist Party Central Committee and Council of Ministers were acting on the behalf of the people" (Kivirahk, 1993: 156). Both Arnold Rüütel, Chairman of the Presidium of the Supreme Soviet, and Vaino Väljas, First Secretary of the ECP, openly supported the Popular Front's demands for extensive autonomy (Misiunas and Taagepera, 1998). "The mood of 'it cannot be done' changed into 'we will do it anyway'" (Taagepera, 1993: 124).

In June 1987, taking advantage of the Central Committee's decree "to make local problems the business of local Soviets", a group of liberal economists and planners drew up a plan, which focused on three main areas: to regain economic autonomy for Estonia, to put an end to the environmental degradation of North-eastern Estonia, and to advance the "democratisation of political, economic and cultural life in Estonia" (Miljan, 1989: 151). Siim Kallas, one of the chief architects of these proposals, remembers:

"...this called for Estonian economic independence... Somewhere it was in the beginning of '88, at least for me it started to be visible that there is a possibility that all this system is going to be changed radically."

The plan was aimed at bringing the Estonian economy under local control and put an end to the ecological devastation of large parts of the country. The extraction of oil shale and phosphate by open-pit mining methods led to the ecological destruction of five percent of Estonia's territory. To aggravate the situation, half of the output was

exported to Latvia and Leningrad at prices fixed at very low levels (Lieven, 1993; Taagepera, 1993).

The drive for democratisation had multiple objectives. Firstly, it was aimed to create public awareness of sensitive issues, such as the true state of the Soviet economy, the excesses of the Stalinist era and the Molotov-Ribbentrop pact. Secondly and more importantly, it was an attempt to start a public debate among the Estonian people and “create a sense of participation and responsibility”, which Soviet rule diminished by indoctrinating people to accept socialism unquestioningly (Miljan, 1989: 153). As a leading politician of the time puts it, “people needed some sort of courage after decades of being grey and silent”. These discussions “prepared the views of people”, which proved invaluable during the shock therapy of the early 1990s. Erik Terk attests to the significance of these experiments:

“A lot of young economists were engaged with these reforms and it had a very big influence.”

The economic programme intended to decentralise control and achieve economic autonomy. The aura of permissiveness after the Brezhnevite repression fuelled nationalist movements in the CEEC, which in turn revived Baltic hopes for economic as well as political sovereignty (Hamilton, 1990). The Economic Autonomy Initiative was based on the examples of Poland, Slovenia and mostly Hungary that took advantage of Gorbachev’s decentralisation and encouragement of local reform initiatives. Hungary launched the New Economic Mechanism (NEM), a reform programme, in 1968. NEM’s significance lied in the complete abandonment of central planning in quantitative units, the central management of resources and the introduction of the profit motive as a goal for enterprises. It advocated the withdrawal of the state from short- and medium-term decisions regarding the allocation of resources and goods in favour of the market (Swain and Swain, 1998). As a result of these measures, while the populations of the rest of the CEEC endured “not lack of money but lack of goods”, Hungarian consumers were facing “not lack of goods but lack of money” (Swain and Swain, 1998: 126) as the shortages became less chronic and disappeared altogether for staples.

Estonian reformers maintained very close links with Hungarian reformers. One of my interviewees, Erik Terk even wrote a book on the Hungarian reforms. As another interviewee remembers:

“...they knew very well János Kornai. He visited Estonia, his books were translated and they knew a lot about Hungarian reforms.”

The Initiative included a ten point plan, which enjoyed the support of Estonia’s cultural and scientific elite. Subsequently, a competition invited proposals for the decentralisation of the economy (Miljan, 1989: 151). I interviewed Enn Listra, one of the prize winners of that competition, who stressed the “very important symbolic value” of IME, which to many meant the beginning of “breaking away”. He argues that

“If you read the text, it is about what to do with the economy but people didn’t read it in such a way. Why it was so important and popular because it showed a clear way... It gave hope...”

Close examination of these initiatives, which later gained the name IME as it was mentioned previously, provides clues regarding their contribution to Estonia’s post-socialist transition. Figure 6.1 details the plan.

Figure 6.1 The reform policies of IME

1. The Estonian economy must be managed according to the market forces of demand and supply. Prices need to reflect scarcity.
2. The ESSR must have authority over all economic activities taking place within the Estonian territory.
3. All commercial and trade relations must take place directly between domestic and other Soviet republics as well as foreign parties.
4. International convertibility of the currency (rouble) must be set at a unified exchange rate.
5. The ESSR is an integral unit, which must have its own independent tax regime and a separate republican budget.
6. Management at all economic levels must rely on economic autonomy.
7. The economy must be based on a decentralised system, in which decisions reflect consumer preferences. Output quality must meet international standards. Enterprises must be given access to domestic as well as foreign savings.
8. Labour mobility between the ESSR and other part of the USSR must be controlled according to economic requirements.
9. Planning of the economy must be restricted to general macro-level decisions. All economic enterprises must be autonomous and managed according to market principles. Unnecessary bureaucratic organs will be dismantled.
10. Accountability must be coupled with authority in decision making.

Source: Miljan, 1989

The centrepiece of the proposal is economic autonomy, which was a precondition for all other reforms. These measures were intended to improve the life of Estonians and not the whole of the USSR. The goal was to replace centrally administered prices with

prices determined by the market forces. It called for limiting the role of the state to macro-economic management, its withdrawal from interfering in economic transactions and delegating micro-level decisions to organisations. Indeed, these proposals bear many of the characteristics of a market economy. Panagiotou (2001) regards these experimental reform programmes of the Soviet era as the main contributor to the relative success of Estonia's economic transformation.

Thus, in Estonia reforms were not a case of “*perestroika* from below” (Swain, 2006: 218), as the ‘transition industry’, “a body of expertise... that had a formative impact on economic practices through the geographical transfer of models and representations” (p. 208) in Estonia comprised of not only academics and journalists but also virtually the whole political leadership. In the late 1980s it included the Supreme Council, the Communist Party Central Committee and Council of Ministers (Kivirahk, 1993: 156), Presidium of the Supreme Soviet, and Vaino Väljas, as well as the Estonian Communist Party (Misiunas and Taagepera, 1998).

Certain politicians and leaders of post-socialist Estonia's first government claim that these policies represented a clean break with the past. IME was a plan with “Estonia as a kind of special region inside the Soviet Union” (interview) in mind and was not suited to the management of a sovereign national economy. Thus, in the words of Jaak Jõerüüt, in the wake of independence

“We had nothing, we had to build up at all. Everything had to be built from scratch. Everything at the same time”.

Lieven (1993: 316) labels the year of Baltic independence, 1991, “the year zero”, which it certainly was as far as political sovereignty is concerned. The question, however, is whether it was a fresh new start in economic policies as well. As Mart Laar, who became post-socialist Estonia's first freely elected prime in 1992 minister argues:

“Estonian transition must not be compared with other Soviet Republics. When we compare it with all the transition countries, with all CEEC and all the Soviet states, then we understand a lot more of what happened. And in this context Estonia started late”.

According to this view, Estonian economic transition started together with political independence.

However, I agree with those (Terk, 2000; Panagiotou, 2001; Rajasalu et al. 2003; Lauristin and Vihalemm, 2009) who support the continuity hypothesis arguing that the socialist-era experiments significantly influenced the whole period of transition in Estonia creating continuity from the late 1980s. The country's post-socialist transition was "pretty dependent on what happened in Estonia in the late 1980s" (interview). Those politically active in the ESSR, who by the nature of their work were associated with the Soviet authorities, claim that IME gave Estonia a "flying start" (interview) to its economic transition to a market economy because the policies were already in place waiting for implementation in independent Estonia. One interviewee insists that "the reform programme was prepared and ready", as in the words of Jaak Leiman¹⁵:

"...we did much work before independence... to liberalise the economy, even in late '87, so we had at least '88, '89, four years of preparation for independence."

Not surprisingly, some found it a "very useful experience" (interview) in preparing the ground for a capitalist economy. One interviewee calls claims of a brand new start "foolish". Tiit Vähi explains in detail:

"When we restored independence on August 20, 1991, the situation in one week was the same as during the previous period... The situation was the same. But at the same time, the situation was already completely different. The people already got the belief in the future and independent Estonia. Before the 20th of August a lot of laws were already prepared for a free society. We already prepared even the constitution text then all the property laws about the local governments, etc. the monetary reform, etc."

As one politician stated, IME "started these transitional processes" (interview). IME was an admission of the failure of central planning (Lieven, 1993) and an unambiguous call for Estonian economic autonomy, which was necessary if they were to go ahead with these policies. The debates surrounding IME unveiled the real economic situation in the ESSR (Taagepera, 1993). Evidently, the constraints of central planning, the lack of sovereignty, as well as limited economic expertise seriously restricted the scope of Soviet-era Estonian reforms. Since Estonia was not an independent state, only those economic measures could be formulated which did not require political sovereignty. For Estonia to have its own currency, monetary and fiscal policies, border guards and independent judiciary, a sovereign statehood was essential. However, some measures, such as small-scale privatisation or reforming managerial practices were possible to

¹⁵ Minister of Finance 1991-1992, 1996-1999

carry out as part of the USSR. Some restrictions on private ownership were removed as early as 1988 (Terk, 2000; Rajasalu et al. 2003). As Terk (2000: 24) explains:

“Estonian economic reform freed itself and left behind the limitations of the general perestroika of the Soviet Union and took its own path well before the arrival of the country’s political independence.”

Thus, IME is a clear example of active local agency in Soviet Estonia.

Despite the substantial achievements of experiments and discussions about “the ways how to become more independent... inside the former Soviet Union” (interview), IME was limited to economic autonomy within the framework of the USSR. Gorbachev’s reforms were aimed at strengthening the Soviet Union and not dismantling it. He envisaged *perestroika* as a continuation to the October Revolution of 1917 and the implementation of the principles of the Bolshevik Revolution. *Perestroika* was based on “new socialist principles” with the objective “to refurbish our common home”. Gorbachev left no doubt about his ideological conviction on December 20, 1989 declaring that “I am a communist, a convinced communist. For some this may be a fantasy. But for me it is my main goal.” (Doder and Branson, 1990: 273 and 390). He also made his view of Baltic independence very clear by calling their annexation a ‘marriage’ (Taagepera, 1993; Gorbachev, 2000; Smith, 2001).

At the same time it is important to remember that Gorbachev’s policies alleviated people’s fear for their lives for speaking out with far-reaching consequences. *Glasnost*, which Doder and Branson (1990: 142) call Gorbachev’s “war cry”, transformed Soviet media. “Some outlets remained conservative and cautious. Others plunged into the business of more honest reporting with zest...” (p. 146). This is acknowledged by numerous interviewees, for example:

“Very important that at that time that there were a lot of different cultural and scientific experiments and the people came to discuss the reasons why the situation in Estonian economy is so bad and becoming worse and worse. Despite the fact that the media at the time was under the control of the Soviet organs, the press and the media also started to discuss the same issues and they were involved in these processes.”

Despite official rebuttals from Moscow (Miljan, 1989; Lieven, 1993; Smith, 2001) and the occasional reprimands, “it was possible to go very far” (interview). Even after the declaration of the precedence of Estonian legislation over that of the USSR they “were told in Moscow that it’s a very bad habit but they did nothing practically against it”

(interviews). Erik Terk recalls a meeting he attended in Moscow that was chaired by Nikolai Ryzhkov, Chairman of the Council of Ministers of the USSR:

“Each representative of the republics did some kind of presentation about the situation and I did the same. Usually these other republics asked money and I told about our economic reforms... and then Mr. Ryzhkov started to be very angry and started to shout at me and the message was that you must understand that you have freedom only to liberalise the prices of beer but not the prices of vodka, for example. It’s the limit of your freedom. I told that ok but we have this something called ‘parliament’, the Supreme Soviet, and they gave us the basis to do it and we shall continue. And we did it and it’s really interesting because... we needed more currency to pay because prices went up and they gave it. They did.”

These narratives underline Estonian agency stretching the limits of structure. Eventually Moscow “gave us the possibility to go ahead with liberalisation and our economic reforms more quickly” (interview). Despite the criticism, these policies were endorsed by the Soviet parliament in November 1989 and subsequently became a model for reforms in other republics (Lagerspetz, 2001).

Glasnost was crucial for Gorbachev’s reforms; as he (2000: 61) put it - “(w)ithout *glasnost* there would have been no *perestroika*”. Open discussion of the reforms minimised attempts to sabotage their implementation. “The sprawling bureaucratic elite was resisting the reformist tsar”. Frustrated by the bureaucratic inertia and with his party, “which was either unwilling or unable to enact even modest changes”, Gorbachev “turned to *glasnost* to increase political pressure for his programme” (Doder and Branson, 1990: 142-143). As Rein Ruutso sheds light on the situation, discussion of economic reform was in a way ‘newspeak’.

“Nobody wanted perestroika, nobody wanted glasnost... All perestroika was possible because Gorbachev was quite clever... Everybody conspired. It was the only chance to win... because the alternative was Stalinism in those years. And we supported anything that helped us escape the Soviet Union but not the local communist party. He was against local communists because he was a Honecker- type of guy who was very scared about what would happen. It was a game... metaphysical language they used.”

He refers to Karl Vaino, the First Secretary of the Communist party of Estonia, a ‘hardliner’ who took office in 1978 and was a “typical Brezhnev appointee: stable, unimaginative, unproductive” (Taagepera, 1993: 119), a “lackluster technocrat, whose main qualification seemed to be his Estonian surname” (Misiunas and Taagepera. 1993: 205). He was replaced by the reform-minded Vaino Väljas, an “enlightened communist”

(Doder and Branson, 1990: 350), in June 1988, who was the first native Estonian to hold that post since 1950. His appointment increased the momentum for radical experiments (Miljan, 1989; Lieven, 1993). Liberal Estonians supported Gorbachev's policies because it coincided with Estonian interests. *Perestroika* allowed room for experimentation; *glasnost* encouraged their open discussion.

External events played a significant role in shaping the geopolitical situation in the CEEC, to which the various countries and Soviet republics responded with varying enthusiasm. Starting March 1989, Estonians were able to cast their vote in the first multi-party elections in over half a century. During the three years leading to Baltic independence civic participation reached very high levels. Within one year Estonian voters went to the polls four times. They were called upon to elect delegates to the new Congress of Deputies in Moscow, in local government elections, to choose delegates to the non-Soviet Congress of Estonia and to elect representatives to the Supreme Soviet of the ESSR. Despite the frequent elections voter turnout averaged between 78 and 90 percent (Raun, 1991; Kivirahk, 1993; Lauristin and Vihalemm, 2009). People of all backgrounds took part in discussions, which was reflected in the large number of articles and letters published in the media (Taagepera, 1993).

Active public participation manifested itself in the strong reaction to Gorbachev's proposition to amend Article 72 of the Soviet constitution, which granted each republic the right to secede from the USSR freely, and transfer the power solely to the USSR Congress of the People's Deputies to take decisions about the composition of the Soviet Union. This move, which would have further centralised power in Moscow, met with fierce opposition. 861 thousand Estonians signed a petition to oppose the changes (Taagepera, 1993).

Estonian reform experiments surpassed the reform policies of all other Soviet republics (Panagiotou, 2001; Norkus, 2007). Just as the Soviet-era policies were far-reaching, the reform policies of post-socialist Estonia were ultra-liberal (Lauristin and Vihalemm, 2009; Feldmann and Sally, 2002). The 'living memory' of the First Republic certainly played a crucial part but Latvia and Lithuania were also independent states in the interwar period until their Soviet annexation. Another crucial factor that contributed to

Estonia's 'flying start' is its geographical proximity to Scandinavia and its Finno-Ugric 'sister', Finland.

6.4 Estonia's 'window to the west'

The enthusiastic support for reforms was further motivated by what Miljan (1989: 149) calls the "relative deprivation syndrome", which aggravated the dissatisfaction of the Estonian population. Their higher than Soviet average living standards were paltry when compared with Western levels. Estonia's aspirations for economic and eventually political independence were significantly fostered by Helsinki's proximity to Tallinn; the two capitals are separated by a mere 80 kilometres across the Baltic Sea. This made it possible for Estonians to watch Finnish television and listen to Finnish radio, providing them with a "window to the West" (interview). People had a basis for comparison with a non-socialist country. Jaak Leimann explains the importance of the 'Finnish link':

"...even from the 50s, we watched Finnish TV. It was, in some way, a window to the western world... we could compare all the time our life and Finnish life in detail even and of course our dream was as soon as possible to be as, how to say, as rich and happy and nice as Finland..."

The significant differences in the quality of life between the two countries, which had similar living standards in the 1930s, fed disillusionment with the 'socialist ideal'. While official ideology claimed the superiority of the socialist system over capitalism, the Soviet economy failed to deliver higher living standards undermining people's faith in the system, which was strengthened by Estonians' opportunity to compare their life with the life of their Finnish neighbours (Lieven, 1993).

"One important factor, I think, was this Finnish TV... It was a biased factor there because you didn't see from TV how much you have to work but you saw the results... When you look at TV and compare, it was a clear difference and it was a disaster then... Well, you cannot say that the shops were empty but still there was nothing to buy. What was also very important was that there was nothing to choose." (interview)

Such narratives are reminders of Hayek's (1944: 37) criticism of central planning. When compared with "automatic coordination... central direction is incredibly clumsy, primitive and limited in scope".

"...if we had to rely on conscious central planning for the growth of our industrial system, it would never have reached the degree of differentiation, complexity, and flexibility it has attained". (p. 37)

Turning to Kornai (1992), people's minds were 'irreversibly infected' with western images and ideology. In addition to feeding the disillusionment of Estonians with their life, the 'Finnish window' provided them with access to uncensored information. Estonians were much less isolated than other Soviet republics from the rest of the world (Norkus, 2007). As one interviewee admitted, "the Iron Curtain was not as closed as one could imagine", which was crucial given the distortion and manipulation of information by the Soviet authorities about domestic as well as international affairs (Lieven, 1993).

Narratives describing the prevalent shortages are all too common. A local acquaintance recalls an official propaganda line from the Stalinist era, as an example of how the authorities dealt with the lack of necessities:

"It is not the bread loaf that is too small – it's your mouth that is too big."

Many items that we consider staple goods, such as tomatoes, were a rare delicacy; any clothes displaying foreign logos or words were a status symbol and only available on the black market. Estonians spent approximately two-thirds of their income on food and bought not what they wanted but what was available. Comparison with their fellow Finno-Ugric neighbour placed Estonian life-style in a very unfavourable light enhancing Estonians' sense of their own poverty (Kutsar and Trumm, 1993; Taagepera, 1993), which gave them, in the words of an interviewee, a "very strong commitment to close the gap between Estonia and Finland" in the post-socialist era.

Following the Finnish media became a national pastime making fluency in the language widespread creating an underground industry readjusting radios and TVs because

"...the TVs had different systems in the Soviet Union and in Finland... but even the official TV repair stations did it."

The 'Finnish link' had additional effects besides the 'relative deprivation syndrome'; citizens of the ESSR became familiar with the workings of a market economy.

"... in all that Soviet time Finnish TV was observable in half of Estonia. It was like a window to the West all the time. At that time a normal person in Tallinn knew Finnish language, at least passively because his major TV was Finnish TV. And it was impossible that something happens in the world and they don't know in Tallinn. Of course we knew it immediately. We heard about Chernobyl from Finnish TV, not Soviet TV. These links with Finland helped to be aware of what it means also: 'market economy', 'private firms', and all these kinds of issues." (interview)

The entrepreneurial spirit and familiarity with a market economy did not fade away with the survivors of the First Republic. Contact with Finland helped maintain a sense of entrepreneurship (Taagepera, 1993). This link also provided much needed access to resources, including know-how and skills, which smoothed transition and adjustment to the new economic system. Estonian managers were more prepared for economic reforms than their counterparts in other Soviet republics. They were able to communicate with their Finnish counterparts, since “the language was not an issue at all because a lot of people spoke Finnish” (interview). The ESSR had extensive economic, cultural, social and educational relations with Scandinavia (Raun, 2001; Lauristin and Vihalemm, 2009). Many Estonian projects were “copied from the Finnish model” (interview), the importance of which is emphasised repeatedly.

“...Soviet republics Ukraine, Georgia, they did not have such kind of comparison and our dream was to be very soon, if not on this level but close to it and our understanding was that we are as work oriented or as educated or as culturally prepared as our Finnish brothers... our self-evaluation was quite high and we rated our resources, forests, sea, location, education and it seemed it's not so difficult to achieve something special.” (interview)

Estonia and its Finno-Ugric ‘sibling’, Finland, were at similar levels of socio-economic development in the interwar era (Mygind, 1997; Maddison, 2003). As the two countries’ paths diverged in 1940, Finland serves as an example of what could have happened had Soviet occupation not taken place.

During the Gorbachev era, travel to Finland and Sweden became much easier for Estonian officials, which opened up numerous possibilities for cooperation. It was not uncommon for Finnish and Estonian academics to publish jointly, as Urmas Varblane explains:

“...this knowledge flow from Scandinavia was very important and the location of Estonia was really good in that sense. I have sometimes compared it with Bulgaria, for example. Who are its neighbours – from one side they have Romania, from the other side Turkey, Greece, Serbia, then this knowledge inflow is much less probable from these countries. We got Finland, Sweden and it was the time when Nokia and telecommunications started to emerge... That helped a lot.”

Due to difficulties to travel to the West in the Soviet era, the number of Estonians going abroad was minuscule compared to the number of Finnish tourists visiting Estonia.

However, Estonian academics were able to work at Finnish universities working as visiting researchers, which provided them with a “more systematic view of an alternative society” (interview). This supports Bockman and Eyal’s (2002: 337) findings that Western economists in post-socialist transition were not “bringing a new worldview, knowledge, and practice to this blank slate of Eastern Europe”, as there had been an ongoing dialogue about and planning for decades”.

Estonian politicians were able to establish valuable contacts abroad, the significance of which is not lost on Margus Laidre, as he recalls:

“...and Meri¹⁶ was very skilful using this, he knew quite many Finns in high positions... Then the Nordic countries were very important.”

As discussed in Chapter Five, the Scandinavian countries were among the first to give official recognition to Estonian independence in 1991. They also enthusiastically supported Estonia’s EU candidacy (Raun, 2001). These links had not only practical but also symbolic significance, as Tiit Vähi proudly recalls:

“Sweden also participated and assisted to organise a tour on a big ferry for these ministers to Stockholm and back without visas. We were one day in Stockholm, had good meetings and also visited good places. It was a big surprise and achievement that from Estonia all these ministers without any visas and without some permission from the centre, they went to the foreign western country and came back and behaved independently.”

Such narratives underline the importance of relations with Scandinavia. While Soviet citizens were restricted in their travel within their own country, an official of Soviet Estonia was able to travel to a western country unimpeded without any visa requirements! Such experiences further encouraged those in charge to “push the boundaries wider, wider, wider” hoping to achieve autonomy and ultimately independence. In the words of an interviewee, “we were optimists”.

As Raun (2001) argues, the Scandinavian, mostly Finnish, visitors were more than just ‘vodka tourists’, bringing numerous benefits in socialist as well as post-socialist Estonia. As highlighted by Urmas Varblane:

“...this inflow of Finns has also been very important because in 1980s, as I told also in Tallinn, every Estonian family should have its own domestic Finn, who comes to visit, with whom to talk, who brings also some presents... We can think of it as knowledge transfer. Because it was very important and not

¹⁶ Lennart Meri, President of Estonia from 1992 to 2001

only that. In the early '90s, all these business opportunities were opened and these personal links helped to establish huge amounts of small and medium size enterprises. And they helped to market products. This role should not be undervalued, it was very important. Then in Estonia labour costs were low, and now these Finns saw immediately that this is a good place to produce many things, to buy something, to sell something."

To date, Finland and Sweden have provided two-thirds of total FDI stock in independent Estonia (Bank of Estonia). Within one year of regaining independence, Finland replaced Russia as Estonia's main trading partner (Raun, 1994). Norkus (2007) underestimates the effect of Estonia's link with Finland when he argues that due to the recession of its economy in the early 1990s, Finland was not in a position to drive Estonian economic development. As Raun (2001) points out, the Finnish link was more than just economic aid; it provided Estonians with invaluable insight into an alternative way of life, which subsequently smoothed their transition. Grassroots-level economic and cultural relations significantly facilitated adaptation to a free-market economy, as attested by this interview passage:

"The openness gave a boost to entrepreneurship... Estonian small entrepreneurs had good relations with Finland... And Finnish language is very close to Estonian... It was very easy to learn Finnish so this was the first window where people learned how the economy works and they had all their friends in Finland."

Numerous respondents claim that these connections helped to 'jumpstart' the Estonian economy. These links with Finland proved instrumental in post-socialist transition providing invaluable tangible and intangible benefits that Estonians took advantage of proving active agency on their part.

Next I turn to the Russification of Estonia, which had serious consequences in the post-socialist era in the form of ethnic divide and tension influencing the geopolitical situation and in turn Estonian policy decisions.

6.5 The Russification of Estonia

Estonia's admission to what Kukk (1993: 370) ironically calls "the friendly family of the Soviet people" in 1940 had a long-lasting drastic impact on its economy, polity, society and above all its national consciousness. One interviewee captures its essence saying that "the Soviet time lasted too long." To put it into perspective, Soviet

occupation lasted two and a half times longer than Estonia's interwar period of independence. Those twenty-two years are the only time that the country enjoyed sovereignty between 1219 and 1991. Estonians were facing the terrifying prospect that what they now call the 'First Republic' would be the only republic they ever knew. Vihalemm (1997) argues that historically Estonia was able to survive and develop under foreign rule throughout the centuries until Soviet annexation because there was no mass immigration to Estonia from its occupiers. Soviet occupation changed that. The loss of the country's indigenous population followed by the repatriation of large numbers of workers from other parts of the USSR to "help out the Estonians" (Kukk, 1993: 370) permanently altered Estonia's ethnic scene. In absolute figures, the number of ethnic Estonians living in the ESSR in 1989 was lower than in 1934 (Statistical Office of Estonia). Taagepera (1993) argues that Russification of Estonia was close to the point of irreversibility. This view is echoed by an interviewee:

"There are so few of us, we sometimes think that we are like the Mohicans!"

The onslaught of Soviet ideology and culture threatened the very survival of Estonian national identity. The Soviet policy towards nationalities was to eradicate nationalistic and ethnic differences and create a 'new transcendent Soviet identity', which Shaw (1995) describes as 'federal colonialism' and Smith (2001) labels 'ethno-territorial federalism'. The cultural and social policy of the USSR was aimed at the integration and assimilation of nationalities, Balts included, by shifting their national identification from Estonian to Soviet. Russian language was squeezing out Estonian in public life and in the media. History was being rewritten to underline Estonia's 'close link' with Russia (Vardys, 1966).

The Party Programme of 1961 referred to the peoples of the Soviet Union as 'united into one family' (Shaw, 1995). Khrushchev spoke of a merger between the various peoples of the USSR ultimately leading to the emergence of the *homo sovieticus*, the new Soviet citizen (Smith, 2001). Brook (1972: 15.) argues that the emergence of the Soviet people as the "drawing together of socialist nationalities in the course of building socialism" led to a "new historical community", which has "sprung up during the period of socialist construction in our country". The movement of ethnic Russians served not only the purpose of meeting the demands of industrialisation for labour but also facilitated the assimilation of the peoples of the Soviet Union and the creation of a

‘Soviet urban proletariat’. The Soviet authorities distrusted non-Russian nationalities and regarded Russians as the pioneers of socialism (Mettam and Williams, 2001). As Doder and Branson (1990: 375) explain, “the legitimacy of Russian communists to rule a vast empire rested on a dubious Marxist-Leninist assumption that they had the right to hold power indefinitely in the name of the socialist revolution”.

The Estonian nation had to deal with the full impact of Soviet occupation, which was more than just the loss of political and economic independence. In Taagepera’s (1993: 68) view, the Soviet annexation of Estonia was nothing short of Estonia’s colonisation, an “unmitigated disaster”. He recalls his own parents’ reaction to Soviet occupation:

“As an eight-year old boy, I overheard my parents saying sometime in spring 1940: “At the rate things are going, even a German rule would have been better”. I remember my surprise because the Baltic Germans were the historical enemy. Within a year, Stalin had succeeded in turning the Estonians around.” (p. 67)

As anti-German sentiments quickly transformed into anti-Russian feelings, the majority of Estonians welcomed the German invasion in 1941. During World War II, over 70,000 Estonians served in the German army, including an entire division of 11,000 men in the Waffen SS, as opposed to only 10,000 Estonians in the Red Army (Misiunas and Taagepera, 1993).

The collective memories of Estonians and Russians diverge to a great extent, which led to a significant ethnic divide over decades of Russification, as reflected by a respondent:

“Russians were thinking in different categories. Russia is like a thousand year Reich.”

The choice of the word ‘Reich’ by the interviewee is not a coincidence; some interviewees describe Russification of the non-Russian territories of the USSR as ‘lebensraum’ echoing Hayek’s (1944) comparison of communism with fascism. Whereas to Estonians the end of World War II means “renewed occupation”, to Russians it is the Great Patriotic War signifying victory over Nazi Germany and the “liberation of Europe from fascism” (Smith, 2008: 420). In the eyes of Soviet rulers, the existence of the Republic of Estonia was a “historical mistake” (Vardys, 1966: 512). “an anomaly in the nation’s history”, which “discontinued the natural economic relations between Estonia and Russia” and the events in 1940 simply represented a “return to

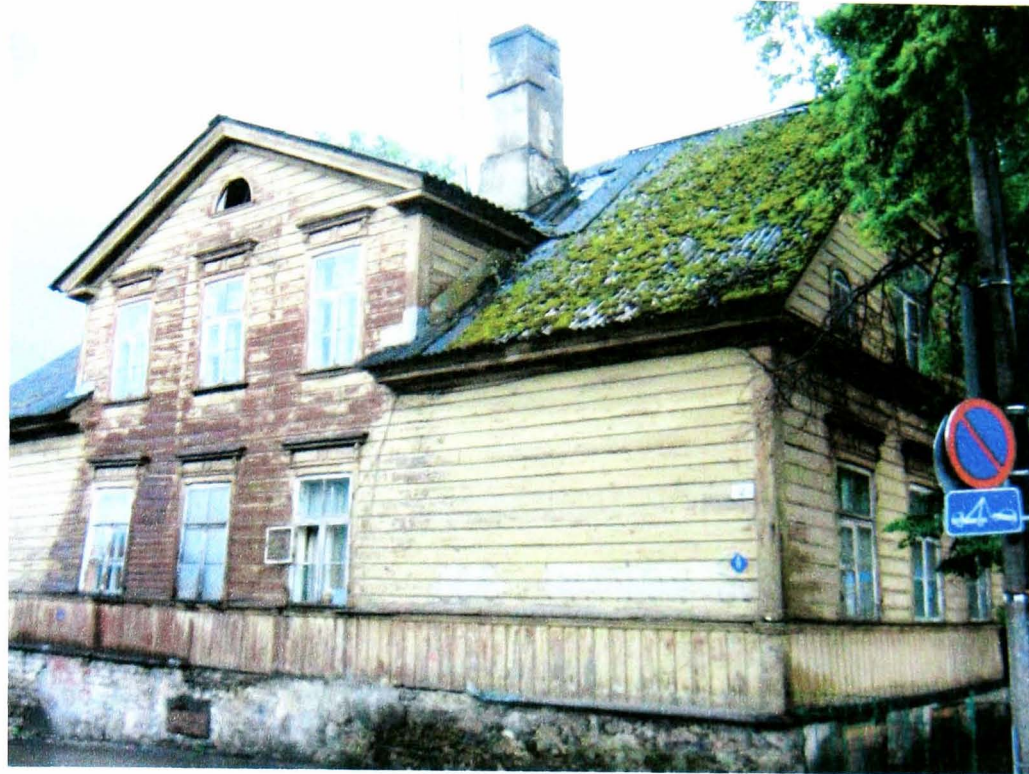
normality” (Klesment, 2009: 246). Estonia’s rightful place is within the USSR, as its survival and prosperity can only be ascertained within the Soviet Union (Vardys, 1966). Estonia was not forcibly occupied by the Soviet Union; it voluntarily joined the USSR at the initiative of workers in order to alleviate their lot in ‘bourgeois Estonia’. The people of the ESSR would only benefit from the experience and help of other Soviet republics. Soviet official figures were manipulated to prove the advantages of Estonia’s membership of the USSR, according to which Estonian real wages were 34 percent above Finnish levels and per capita consumption levels of meat, butter, eggs, and milk were above Nordic rates in the 1960s (Klesment, 2009).

The Russian populations in the non-Russian republics enjoyed extra-territorial privileges, such as their own Russian-language schools, cultural facilities, better access to prestigious jobs and senior positions, and priority access to better housing. Whereas the vast majority of agricultural employees were Estonians, they represented less than half of the industrial workforce (Mygind, 1997). Industrialisation, collectivisation and the influx of industrial workers from other parts of the USSR resulted in the highest rate of urbanisation ever, causing severe housing shortages. While Estonians had to wait years for housing, the immigrant workers and their families were quickly accommodated in newly constructed apartment blocks (Lieven, 1993; Taagepera, 1993; Smith, 2001), as attested by an interviewee:

“What was the policy of the Soviet Union is that immigrants, who came, they got new apartments and Estonians they mainly lived in wooden houses and they were in bad conditions mostly”.

For illustration, I include a photo of a typical Estonian house, which I took in Tallinn.

Figure 6.2 Traditional Estonian house



Ethnic discrimination – in favour of the Russian population - in the ESSR further strengthened Estonians' sense of historical injustice and resulted in a backlash in post-socialist Estonia in the form of persisting anti-Russian sentiments and very restrictive citizenship requirements, leading to the disenfranchisement of a large segment of Estonia's ethnic Russian population.

The concentration of immigrants in newly-constructed tenements created ethnic enclaves with grave consequences in the post-socialist era. Although half of Tallinn's population consists of Russians, they are mostly concentrated in the districts of Majaka, Lasnamäe and Mustamäe where the vast majority of Soviet-era apartment blocks were built. Below is a picture that I took in Lasnamäe district where tens of thousands of apartments were built in the 1970s for ethnic Russians.

Figure 6.3 Apartment block in Lasnamäe district, Tallinn



Whereas rural areas have remained mostly Estonian, the industrialised urban areas have sizeable non-Estonian – predominantly Russian – populations. Ida-Viru County in Northeastern Estonia clearly illustrates the impact of Soviet industrialisation on its population. The small town of Kohtla-Järve, became a virtual ‘branch-plant town’ as its economy became dependent on the oil-shale industry, which was developed to fulfil the needs of the USSR. Its population’s proportion of ethnic Estonians of 91.7 percent in 1934 shrank to 23.1 percent by 1989. The towns of Narva and Sillamäe have undergone similar transformations becoming what Mettam and Williams (2001: 143-146) describe as “colonially developed enclaves”.

The distribution of power, income and wealth explicitly favoured the ethnic Russian population in the Soviet era. Although Russians were a minority, Russification intensified in 1978 when the Estonian Communist Party, inspired by Moscow, declared Russian language as the “uniting factor in communicating among nations” (Kukk, 1993: 379), which had an “important role for the rapprochement of the USSR peoples” (Brook, 1972: 21). Two years later, for the first time ever, all public speeches were delivered in Russian during the All-Estonian Song Festival in Tallinn. Despite cultural autonomy, Russian was used in most day-to-day transactions. Increased Russification placed strong emphasis on the study of Russian in non-Russian schools (Raun, 1995).

Keeping an ethnic Estonian majority was crucial in order to retain the benefits of cultural autonomy and avoid the amalgamation of Estonian territory into the Russian Soviet Socialist Republic. A good example was the Karelio-Finnish Republic, which as a result of overwhelming Russification, lost its federal republic status and privileges in 1956 and was transformed into an autonomous republic of the Russian SSR (Smith, 2001). The consecutive Soviet censuses show a continuous decline in the number of nationalities. The 1959 census recorded 109 nationalities in the USSR; by 1970, that number decreased to 91 (Brook, 1972). Although the federal republics had very limited autonomy, they enjoyed considerably more freedom than the autonomous republics. Cultural autonomy in the federal republics meant the ability to use their vernacular languages in administration, education, and culture. Even though heavily influenced by Soviet ideology, the teaching of Estonian geography and history was reinstated in schools in 1957. Estonian language was used in the publishing industry, and in secondary and tertiary education. Furthermore, Estonians were able to use their mother tongue at their workplaces (Shaw, 1995; Smith, 2001).

The ethnic Estonian and ethnic Russian populations have very different historical, cultural, psychological and economic background. Estonians and Russians living in the same city side-by-side led different lives. The majority of non-Estonian migrants did not settle down permanently in Estonia but even those who stayed were not motivated to learn Estonian. The Estonian language was either not part of the curriculum or was taught at a very poor level in Russian schools (Raun, 1995). Whereas in 1980 between 80 and 90 percent of Estonians were conversant in the Russian language, only 12 percent of non-Estonians were fluent in Estonian. According to a survey in 1988, a mere 38 percent spoke even minimal Estonian (Lieven, 1993; Smith, 2001) and over half of non-Estonians spoke no Estonian at all (Raun, 1995). To many Russian immigrants life in the Estonian SSR was no different from living in the Russian SSR. They were under no pressure to integrate with the local population culturally, socially or linguistically (Smith, 2008). In the words of Mikkel (1999: 162),

“...Russians and Estonians had quite separate lives, as if they were living in two different worlds. They used to work in factories or offices where most workers spoke the same language and had almost the same views on social and political issues. They visited “their own” shops and services and took part in “their own” cultural organisations and undertakings. At home they watched primarily “their own” TV programmes and listened to “their own”

radio programmes. Their children went to separate schools with different ideological, cultural, and traditional backgrounds.”

As discussed in the following chapters, the lack of motivation and reluctance on the part of ethnic Russians to learn the Estonian language had adverse effects in post-socialist Estonia. Estonian replaced Russian as the only official language of the state, which placed Russians at a serious disadvantage on the labour market, as most jobs require sufficient knowledge, if not fluency, of Estonian.

Gorbachev (2000) took note of the ‘binary’ nature of the population between Russian and non-Russian ethnic groups in the non-Russian republics but grossly underestimated its importance (Raun, 1984 and 2001). Although he was aware of the widespread anti-Soviet sentiment in the Baltic Republics, “such ferment had always existed there” (Gorbachev, 2000: 90), he argued that his political and economic reforms were to be implemented within the framework of the USSR as a multinational federation. His overall objective was to reform Soviet society; alternative political systems were out of the question. He (p. 63) leaves no doubt about his disdain for the dissolution of the USSR when he describes it as a “tragedy for the republics that were part of the Soviet Union”. It was a “most flagrant error”, an outcome which was only favoured by “no other than rabid anti-communists”. He squarely puts the blame on the disintegration of the USSR for the inadequacies of his reforms because it disrupted perestroika.

Gorbachev intended to transform the Soviet Union into a confederation without having a plan to deal with the “national ferment” (p. 90). However, according to a survey of May 1990, only 1 percent of Estonians were in favour of Estonia becoming a member of a confederation (Lauristin and Vihalemm, 1997). Soviet culture, which in Lauristin’s (1997: 30) interpretation, is a “strange mixture of collectivist values of Marxist philosophy with traditions and rituals of specifically Russian (orthodox) origin” was alien in individualistic and Lutheran Estonia with a strong sense of western affiliation. Quoting Taagepera (1993: 108), Estonians were “more impressed with Helsinki, not to mention the great western capitals” than Moscow.

The attempts by Gorbachev, whom Swain and Swain (1998: 173) call “Moscow Dubček”, to reform the USSR “unwittingly opened the floodgates of revolutionary change” (Raun, 1991: 251). As elaborated in the previous chapter, for Estonians the

issues of sovereignty and language have always been inseparable. Their cultural renewal and national assertion culminated in the Language Law of 1989 with widespread Estonian support. The law declared Estonian as the “administrative language of governmental organs in the ESSR” but allowed Russian to be used “temporarily” (Raun, 1989: 519). Primary and secondary school education would still be accessible to the Russian-speaking population but the law put an end to the requirement enforced by Moscow that all doctoral dissertations be submitted in Russian. Article 25 stated that “ethnic cultural organisations have the right to unrestricted use of their own language and may also publish freely in that language” (p. 519). The law met fierce opposition from ethnic Russians, including the Russian-speaking political elite, managers of all-Union factories and the intelligentsia. Some all-Union factory managers went as far as calling for a general strike, in which “30,000 people, about 4 percent of Estonia’s total workforce” participated, disrupting public transportation and supplies but enjoyed a small percentage of the support of the labour force (Taagepera, 1993: 155). Due to the close integration of the ESSR’s economy into the economy of the USSR, Estonian factories relied on supplies from and delivered most of their outputs to other part of the Soviet Union (Kahk and Tarvel, 1997). Thus, the colonial nature of the Soviet economy significantly dampened the impact of such industrial actions on everyday life in Estonia because

“...these enterprises, the so-called Russian ones, produced consumer goods not for Estonia but for the Soviet Union. They received their resources from the Central Government, produced the goods that the Central Government wanted and then sent them back. For us it was nothing when they started to strike because we didn’t get their production.” (interview)

Estonia’s intensive Russification and the privileges enjoyed by the Russian population strongly fuelled Estonian nationalistic feelings with lasting adverse effects on both ethnic groups, which subsequently became apparent in independent Estonia. The accommodation of non-Estonian immigrants in newly-built apartment blocks had put ethnic Estonians at a disadvantage in the privatisation process of the post-socialist era. Tenants of these apartments were able to purchase their apartments on favourable terms raising concerns of equity in the privatisation process of the early 1990s, as echoed by Urmas Varblane:

“...(restitution) was very unfair in that sense some people got back what they owned and some people not... In Kohtla-Jarve, Narva, the whole town consisted only of apartment blocks, there were no private houses. In Tallinn Lasnamäe, Mustamäe were all these apartments, which were state-owned. In

private houses only Estonians were living. They got nothing back. Because it was built by themselves they had nothing to claim. I am the same, I got nothing by this voucher process because I had no Soviet apartment at all.”

The unfavourable treatment of Estonians was possible due to the existing power structure and hierarchy in the ESSR. Estonia's most powerful body, the Central Committee of the Estonian Communist Party, consisted mostly of ethnic Russians and Estonians who grew up in Russia but were repatriated to Estonia. The Supreme Soviet of the ESSR was predominantly native Estonian but it was only a 'rubber stamp assembly' with very limited authority until the reforms of Gorbachev (Misiunas and Taagepera, 1993).

6.6 The repercussions of Russification

Estonian independence in 1991 saw its Russian population to become an ethnic minority, which many Estonians consider “a huge headache” (interview). Out of fear of becoming a minority in their own state, the Estonian Supreme Council in the autumn of 1991, just three months after regaining independence, decided to reinstate the Citizenship Law of 1938, which restored Estonian citizenship exclusively to pre-1940 citizens and their descendants. The ethnic Russian minority subsequently lost its status of citizenship, which could only be regained by undergoing a rigorous naturalisation process that included an oath of loyalty and written examination in Estonian history, culture and language (Lieven, 1993). Lauristin and Vihalemm (1997) estimate that about one-third of Russians would be unable to pass the language test.

The Alien's Law of 1993 required all non-citizens to acquire a residence permit. They are entitled to the same benefits as citizens with two significant exceptions. They have the right to vote in local elections and are able to obtain privatization vouchers to buy apartments or shares in businesses. However, non-citizens do not have the right of land ownership; they can only lease for 99 years. Nor are they able to vote in referenda and in parliamentary elections (Lauristin and Vihalemm, 1997). Despite increased rates of naturalisation, Estonia still has some of the highest proportion of non-citizens in Europe (Ehin, 2007); 165,000 Russians are stateless with the status of 'citizenship undetermined' (Statistical Office of Estonia). The strict citizenship requirements had various reasons. One was to motivate the Russian population to leave. Another one was

to exclude them from national elections, which eased Estonian concerns of Russian political influence in the Estonian parliament (Lieven, 1993). Indeed, the elections of September 1992 resulted in a mono-ethnic national assembly (Raun, 1994).

The ‘Russian question’ is not a straightforward issue; it has divided Estonian politicians over the past twenty years. In 1989, the radical Estonian Congress, which consisted mostly of young dissidents, many of whom subsequently participated in the first independent Estonian government, labelled all Soviet government institutions as arms of foreign occupation and took an explicit anti-Russian stance. Their stated goal was to put an immediate end to Soviet occupation and the subsequent restoration of the First Republic (Smith, 2001; Lieven, 1993; Lauristin and Vihalemm, 2009). Estonia’s first independent administration headed by Mart Laar, a founding member of Estonian Congress, did not include any non-Estonians.

The moderate-leaning National Popular Front saw cooperation with the Soviet and subsequently Russian leadership essential and advocated a cautious, ‘step-by-step’ approach to changes with the Russian troops on Estonian soil in mind (Lauristin and Vihalemm, 2009). They realised the necessity of peaceful coexistence with the ethnic Russian minority, many of whom are second and third-generation descendants of Russian immigrants. Their leaders have been arguing for peaceful coexistence with Russia as a matter of necessity, as attested by Tiit Vähi:

“From my point of view, it was necessary and very important after joining the EU and NATO to find a peaceful coexistence with our Russian neighbours and especially economic cooperation... if you hate Russia, you can’t exist. You don’t need to love it but you can’t hate it. So you have to coexist. We joined the EU and it’s obvious that it is a more powerful union than Russia. We shouldn’t be afraid of Russia, it’s like a psychological complex of our people in front of Russia. We are under the NATO umbrella, we are a member of the EU.”

It is not a coincidence that independent Estonia pursued the policy of ‘bandwagoning’, which Lamoreaux and Galbreath (2008) call the joining of a small country with a strong nation or alliance in order to protect its sovereignty. Estonia was eager to gain membership in powerful international organisations because, as Taagepera (1993) argues, Estonian independence depends on events in Russia to a great extent. Fifty years of Soviet domination, which ended the country’s brief independence, made Estonians

very sensitive to Russian policies. Estonians, Latvians and Lithuanians alike consider Russia a very real threat to their sovereignty (Lamoreaux and Galbreath, 2008) greatly enhancing their sense of insecurity. These attempts to secure their place in the 'West' also explain the speed at which decisions were made in the early 1990s. Similar to other CEEC, EU accession has economic as well as political and national security significance. The presence of Soviet/Russian troops until August 1994 further enhanced the nation's sense of insecurity (Lagerspetz, 2001), as elaborated in Chapter Seven.

Assessments of the citizenship regulations have been controversial. Estonians view it as 'historical justice' and a necessary measure to restore and protect Estonian culture and political sovereignty. They perceive the learning of Estonian language by non-Estonians as a symbol of recognition of their country's sovereignty and appreciation of its own history and culture. They consider lack of Estonian language skills disrespectful and arrogant (Korts, 2009). I have personally come across this view on occasions. Recently, I was buying bus tickets at a kiosk in Tallinn when the Estonian sales lady commented on my use of Estonian:

"You see, even foreigners try to speak Estonian. These Russians have been living here for years but don't even want to try!"

Non-Estonian critiques view the citizenship requirements differently; they treat it as a human rights issue (Smith, 1998; Lauristin and Vihelemm, 2009) pointing to the lack of funds and the insufficient number of qualified teachers, which hamper the efforts of non-Estonians to learn Estonian (Minority Rights Group International).

Large parts of the Russian population have been alienated by the citizenship regulations. Proficiency in Estonian is a requirement for public sector employment; all local and state government positions are filled by Estonian citizens. Unemployment today is higher among ethnic Russians due to their poor command of the state language. Although the majority of Russians were able to get new jobs without proficiency in Estonian during the first half of the 1990s, fluency in Estonian has gradually become a necessity in gaining employment in the private sector as well (Smith, 2001). This has been verified by an expert on labour markets who reflects on the high unemployment rates in Ida-Viru County where 96 percent of the population are of ethnic Russian origin (Statistical Office of Estonia):

“We have been asked in many places and by many foreigners, especially, what is the reason behind this Ida-Virumaa labour market problems – is it xenophobia, is it discrimination on national grounds? But the surveys show that it’s not national grounds but lack of language knowledge – that is the main reason.”

The lack of Estonian language skills of Northeastern Estonia’s predominantly Russian population does not only make it much harder for them to find employment but also amplifies a feeling of alienation from Estonian society. The rising socio-economic gap between the two ethnic groups has been feeding a heightened sense of dissatisfaction and insecurity among the Russian minority (Smith, 2008). According to a 2004 survey, only 3 percent of Russians picked Estonia as their primary place of identity while 72 percent mentioned Russia (Ehin, 2007). Many of them consider the government bodies and state institutions of post-socialist Estonia detached from everyday life. Their disappointment with government policies was reflected in their opposition to the administration’s goal of EU accession (Kirch and Tuisk, 2004). A study, carried out in 1996, showed that Russians felt increasingly discriminated against and saw their socio-economic situation worsening (Anderson and Romani, 2005). Another research 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. They point to ethnicity as the main reason for their perceived disadvantaged situation (Smith, 2008; Vihalemm and Kalmus, 2009). Russians tend to learn western languages as a foreign language and not Estonian (Minority Rights Group International). The divergent experiences and statuses of the two groups are underlined by this interview excerpt:

“...we have a critical mass of non-Estonians who do not relate themselves neither with Estonia, nor with Estonians, who also do not want to go back to Russia, who are kind of nobodies, who just want to seek rights but do not want any obligations. Who could be very easily manipulated by Russia. They live in a completely different information space and media space. Their socio-economic situation is much worse than that of Estonians. These especially bad relations between Estonians and Russians have very much affected the current situation. ...due to this image of a rather unstable, insecure society with bad relations between the nationalities that has been established in Estonia reduces the chance of investments entering Estonia.”

Numerous interviewees highlight the manipulation of ethnic Russians by the Kremlin further enhancing Estonians’ sense of insecurity, which was aggravated by the ‘War of Monuments’ that “broke out during 2004-2007, and reached its peak in the April 2007

riots” following the relocation of the Bronze Soldier from Tallinn city centre to a cemetery. The subsequent cyber attacks on Estonian government websites and the blockade of the Estonian embassy in Moscow further intensified Estonian anxiety (Smith, 2008: 419-426).

Contemporary Russians and Estonians have different media spaces within Estonia. The Russian-speaking minority heavily relies for news and information on the state-controlled Russian media (Smith, 2008). Another interviewee echoes these concerns:

“I am not saying that the majority of Russians living in Estonia are anti-Estonian, they definitely are not, but you can always find people who are not satisfied with their way of living and there are, of course, political circles in the Kremlin, who will use this occasionally... In a small society it is very easy to capitalise on this.”

Segregation along ethnic lines is aggravated by the separate spaces and networks of the two ethnic groups. Almost fifty percent of the Russian-speaking population lives in the homogeneously Russophone North-eastern part of the country, which seriously inhibits inter-ethnic communication (Korts, 2009). The districts of Majaka, Lasnamäe and Mustamäe in Tallinn are predominantly ethnic Russian. A study in 2007 found positive correlation between higher frequency of inter-ethnic contact and higher levels of ethnic tolerance. Ethnically separated personal networks restrict inter-ethnic communication including the chances to learn one another’s language (Korts, 2009). While living in Estonia, I had first-hand experience of inter-ethnic separation. I taught at an international university in Tallinn with a very international student body. In the lecture halls Estonian and Russian students sat separately. One could have drawn a line around the various ethnic groups.

Anti-Russian emotions have been very strong despite the helping hand that Estonia received from Russian politicians between 1989 and 1991 (Lieven, 1993). An interviewee made his views of the presence of a large Russian minority in Estonia very clear:

“...the consequences are that the visual Russian presence, which of course... disturbs me, will be even bigger. I went to the cinema with my son and there was something that disturbed me... The movie was subtitled in two languages... Of course, would I be a cinema owner, I would do the same because I want more money, I would want Russians to attend the cinema as well. From the commercial point of view it is very understandable but from a

nationalistic or patriotic point of view, it's not that good. The Russian presence in Estonia is actually quite strong and visible in Estonia."

Foreign films shown in Estonia are not dubbed; they carry both Russian and Estonian subtitles.

Estonian and Russian ethnic groups significantly diverge in their perception of the democratic process that has taken place in Estonia (Adam et al. 2009). A study carried out in 2004 found a continued sense of insecurity and a mistrust of increased Russian political participation among the Estonian population. According to another survey conducted in 2007, one third of ethnic Estonians outright perceived it 'harmful'. While only 28 percent consider active Russian political participation beneficial for Estonia, 26 percent showed low levels of tolerance towards Russians. Almost two decades after regaining independence, Estonian society is polarised along ethnic lines. The divide is apparent, as proven by the large-scale violent riots of April 2007 that took place in the centre of Tallinn in opposition to the government's relocation of the Soviet War Memorial (Smith, 2008; Korts, 2009; Vihalemm and Kalmus, 2009).

Another interviewee expressed the Estonian view of Russia during our conversation in his office in Tallinn. He held up an Estonian 5 Krooni bill, which features the Narva River on the border between Estonia and Russia, and pointed to the dark clouds on the right-hand side of the bill, hanging over the Russian side. (See figure 6.4)

"...see where these heavy clouds are? They always come from the east."

Figure 6.4 Estonian 5 EEK currency



One of my respondents ironically summarises a common Estonian perception of relations with Russia:

“The relations with Russia cannot be improved anyway unless we rejoin mother Russia.”

Such sentiments added more pressure to the country’s post-socialist efforts to distance themselves from the Soviet past and Russia by joining international organisations, particularly the EU and NATO, and greatly contributed to their speedy implementation of reforms in order to quickly reorient the country’s economy from east to west.

As Smith (1998 and 2008) points out, although Estonia’s Russian-speaking population is of diverse origin, over time they have developed a distinct ‘Baltic’ identity with its own ‘collective memory’, which differentiates them not only from Estonians but also from Russians living in the Russian Federation. Non-Estonian immigrants included Ukrainians, Byelorussians, etc, who moved to Estonia attracted by the higher living standards in the ‘Soviet West’. More importantly, even though only one-third of non-Estonians supported Estonia’s strive for independence the majority did not oppose it and considered life in Estonia a better option than in Russia (Smith, 1998). According to a survey conducted in the autumn of 1988 (Taagepera, 1993), one-third of non-Estonians showed solidarity with Estonians, one-third remained neutral, leaving a minority opposing Estonian independence. Still, many Estonians view non-Estonians as ‘Soviet people’ and refer to them as ‘uninvited guests’ or *‘tovarishi’*¹⁷, who in essence are viewed as remnants of a colonising population (Mikkel, 1999; Taagepera, 1993; Smith, 1998).

My findings support the argument that anti-Soviet sentiments in Estonia are an ‘umbrella viewpoint’, which include anti-communist, anti-Russian and anti-statist attitudes with far-reaching consequences, which manifested itself in the objectives of newly independent Estonia. To Estonians socialism meant totalitarian alien rule, oppression in all areas of life.

“The basic idea was very simple, to get rid of the Soviet system. Everything. I exaggerate a little bit but then the picture was that everything, which was characteristic of the Soviet system was bad, let’s get rid of it...” (interview)

¹⁷ Russian word for ‘comrades’

Soviet occupation meant the end of Estonian political sovereignty, an externally imposed economic and political system, exploitation of the country's resources, a drastic decline in living standards and a threat to the nation's culture and language. In many ways Estonia regressed under Soviet domination. One interviewee perceives the Soviet era as a "huge distortion". Estonians' desire to break free of Soviet rule was reflected in the vagueness of economic and political goals, which were more specific about what they wanted to abandon – external domination and communism – than what they were after. This discourse of transition coincides with the findings of Lagerspetz (2001) contrasting the negative past of Sovietisation with the positive future of building a pluralistic free market economy. As one respondent expressed the Estonian perception of the situation on the eve of independence:

"...there was basically only one deliberate choice. To put Estonia back on the map of the free world... there was no other option!"

6.7 'Broad national consent' of liberal reforms

Their aspiration to get out of the grip of the USSR, "clean the house" and "return to the West" (interviews) had a serious implication, as another interviewee observed it:

"...there was such a push from below to 'let's just get this done and the main thing is to break away, the sooner the better'. So it was very much a kind of an impatient period when people were ready to take a risk and somebody told them 'this is what we need to get ahead and break towards the West'. People would give the government the benefit of the doubt at that time... Certainly, it really took probably several years before you could start saying that this is really paying off."

The goal to "break free regardless of the costs" (interview) touches upon a crucial factor: the patient reaction of the population to the ultra-liberal policies of the successive governments of post-socialist Estonia. The radical reforms of the new government "enjoyed broad national consent" (Lauristin and Vihalemm, 2009: 9). Although, as Taagepera (1993: 216) points out, "frugality now for the sake of the future well-being was a notion discredited by decades of Soviet empty promises", once Estonia regained its independence, the population was willing to make serious sacrifices and waited patiently for the fruits of shock therapy to materialise providing the new administration with plenty of room to manoeuvre. The commitment of the population to reforms was crucial. Erik Terk explains the reaction of the population at the time:

“...we thought a lot about the reactions of people. But there was a belief that as the main aim is to get independence, the people understand that if we fall on hard times, there is nothing to do and it’s just a price for independence...”

The experiences of the Soviet era fuelled Estonians’ desire for freedom. They wanted to move quickly from the Soviet Union to the western world, despite the benefits offered by the paternalistic socialist state, such as guaranteed employment and subsidised provisions, as lack of sovereignty was too high a price. Indeed, the

“...political ideals of individual liberty and freedom... are indeed compelling and greatly appealing concepts. Such ideals empowered the dissident movements in Eastern Europe and the Soviet Union before the end of the cold war...” (Harvey, 2007: 24).

People gave the new “government plenty of breathing space” (interview), despite the costs of transformation from a paternalistic command economy to a free-market, which were significant, as Urmas Varblane points it out:

“Another issue was protection delivered by state-owned enterprises. All kind of benefits – kindergartens, etc. they provided. Prices were low for foodstuff, energy, housing, which was heavily subsidised. I don’t praise it but I explain what was the situation and background from which people came to this fight in the early ’90s. I would like to stress that Estonian people, in order to become free, were able to give up many of these kinds of things. And not like East Germans who got big present from West. And in our case in the early ’90s, I think, people sacrificed quite a lot in the standard of living because of becoming independent. It gave the policymakers room to make unpleasant decisions which in my opinion is very important because these decisions were very unpopular at the time, in the sense of affecting your standard of living.”

6.8 The ‘soup kitchen of the welfare state’

The post-socialist administrations of Estonia were intent on getting rid of all Soviet-era policies, including welfare measures. Socialist enterprises were not only suppliers of goods, services, jobs, wages and salaries but also provided their employees with numerous non-monetary benefits including housing, vacationing, healthcare, and education at heavily subsidised prices. Organisations had taken on many of the traditional responsibilities of families. Socialism created a fairly egalitarian system with a more even distribution of income and wealth than in the capitalist countries (Kornai, 1992; Gregory and Stuart, 2001). People’s basic economic needs were satisfied; free healthcare and education was provided to all. Unemployment was virtually unknown. Paternalism in the form of the cradle-to-grave welfare system provided by the state had

significantly reduced the scope of decisions taken by the family. Although the household still formed the basis of society, its role was restricted to child rearing and purchases for personal consumption, which was a serious challenge given the shortages of many necessities. Functions traditionally carried out by nuclear and extended families were taken over by institutions of the state. They ate at work, they lived in accommodation provided by the state, even their annual summer holiday was organised and subsidised by the state (Kornai, 1992).

These welfare provisions, free education and health care in particular, positively affected the quality of the labour force, which was a significant contribution to Estonia's success in attracting large amounts of foreign investment in the post-socialist years (Estonian Investment Agency). As far as health care is concerned

"...everybody was able to go to the doctor paying nothing... I am not saying that at that time quality was so bad. Technically they were not so well equipped. But the knowledge was good. I think maybe even sometimes better because doctors should be able to deal with observation with talking, not only using equipment. And that had its positive side." (interview)

As for education, it

"... was completely free to everybody... It was not possible to buy higher education for money. It was your knowledge or quality, which gave you entry to the school." (interview)

On the other hand, the life philosophy of the paternalistic state created a mentality of reliance on the state making adjustment to new situations very hard (Kutsar and Trumm, 1993). Gorbachev (2000) himself became frustrated with the "tremendous inertia" prevailing in the USSR. He tried to prevent attempts to sabotage the reforms through open discussion and freedom of criticism. His goal was to 'awaken the citizenry' by putting an end to their alienation from the state through transfer of power from 'bureaucrats' to the people (Gorbachev, 2000).

A job for life and the heavily subsidised provisions guaranteed by the paternalistic state were coupled with a very weak link between pay and performance. Hard work or shirking, high quality or defective output all earned the same return (Kornai, 1992). The socialist system throughout its existence struggled to solve the question of incentives. The Stakhanovite movement of the 1930s attempted to motivate workers politically by

celebrating high achievers as ‘heroes’ of the Soviet Union. In later decades ‘worker brigades’ were formed, which vowed to fulfil the set targets. Enterprise councils were set up in Hungary, which had the authority to elect the managers and directors of organisations. However, all these measures failed to solve the problem of incentives leading to an illusion of participation, low quality output, lack of competitiveness and dismal productivity levels. In the centrally-planned economies subordinates and managers alike had very limited autonomy over production decisions (Lavigne, 1999). All the experiments aimed at improving quality and productivity failed (Gregory and Stuart, 2001). Miljan (1989: 150) relies on a passage from *The Economist* to underline the missing link between pay and performance, as one of the root causes of dismal productivity in the Soviet economic system:

“A reason is that there is little or no difference between the pay people get for just turning up and the reward for extra effort; why go to the trouble of working hard?”

This is supported by Gorbachev, who was shocked by the apathy and resistance to change in the Soviet Union. Soviet society was “politically, ideologically, spiritually in a thrall of old customs and traditions” and “the inert conditions of the masses used to carrying out orders and decisions handed down from above” necessitated top-down reforms (Gorbachev, 2000: 56). As Doder and Branson wrote in 1990 (p. 201) “(o)ver the past seven decades, the system has degenerated into one that penalises initiative, efficiency, decency, and responsibility while rewarding opportunism, laziness, sloganeering, and deviousness”. Soviet managers and employees alike shunned responsibility and decision making. As central planning generated “total aversion to risk” (Gros and Steinherr, 1995:47), “mediocrity and risk avoidance became the rule” (Sutela, 2003: 26) with lasting effects. Poor quality control, rude customer service, restaurants shutting down during lunch hour so that the staff can have lunch, were all commonplace even in post-socialist private enterprises. Many interviewees recall an old adage from the Soviet-era: “they pretended to pay us and we pretended to work”. Apathy’ is a returning theme in my interviews.

“...in some ways socialism was a very convenient system. You were always told in the morning what to do, no responsibilities, nothing.”

This ‘convenient system’ had an unforeseen consequence in the post-socialist era, the loss of personal initiative, “except for considerable skills in procuring scarce goods and

services, legally or illegally” (Taagepera, 1993: 107). By their own admission, one of the objectives of the first government of independent Estonia was to “wake people up” (interview). Estonia’s speedy transition to a capitalist system meant that the “soup kitchen of the welfare state” (Krugman, 2007: 105) was replaced with self-reliance overnight. Transition meant disruption and socio-economic problems on a massive scale for which many were unprepared. To use Kelsey’s (1997) assessment of the impact of the economic restructuring of New Zealand’s economy in the 1980s and early 1990s, ‘raw capitalism’ brought on an all-out attack on the welfare state and the move of responsibility onto the family. Although “a free society releases the energies and abilities of people to pursue their own objectives” (Friedman, 1980: 149), adaptation to the fundamentally new circumstances was often painful, as emphasised by Jaak Jõerüüt:

“There are winners and losers. This situation was absolutely new. Some people lost their hope and lost everything because they just couldn’t understand what’s going on. There were a lot of emotions... The intellectual power of this or that person was very important. It is somehow dramatic to look at the people and you see that one understands that it’s a new time, just wonderful to have many possibilities, you have to work hard but to look at another and he complains about what’s going on. The emotional and intellectual approach of people was very visible back then.”

This quote resonates Hayek’s (1960) assessment of socialism as a system that destroys individual liberty and fundamentally reorganises society. He and neoliberals condemn the welfare state not only because of the burden it imposes on public spending but also because it demotivates people to look after themselves and encourages even those who would be able to make it on their own to rely on public welfare provisions (Hayek, 1960; 1976). As Lauristin and Vihalemm (1997: 100) writes, the end of socialism meant that “like prisoners released after long isolation from the free world, they had to relearn the art of living and coping with normal, everyday functions.” Mart Laar reflects on the legacy of the Soviet era:

“...the citizens of the Soviet Union were always regarded as children. And the state was like your mother and father, who always will take care of you, who would solve your problems and think about you and control you. The Estonian Republic of today is not that model of a country... Therefore the very idea, although it was maybe not articulated deliberately at that time, was that everyone should be able at least to try to take care of himself. Therefore only then when the citizens are strong, the society is strong”

Such narratives echo Hayek (1960) advocating personal accountability for one’s own welfare and standard of living through individual success or failure. Indeed, “getting

people out of this Soviet apathy” (interview) coincides with the neoliberal concept of ‘active society’.

Larner (2000: 18-19) highlights the reformulation of Maori identities in the context of the economic restructuring of the economy of New Zealand in the late 1980s. As in the case of the Maori, Estonians “have become more closely aligned with the individualistic assumptions that underpin neoliberalism”. Larner (2000: 12-13) emphasises the neoliberal treatment of people as “entrepreneurial, enterprising and innovative... political subjects”.

“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.”

The market economy’s efficiency is superior to that of the centrally-planned system due to decentralised decision making based on individuals’ best knowledge of their own circumstances and the existence of incentives. The sheer complexity that arises from the myriads of decisions taken by households and businesses every day precludes the possibility of effective central planning. Thus the right to own property and deciding about how to allocate resources are essential freedoms (Sen, 1999). Transition to a market economy meant substantially increased freedoms but also the disappearance of subsidies, guaranteed employment and welfare provisions. An interviewee discusses this dilemma:

“...it was clear that the standard of living was falling. And seriously. I guess in the early 90s, everybody felt that. It was quite a strong decline in your personal welfare. We talked about that also – how much freedom can compensate for your living standard decline?”

However, while the paternalistic state provided extensive welfare benefits, they were also seen as parts of a totalitarian regime (Kornai, 1992: 77-80). Come independence, Estonians wanted to get rid of them as quickly as possible, and transfer responsibilities back from the state to families as part of regaining ‘total freedom’. “Through resistance to state intervention and the perceived eradication of individual liberty under actually state socialism... neoliberalism was ‘domesticated’ in ECE from the outset” (Stenning et al. 2010: 39).

6.9 Conclusion

Fifty years of paternalistic Soviet rule has left a very deep impact on Estonia. The legacy of central planning was an inefficient and obsolete peripheral economy with standards of living lower than in the 1930s. Estonia's ethnic composition had been transformed drastically leaving a deep psychological impact. Extreme levels of centralisation transferred production and consumption decisions from individuals to the state diminishing personal responsibility and initiative, which ultimately contributed to heightened aversion of state intervention in the post-socialist era.

External events led to the demise of the First Republic in 1940 and created a favourable climate for independence movements in the 1980s. The reform policies of *perestroika* and *glasnost* permitted economic and political experimentation leading to a revival of national debate and civic activism. The country's geographical proximity to Finland provided Estonians with a window to the world diminishing their isolation. Relative to other Soviet republics, Estonians were better prepared for transition to a market economy. The dual goal of regaining independence and economic welfare at par with Western economies created an aura of hope and patience leaving the post-socialist governments with plenty of room to manoeuvre.

Estonian agency manifested itself throughout the Soviet era. By taking full advantage of Khrushchev's reforms, through introducing self-management and transforming Estonia into an economic testing ground, they achieved the highest standards of living and productivity rates within the USSR. They successfully exploited Gorbachev's reform opportunities aiming to achieve economic autonomy, create public awareness of political, economic and social issues, and encourage participation. Moreover, these reforms paved the way for the country's post-socialist transformation. Estonia's links with Finland provided them with much needed access to uncensored information and a basis for comparison with an alternative political-economic system. Their social and economic links were of great help to jumpstart Estonia's economy in the early 1990s, as Finland served as a model for Estonian economic aspirations.

To Estonians socialism meant poverty, hegemonic oppression, and a paternalistic state restricting personal liberty, from which they were eager to escape. Estonians desired

freedom at any cost, sacrificing the benefits and security of the cradle-to-grave welfare system, putting the neoliberal utopia of 'perfect liberty' in a very attractive light. By 'pushing the boundaries' of the Soviet system, Estonian policy makers actively exercised agency within the constraint of objective reality throughout the Soviet era. After decades of paternalistic rule the desire to instil personal responsibility and self-reliance in people led to higher tolerance of income inequalities and lower levels of social empathy. Whereas the centrally-planned socialist economic system was imposed hegemonically and externally upon Estonia, the ultraliberal policies of the 1990s were of local origin, the result of Estonian agency, as discussed in the following chapter.

Chapter 7. Estonia's Post-socialist Transformation

7.1 Introduction

Those who regard transition in the CEEC (Central and Eastern European Countries) as transformation from 'one hegemonic system to another' (Smith and Swain, 1998) assume that these countries embarked on a well-defined path based on explicit decisions that were guided by the principles of the Washington Consensus, which Offe (1996) calls 'capitalism by design'. The discourse of linear transition from the negative socialist past to a positive capitalist future ignores the enormity of the challenges and presupposes these populations' desire to adopt a free-market economy. They exclude agents' choices from among a variety of systems of political economy, such as the Yugoslav and Hungarian experimentations with a 'third-way' based upon a managerial type of socialism (Gros and Steinherr, 1995; Adam, et al. 2009).

Following Larner, I argue that the view that Estonian politicians made a conscious strategic decision to pursue the neoliberal agenda dictated by international financial organisations is mistaken. In the previous two chapters I have argued that their decisions were mediated by path dependence, their views of Estonian history and culture, by memories of pre-war independence, and by experiences of the Soviet period: Russification, living in a paternalistic welfare state, pre-1991 reforms, and Estonia's connections to the west. History and culture predisposed Estonians towards values of self-reliance and single-mindedness. Memories of the First Republic provided them with proof of their ability to function as an affluent market economy. Soviet-era experimentations with economic reforms and contacts with the west prepared the population for post-socialist transition. Neoliberalism has different faces, some of which even "enhance social well-being", such as the encouragement of an 'active society' (Larner, 2000: 13 and 21) in Estonia.

Overall, half a century of Soviet domination left its imprint in the forms of resistance to hegemony and the will to achieve 'total freedom'. To Estonians socialism meant security but also totalitarianism. "The emergence of new forms of political power does not simply involve the imposition of a new understanding on top of the old" (Larner, 2000: 21).

There are issues of contingency. The regaining of Estonian independence happened unexpectedly due to unforeseen but favourable geopolitical circumstances beyond the control of Estonia's leaders. The coup in Moscow on August 19, 1991, followed by the collapse of the Soviet Union created a unique window of opportunity, which Estonians exploited finding themselves in charge of their nation again after half a century of Soviet occupation. Grave uncertainty surrounded the nation's sovereignty due to the presence of Russian troops on Estonian soil until 1994 and the unpredictability of Russia's policies. The leaders of the new Republic lacked the experience and the know-how of running a market economy but were greatly attracted by the 'neoliberal utopia' with its emphasis on freedom.

In this chapter I examine why policy makers chose ultra-liberal economic objectives and priorities and how they were constructed and implemented in the early years of Estonia's post-socialist transition. I argue that Estonian neoliberal policies were not consciously designed under the control of international financial institutions but were formulated endogenously in an *ad hoc* fashion, within the structures of lack of capacity, highly unstable geopolitical and economic situation, affected by Estonians' collective memory of historical suffering and 'go it alone' approach. Path dependence and the volatile environment called for policies that were simple and fast to design and implement and emphasised liberal values. Furthermore, Estonian policy makers mostly relied on themselves and Estonian émigrés for advice and not on the international financial institutions.

By analysing Estonian agency in the country's post-socialist economic transition, I show that neoliberalism in Estonia is not a mutation of mainstream neoliberalism imposed upon it from the centres of neoliberal thinking in Washington D.C. and London but an indigenous domestic project. Estonians willingly opted for neoliberal policies. Firstly, the neoliberal utopia of total liberty agreed with Estonians' desire to get rid of foreign domination and regain sovereignty. Secondly, the uncertain geopolitical climate and lack of economic expertise in the early 1990s required simplistic rule-based policies, for which monetarism and supply-side economics – the pillars of neoliberal economic policies - were well suited. In section 7.2 I provide a

chronological account of the events then I examine the emerging themes from the literature and my interviews.

7.2 Rebuilding the state

“Not so long ago, few Western observers would have dared to predict the vertiginous decline of communism that culminated in the liberation of Eastern Europe and the break-up of the Soviet Union during 1989-91” (Gros and Steinherr, 1995: 33-34). Post-socialist transition was an interrelated transformation of structures as well as agencies both at the institutional and the cultural level. The spatial transformation included changes in the economy, international relations, media, education and sciences, the legal framework and the structure and function of institutions. Behavioural patterns, including the role of the family, communication, language usage (English becoming the main foreign language replacing Russian), life-style and usage of technology all have radically transformed in Estonia (Lauristin, 1997).

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’ (Riigikogu¹⁸). In June 1992, the citizens of Estonia overwhelmingly approved in a referendum the Constitution of the Republic of Estonia, which transferred political power back to the Riigikogu, a unicameral parliament with 101 members elected for a four-year term following the country’s tradition of the interwar period (Raun, 2001). In the eyes of Estonians their country was never legally part of the Soviet Union. To underline the annexed status of Estonia, the first national assembly elected in 1992 was named the 7th *Riigikogu*, the 6th *Riigikogu* having convened in 1938. Every assembly in the intervening years was considered a “quasi-parliament of a non-existing state” (Lauristin and Vihalemm, 1997: 95). Estonian citizens became free to form political parties. On October 5, 1992, Lennart Meri became President of the newly independent country. He was subsequently reelected in 1996 and received the ‘European of the Year’ award in 1998 (Smith, 2001).

During the first year of independence, the most important tasks were to establish a democratic constitutional order, to achieve financial sustainability, and to consolidate

¹⁸ The national assembly of Estonia

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). The objectives of economic, political and social reforms were to achieve a Western-style institutional and legal order. The country's desire to reorient itself geopolitically and economically manifested itself in the objectives of European Union and NATO accession (Lauristin, 1997).

On the day of declaration of Estonian independence, Edgar Savisaar, Chairman of the Council of Ministers of the Estonian Soviet Socialist Republic became the first Prime Minister of the Republic of Estonia. Due to the severe economic problems, his administration was replaced with a caretaker government on 30 January, 1992, with Tiit Vähi at the helm, which consisted of 'technocratic specialists, not politicians'. As such, his cabinet did not intend to participate in subsequent elections. Their goal was to lead the nation to its first free election and help to create a multi-party democracy with a functioning market economy (Smith, 2001). The new government was faced with the ruins of a centrally planned economy: declining production, empty shops, 'dollarisation' due to increasing inflation rates, a thriving black market, corruption and crime. Prices were liberalised for almost all consumer goods, salaries and wages were frozen, and earnings-related pensions were replaced with flat-rate benefits (Lauristin and Vihalemm, 1997).

Estonia's first freely elected government, with Mart Laar as Prime Minister, took office on 21 October, 1992, signalling the end of the period of post-Soviet intermediary statehood and the beginning of a legitimate and democratic state. The priorities of the new government were 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. During his time in office the progressive personal income tax was replaced with a proportional personal and corporate income tax rate of 26 percent. By steadfastly adhering to maintaining a balanced budget state subsidies were phased out (Lauristin and Vihalemm, 1997 and 2009; Smith, 2001). Between 1991 and 2010 post-socialist Estonia had eleven administrations, as seen in Figure 7.1, pursuing economic reform through ultra-liberal policies.

Figure 7.1 Estonia's post-socialist administrations

Prime Ministers	Terms in office
Edgar Savisaar	8 May 1990
Tiit Vähi	30 January 1990
Mart Laar	21 October 1992
Andreas Tarand	8 November 1994
Tiit Vähi	17 April 1995
Tiit Vähi	6 November 1995
Mart Siiman	17 March 1997
Mart Laar	25 March 1999
Siim Kallas	28 January 2002
Juhan Parts	10 April 2003
Andrus Ansip	13 April 2005

Source: Handbook Life in Estonia

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 that were discussed in the previous chapter, 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).

Having been cut off from membership in significant international organisations, Estonia was keen to rejoin the international community. Within three weeks of regaining

independence Estonia became a full member of the United Nations (Riigikogu). In autumn 1991 Estonia joined the Conference for Security and Cooperation in Europe. In March 1992, Estonia, along with Latvia and Lithuania, were founding members of the Council of the Baltic Sea States (Raun, 2001). In May 1993, Estonia gained membership in the International Monetary Fund and the Council of Europe (Smith, 2001). The country immediately started negotiations on a trade and cooperation agreement with the European Union. Having become an associate member in 1994, it joined the organisation in May 1, 2004. Estonia also strived to form closer ties with NATO (Raun, 2001), which eventually led to full membership on March 29, 2004 (Handbook Life in Estonia).

A national currency was proposed in Soviet Estonia in 1987 but had remained a distant prospect given the political constraints (Kukk, 1997), as it would have needed Moscow's consent. The Estonian Central Bank was established in January 1990 and subsequently was made entirely independent in the post-socialist era with the mandate to maintain monetary stability (Eesti Pank¹⁹). The Central Bank had a decisive role in successfully creating a two-tiered banking system (Mygind, 1997).

Estonia was the first transition country that opted for a currency board arrangement. The country pegged its currency to the German Mark, which was selected for its respectability and strength, at the exchange rate of 1:8. This choice was justified by the difficulties for a young nation to acquire credibility for its currency. Currency board arrangements require a 100 percent foreign reserve backing by the Central Bank as guarantee. Thus effectively, Estonia's monetary reform was made possible by the recovery of the 11 tons of gold bullion reserves of the interwar republic, which had been deposited in Britain, the USA, Switzerland and Sweden. Existing roubles were removed from circulation through exchanging them at the rate of 10 roubles equalling 1 kroon, reflecting the black-market rates between the rouble and the German mark. The currency board exchange rate policy meant sacrificing the use of monetary policy, thus inhibiting the monetary financing of fiscal deficits. The currency board arrangement was anchored in the 1992 constitution along with an act that obliges the government to maintain a balanced budget, which would take a two-thirds majority vote in the

¹⁹ Bank of Estonia

parliament to be overturned (Bennett, 1993; Smith, 2001; Rajasalu et al, 2003; Gros and Steinherr, 2004).

Over the subsequent years, Belarus and Lithuania also chose to use the currency board mechanism leading to successful economic stabilisation. However, whereas Estonia had been proactive, the latter countries did it as a belated reaction to their desperate economic situation (Gros and Steinherr, 2004).

Privatisation had multiple objectives in the post-socialist economies. Economic reasons included the need to increase productivity and allocative efficiency. The political goal was to create a class of entrepreneurs by taking property away from the state and handing them over to private hands. Restitution was high on the agenda due to equity considerations. Last but not least, privatisation also served as an important instrument of economic stabilisation (Lavigne, 1999). Privatisation in Estonia has been considered the most successful in the FSU states. The process was based on the *Treuhand* model of Germany, which placed priority on attracting foreign, mostly Western, investment. The right to buy state-owned assets was not restricted to Estonian citizens; anyone who had been living in the country for the past ten years could participate. In June 1993, the Estonian parliament passed the Privatisation Act, which set “more clear and universal rules” (Terk, 2000: 75), and unified privatisation of SOEs in the Estonian Privatisation Agency. By 1997, the privatisation of SMEs as well as large-scale organisations was completed. By 1998, approximately 90 percent of housing was privately owned (Smith, 2001).

Estonian economic development exhibits neoliberal features, as it has been based on supply-side economics and monetarism. 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 indirect, rather than direct taxation. Value added taxes are set at 18 percent. Personal incomes and distributed corporate profits are subject to a proportional tax rate of 20 percent. As of January 1 2000, 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”.

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 (Raun, 2001).

In the remainder of the chapter I analyse the significant role of Estonian agency in the design and implementation of neoliberal policies.

7.3 Capitalism by design?

7.3.1 ‘What comes next’?

I argue that Estonia’s transition was driven by “neither voluntarist design nor structural determinism” (Smith and Swain, 1998: 27) but by people under constraints of path-dependence and dynamic political, economic and social conditions. Transitions, that follow policies designed and imposed by international organisations, do not involve a “lot of ‘what comes next’” (interview), which was the case in Estonia.

Not unlike in 1918, Estonia became an independent nation by exploiting the favourable geopolitical situation created by nationalist movements in other parts of the USSR and the coup in August 1991, which hastened the disintegration of the Soviet Union (Taagepera, 1993). The unexpectedness of independence is not lost on this interviewee:

“I remember that my mother always laughed when I said that I am convinced that Estonia will be free one day... This, what happened, is really unbelievable. Free again, I can sit and talk to you as a free man... When I think about that, it’s an incredible thing.”

Taagepera, who was a member of parliament of newly independent Estonia in 1991, describes Estonian independence as an “eminently historical moment and yet it felt like business as usual” (1993: 207). Numerous interviewees verify that regaining Estonian independence in itself is a huge achievement, as demonstrated by this interview excerpt:

“You see, success story, it’s not so much an academic term. It is an emotional term. It’s a success in general. A success, that a small nation, a small country, had the possibility, the second time during one century to regain independence.”

As stated in Chapter Three, the neoliberal view of transition as an unproblematic transformation from socialism to capitalism ignores the diverse historical experiences, geopolitical and economic conditions of the CEEC (Pickles and Smith, 1998; Smallborne and Welter, 2010), which are the very clues to Estonia’s choice of neoliberal policies. Neoclassical economics presumes conscious and fully rational macroeconomic decision making on the part of national governments. However, the Estonian dream of “getting out of the Soviet Union” was suddenly and unexpectedly realised after 51 years of foreign oppression, even though “it was very difficult” (interviews). To underline the unexpectedness of the realisation of independence I quote one of my interviewees, according to whom, many Estonians had only one question in mind: “now what?” Margus Laidre recalls the approach that Estonian leaders took at the time of regaining independence:

“You know, as Napoleon said ‘just start and we will see what happens’.”

Having been integrated into the centrally administered economy of the largest country in the world, the newly established state lacked all the political and economic institutions necessary for the functioning of a sovereign country. Post-socialist

transition was much more complex because the ESSR with its peripheral ‘planned production system’ (Rajasalu, et al. 2003) of the Soviet Union was to be transformed into a sovereign state with a national market economy, a complex and complicated process that includes setting up the prerequisites of independent statehood, such as a constitution, national assembly, national currency, diplomatic relations, customs and border control, etc. (Lauristin and Vihalemm, 1997). In contrast, Tiit Vähi, who was in charge of the whole nation, admits:

“We had to do completely new things that we didn’t know how to do.”

Lavigne (1999: 264) defines transition, as a “journey from one point to another”. More specifically, she refers to the ‘systemic transition’ of the CEEC, as the “departure from a socialist, centrally planned economy, towards a free market economy”. This definition assumes that agents are aware of the end of one era and the beginning of the next one. However, decision makers of Estonian transition were uncertain about the end point of socialism and the start of transition because “nobody knew actually what was going on” (interview). As opposed to the specific objectives and well-defined steps of mainstream transition theory of marketisation, privatisation, liberalisation and democratisation, the leaders of post-socialist Estonia saw their tasks in a much more simple light:

“...a lot of it was just breaking from East to West hoping to do the right thing and moving towards Europe... and to become part of a better neighbourhood economically and increase your chances to get pulled up by integrating with the richer.” (interview)

As another interviewee says, “when we regained our independence we had nothing compared to others”. There are some similarities between 1918, the birth of the First Estonian Republic, and 1991. On both occasions independence had “less to do with Estonia than with the empire” (Taagepera, 1993: 208), as independent Estonia twice emerged from the implosion of the Russian domain. However, Estonia had a great advantage in 1918 because it

“...had been part of capitalist Europe, and had many people, officials, and private businessmen, Balts and members of other communities, with a tradition of experience in the workings of capitalism. Baltic industry was also equipped to Western standards and the Balts had longstanding markets in the West. Today, these markets have to be created from scratch.” (Lieven, 1993: 61)

Unlike in 1991, Estonia in 1918 inherited a small but competent body of civil servants, which carried on fulfilling its duties (Lieven, 1993). The situation in 1991 was completely different because

“...when Estonia regained independence in 1918, first time after the First World War, then the transition was from market economy of Czarist Russia to market economy of independent Estonia. So many roles and many organisations and institutions were more or less... in condition. But now the situation was totally new.” (interview)

Parallels can be drawn between the Bolshevik revolution in 1917 and Estonian independence in 1991. The Bolshevik leaders when “much to their surprise, found themselves the rulers of Russia in 1917, they had hardly any clue as to how to build the communist society...” (Sutela, 2004: 11). Similarly, Estonians suddenly found themselves in charge of their own nation, facing the complex transition of economic, social and political structures. Just as very few Bolsheviks had any experience in economics and administration, most Estonian policy makers were historians, mathematicians, sociologists and engineers. The Bolsheviks relied on Marxist premises to build a socialist economy, although Marx emphasised that his critique of capitalism was not meant as a blueprint for constructing a communist society (Swain and Swain, 1998). Over seventy years later Estonian policy makers had the desire to create a free-market economy without the know-how. Sutela’s (2004: 13) summation of the Bolsheviks’ readiness to the immense task of state-building - they had “only the vaguest of ideas about the final goal and essentially none on how to get there” – is reflected by Mart Laar when I asked him about the consideration of policy choices by his administration:

“I have been asked this question so many times on several occasions but I couldn’t answer it very precisely... I was so much part of the decision making but I didn’t know how it happened, it just happened.”

I bluntly put the question to him as to why they chose neoliberal policies. His response is telling:

“I am a conservative myself. I use this world, neoliberal, liberal in many ways. I am not so sure what it exactly means, so I never try to call myself a liberal or a neoliberal, whatsoever. That is what we have done... I think to find a name would be useless, so I never wasted my time. So actually I am not wasting my time thinking what policies I made. I tried to do the best.”

His narrative contradicts the neoclassical tenet of the fully rational individual, as decision making on the part of Estonia's policy formulators in the early 1990s manifested none of the characteristics of fully rational decision making. There was no conscious information search, construction of alternatives and lengthy evaluation of the various options. The country was free and Estonians had to grab the chance to rebuild the country. These enormous challenges were aggravated by the situation that

"...nobody had a clear vision how to flow from planning to market economy, how to pass this transition, what kind of steps and how fast you have to pass this way. It was a question unclear for all the world." (interview)

These narratives reflect Swain and Swain's (2009: 234) argument that in the CEEC the "first decade was an era of national paths to capitalism, whose nature depended on the particular constellation of political forces in each country; unlike the transition to socialism, there was at first no single model imposed from outside". As elaborated later in the chapter, starting the second half of 1990s the EU's *acquis communautaire* spelled out reform measures for the CEEC, which were prerequisites of EU membership (Swain and Swain, 2009).

Unlike in other types of transitions, post-socialist transition included extensive transfer of state-owned property and resources to private ownership as well as the creation of an entrepreneurial class (Offe, 1996). The phrase 'triple transition' has been used in different connotations. Offe's (1996) interpretation refers to the political transition to democracy involving national-level identity related decisions, constitutional-level decisions concerning the institutional framework, and 'every-day' politics-level decisions regarding 'who gets what, when and how'. In this context, every former socialist state faced a 'triple transition'. Others (Lieven, 1993; Lavigne, 1999; Smith, 2001) use this term in the multidimensional context of transition that involves change from a totalitarian one-party system to pluralistic democracy, from a centrally administered economy to a market economy, and from Soviet imperial hegemony to fully independent statehood. This interpretation of transition refers to the FSU states exclusively. However, regardless of which interpretation is used, the "very simultaneity of the three transformations generates decision loads of unprecedented magnitude" (Offe, 1991: 871). A respondent reflects on the uniqueness of the 'triple transition' faced by Estonia:

“...there was at that time no certain theory, no Keynes or Friedman, no Brzezinski or whoever behind it. It was only this idealistic, maybe even stubborn, blind-minded desire that Estonia should be free again.”

7.3.2 The ‘window of opportunity’

The term ‘transition’ has been applied to other cases as well, such as the transformations of the Latin American economies in the 1980s and South Africa in the 1990s. In all these instances, transition meant systemic changes, marketisation and democratisation, permeating all levels of society (Lavigne, 1999). However, the challenges faced by the FSU were more complex, due to the territorial changes and large-scale population migrations that took place in the Soviet era. Uncertainty is a key determinant in shaping policy formulation in Estonia. It is important to keep in mind that Estonia declared independence on the second day of the coup in Moscow and Russian troops were stationed on Estonian soil for three more years. Jaak Jõerüüt leaves no doubt about Estonia’s prospects at the dawn of independence:

“You can find nowadays many people who say bravely that ‘I knew it from the very beginning that the coup will fail’, this kind of stuff you hear always... but knowing how absurd the Soviet Union was, that old fashioned system, knowing all that... and you had to ask yourself ‘ Will it fail in 2 hours? 2 Months? Or 2 years?’ ...how long time will it take? That was the question. And what kind of mess and how much blood will appear? Absolutely nobody knew. And what would happen? Because of that it was a very short time for us to make those decisions.”

As mentioned in the introduction to this chapter, Estonian agency was constrained by structure, such as the coup attempt in Moscow, the uncertainty of the intentions of Russian commanders stationed in Estonia and the unpredictability of Russian policies. Relations with Russia were a major cause for concern and the number one foreign policy issue. The unpredictability of the intentions of Russian leaders in Moscow and military commanders in Estonia, the fast changing political situation in Central and Eastern Europe where state socialism was quickly disappearing, and instability within Russia gave Estonian policy makers a sense of great urgency. Negotiations between Estonia and Russia regarding the timetable for troop withdrawal, compensation for environmental damages and annexation of 5 percent of Estonia’s territory by Stalin in the 1940s were progressing slowly (Taagepera, 1993; Raun, 1994, Pickles and Smith, 1998; Swain and Swain, 1998). Jaak Jõerüüt explains:

“The surroundings, the mood, thoughts, persons, visions were absolutely different. We were full of hope... in 1992-93 we had to consider Russia as well. I don't know the moment when Russia turned but I think one of those very crucial moments was when Yeltsin decided to attack the Russian Parliament. In the very beginning it was about Russia taking its troops out of Europe. Then, of course, politically quite early it was clear that we have to get the troops out of Estonia.”

The relative success of the extreme right in Russia's parliamentary elections in December 1993 further exacerbated an already sensitive situation, in which Russian politicians, including Defence Minister Pavel Grachev, linked the issue of troop withdrawals to the condition of Russians living in Estonia (Raun, 1994). The presence of Russian troops was causing great uncertainty for newly independent Estonia, in view of the Citizenship Law, which many Russians in Estonia considered discriminatory, and the pain that reforms caused the sizeable Russian minority who were mostly employed by state-owned industrial producers facing privatisation and subsequent downsizing.

The Estonian government was walking a tight-rope, as Tiit Vähi remembers:

“It was a very complicated issue with the Russian troops. I remember when I was the Prime Minister in 1992. The State Minister was Uno Verid at the time... Uno Verid called me and told that the self-defence forces captured some Russian officers. They arrested them and got their car. General Abdulrahman called me who was at that time the commander of the force. Of course we had to resolve this issue and release the Russian officers and give them back their car and peacefully resolve this.”

Lieven blames the lack of resources resulting from the acute economic situation in Russia and the low morale for the troops' inactivity. Relying on admissions of Russian officers, he argues that “the army was no longer able to feed itself” (1993: 202). The gradual withdrawal was due to drastic housing shortages in Russia. Nevertheless, by 1994 much of the naval base in Estonia was cleared. Raun (1994: 75) puts the number of Russian troops on Estonian soil at around 25,000 in 1992 and 2,400 in December 1993. However, this was still a substantial number, considering the ill-equipped status of the small and mostly untrained Estonian army, not to mention the political ramifications of armed conflict (Lieven, 1993).

The Estonian government managed to keep good relations with Russian officers reducing the risk of clashes. The Soviet – later Russian – army was much more passive in Estonia than in the other Baltic States (Lieven, 1994). Tiit Vähi offers empathy

among the minority ethnic groups towards the struggle for independence as an explanation for the passivity of the Russian armed forces stationed in Estonia:

“We understood the role of these Russian officers who were on our territory. We wanted to find with them common language because we realised that they are fulfilling the commands of Moscow but we wanted them to be as passive as possible because they were not interested in fighting against us and we wanted to coexist with them peacefully in order to avoid the conflicts... these officers in general were not interested to fight us. There was General Dudayev and he was in Tartu at the time, the Commander. General Abdulrahman was from Azerbaijan and Dudayev was Chechen. And their homeland, Azerbaijan and Chechnya were also in the fight for independence. So they didn't want to fight us. In their mentality they even supported us.”

Regaining independence through peaceful means despite the presence of the Russian military and maintaining “quite stable relations between the nationalities” (interview) has been a significant achievement. My interviewees have unanimous agreement of the significance of Estonia's peaceful transition. Despite the anti-communist and anti-Russian sentiments, independence was

“...regained without shedding a single drop of blood. And that we managed to maintain the social stability and we did not end up having a civil war and relations between the nationalities have been quite stable.” (interview)

Taagepera (1993: 1) also stresses the non-violent nature of Estonia's independence

“In 1991, Estonia regained independence, after four years of intense political struggle without a single politically motivated death or even (to my best knowledge) hospitalisation.”

Nevertheless, Jaak Jõerüüt pinpoints the presence of Russian troops in Estonia as a prime cause of uncertainty. As he explains:

“We are lucky that they left in 1994. But for those 3 years it was very difficult. You can see what is going on in the Caucasus. Nobody knew how much Moscow has changed. There was a window of opportunity... I remember very well that feeling. For a very long time you just don't know what situation comes and then one nice August day the window opens. You had to act immediately.”

This ‘window of opportunity’ is what many refer to as the long-awaited chance to “run away from the colossus of the Soviet Union as quickly as possible” (interview). To all interviewees regaining independence took place within a unique ‘window of opportunity’, which they believe has been shut since. They all agree that had Estonia not regained independence when it did, it would be impossible today.

“Russia quickly reconsidered. At the end of '91 and beginning of '92, already Russia started to invite the former Soviet states back to this Commonwealth of Independent States. But Baltic States, refused.” (interview)

Exploiting the opportunity to “break free” required immediate action, thus speed was essential. Policy makers realised that “there was no other option. You just must go forward.” To quote Mart Laar:

“It was absolutely necessary to do these reforms so fast, as we did... So we wanted to do everything in a short time. We just did it... We were enormously hurried.”

Another respondent sheds more light on decision making at the time:

“...there was more of an urgency to do something fast. It's probably just being in such dire straits in such a bad situation you do different things than you do in normal times”.

7.3.3 Freedom!

As discussed previously, Estonia's objectives in the socialist era were ‘self-evident’ (Lauristin and Vihalemm, 2009) and straightforward, if vague, as illustrated by the following quote:

“...at the time the priorities were very simple – to get independence. That's it. Very simple. What kind of freedom and what kind of republic and what kind of legal systems – it was a continuation only.”

Freedom is a central theme of Estonia's transition, as attested by many respondents.

“The first goal was to become free and independent and the second very important issue was to live in a free country and free society.”

These narratives echo Polanyi's (1944) description of a liberal economy as a utopian vision and Friedman's (1962: 20) argument that “communism would destroy all of our freedoms”. Under communism Estonians were not free to manage their national economy, they were banned from starting their own business or travel abroad and the assets of the First Republic were confiscated and nationalised by the Soviet Union (Lieven, 1993; Taagepera, 1993; Smith, 2001). A respondent underlines the importance of freedom:

“This idea of personal freedom and freedom for the nation, these were the most important things. Now when we take this idea of freedom, I guess in many cases for many people it was just carried over to economic freedom.”

Such narratives coincide with Friedman (1962: 8) analysis of economic and political freedoms:

“Economic arrangements play a dual role in the promotion of a free society. On the one hand, freedom in economic arrangements is a component of freedom broadly understood, so economic freedom is an end in itself. In the second place, economic freedom is also an indispensable means towards the achievement of political freedom.”

Hayek (1960) defines collective freedom as the ability to decide for oneself and freedom from foreign domination. He describes personal liberty in terms of the degree to which an individual is able to act guided by his/her own reason and equates it with lack of coercion. Independence to Estonians meant that

“When these outside restrictions went away people felt total freedom. You can see it even now in our society... I think this was one important mood of people.” (Enn Listra)

The neoliberal paradigm regards the “political ideals of individual liberty and freedom as sacrosanct” (Harvey, 2007: 24). The term ‘total freedom’ is brought up repeatedly in my interviews. Estonia’s ‘return to Europe’ progressed through ultra-liberal policies, which were unparalleled in many respect among the transition countries, as clearly stated by Mart Laar:

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

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, as discussed in section 7.6. 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, my interviewees, a senior advisor to the President of the Republic of Estonia included, make no secret of their endorsement of neoliberal policies. Enn Listra 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). These accounts unequivocally contest Harvey’s (2007) and Peck and Tickell’s (2009) conceptualisation of neoliberalism as a hegemonic project. Market rule may be “tyrannical” (Peck and Tickell, 2009: 109) but its adoption is contingent upon local economic, political and socio-cultural circumstances, as well as local agency.

7.3.4 The 'pendulum' effect

The Estonian narrative of the socialist era is simple; in the words of an interviewee "everything was bad that was in the Soviet time". All interviewees unanimously argue that anti-communism has been a strongly popular sentiment among Estonians, as illustrated by this excerpt below:

"Everybody wants to get free! I hate this system; I hate the communists!"

Another respondent also reflects on the perceived simplicity of the situation:

"Back then things were rather simple. There was one goal for everybody: to regain independence..."

To quote a third one:

"To get out of the Soviet Union. This was top priority. This was so important a goal that everything else was details."

The experiences of the Soviet era prejudiced Estonians by what Enn Listra calls the 'pendulum effect'.

"This may be one reason, this going away from the old system – this is a pendulum, you start from one end and you are going all the way to the other."

The pendulum effect echoes Bockman's and Eyal's (2002: 311) argument that "East European reformers... not only perceived the need for neoliberal reforms, but also became some of the strongest global champions of such reforms". According to interviewees the paradigm to "take care of yourself... went to the extreme" and "at this time it was very popular to be very right wing" echoing Gros and Steinherr (2004: 1) "(t)oday, communism appears to many as a historic stupidity and, without a shadow of a doubt, capitalism has victoriously emerged as the dominant paradigm." Rein Ruutso highlights the effect of anti-communism on policy choices:

"Basically anti-communist mood. Anti-communist mood was incredibly high. And the discourse was black and white and people had, nobody had any idea, not even me, nobody actually had understanding what is economic policy. At the same time this liberalism was very popular..."

Interestingly, Mart Laar confirms this:

"One can't say that this was objective or distinctive. I would say it was not too much considered so it was just a basis of popular movement, a popular understanding of the identity, history, and so on... it was not so complicated... because there was no time."

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 supports the ‘pendulum’ effect explanation:

“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.”

Such accounts of the goal to build a ‘minimum regulated’ state are reminders of the neoliberal argument that liberal democracy with free markets is the sole system capable of guaranteeing lasting prosperity. While neoliberals emphasise the inherent problems of central planning, they ignore the multiplicity of market-oriented economies, such as the heavily shareholder-oriented Anglo-American model or the bank-dominated and more stakeholder-oriented Germanic and East-Asian systems (Plender, 2003). To them the demise of state socialism is paramount to the disappearance of all alternatives to a free-market economy. A senior advisor to the President of Estonia labels pre-EU Estonian policies as “ultra-liberal”. A former government official presents the view of Estonian policy makers championing a *laissez-faire* economy free from government intervention:

“What planning do you want in an economy? The main principle of market economy, self-regulation is there...”

Estonia’s first freely elected government in 1992 spearheaded a quick break with the Soviet past. The government’s top priority was to get rid of the legacies of Soviet power, including officials with the “burden of Soviet-era competence” (Lauristin and Vihalemm, 2009: 4), as commented by an interviewee:

“People said experience doesn’t matter much because it’s the wrong kind of experience...”

In order to free the country from Soviet-era networks of the *nomenklatura*, which in some transition countries became a major obstacle in the establishment of a legal framework and a market economy (Smallborne and Welter, 2010), the new

administration reorganised ministries and their personnel were replaced by a new political generation that had no communist ties whatsoever (Raun, 2001).

7.3.5 Back to the future?

For reference, the leaders of post-socialist Estonia looked upon the experiences of the First Republic as a template for nation-building. Numerous laws passed and enacted in post-socialist Estonia were modelled on their predecessors in the First Republic, such as the Land Reform Law without much “conscious examination” of its impact on agriculture (Unwin, 1998: 297). As Mart Laar argues:

“...when we look at the background of these policies, many of them come from history. The experience of the First Republic wasn't bad...”

Estonian leaders see their objective in simple terms - “the overall goal was to return Estonia to Europe...” (interview).

Vast segments of the populations of the Baltic States and the CEEC share a strong desire to distance themselves from the socialist past, in which Offe (1996) detects a contradiction between ‘modernisers’ emphasising their ‘return to Europe’ and ‘Christian, rural and populist forces’ underlining ‘return to ourselves’. Modernisers representing hope, ambiguity and uncertainty conflict with the viewpoint of populists standing for the ‘bright pre-communist past’. Estonians implicitly solved that dilemma by drawing continuity between the two republics. In that sense, the term ‘First Republic’ is misleading, as Soviet occupation is viewed as a violent interruption in the history of modern Estonia (Lieven, 1993; Lauristin and Vihalemm, 1997; Smith 2001). Time and again, interviewees phrased their post-socialist objectives as “to return to the West”, which to them is synonymous with the desire “to make a historical return”. Although many measures were copied from the First Republic, the ‘pendulum effect’ manifests itself in the discontinuation of economic policy direction. As opposed to the *laissez-faire* approach of the post-socialist administration, the governments of the First Republic did engage in economic management to some extent with the objectives of rebuilding the economy that was badly damaged in World War I, integration into the European economy and subsequently recovery from the Great Depression (Lieven, 1993; Kahk and Tarvel, 1997).

7.3.6 Why not the Nordic model?

The pre-socialist legacies must not be ignored in the discourse of transition, as they shaped a multiplicity of socialisms as well as post-socialist transitions (Smith and Swain, 1998; Sokol, 2001; Berend, 2007). Throughout the centuries, Estonia was a nation engaged not only in agriculture but also in manufacturing and trade. Various Estonian towns were integral parts of the Hanseatic League and subsequently had close economic, political and cultural links with Sweden and Germany (Lieven, 1993; Piiramäe, 1997; Smith, 2001). These links helped Estonia to quickly reorient its trade from East to West in the post-socialist era (interviews).

However, despite their close cultural and historical links and geographical proximity to Scandinavia and Germany, Estonian policy makers have consistently pursued ultra-liberal policies since 1991 (Lagerspetz, 2001; Raun, 2001; Lauristin and Vihalemm, 2009). Notwithstanding Estonia's Scandinavian ties and self-perceived Nordic identity, Estonian leaders did not emulate their economic policies, an act that an advisor found "quite unusual". As echoed by many of my interviewees, Scandinavia seemed "too socialist" with "awful" tax regimes, an "unaffordable" welfare system and "over-unionised" industries. A former government official remembers:

"Then it was very hard-core right wing rhetoric that 'we are brave, we are right, all others are doing bad things and the Swedes are absolutely crazy and then there is only good economic mechanism in Estonia.'"

In addition, many respondents mentioned the downturn of the Finnish and Swedish economies in the early 1990s, which led to decreasing rates of GDP growth rates, industrial output, private consumption, and deteriorating current account balances, (Aldcroft, 2001) as one reason for the Estonian dislike of the Scandinavian economic system. Andres Tarand offers an explanation as to why the Scandinavian social-democratic system was not followed:

"...with Friedman as an apostle it became a bit ridiculous comparing ourselves with the Nordic countries and others."

Estonian policy makers call for minimum "government regulation and control of business activity by the state" (interview).

7.3.7 *The issue of capacity*

Despite the urgency arising from the uncertain geopolitical situation, keeping Soviet-era managers in their positions was not on the agenda of Estonia's new administration. as admitted by the then Prime Minister, Mart Laar himself:

"First of all you must really make it clear that you must kick the communists out. You clean the administration out."

The first administration of independent Estonia did not include any public officials or politicians from the Soviet era; the new government consisted of young people in their twenties and thirties, many of whom were former dissidents with no links to regimes of the socialist era (Raun, 1994). Erik Terk comments on the composition of Estonia's first cabinet:

"Mart Laar said 'I am a historian, I don't know much about economics anyway' and in some areas they would just go for youth.... I think the first government of Mart Laar had three ministers who were in their twenties... the average age must have been in the thirties."

The former administration was "cleaned out" representing a clear break with the past. "Out with the Soviets" was the slogan (interviews). Mart Laar described the composition of his new government:

"...these people who came to the government, to the decision-making positions, they were young and were not connected with the nomenklatura... they already participated in the anti-communist underground in one or another way..."

According to several interviewees, the mistrust of anyone holding government position in the socialist era led to a "lack of qualified people". The new administration consisted of novice public officials with no background in public administration, governance or economics; they were historians, philologists, etc. This is admitted by Mart Laar:

"None of us had any experience in the organisation of government... The Minister of Justice studied forestry."

Although there were a number of economists working in the various government offices, their knowledge was limited because they studied in the Soviet system where taught 'economics' subjects comprised the principles of 'Marxist-Leninist' political economics, instead of the workings of the market economy (Szamuely and Csaba, 1998). Indeed, as in other parts of the FSU, "people were economically illiterate" (Doder and Branson, 1990: 241), as emphasised by Enn Listra:

“We had in Estonia maybe 5 or 10 people who heard the name of Keynes...even economists didn't know these names. So the choices were not clear between different strands in economic policy but it was built up piece by piece.”

All these narratives refute the theory of conscious and fully rational decision making fundamental to neoclassical economics. Estonia's neoliberal transformation shares certain commonalities with the restructuring of New Zealand's economy. In both cases the objectives were to move as fast as possible, foreign investment was considered the key to economic growth and both economies became completely exposed to international competition. The free-market agenda enjoyed the support of the political elite. However, unlike in New Zealand, neoliberalism had popular backing in Estonia. Numerous authors, among them Kelsey (1997), Lavigne (1999), and Gros and Steinherr (1995 and 2004) argue that a crucial argument for shock therapy is to demonstrate irreversibility of commitment to democracy and a free market economy. In Estonia it was not lack of popular support but the dire economic situation and the uncertain political climate aggravated by the presence of Russian troops until 1994 that necessitated speedy reforms. In addition, Estonian macroeconomic policies were not 'systematically formulated', as was the case in New Zealand (Kelsey, 1995 and 1997).

The economy of an entire nation depended on the economic policies of an administration whose knowledge was less than adequate, as an economist remembers:

“I also tried to understand the economic policy in Mart Laar's government and he had one advisor who had a very big influence. I knew him quite well and I asked him who really did them and he answered that 'it's partly me'. But he was a philologist! I remember very much that one month before it he asked me in Amsterdam that 'please, explain me what is the difference between GDP and GNP'. That was the level of knowledge at this time.”

The lack of appropriate qualification of cabinet members had a drastic impact on policy formulation, as “many decisions were based on feelings” and “less on knowledge or a clear picture of how a society should look like” (interviews). The sense of urgency dictated by uncertain political and economic circumstances and lack of expertise affected policy making as well as approval of legislation. Siim Kallas attests:

“...we created three laws about monetary reform, which were proposed and were accepted in May '91 immediately by parliament, within one month. And all these three laws had one vote against them together in parliament. But nobody understood what they were all about.”

Speed, which was essential to take advantage of the ‘window of opportunity’, influenced the process of policy monitoring also. A former government official recalls:

“This was maybe a weak point. The speed was so quick that for monitoring we had not enough power and time even.”

Ardo Hansson explains how policies were monitored in Estonia at the times:

“I don't think that certainly at the cabinet-wide level that it was ever systematised. Maybe the ministries would have had a little bit more monitoring but I just think that there was so much uncertainty that nobody really knew, I think you couldn't articulate 'if I do these inputs, I am going to get these outputs' then monitoring at that point of time it was more just making sure things are not going totally south.”

The inadequate nature of monitoring is supported by a former cabinet member:

“...they were not monitored or were monitored to a very small degree. You just did something in what you had a strong belief.”

Youth, inexperience and lack of appropriate qualifications are a returning theme in my interviews. However, Mart Laar stands by his decision to exclude ex-communists from his administration, even at the expense of experience and qualification:

“And it was a very good decision, looking back afterwards. And these young people who came they were mostly motivated in the same way, they did superb reforms. No man or lady in the regime in the western world would have any chance to make such a career... When they were good, they went up very quickly. That was their possibility and a lot of people and when you are young you ought to use it... in a lot of cases we just changed all the laws, law teams and so on, just to prepare the law at the speed, which we wanted. When I needed the law in a week and when a team of professors came to me and said that they can give the law in a month, not in a month but in a year and they have worked on the same law one year before. We just kicked these professors out and gave this to three young guys and in a week they made the law. And that was the same in the government and the administration.”

A former member of the government supports this view:

“In Estonia it was possible just finish the university and after one year to be department head of, for example, in a ministry.”

Erik Terk attests to the inadequate skills and knowledge of the cabinet members of the Mart Laar administration:

“Mr. Laar and his people didn’t have any experience in economic policy.”

Urmas Varblane comments on the level of preparedness and knowledge of decision makers of Estonia’s first freely elected post-socialist administration:

“The problem was that people had read only the first chapters of textbooks, the very first ones... Very simply stupidity or inadequate preparedness was in that time also an issue.”

The amount of tasks for a newly independent country facing triple transition would overwhelm seasoned experts, let alone “dilettants” (interview). Ardo Hansson explains the implications on policy choices:

“One of them was clearly the issue of capacity, that’s why a lot of the reforms that were adopted turned out to be very simple ones, like the currency board, perhaps flat taxes and all these types of simple rules based.. When you start anew, you have no ability anyway to micromanage the economy, you’ve never done this before, so keep things simple...”

All these statements underline the ill-preparedness of policy makers echoing Fukuyama (2004) that incompetent administrations are a source of serious problems. Many of them were unqualified for the position they filled in thus they were unable to make informed and educated choices. This was aggravated by the speed of changes leading to inadequate monitoring of policies. A former cabinet member brings up the difficulties they faced in obtaining and interpreting statistical information. Such issues support Hayek’s (1960) argument that an inactive government is superior to an active one, as no central body can integrate the knowledge of individuals of their own circumstances, which was especially true in the case of the Estonian administration that was staffed with inexperienced and underqualified officials. Inadequate capacity along with fifty years of paternalistic state control gave additional stimulus to ‘roll back the state’ (Kelsey, 1995; Fukuyama, 2004). In line with Hayek’s (1980) recommendations, a lot of responsibilities have been passed on from the central administration to local governments in Estonia, as attested by the former Deputy Mayor of Tallinn:

“The state has pushed a lot of obligations onto the local governments without providing them with the means; they pushed the limits too far.”

Neoliberal economic policies, as analysed in detail in Chapter Two, are very simplistic, almost primitive. They do not require discretionary fine-tuning; they automatically

follow a few economic targets, such as a nominal inflation rate and a balanced budget. Furthermore, it relies on a proportional tax regime, which is simple to implement and monitor. Relying on the self-correcting nature of the market reduces the need for government intervention and room for error. Indeed, “the lack of experience, of the experts led to implementing standard restrictive fiscal and monetary policies” (Lavigne, 2000: 477). Erik Terk agrees:

“The viewpoint of the 1990s was that economic policies are very simple that you just must have a simple tax system, and so on...”

In the follow-up interview, he commented on another aspect of neoliberalism that invokes Polanyi’s (1944) assessment of neoliberalism’s utopian vision of a free economy.

“...they were new politicians... and it was very easy to find a very clear-cut ideology, very extreme but it’s such a pure picture of the world.”

The simplistic economic policies coupled with the utopian vision of ‘total freedom’ of the neoliberal paradigm appealed to Estonia’s policy shapers. The lack of experience and appropriate qualifications coupled with an anti-statist bias made Estonian policy makers susceptible to the neoliberal principles of a self-regulating market, minimalist government, individual initiative, self-reliance and accountability. Rein Ruutso offers his views on the then prime minister:

“He was fond of Thatcher, Mart Laar... He had no vision, he had no policies at all. He just took a model and proposed it... He saw black and white, he was no expert and had no vision. He had no understanding...It was an ideological decision, not based on logic.”

Lack of capacity, anti-communism and the perceived ‘total freedom’ of neoliberal utopia were joined by another reason why policy makers leaned towards neoliberal policies – the desperate economic situation.

7.4 The ‘economic swamp’

The administration of newly independent Estonia was immediately put to the test, as the country was facing immense economic hardship. The ESSR was one of the smallest republics of the Soviet Union (Dmitrieva, 1996) and, in essence, was a peripheral part of the vast Soviet economy. The disintegration of the Soviet economy dealt a huge blow to Estonia; in the words of respondents, “it was an insane time” because “everything

was falling apart". Supply networks were suddenly disrupted creating shortages of fuel and raw materials. Overcentralisation in the socialist era meant that many producers were monopolies, solely responsible for the production of particular goods, including intermediary products. Any delay or disruption in their production trickled down the supply chain, often bringing factories to a halt. Industrial production decreased drastically by about 40 percent, leading to acute shortages and panic buying. At the same time, the large guaranteed Soviet market disappeared overnight, leaving Estonian factories with \$200 million worth of unsold consumer items in 1992 (Lieven, 1993; Smith, 2001). Erik Terk comments on the disappearance of the Russian market:

"...the big crisis started in Russia in the beginning of 1992... the Russian companies were not able to pay for the goods. The question was not political because Estonian companies wanted to sell their products to Russia but if you don't get money back, then it's meaningless."

Estonia relied heavily on the Russian market for energy supplies because its oil shale deposits met only half of its energy requirements. When Russia began to sell its natural resources at world market prices to non-members of the Commonwealth of Independent States (CIS) in 1992, Estonia's terms of trade greatly suffered, as global market prices were 150 percent above the domestic FSU prices (Gros and Steinherr, 2004).

Although the 'principle of legal continuity' served as an important anchor in post-Soviet Estonia, ethnic 'restoration' of the First Republic was unrealistic. The Citizenship Law of 1992 was interpreted by many ethnic Russians as the creation of 'ethnic democracy' (Smith, 1998). The reaction of the Russian authorities in Moscow was to impose double tariffs on all Estonian imports, which adversely affected Estonian businesses as well as households. Estonian organisations all but lost the Russian market and the country faced the disruption of crucial energy imports (Reiljan, 2001). In the winter of 1991-92 Russia cut its fuel supply to Estonia altogether (Lieven, 1993). Urmas Varblane remembers that winter:

"They didn't ship us oil anymore... And this blockade at that time was very effective in the sense that we had no harbours to take in ships, we had no tanks to keep oil products because in Soviet time it always came by railway from Russia... we were in real trouble. I remember that public transport in Tartu finished at 8 o'clock in the evening. Walk on foot, if you want and we, of course, walked."

In order to alleviate the shortages, the government sharply raised energy prices in March 1992. Using credits obtained from the World Bank and the European Bank for

Reconstruction and Development (EBRD) alternative energy sources were sought (Smith, 2001). The removal of price subsidies and the transmission of world market prices to Estonia led to significant price hikes. Consumer goods prices increased by 1,076 percent between 1991 and 1992 (Statistical Office of Estonia). The highest price rises occurred in medical care (115.1 percent), housing (83.3 percent), personal consumption (51.3 percent) and clothes and footwear (42.8 percent) (Eesti Pank). Gorbachev's prediction of the Baltic States finding themselves in an 'economic swamp' by pursuing their dreams of independence (Smith, 2001) seemed to be coming true.

The immense task of state building was exacerbated by the dire economic situation. A participant of those turbulent events recalls:

"We had a lot of difficulties in the economy – huge inflation – how to run the economy in case of inflation of hundreds of percentages...to keep the economy on the road in some way and on the other hand to cover some services. So, on the one hand, it was to build new systems and, on the other hand, to support the functioning of the state... So the government's position was in some way as that of a fireman..."

The economic hardship aggravated by Russia's policies had two unintended effects. Firstly, it "helped to reorient our economy much faster" (interview) from East to West. Many respondents argue that despite the short-term pain the blockade and the tariffs imposed on Estonian exports proved a blessing in disguise because

"Maybe we should thank the then leaders of Russia, who imposed the double taxation on our country because this was the biggest help one could get. Milton Friedman couldn't have helped us but the Russians did. Moscow did. The Kremlin did. Because the double taxation forced us to reorient our economy much quicker than we would actually have done." (interview)

Not being able to sell their output on the Russian market due to uncompetitive prices caused by the double tariffs, Estonian organisations were forced to look at alternative markets. "Estonia had not too many options" (interview). Helped by the 'Finnish link', that was detailed in the previous chapter, Finland overtook Russia as Estonia's main trading partner as early as 1992 (Statistical Office of Estonia). According to an interviewee, the speed of reforms "was pushed by Yeltsin himself". A respondent remembers the hardship:

"That first winter was quite tough. And still nobody went on the streets to blame the government. It was some kind of common resistance to this outside pressure. And that helped the government also. I think the Russian behaviour was very wrong in that time..."

The second inadvertent consequence of Russian discriminatory economic policies was the strengthening of the population's patience in an unstable economic situation providing the government with popular support. Mart Laar explains:

"It was a greatly desperate situation and desperate situations can be very useful..."

The grim state of the Estonian economy required policies that can be implemented easily and quickly. The uncertain geopolitical situation, the ambivalent attitude of Russia to Estonian independence, aggravated by the presence of ex-Soviet troops in Estonia, and the dire economic situation all necessitated simplistic, easy-to-implement, rule-based policies. Neoliberal policies lend themselves as a solution in such crisis situations, particularly in view of the long 'honeymoon period' enjoyed by the administration.

Thus the question arises, as to whether these policies were the result of hegemonic imposition or local agency?

7.5 The role of international financial organisations in Estonia's transition

7.5.1 Hegemonic imposition of neoliberal policies or active local agency?

Peck and Tickell (2002: 396-397) view neoliberalisation as a "macro process", in which neoliberalism has been "engineered through explicit forms of political management and intervention... in the context of largely uncontested US hegemonic dominance". 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" (interviews). I argue that Estonian neoliberal policies were not imposed externally and hegemonically but were devised and implemented locally.

Limited expertise and grave uncertainty are quoted by my respondents as one of the 'main difficulties', which called for external help in early 1990s. This raised questions regarding the selection of advisors and the extent of external influence over the decisions of Estonian policy makers. The following passage by an active participant well illustrates the role and influence of external advisors on Estonian policy making.

"There were a lot of different advisors who did know well but one thing is to give advice and another thing is to take decision and to act according to that."

So it was based on feelings and less on the knowledge or clear picture of how a society should look like.”

The involvement of external advisors and consultants was limited (Gillies et al. 2002). My interviews indicate that policy makers mostly relied on local advisors and émigré Estonians, as well as “young Estonians and children of exiled Estonians” (interview), the reasons for which are discussed in section 5.3.

Siim Kallas provides as example of his own view of an international organisation:

“...for instance, one EBRD mission came and started to ask ... ‘now you should say what is your plan how to do monetary reform’. I said ‘I have no plan at all. What is your plan?’ They couldn’t say it. I said ‘why are you here?’ There were no such missions anymore to my office.”

The Estonian imaginary, discussed in Chapter Five, clearly manifests itself in such narratives underlining self-reliance and mistrust of outsiders, culminating in a ‘go-it alone’ stance. Estonian policy makers were very selective in utilising external advice; “there weren’t too many of those foreign experts”. The ones they did use were “selected mainly in the basis of individual preferences” (interviews), in which Estonia’s Nordic links played a significant role.

To mistrust of outsiders as a reason for relying on Estonian advisors, Siim Kallas adds speed:

“I am very famous for being very critical about foreign advisors. Even the Finnish President, Mauno Koivisto when once visited Estonia said that ‘ah, you are this person, who doesn’t want any foreign advisors’. We discussed this in the beginning that if the process is fast, you are under enormous pressure as well. We had very little time...”

External advice was used, although

“...we didn’t have many permanent advisors. There was one guy, quite good guy, Ardo Hansson, an expatriate Estonian from Canada and US. Finished Harvard and worked as an advisor.” (interview).

Estonia’s Scandinavian neighbours and “friendly governments who supported us” played an important role – “we got very good advisors from Sweden” (interviews). Whereas many of the leaders and technocrats of the Southern American economies that underwent neoliberal restructuring in the 1980s and 1990s graduated at North-American universities with strong monetarist curricula (Dezalay and Garth, 2002; Harvey, 2005),

that was not the case in Estonia. Among members of the first administrations were climatologists, historians, political scientists, physicists, mathematicians, writers, engineers, etc. all educated in the Soviet era, undergoing further training in Germany and the Scandinavian countries. Only Siim Kallas and a few members of the Central Bank were trained economists. Of all the policy makers and advisors, two people received their degrees in America. Ardo Hansson²⁰ has a PhD in economics from Harvard University. Toomas Hendrik Ilves, the current President of Estonia, has a master's degree in psychology from the University of Pennsylvania (Homepage of the President of the Republic of Estonia). The 'transition industry' (Swain, 2006) in Estonia did not include change agents from neoliberalism's North-Atlantic heartlands. Thus, the theory of the transfer of the neoliberal ideology from its Anglo-Saxon heartlands to the peripheries through change agents with economics or law degrees obtained at American and British universities (Kelsey, 1995; Dezalay and Garth, 2002; Harvey, 2005) does not hold in the Estonian case.

Due to a shortage of expertise, officials accepted help in tactical, technical matters. The drafting of the new constitution in 1992 relied on the expertise of the Council of Europe, IMF, World Bank and EBRD. Guidance was drawn upon in technical economic matters (Lauristin and Vihalemm, 2009), which is supported by the interviewees – “I don't see any big difference between what we did and IMF”. However, similarity of policies does not explain their origins. Based on my findings, the strategic decisions were made independently and the overall direction of these policies was decided upon by Estonian officials. Siim Kallas explains:

“IMF role was... the strategic concept was ours but in practical implementations they helped a lot. They helped a lot in terms of building up treasury mechanisms... Technical matters in all this monetary policy and we were on very good relations.”

Tiit Vähi underlines their single-mindedness and argues local agency:

“IMF was against it (currency reform) but when they realised that we are going to go ahead they started to support us and to also advise on this issue. They sent a group of three specialists who were permanently here until the implementation of this reform.”

Aardo Hanson summarises the role of international organisations.

²⁰ Advisor to the Estonian government 1991 - 1997

“I think there was a kind of tactical assistance that was provided and I think was quite important for very technical issues, like building up a functioning tax administration, tax code, customs, all the legal systems, there is a lot of nuts-and-bolts institution building where I think that really paid off where you need much more than just an instinct about which way to go but you actually need a heck of a lot of capacity building and institutional strengthening, that I think was more where the international community really helped.”

Estonian decision makers used external help as guidance but decided upon strategic policy directions themselves. An interviewee echoes their self-reliance and go-it alone perspective:

“In these kinds of revolutions, like in Estonia, you feel very clearly that you have to do your decisions. You have to do everything humanly possible and only then God comes to help you.” (interview)

In support of this view, I quote Aardo Hanson again describing his own role:

“I think a lot of it was just kind of giving a bit more confidence to people. You might have a prime minister who has some ideas but he is not an economist but he thinks he should do certain things. And to have somebody to say ‘look, you are on the right track and let’s pursue that’, having a trained economist from the west who would confirm those instincts, I think, may have been more important than actually coming up with specific proposals... A lot of it was just trying to avoid big mistakes... If somebody came up with an idea that didn’t make much sense at all, seemed to be too much of a quick fix or a pie in the sky, then you might say ‘hold on, let’s reconsider that’. So, just steering away from the landmines, I guess.”

The political declaration of independence, trade liberalisation through immediate elimination of all trade barriers and the subsequent introduction of the national currency in 1992 are examples of Estonia’s defiance of external advice. Urmas Varblane gave me his view of the external advice provided by the international financial institutions:

“You know what this sentence ‘sound macroeconomic policies’ mean? Whatever it means. It is stupidity. It’s very little help for countries. We acted against other kinds of recommendations in many cases.”

Unprecedentedly, the international financial organisations actually toned the ultra-liberalism of Estonian policies down, as explained by Erik Terk:

“... there was such an understanding that priorities are not needed at all. The market is ruling and long-range planning is not needed at all. It was a very strong and quite primitive understanding. Then the World Bank told that ‘guys, we don’t give you money if you don’t have, for example, long-term infrastructural development programmes’... and Estonia started to introduce planning.”

Then he sheds more light on the country's development plan that is reminiscent of Adam Smith's concept of the 'invisible hand':

"...formally we have a national development plan but it's not a plan in reality, it's a document that was prepared for Brussels to get more money."

In the socialist system, as all factors of production were owned by the state, priorities reflected not the requirements of shareholders but of the central authorities. The fundamental economic questions of what to produce, how and for whom were political decisions and the market was excluded from the valuation and comparison of values. Thus the fulfilment of all needs and wants had to be planned (Swain and Swain, 1998; Sutela, 2003). Having experienced this extreme form of planning, Estonian policy makers chose the other extreme – no planning. While they appreciate the necessity of appropriate institutions - by Mart Laar's admission economic reforms on their own without institutional reform would not work – they share Hayek's (1960) tenet that the only knowledge is the knowledge of the individual and it is the advancement of knowledge that leads to the betterment of society and not conscious control. Their goal to achieve the utopia of 'total freedom' was reflected in the economic objective of "let's just liberalise..." (interview).

It is the European Union that has affected Estonian policies to the largest extent through the pre-accession *acquis communautaire*, as EU accession was a high priority from the very beginning of transition for economic, as well as security reasons. EU assistance was instrumental in putting the 'basic framework conditions' – "the creation of initial legislation and regulations allowing private businesses to legally exist", including the "establishment of private property rights, market-based institutions, as commercial banking system, company and business law" (Smallborne and Welter, 2010: 196). The "detailed and descriptive agenda imposed by the European Union... was closely monitored by annual progress reports from 1998 onwards" (Swain and Swain, 2009: 233-234). Estonia's adjustment to the EU *acquis communautaire* 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 argues 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.”

Although some EU institutions bear certain neoliberal features, such as the restriction of fiscal deficits and the decrease of government borrowing, EU policies are based on a strong statist tradition and social welfare provisions, characteristic of Western European economies. Decreasing employment rates and low tax rates aimed at attracting foreign capital leave the CEEC with low levels of tax revenues putting the inflow of EU funds in a very favourable light. EU accession – even its mere possibility - has moderated Estonia’s ultra-liberal economic policies and their forms of capitalism by establishing their institutions on the western European model (Toporowski, 2005). An interviewee explains:

“There seemed to be a bit of a trade-off. We’ve got this very free regime and if we go to the EU we have to adopt these tariffs, and so on, which will take us back from where we would ideally like to be. On the other hand, you look at the EU as a whole package and say that looking at the pluses and minuses, the pluses still dominate, so that’s a price that we will willingly pay and perhaps the real deep access to the single market maybe trade off the increases in a few tariffs.”

In contrast to the theory of the hegemonic diffusion of the neoliberal agenda, 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.

Another example of endogenous Estonian policy formulation is the abandonment of the rouble zone and the adoption of a national currency.

7.5.2 The introduction of national currency

Estonia’s introduction of its own sovereign currency is a prime example of the single-mindedness of Estonian initiative and defiance of external advice. The financial situation in the Soviet Union was deteriorating fast, partly due to the irresponsible monetary policy of *Gosbank*,²¹. Following price liberalisation, inflation rates reached 2400 percent in Russia in 1992 (Sutela, 2003) aggravating Estonia’s mounting economic difficulties, since Estonia was still using roubles as national currency. Thus.

²¹ State Bank of the USSR

gaining control of Estonia's monetary policy became crucial (Gillies, et al. 2002). A member of the Board of the Central Bank explains:

“Then the question was... How can we fight inflation? That was the reason why in Estonia it was decided, that if we liberalise prices, and let foreign trade to occur, then we should somehow fight inflation and we decided that the best thing is to introduce our own currency, which is convertible from the very beginning. And that is where all these advisors were against it. They said: “introduce some semi-currency”, that was the idea, semi-currency. Which is not convertible and then later if it stabilised, you introduce your own currency.”

Due to astronomically high inflation rates “it was clear that we must act very fast” (interview). A respondent explains:

“...if you don't have money in the state budget at all and if people living in cities are not able to buy food and the price of food goes up and you get big problems in cities, then there is no other option. You must just go forward.”

Despite the hyperinflation in the rouble zone, the IMF advised to “first wait for the rouble to stabilise” (interview). Indeed, the organisation objected to introducing a new currency (Brown, 1993) and “stressed the importance of embedding the currency reform in a... consistent macroeconomic framework”, recommending “the introduction of coupons as a temporary supplement to rouble notes” (Knöbl, et al. 2002: 12 and 8). An economist describes the reaction of Estonian officials:

“...this currency type of monetary reform. Everybody is talking about the international organisations' support. It was just the opposite. IMF was strictly against it – ‘stupid idea, don't do that, we will never support you.’ We did it against all recommendations. Their story was ‘keep the Russian rouble’. Then the inflation rate was 1,000 percent! Crazy!”

Mart Laar strongly criticises the IMF's advice to the Baltic States not to leave the rouble zone:

“Lithuania became independent earlier than we did, so they didn't have any other chance but to start reforms. Then they made some very bad decisions, which means that they listened to the IMF.”

In the end the IMF relented (Lavigne, 1999) and issued a joint statement with the Bank of Estonia in support of the currency reform (International Monetary Fund) on June 19, 1992, just one day before the planned date of the introduction of the Estonian Kroon.

Another economist – echoing many similar narratives – remembers:

“...there was some kind of IMF instruction and then the government did the other thing. Our position was that we must do it another way and then we told the IMF three times they told us that ‘it's ok, it's your decision but please don't say that this is our responsibility behind it’”.

The introduction of a national currency was not just of monetary significance but also of symbolic value, as Jaak Jõerüüt explains:

“The rouble was foreign money, over which we had no control. We couldn't decide what would happen with this money and, of course, the rouble was a problem because of inflation. And symbolically it was very bad... Foreign journalists came and asked ‘why do you have to have your own money?’ Then I explained how it influenced Estonian citizens symbolically. I took a rouble note and showed ‘look, every day, every single person has to look at Lenin, the symbol of the Soviet Union!’ There wasn't even a Soviet Union by then! It was crazy.”

To illustrate his point, I include a scanned picture of a rouble note below:

Figure 7.2 Soviet currency



Amidst the economic crisis the Estonian government went ahead with the introduction of the Kroon as the national currency on 20 June 1992 (Raun, 2001; Smith, 2001). Siim Kallas recalls those ‘fateful’ days and the huge responsibility that he was facing:

“I had a very important meeting in Washington on the 25th of May, probably, which I always have described in Estonia as one crucial moment. I went to Washington alone... I arrived Sunday evening then I had an apartment hotel close to Watergate. Then I went just to walk on the Potomac bank to avoid jetlag and there was nobody, no single person and the sky was surrealistic like in a romantic or Antonioni film and nobody walked there, I only walked. Then I had a terrible fear, then I thought ‘ok, I know that tomorrow IMF starts to recommend and suggest to postpone monetary reform and if I say yes, we will postpone, I will come back to Estonia and people will be, of course, a little unhappy but they will accept, you know, IMF, so important, clever people. But if I say no and we will not postpone it, then the responsibility is only on me.’ Only! Because if we fail, of course, who will be hanged is absolutely clear. Because in the later stage they all – the Prime Minister had certain hesitation, everybody – but it was in this particular moment. Then was the final event in Washington when the next day I started to visit different IMF departments and they all said ‘you should postpone and we said no, we will not postpone, not postpone’ and then finally was Michel Camdessus, Managing Director. We had lunch and the table was already

empty, only flowers and Camdessus had such a fruit knife and he turned it in a way and he said that 'I still think that you should postpone' and I said 'no, we will not postpone'. Then he always was a very positive person, it was only one moment when I saw his constant smile disappear and said that 'ok, you are the state, you are the country, you are responsible, you decide. We will assist you. But you will be in turbulent waters.'"

Estonia's adoption of the national currency is yet another example of active local agency. A country of barely one and a half million people having just regained its independence with no resources defied the advice of a major international organisation and decided to 'go it alone' again.

In order to avoid any misunderstandings, I asked my interviewees whether Estonians made policy decisions independently. Mart Laar, then prime minister, for whom the policies of the IMF and the World Bank were "too mild", categorically stated that they "did not listen to the IMF at all". Andres Tarand agrees that they "didn't follow their recommendations". Siim Kallas provides a detailed explanation:

"Independently. I was an economist who saw an enormous chance; millions of economists would like to have such a chance really to make monetary reform. But, of course, I and my colleagues, we were in the learning stage. And IMF suggested actually to first stabilise the rouble. But at that time, being an economist, I was also a politician clearly and understood that we must do it fast, it means that it must be very simple and understandable and manageable because the monetary reforms that the IMF suggested actually predicted the availability of skilled staff and established institutions. We didn't have anything!"

His narrative is telling. Firstly, it reinforces the theory of local agency with endogenous policy formulation. Secondly, it underlines the presumption on the part of the IMF that a newly established state just a few months after escaping from half a century of Soviet domination would have skilled staff available. It also draws attention to the Washington Consensus' neglect of the importance of institutions and its mistaken assumption of the automatic emergence of the preconditions for the functioning of a market economy and lends support to its strong criticism.

Again, lack of capacity, resources and foreign as well as domestic confidence in the nation's economy limited the available options. The currency board arrangement is the most extreme loss of economic sovereignty, as the money supply is restricted by the country's foreign exchange reserves (Lavigne, 1999), which is a central bank guarantee needed in order to pledge convertibility. Maintenance of the peg to another currency, in

this case to the German mark, prevents the central bank from lending funds to the government, seriously constraining its ability to interfere in the economy to rescue struggling organisations and industries. Another source of funds for a cash-strapped government in an underdeveloped economy with a primitive financial system, such as Estonia in the 1990s, is to borrow from commercial banks. However, with scarce funds very much in demand by entrepreneurs, the authorities found it appropriate to prevent any temptation on the part of the government to cover its costs with loans and coupled the currency reform with a commitment to maintain a balanced budget. Although, a balanced budget is not a requirement for a currency board, the subsequent Estonian administrations have kept it in place (Bennett, 1993; Gros and Steinherr, 2004).

Given the lack of capacity and the urgent and immense tasks faced by the administration, simplicity was a key determinant in policies. The choice of currency board, the elimination of trade barriers, the proportional tax system and adherence to a balanced budget are all examples of simple-to-follow, rule-based policies, which facilitate the functioning of a minimalist government with limited expertise. Indeed, numerous interviewees support this argument:

“...there was a lack of knowledge to introduce more complicated systems. For example, we were not able to introduce a very complicated tax system... and we decided to design simple systems that were right – flat tax, for example... I think this is important for understanding decisions in the 1990s.”

“...my view was that let's leave everything, let's have some very strong pillars that we can manage. Currency we can manage. If we cannot manage customs barriers – this also needs people to check – then we cannot have these barriers. If we cannot manage subsidies to agriculture because it is a huge bureaucracy then we don't have such a bureaucracy. Taxes must be simple because we don't have skilled people who can collect taxes.”

Within one week of its introduction, “the new currency became generally accepted as the new and exclusive medium of exchange in Estonia” (Knöbl et al. 2002: 17). Despite the pessimistic forecasts of international advisors, by anchoring the Kroon to a stable currency, Estonia was able to stabilise prices and resume growth quicker than other CEEC economies (Rajasalu et al, 2003; Gros and Steinherr, 2004). Confidence in the Kroon was enhanced when the Bank of Finland started to publish rates for the Estonian currency for information purposes in December 1992 (Bennett, 1993). The quick and successful introduction of a stable and convertible national currency greatly contributed

to the recovery of the Estonian economy by letting the country escape from the hyperinflation of the rouble zone in the early 1990s (Raun, 2001; Smith, 2001). The consumer price index decreased to 89.8 percent in 1993 and 47.7 percent in 1994 (Statistical Office of Estonia).

Currency stabilisation was also a key factor in successfully attracting foreign direct investment, crucial for a country with very limited amounts of domestic capital. Estonian per capita FDI inflow has been among the most successful in CEE. Pegging the Estonian currency at a significantly undervalued rate helped to boost exports and reorient trade from East to West. Subsequently, the IMF approved Estonia's currency reform (Lavigne, 1999; Raun, 2001).

The currency board regime is not a neoliberal policy *per se*, although by restricting monetary policy choices it precludes the possibility of fine-tuning (Lavigne, 1999). However, the preservation of the balanced budget requirement is. By imposing the balanced-budget restraint, they prevented central bank lending to the government and decreased the likelihood of an economically 'active' administration. In order to balance the budget, Estonian policy makers have invented the unique 'negative supplementary budget', which means automatic expenditure cuts if tax revenues do not meet expectations. Urmas Varblane explains how the 'negative supplementary budget' works:

"We have done something, which is quite extraordinary: 'negative supplementary budget' within the year to reduce the size of the budget, which is a very heavy thing. In many western countries no parliament is passing this kind of document. You have planned, you have 80 billion budget, now you see that tax incomes are not so good and in the middle of the year you say 'now I take away 5 billion'. We did it."

Estonia's conservative budgetary and banking policies are examples of the hands-off approach to economic management. While the currency peg regime rendered monetary policy ineffective, strict adherence to a balanced budget deactivated fiscal policy. As an economist testifies:

"I think there was also this kind of rules-based policies. Certainly in the currency board, for instance, there was a certain kind of political economy argument that they tied their hands – we know that we are going to get all this pressure from these old school state enterprises to bail them out – therefore setting up these rules, which say, 'sorry, we can't help you because we are not allowed to'. I think it was also attractive to some of these people"

to actually facilitate, kind of dampen this political pressure. Currency board and other things like that qualify as rules-based... ”

Referring to Hayek (1976), Estonians had ‘government by orders’ imposed on them in the Soviet era that was subsequently replaced with ‘government by rules’ prescribing passive long-term policies as an effective set of rules. The anchoring of the balanced budget requirement in Estonia’s constitution means just that, as it takes a two-third majority of the Parliament to overturn this regulation. The determination of policy makers – government official as well as Central Bank specialists – to maintain a balanced budget leaves very little room for active economic intervention.

7.6 Conclusion

The key themes in this chapter are anti-communism, self-reliance, lack of capacity, uncertainty, urgency and simplicity. My findings indicate that the popularity of neoliberal policies, prevailing anticommunism, the uncertain geopolitical situation, and the state of the Estonian economy had a combined effect over policy options in post-socialist Estonia. Estonian policy makers strived to construct the form of economy that they perceived most compatible with their value system and their understanding of their environment. Their policy choices were based on cognitive as well as affective criteria.

Estonia’s post-socialist transition refutes the assumption of linear, unproblematic transformations. The country regained its independence in 1991 among highly volatile political circumstances. The sudden collapse of the Soviet Union created an unexpected ‘window of opportunity’ that Estonians peacefully exploited by regaining their political and economic sovereignty. The country was facing the complex and unprecedented triple transition from a totalitarian regime to a multi-party democracy, from a centrally planned to a market economy and from a Soviet republic to a sovereign state. The assumption of linear transition from a negative past to a positive outcome did not materialise.

Having suffered half a century of Soviet domination Estonians rejected communism and all aspects of socialism. Their perception of the state as an authoritarian institution

strengthened their desire of establishing a free-market economy based on the unrestricted 'total freedom' of the individual placing neoliberal theory in a very favourable light reminiscent of Polanyi's (1944) analysis of 'neoliberal utopia'. Due to the nation's recently regained freedom and the adverse Russian policies towards Estonia the country's population patiently endured the impact of ultra-liberal policies providing the administration with the benefit of the doubt. The uncertainty of the geopolitical situation aggravated by the presence of Russian troops on Estonian territory until 1994, the absence of well-qualified staff and the grave condition of the Estonian economy called for decisive and speedy actions. Estonian policies of the early 1990s were not well thought-out, consciously designed policies. Policy makers utilised on simple-to-devise and simple-to-implement rule-based monetary and fiscal policies, such as a currency board regime, a proportional tax system and adherence to a balanced budget.

They relied on themselves and the Estonian diaspora, most of whom were educated in the Soviet Union, Germany and Scandinavia thus they were in no position to transplant neoliberal ideas from the USA and the UK. "The US research universities" may have been "training grounds for many foreigners who take what they learn back to their countries of origin" (Harvey, 2005: 54) but they played no part in educating Estonian change agents.

Estonia's unilateral complete liberalisation of trade, *laissez-faire* economic management, introduction of the national currency have all happened in defiance of the advice of international financial institutions. The indigenous nature of these policies is illustrated by their ultra-liberal nature prompting international financial organisations, such as the IMF and World Bank, which Harvey labels (2005: 29) "centres for the propagation and enforcement of 'free market fundamentalism' and neoliberal orthodoxy" to advise Estonia to de-neoliberalise its economy disproving the view of neoliberalisation as a hegemonic project.

Last but not least, the IMF's insistence on Estonia staying in the rouble zone underlines the Fund's neglect of context and its presumption of the existence of appropriate institutions required for successful reforms.

Chapter 8. The Emperor's Clothes

8.1 Introduction

By examining Estonia's post-socialist transition, I argue that local agency has a crucial role to play in the diffusion of the neoliberal paradigm. History and the country's ambivalent geopolitical situation instilled a collective memory of injustice in Estonians leading to a self-image of individualism and self-reliance. Half a century of Soviet totalitarian domination left them with strong anti-statist attitudes resenting dependence on a 'nanny state'. Estonians proactively discarded the legacy of central planning in favour of a free market economy emphasising values compatible with neoliberal theory, such as individual initiative, self-reliance, accountability, and a minimalistic state. Structure restricted agency in the forms of uncertainty surrounding Estonian independence due to Russia's policies and Soviet/Russian troops stationed in Estonia until 1994, the drastic state of the economy, and the absence of expertise when facing the immense challenges of state building, which required simplistic easy-to-implement rules-based policies. Estonian policy makers chose neoliberal policies because supply-side economics and monetarism are well suited to crisis situations due to their simplicity, and the neoliberal utopia of 'total liberty' held a great appeal to them.

In this chapter I explain why the European Commission (1999) named Estonia 'the shining star of the Baltic'. I examine the restructuring of the Estonian economy and 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, fast economic growth and high levels of 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.

8.2. The 'shining star of the Baltics'

The literature praising Estonia's post-socialist economic transformation is vast (Hoag and Kasoff, 1999; Panagiotou, 2001, Gillies, et al. 2002; 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". According to Gillies, et al. (2002: 175), "one of the greatest and most successful of these transitions took place in Estonia during the 1990s". 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 until 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. The same year, Estonia ranked number 4 on the Index of Economic Freedom Ranking (The Heritage Foundation) behind Hong Kong, Singapore and Luxemburg. It regularly outranks all other Central and Eastern European countries on the World Competitiveness Index. Ardo Hansson 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..."

The various international agencies, such as the IMF, have praised Estonia's post-socialist economic transition. "For the EU, Estonia is the darling of the Baltic States..." (Panagiotou, 2001: 262). According to Moody's Investors Service (2007), "Estonia has demonstrated exceptional economic performance since the beginning of the transition process in 1991." It also states in its analysis that

“Rapid economic growth with relative stability can be largely credited to the consistent application of sound economic policies and strong institutions. The depth and quality of structural transformation over the past sixteen years has been among the best of the new EU members and contributed to the evolution of a flexible, dynamic economy.”

My interviewees 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. The transformation from a Soviet republic to an independent state “has been extremely successful” (interview). Tiit Vähi sums it up:

“We achieved all the goals that we established for ourselves at the time – independence, EU and NATO membership and monetary reform of our own currency, our own economy.”

Various economists (Feldmann and Sally, 2002; Gillies et al, 2002; Rajasalu, et al, 2003) point to Estonian exceptionally high economic growth rates as proof of the nation’s success (Statistical Office of Estonia). 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.”

In recognition of the country’s economic achievements and its fulfilment of the requirements set in Article 121 of the Treaty of the European Union and protocol no. 21 annexed to the Treaty, the Council of the European Union allowed Estonia to adopt the Euro as national currency as of January 1, 2011 (Eesti Pank).

Next, I examine the ultra-liberal policies with which Estonia achieved its ‘exceptional’ performance. By analysing their impact I argue that high economic growth rates are not a reflection of the nation’s socio-economic development. It is the means and not the ends in economic development.

8.3 The ‘shock without the therapy’

8.3.1 The complete liberalisation of trade

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 (Reiljan, 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. They did it in one stroke defying the recommendations of international organisations of a more gradual approach (Feldmann and Sally, 2002). Estonian policy makers defied external advice again claiming that trade protection invites pressure from interest groups in the various industries for prolonged trade restrictions. The insistence of the Estonian authorities to liberalise trade overnight in defiance of the advice of international financial institutions is a clear example of the central role of local agency disproving the hegemonic diffusion of neoliberal policies.

As a result of discontinued subsidies, input costs of Estonian producers increased 17 fold between 1991 and 1994 (Smith, 2001). State owned enterprises, which had been sheltered from international competition during the Soviet era, found it very hard, if not impossible to become competitive overnight (Gros and Steinherr, 2004). Instantly, they found themselves between the ‘rock’ of sharply rising input costs and the ‘hard place’ of foreign competition even on their domestic market. A large proportion of enterprises employing a significant share of the labour force produced negative value added in the first years of transition (Gros and Steinherr, 2004). Despite the hardship faced by domestic producers, numerous policy makers strongly argue the necessity of ‘shock therapy’ over a more gradual approach. Andres Tarand 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...”

Rajasalu et al. (2003) claim that these policies were crisis-driven and did not cause socio-economic hardship. Mart Laar agrees:

“I think Estonian transition has not yet been studied too well. Because I think there are a lot of misunderstandings. The main misunderstanding is that the reforms brought the social economic problems. When we introduced the market reforms they created the misery but actually, in most cases, they started to cure the mess. And the most misery has been before we started the economic reforms... The highest inequality has not been in the period after the reforms but before the reforms.”

I agree that Estonia’s reforms in its early transition were crisis driven, however. as elaborated in this chapter, I argue that their continuation as been very costly and misguided.

Feldmann and Sally (2002) maintain that Estonia's undervalued currency made imports expensive and unaffordable to Estonian consumers giving domestic producers time to adjust. This argument would stand in a world of free trade. However, Estonia's unilateral trade liberalisation was not reciprocated and the protectionist policies of the country's trading partners artificially improved the competitiveness of their exports. Trade liberalisation on its own does not guarantee successful economic development. Whereas in other economies pursuing rapid growth strategies, such as South Korea and Taiwan, the government played an active role in improving return on investment and profitability of exports (Wolf, 2005), in Estonia the policy of economic non-interference prevailed.

The sudden imposition of 'hard' budget constraints, the shift to trading inputs and outputs at world markets prices, the disruptions in supplies and the virtual disappearance of the Soviet market were aggravated by the protectionist trade policies of Estonia's main trading partners – the EU and other CEEC. While Estonian enterprises were quickly exposed to international competition without any adjustment period or protection (Heinonen and Emmert, 2006), the country's trading partners took advantage of Estonia's unilateral openness by keeping protectionist policies in place. They did not follow Estonia's immediate conversion to free trade but continued aiding their producers with subsidies up to 40 percent of production costs (Reiljan, 2001). Estonian producers were competing with subsidised imports while scarcely available credit made it very difficult for them to invest in technology needed to improve efficiency and product quality in order to meet the high EU standards. Many enterprises decided to discontinue the production of goods that could not be sold. Others found it hard or impossible to adapt, as most Soviet-era managers were lacking the skills required to thrive in a competitive market economy (Lieven, 1993; Mygind, 1997). Between 1992 and 1995, the Estonian economy lost 500 companies with more than 100 employees each, representing a job loss of 164,000 (Liuhto, 1996). Overall, Estonia's GDP suffered a 40 percent decline between 1990 and 1992 (Mygind, 1997).

8.3.2 Enterprise development

Estonian economic development policy has been in line with the neoliberal principle of making the market work wherever possible. Jaak Leimann highlights the general mood of the times invoking the neoliberal principle of self-reliance:

“People were entrepreneurs, people thought that they should do something, go to work, or establish their own business.”

Having endured half a century of restrictions, people were eager to take the initiative. According to Rein Ruutso “the totally liberal discourse” was accepted implicitly that “proof of freedom is that the individual is able to take care of himself”. As an economist recalls, “new entrepreneurship started very quickly”. In Mart Laar’s words, “it was very raw capitalism at the very beginning.”

Expectations were that economic restructuring would lead to the quick development of private enterprises replacing SOEs and absorbing surplus labour. Policy makers as well as advisors were hoping that job creation would outpace job destruction (Smith, 2000; Stiglitz, 2002; Gros and Steinherr, 2004). According to expectations of the “neoliberal structural adjustment model” a “decline of employment in state-owned enterprises would... be countered by the rise of private-sector activity including new industries and increasing service sector activity that would absorb workers who lose jobs in the state sector” in the post-socialist economies (Smith, 2000: 1760). Expectations regarding the transition of the CEEC were optimistic.

“It was expected that the stabilisation programmes would restore external and internal balances in the countries, and also bring about a recession, which would bottom out in the one or two years following the inception of the programme. Then, it was anticipated, the structural transformation could really develop. What happened did not meet these expectations. ” (Lavigne, 1999: 113)

Estonia did experience 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 next year (Liuhto, 1996). However, of these 25,856 were family farms and associations. Over the next three years, the number of active private firms decreased to 25,000. Due to lack of capital, the average size of these companies was very small; 80 percent of all organisations had fewer than five employees in 1995. The same year, only 4 percent of firms employed more than 100 workers (Liuhto, 1996).

Although the share of labour force employed by SMEs increased from 26 percent in 1992 to 40 percent in 1994, the lack of domestic capital significantly inhibited their development. The vast majority of enterprises were small retail outlets, as opening and running a small shop was possible with modest personal savings. Indeed, a salient feature of Estonian businesses was their ‘miniature’ size; 60 percent of all private firms were valued at 625 German Mark, which was the minimum required founding capital (Liuhto, 1996). In 2003, micro-enterprises²² accounted for 86 percent of all firms, with over half of them having less than five employees. The number of enterprises per 1,000 people was less than half of the EU average. The small start-up capital of many firms reflects the scarcity of jobs in rural areas, as self-employment is often a last resort in eking out a living (Saar and Unt, 2006). In 2007, only 15.1 percent of the nation’s enterprises employed more than ten workers (Statistical Office of Estonia).

Saar and Unt (2006) investigate entrepreneurship in post-socialist Estonia. According to their findings Estonian policies were not conducive of SME development. The ‘unemployment push’ factor dominated over the ‘entrepreneurial pull’ factor, as many started their own business out of inability to find employment in line with the “ideology that people and households have to help themselves” (interview). They cite a 2002 survey, according to which the vast majority of new businesses were self-financing, as only 32 percent of new enterprises received some kind of external funding. Once family and friends are excluded, this figure falls to 21 percent. Many small firms self-select in their financing; they do not bother to apply for a bank loan out of belief of being rejected. A large portion of them fail due to lack of business skills, financing and insufficient purchasing power of the population. Those that do succeed work long hours under poor work conditions with very limited returns (Saar and Unt, 2006).

Findings by Smallborne and Welter (2010: 200) describe business development in Estonia as “noticeable by their absence”. They characterise Estonian development policy as “one of limited intervention, focusing on establishing the framework conditions to facilitate productive private enterprise development”. Recently a network of business development centres has been established all over the country with the aim of facilitating SME growth. The tasks of the regional centres are to provide

²² Business employing fewer than ten workers

entrepreneurs with economic, managerial and legal advice on starting and operating a company and to offer information on developments in the external environment (Enterprise Estonia). However, as one expert elaborates, these centres fall short of reaching these goals due to a shortage of skilled staff and their detachment from their local community. I quote his assessment of these centres:

“None of them has enough resources or interest or idea how to run them. They are overloaded with all kinds of bureaucracy, seriously underfinanced, critically short of skilled staff...”

Over time, Estonia has evolved into a two-tier economy. Foreign producers and local businesses receiving foreign investment benefit from the transfer of technology and best practices. They achieve higher rates of productivity, efficiency and competitiveness enabling them to pay above average efficiency wages, with which they dominate the primary labour market. Purely domestic enterprises make up the lower tier of the economy with low productivity rates, outdated technology, and inadequate access to resources. Lack of capital puts domestic enterprises at a great disadvantage. As banks mostly consider fixed assets and not earning potential when providing loans, these organisations have very limited access to capital. Although they employ the bulk of the labour force, they are greatly constrained in their ability to provide competitive wages, training and attractive career opportunities (Liuhto, 1996; Heinonen and Emmert, 2001; Faggio and Konings, 2003).

8.3.3 The fate of Estonian agriculture

Although rural way of life and the land takes central place in Estonian culture, agriculture underwent drastic changes in the early 1990s (Unwin, 1997). As an interviewee puts it, it just “disappeared”. Reforms were necessary, as after gaining independence and the break-up of the Soviet Union, the economic environment dramatically changed, to which agriculture had to adapt. The question is, however, whether the ultra-liberal reforms that followed were the required remedy. Siim Kallas justifies the use of shock therapy:

“...people in today’s Estonia are complaining that Mart Laar killed Estonian agriculture. But it was necessary.”

Reiljan (2001) rates the Soviet era Estonian agriculture as the best developed among the primary sectors not only within the Soviet Union but also among the CEEC. He blames the contraction of agriculture’s share in national output on the complete lack of

regulation and unilateral openness of the country's internal market. This view is shared by Erik Terk, who argues that agriculture

"...was not in any bad shape but the context changed. Of course there were some problems, for example ecological problems and maybe productivity was not so high... but there were no big problems before the reform."

Economic restructuring, including the privatisation of cooperatives, the complete elimination of subsidies and unilateral trade liberalisation, has taken its toll on Estonia's primary sector. In line with the neoliberal dogma, any intervention by the state was thought to delay the sector's adjustment (Hayek, 1960). In the words of an interviewee, "it had a very hard impact on agriculture, it went down very deeply". Indeed, Mart Laar got the nickname "destroyer of agriculture" (interview). A net exporter of agricultural products in 1992 became a net importer by 1995. In 1998, Estonia had a trade deficit of 50 percent in food products. Agricultural output continued to suffer, although the Estonian economy started to grow in 1994 and purchasing power picked up the following year (Reiljan, 2001). Restitution on grounds of equity was a main argument for privatisation, preceding land use considerations. Privatisation meant the breaking up of Soviet-era cooperatives and return to the land structure of the First Republic, which was dominated by small farms (Terk, 2000).

"Mart Laar is a historian, he has no understanding of the economy at all... His basic attitude was anticommunist and anti-Soviet ... Some of his moves, like destroying the kolkhozes, it was an absolute catastrophe. It was ideologically motivated... it was mainly based on political decisions and anti-communist mentality – to stop kolkhozes and finish these things." (interview)

Given the lack of domestic capital and limited access to credit the new agricultural enterprises were unable to grow. Agriculture's contribution in value creation declined in almost all areas (Reiljan, 2001). Urmas Varblane sums it up:

"They owned the plant before and now they should get it back. What it means it doesn't matter. And also people, who got back in the beginning didn't understand that I will never survive in competition with my 5 cows and 20 hectares of land, that is only a short-run dream... it was a lot of human loss. We also left 30 percent of our arable land not used for agricultural purposes; it is out of circulation because of that time. Now it is forest or bushes..."

EU accession brought about the re-introduction of trade barriers in Estonia, as required under the Association Agreement. However, EU membership has had mixed blessings for Estonian agriculture. Although the barriers to Estonian exports were gradually phased out, agricultural production was capped at the average level of production three

years prior to accession. EU food standards are very rigorous necessitating large investment outlays, which the majority of local producers are unable to afford. Aid from Brussels covers less than five percent of the costs associated with the upgrade requirements. The unilateral openness of the country's internal markets dictated by ultra-liberal policies artificially worsened the competitive position of domestic producers both on international and Estonian markets. It led to diminished output, increased unemployment rates and the withdrawal of thousands of people from the labour market (Reiljan, 2001; interviews).

8.3.4 The readjustment of the labour market

The populations of the CEEC were promised unparalleled prosperity but received unprecedented misery (Stiglitz, 2002). The fastened and uninhibited pace of 'creative destruction' had a drastic impact on the labour market, due to the radical free market policies of the country. It significantly redistributed income among professions and jobs in a short period of time. Total employment in Estonia decreased from 837.9 thousand in 1989 to 572.5 thousand in 2000 (Statistical Office of Estonia). The changes in the FSU states were much more dramatic and shocking due the tight integration of their economies into the Soviet economy than in the satellite states of CEE. The egalitarian wage structure of the Soviet era with little relation between pay and individual performance was transformed to a pattern typical of a market economy (Noorkoiv, et. al. 1997). The sectoral shifts in the economy, which are demonstrated by Table 8.1, were closely followed by the Estonian labour market.

Table 8.1 Sectoral composition of GDP in Estonia (in percentages).

	1993	2000	2008
Agriculture	10.3	4.8	2.6
Industry	31	28	29
Services	56.5	67.2	68.4

Source: Statistical Office of Estonia

Job creation lagged behind job destruction (Jurajda and Terrell, 2008), which was aggravated by the changing nature and pay level of jobs on offer. 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. By 2003,

Estonia's workforce decreased by 27 percent, which translates into the loss of 218,500 positions in a country with a population of 1.4 million (Saar and Unt, 2006). Thus, in line with Polanyi's (1944) critique of the liberal argument, labour supply did not create its own demand in Estonia. Urmas Varblane sums up the impact of *laissez-faire* policies on Estonia's labour market:

"... it cost us 100 thousand employees who actually went out of the labour market and never returned. Roughly 100 thousand. One part of them started to smuggle vodka, second went to cut down the forest they got back by restitution, and lived on that but basically they started a bit later to drink vodka, and now they are getting some pensions from government for being sick due to alcoholism. That is the reality of that 100 thousand... There are villages in Southern Estonia where you have 30 percent of the population living on disability allowance... This is one side effect, cost of the early '90s decision to destroy completely this agricultural system."

Sectoral restructuring has drastically transformed the labour markets of the CEEC. Guaranteed employment and relatively singular labour markets have been replaced with lower participation, insecurity and segmentation in terms of pay, employment and status conditions (Smith et al. 2008). Employment in the utilities, retail and wholesale, hotel and restaurant, finance, insurance and real estate sectors increased. However, many of those new positions in the service industry require limited skills and pay low wages in return (Noorkoiv, et. al. 1997; Faggio and Konings, 2003). As in other parts of the CEEC, Estonian policy makers concentrated on creating new jobs without paying much attention to their quality. The labour markets of the post-socialist states are characterised by individual representation, unstable work hours and job tenure, and holding of multiple jobs, which led to the emergence of the working poor who struggle to make ends meet despite working long hours (Smith et al. 2008). Indeed, Brady's (2003: 391) findings contradict the neoliberal ethos of personal effort and investment in one's skills improving one's standard of living. "Nations with more productive workers – and ostensibly more human capital, education, skills and training – do not have less market generated poverty".

Winiecki (2008) identifies two causes for transitional unemployment: cyclical, which was associated with the drastic drop in output in the early 1990s, and structural, due to overemployment in SOEs in the socialist era. Whereas cyclical unemployment "resulted from the well-observed fall in demand during the 'transformational recession' in the

early years of systemic change”, structural unemployment “was – and to some extent still is – associated with institutional legacies of the communist past” (p. 377).

Unreliability of supplies encouraged socialist organisations to be self-reliant; the more you could produce yourself, the lower the chances of production disruption and failure to meet the mandatory targets. Centrally planned economies had higher demand for blue-collar workers due to under-specialisation, as a result of vertical integration. Limited authority at organisational level coupled with cumbersome bureaucratic procedures discouraged innovation. Lengthy delays in approvals often meant that new technology was often obsolete by the time it was put into practice. The distorted incentive system of the socialist era served as an additional burden on technological improvement further decreasing demand for highly skilled labour. Thus at the dawn of transition the supply of highly skilled labour was inadequate to meet demand that arose from the technological upgrading of production processes and quality improvements creating significant levels of structural unemployment (Winiecki, 2008). Faggio and Konings (2003) support the existence of structural labour market problems by showing that many workers tend to seek occupation-specific jobs in similar sectors offered by similar firms.

In Estonia, as in other parts of the CEEC, “there is no clear, one-way relationship between the severity of economic collapse and the extent of employment loss” (Smith, 2000: 1762). Layoffs of such magnitude should have indicated a 15-20 percent unemployment rate contradicting the official figures of between 2 percent (Liuhto, 1996) and 7 and 8 percent (Smith, 2000). Erik Terk remembers:

“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.”

However, the official unemployment rates of the early 1990s did not reflect the fast contraction of SOE output and the slow rise of the private sector. Many businesses would not downsize, instead they sent their workers home with no pay (Myngid, 1997). Harter and Jaakson (1997) point to the inaccuracy of unemployment figures of the times and the lack of incentives for the unemployed to apply for benefits, as justification for the low official unemployment figures. The extent of bureaucracy involved in registering for “almost negligible” (interview) unemployment benefits led to both

hidden employment and unemployment. A large proportion of young workers took on temporary or 'odd' semi-legal or illegal jobs and did not bother to register. Urmas Varblane supports this view:

"...the problem was that many were not officially unemployed but were simply out of the labour market. And they never returned... They became inactive and remained inactive."

The repatriation of 63,000 people to Russia and the Ukraine also alleviated unemployment partly explaining the discrepancy between official unemployment rates and the decline in the number of work places (Liuhto, 1996; Harter and Jaakson, 1997; Mygind, 1997).

Jurajda and Terrell (2008: 2145) examine the "dynamics of economy-wide job reallocation" in Estonia and the Czech Republic, which followed markedly different policies. The Czech approach was gradual, whereas Estonia chose a radical path. Czech bankruptcy laws did not take effect until 1996 and the state continued to support many SOEs in an effort to slow down job destruction. Unemployment benefits were more generous, both in monetary terms and in terms of entitlement period. While unemployed Czechs received 50-60 percent of their previous wage for twelve months, which was gradually reduced to six, laid-off Estonians got benefits of only 7-10 percent of wages for six months. Job creation also enjoyed more generous support in the Czech Republic; the country allocated 0.19 percent of its GDP to finance new jobs as opposed to 0.08 percent in Estonia. As an outcome of faster job destruction and slower job creation, by 1996 Estonian unemployment rates were in the double digits, while in the Czech Republic they stayed at 3 percent, gradually rising to 9 percent by 1999. In the end, the diverging paths of the two economies resulted in similar levels of sectoral reallocation. The greater distortion of the Estonian economy partly justifies the low level of unemployment support (Jurajda and Terrell, 2008), which is echoed by a respondent:

"We are not so rich to introduce all these social security systems as advanced western countries have today. The economic level of a country influences these decisions".

Indeed, the state of the Estonian economy in the early 1990s was dramatic. The recession caused by macroeconomic restructuring and restrictive deflationary policies significantly depressed government incomes and revenues (Aage, 1997). As an

interviewee recalls, “we saw how poor we are”. Public revenues substantially declined due to the erosion of the state’s tax base with the privatisation of state-owned enterprises. By 1995 their share in the Estonian economy fell to a mere 1 percent. These were exacerbated by low levels of proportional income tax regime, initially lax registration policies and inadequate controlling mechanisms (Liuhto, 1996). Despite the low levels of government revenue, neither the low proportional tax rates, nor the free trade regime was touched (Heinonen and Emmert, 2006) in order to afford more generous unemployment benefits. Andres Tarand summarises the paradigm of Estonian policy makers: “we can’t touch any taxes.”

Studies carried out by Faggio and Konings (2003) found similarities between labour market flexibility and low levels of employment protection between Estonia, the UK and the US. Estonian rates of job reallocation were high above CEEC and western European levels and closer to US averages. The Estonian government’s hands-off approach is expressed by Mart Laar reflecting the neoliberal argument that social security demotivates people to help themselves (Hayek, 1960):

“...no subsidies, no help, we can only help those people who are interested to help themselves. That was a very unpopular slogan and it worked very well.”

Jaak Jõerüüt explains the trade-off in hands-off economic management between ‘total freedom’ and welfare.

“The first demonstration, proof of freedom is that the individual is able to take care of himself. But they are big losses... It means that you will lose a lot of people... This mechanism is effective but it is without mercy. It kills those who are not able.”

8.3.5 The absence of organised labour

Despite the harsh social impact of economic restructuring, Estonian trade unions have been very quiet, according to my interviewees, contradicting the “simplistic” assumption that “the role played by the unions will mirror that of their western counterparts” (Herod, 1998: 204). One interviewee claims that “they failed to influence decisions in the ‘90s”. Another respondent goes as far as calling them a “joke”: according to Mart Laar their impact was “zero”.

Their relative unpopularity is partly due to the individual nature of Estonians, as attested by Urmas Varblane:

“It is also maybe the individualistic psychology of Estonians. They are trying to negotiate with the employer themselves...”

Egle Käärats also underlines the individualistic nature of Estonians that manifest itself in employer-employee relations.

“They are trying to negotiate with their employer their terms and contracts individually and handle their problems on their own... Estonians rely on individual negotiation and individual dispute resolution rather than collective actions.”

She offers an example:

“...we don't have a culture of strikes. You don't have to be afraid that the transportation isn't going or the hospitals are shut because of strike.”

Another reason is the reputation of trade unions as the “transmission belts of the party” (Lavigne, 1999: 7), serving as “the link between the cadre of the party and the mass of the workers” (Herod, 1998: 200) in the socialist era. Gros and Steinherr (1995: 330) underline the “perplexing” role of trade unions. “The basic contradiction lies in having an institution that represents workers’ interests when all of society is supposedly controlled by workers”. Post-socialist transition has “fundamentally change(d) the relationship between enterprise managers, the workforce, the state and the trade unions” (Herod, 1998: 197). Egle Käärats explains the decline of trade unions in Estonia:

“...during Soviet time everybody belonged to unions and participation rate was approximately 100 hundred percent... there was a big drop in the early 1990s... and now it's approximately 7 percent. I would say that at the workplace they are very weak.”

Kaia Jäppinen puts part of the blame on employers:

“Many enterprises do not allow them... Of course, no one mentions it in public but none of the large enterprises are interested in having trade unions or having relationships with them. Although they are active, I am not sure if their voices are heard too often.”

Taagepera (2002: 253) draws a comparison between Estonian individualism, “uncooperative work” and inadequate social capital. In his words:

“Instead of hoping for improvements in life through social synergy based on mutual trust, the survival package places hopes on individual struggle... it is income and income security that matter; friends are less important than material goods.”

The relative lack of organised labour has contributed to rising income inequalities. Beugelsdijk and Schaik (2005) find robust and positive significant link between social capital and regional economic development, as active involvement in social networks contribute to growth. Estonia has low levels of unionisation, interviewees put it at between 7 and 10 percent, and membership in informal as well as formal social networks is rare. Contradicting Friedman (1962: 124) that unions' "effect has been to make high-paid workers higher paid at the expense of lower-paid workers", Krugman (2007: 262-264) draws a direct link between levels of union membership, union activity and income gaps, as unions attempt to achieve larger wage increases for their worst-paid members.

"Unions raise the wages of their members, who tend to be in the middle of the wage distribution; they also tend to equalise wages among members. Perhaps, most important, they act as a countervailing force to management, enforcing social norms that limit very high and very low pay among people who aren't union members."

Bruszt (1991) compares the Estonian and Czechoslovak transition experiences between 1989 and 1991. As in Estonia, post-socialist Czechoslovak leaders sought discontinuity with the policies of the old regime, which resulted in the introduction of Thatcherite policies. However, unlike in Estonia under the aegis of IME, no public debate had taken place leaving many unprepared for the ensuing economic hardship. In the end it was not popular discontent but the trade unions that put an end to the neoliberal policies. In defiance of the attempt of the "Thatcherite technocrats" to restrict trade union activities, trade unions threatened with a general strike, which led to a shift away from the neoliberal agenda (Bruszt, 1991: 61-68).

In contrast, the neoliberal economic transformation in Estonia has enjoyed popular support on the basis of 'there is no alternative' (Lauristin and Vihalemm, 2009). The liberal

"...policies were difficult to bear for many people. The majority accepted shock therapy as the only safe way to get out of Russia's economic influence and achieve economic sustainability. Even if protests were voiced... they were not heard." (p. 11)

The 'shock without the therapy has taken its toll. Margus Laidre reflects:

"...maybe on the social side, we should have thought more about people... about the general living standard, which should have been more developed."

8.5 The socio-economic costs of neoliberal development

8.5.1 Highly uneven regional development

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 following quote is a telling example of the neoliberal view of economic development by Estonian policy advisors, as well as some academics.

"The success of economic reforms can be relatively well measured by overall economic freedom index and sub-indices (produced by the Heritage Foundation), as well as by competitiveness of the economy..."
(Rajasalu, et al. 2003: 11)

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 liberal economic tenet of the 'trickle-down effect' that a growing economy reduces poverty (Hayek, 1960) 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, as elaborated in section 8.6.1.

Table 8.2 Real GDP growth rate

	1996	2000	2009
Czech Republic	4.0	3.6	-4.1
Estonia	5.7	10.0	-13.9
Hungary	0.7	4.9	-6.7
Poland	6.2	4.3	1.7

Source: Eurostat

Table 8.3 GDP per capita in PPS. EU average=100

	1996	2000	2009
Czech Republic	73	68	82
Estonia	36	45	64
Hungary	52	55	65
Poland	43	48	61

Source: Eurostat

Table 8.4 Unemployment rate

	1997	2000	2009
Czech Republic	4.8	8.7	6.7
Estonia	9.6	12.5	13.8
Hungary	9.0	6.3	10
Poland	10.9	16.4	8.2

Source: Eurostat

Although “the size and nature of the problems in the FSU are uncommensurable 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 8.3. Estonian households, overall, have been enjoying an improvement in their living standards. Between 1997 and 2004, the average annual disposable income per household member increased by 36 percent in real terms (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 (1996: 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 (Liuhto, 1996). 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. By the end of 2005, 78.9 percent of all foreign direct investment stock was in Tallinn (Estonian Investment Agency).

Kaia Jäppinen defends the government's position on welfare reminiscent of the Hayekian (1960) 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."

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 (Jauhiainen, 2002). Regional disparities in income levels have not decreased but slightly increased, as demonstrated by the following tables.

Table 8.5 Differences in disposable income in Estonia in 1996 and 2004

	1996	2004
Disposable income in the poorest county, as a percentage of national average	74.8	74.9
Disposable income in the poorest county, as a percentage of the richest county	63.0	64.0
Disposable income in the poorest county, as a percentage of the capital, Tallinn	61.6	63.4

Based on the author's calculations, using data from the Statistical Office of Estonia

Table 8.6 GDP per capita as a percentage of national average

	1996	2000	2006
	Percentage		
Whole country	100	100	100
Harju county	150.4	148.3	157.3
Tallinn city	n/a	162	172.0
Hiiu county	78.8	83.4	60
Ida-Viru county	65.3	67.2	56.4
Jõgeva county	50.0	51.0	43.8
Järva county	72.9	74.7	61.7
Lääne county	67.9	69.6	60.9
Lääne-Viru county	73.7	74.7	64.5
Põlva county	56.2	58.3	47.4
Pärnu county	81.9	82.6	73.1
Rapla county	65.1	67.8	53.9
Saare county	67.3	68.0	63.9
Tartu county	77.6	77.0	88.3
Tartu city	n/a	n/a	110.8
Valga county	55.7	57.8	48.8
Viljandi county	61.3	63.9	54.9
Võru county	59.5	61.4	49.9

Source: Statistical Office of Estonia

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), as illustrated by Table 8.7. 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.

Table 8.7 Regional gross value added and share of value added at current prices

	1996			2006		
	Percentage share of value added					
	Primary sector	Secondary sector	Tertiary sector	Primary sector	Secondary sector	Tertiary sector
Whole country	5.5	31.2	63.3	3.1	26.7	67.2
Harju county	1.8	29.4	68.8	0.8	25.3	73.8
Hiiu	19.5	21.9	58.6	15.5	29.1	55.5
Ida-Viru c	3.9	49.1	47.1	1.6	49.6	48.8
Jõgeva c	23.3	21.4	55.3	19.3	26.7	54.0
Järva c.	21.0	28.0	51.1	13.0	38.4	48.7
Lääne c.	10.3	27.8	61.9	6.2	34.7	59.1
Lääne-Viru	12.1	36.4	51.5	9.6	43.1	47.3
Põlva c.	14.8	28.8	56.4	17.0	29.4	53.6
Pärnu c.	10.4	33.4	56.1	6.0	34.2	59.8
Rapla c.	15.2	25.4	59.4	12.5	35.3	52.2
Saare c.	9.2	28.0	62.9	6.6	31.9	61.5
Tartu c.	4.3	27.6	68.1	2.9	30.2	66.9
Valga c.	12.6	26.0	61.4	9.3	33.7	57.0
Viljandi c.	14.2	25.0	60.7	12.3	36.3	51.4
Võru c.	11.0	28.1	60.9	9.7	34.2	56.1

Source: 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 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. Table 8.8 illustrates the growing income inequalities by comparing disposable income from wage labour and disposable income from transfer payments between the richest and poorest counties.

Table 8.8 Breakdown of income sources

	1996	2004
Proportion of income from wage labour in the richest county	70.50%	71.80%
Proportion of income from wage labour in the poorest county	42.10%	44.30%
Proportion of income from transfers in the richest county	19.10%	20.40%
Proportion of income from transfers in the poorest county	37.20%	45.50%

Source: Statistical Office of Estonia

Estonian development has been based on the neoliberal paradigm, as attested by Rein Ruutso:

"(This system) was not created for the people who are not able to do something for themselves, to help themselves... Mart Laar and Kallas have accepted the absolute liberal discourse, the totally liberal discourse..."

Estonian policy makers' heavy emphasis on freedom echoes neoliberal views.

"Clearly, economic freedom, in and of itself, is an extremely important part of total freedom... in a society freedom has nothing to do with what an individual does with his freedom... The "really" ethical problems are those that face an individual in a free society – what he should do with his freedom." (Friedman, 1962: 9 and 12)

However, "freedoms depend also on other determinants, such as social and economic arrangements", including "poor economic opportunities" (Sen, 1999: 3). 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).

8.5.2 ‘The way human life goes’ in Estonia

Average life expectancy at birth, which is considered by Sen (1999) and Hayami (2001) as a more adequate measurement of quality of life than per capita income levels, 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). Crime rates, drug addiction, suicide rates and levels of social inequality have all risen (Lauristin and Vihalemm, 1997). 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 since 1991. 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)²³. By comparison, in 2006 Estonia was 42 on the same ranking (UNDP, 2003).

The healthcare system of Estonia is in dire straights. In the case of sexually transmitted diseases, Estonia has the worst record within the EU (UNICEF). The expenditure needs are much higher than the funds available. In the year 2000, Estonia spent only 14.8% of its GDP on social protection, which decreased to 13.4 percent in 2003 (the lowest in Central and Eastern Europe, excluding the Balkans) as opposed to an average of 26.3% in the European Union (Eurostat). There is strong evidence of deteriorating living conditions with alarming consequences. Tuberculosis incidence rates – the number of new cases per 100,000 population in a year – have more than doubled within ten years between 1992 and 2001. Estonian tuberculosis incidence rates were over 4 times the EU average. None of the EU member or candidate states were even near these rates, with the only exception of Romania (Eurostat).

The European Monitoring Centre for Drugs and Drug Addiction wrote in its report in 2003 that in 'Estonia HIV infection spreads at an alarming rate'. The main cause behind it is injecting drug use. An estimated 1% of the total population inject drugs. Over 80% of HIV-positive people are under 30 years of age. Whereas Estonia had 12 new cases in 1999, it reported 899 in 2002. Estonia's adult HIV prevalence rate of 1.1 is the highest in Europe; it is almost four times the Western European rates surpassing the average rate for the region of Eastern Europe and Central Asia (Centre for HIV Information). 70% of all HIV positive cases live in predominantly ethnic Russian North-eastern Estonia. Most of them are between the ages of 18 and 24. The most common reasons cited are lack of employment opportunities, sense of hopelessness, lack of identity, and the lack of places to pass time (Ahas, Koduvere, Mark, 2001). Death by suicide rates are also among the highest. In 2003, Estonia had more than two and a half times the

²³ HDI measures three main areas of human development: life expectancy, standard of living, and education.

average EU rate, occupying second place behind Lithuania on this grim ranking (Eurostat).

8.6 The continuity of the neoliberal trajectory

8.6.1 *Were there alternatives?*

Whereas the ‘strategic’ decisions regarding the stabilisation of the centrally-planned economies was fairly uniform, the “tactical choices” of ‘how’ and ‘when’ to carry out economic stabilisation and restructuring varied according to “the state of the economy, to the level of popular tolerance for the disruptions that are sure to accompany reform, and to the political situation” (Lavigne, 1999: 105 and 116). Thus pressure exerted by international organisations does not explain the diversity of post-socialist transitions and the differing degrees of neoliberal policy implementations in the CEEC.

As discussed previously, Estonia inherited a grossly distorted economy due to its full integration into the USSR. Easter Germany aside, which “has ceased to be an independent country” and whose transition has been managed by the former West Germany, the Central European states of the Czech and Slovak Federal Republics (CSFR), Hungary and Poland could be placed in the group of “middle-income countries” of the world at the time. They were facing problems somewhat similar to Brazil, Mexico or Israel, with one major difference. Although following “long periods of growth” they also suffered severe structural crises, as in Central Europe it was “the whole political and economic framework that has collapsed” (Gros and Steinherr, 1999: 231-232).

The disintegration of the socialist system began in Hungary and Poland. “Communist failure in Hungary was the failure of ‘actually existing socialism’ at its most sophisticated”. Hungary started its transition with a headstart and was the “most liberal country, with the most radically reformed economy... with a standard of living that was the envy of all except the wealthier republics of Yugoslavia”. Its political leadership was of the younger generation, characterised by “institutionalised cynicism” with the socialist ideal instead of ideological commitment. Indeed, by 1989, “socialism was a dirty word” (Swain and Swain, 2009: 202). With economic reforms dating back to the 1960s, by the late 1980s the country already moved away from central planning.

Enterprises “gained almost total autonomy from the centre” by 1985, Western-style banking was introduced in 1987, followed by Western-style taxation the next year, and measures to attract foreign investors were in place by 1988. Private entrepreneurship grew rapidly. Thus, by the time socialism collapsed, the “population was well used to price increases” that accompanied liberalisation. However, the state of the economy significantly worsened in the 1980s due to sharp increases in foreign convertible currency debt, which led to the liquidity crisis of 1981-82 and the deterioration of “all financial discipline” of state enterprises. By 1987, Hungary accumulated the highest per capita debt in Eastern Europe (p. 190-191 and 211).

Hungary “definitely applied a gradualist policy in the beginning of transition”, although “its government never proclaimed itself a gradualist”. There was a widespread sentiment among the population that “Hungary had already been on the road to a market economy for many years and need not suffer the sacrifices endured by other countries”. It was not until 1995 that tough economic measures were implemented by the “‘post-communist government’ that replaced the right-wing coalition in 1994” (Lavigne, 1999: 119) despite “widespread demonstrations” (Swain and Swain, 2009: 246).

Hungary’s “arch gradualist” (Swain and Swain, 2009: 236) position relies on three arguments. Firstly, structural reforms, such as privatisation and reforming a country’s financial system, cannot be carried out overnight. The second argument points to the lesser social costs of gradualism. The third reason is that the Hungarian economy was in less of a need of urgent economic reforms than, for example, Poland. Hungary negotiated a stabilisation programme with the IMF in the mid 1980s (when the country gained entry to the IMF and the World Bank) which it went on servicing without rescheduling (Lavigne, 1999).

Although Poland and Czechoslovakia were “advocates of shock therapy”,

“Poland effectively gave up shock therapy after the first six months when the first shocks hit home and there was industrial unrest, while the Czech Republic was selective about its shock therapy measures from the start...”
(Swain and Swain, 2009: 236).

Sachs (1999: 12-13) brings up various reasons for the impoverished state of the Polish economy. It was over-industrialised in the communist era but retained a very large

agricultural sector with low productivity and “high political demands on the state”. The country’s economy was not only “overwhelmingly state-owned” but also lacked SMEs. In an effort to remedy the desperate economic situation, the country’s parliament “passed a budget drawn up by Finance Minister Leszek Balcerowicz, the nearest thing in political and economic reality to the ‘shock therapy’ tactics advocated by the Harvard economist Jeffrey Sachs.” However, “despite the initial success of ‘shock therapy’, the economic situation was precarious”. Poland was given relief in 1991 when “the ‘Paris Club’ of seventeen creditor countries had agreed to write off fifty percent of its debt to foreign governments”. Shock therapy and “anti-recessionary policies” have had strong political opposition in Poland (Swain and Swain, 2009: 205-206).

As opposed to Czechoslovakia (and its successor states of the Czech Republic and Slovakia), Hungary and Poland, Estonia only had right-of centre to right wing administrations, which enjoyed a strong political base. The weakness of trade unions also contributed to the lack of viable alternatives. Erik Terk explains:

“There was a belief that as the main aim is to get independence, the people understand that if we fall on hard times, there is nothing to do and it’s just a price for independence...”

In addition, the transitional recession was “much larger throughout the FSU” than in Central Europe (Gros and Steinherr, 2004: 111) and Estonian cabinet members were eager to ‘catch up’. As Margus Laidre testifies:

“It was crucial not to look back, just to rush, rush forward and reach and then maybe when you are out of breath, then first to look back and view the damage.”

8.6.2 The ‘paradox of unhappy transition’

In contrast to Polanyi (1944), who assesses the concept of a self-adjusting market as a utopia based on self-evidently held assumptions, Estonian policy makers regard society as a mere function of the economic system. They view the economy as an end in itself to which social relations are subordinate. As opposed to pursuing “socially bearable economic improvement”, they expect society to accept the consequences of “unregulated economic improvement, whatever they might be” (p. 35). To quote Urmas Varblane:

“The basic slogan was that everybody should help themselves. That was the slogan, the Anglo-Saxon method. You swim or fall to the bottom, that’s it.”

Such narratives are reminders of the neoliberal principles of adverse long-term effects of the welfare state on poverty and the supposedly strong positive correlation between individual productivity and destitution (Brady, 2003).

Building on Kelsey's (1995) analysis of New Zealand's economic restructuring, Estonia's neoliberalisation can be viewed as a "success story" reflecting a narrow economic-growth based view, or as "the emperor has no clothes", when evaluating socio-economic outcome. Addressing the excessive social costs of the shock therapy was not high on the agenda, as attested by an interviewee:

"...the cabinet didn't think about the social side... I believe that the social aspects were, to a large extent, forgotten".

Another interviewee admits:

"...maybe Estonia has been too much on the right side of the political scale. Estonia would need a stronger, modern social democratic movement..."

To quote Lauristin and Vihalemm (2009), "the expected change from the libertarian paradigm of 'minimal state' to the socially responsible state did not succeed". Despite the hardship, opinion polls show public support for liberal economic policies in Estonia (Ehin, 2007). As an example of Estonians' high esteem of neoliberal theorists, one of the country's most prominent universities, the Estonian Business School, has a classroom named after Friedrich von Hayek. I have taught in that very classroom. According to an EBRD (2007: 44) survey, "most people interviewed are satisfied with their lives and are optimistic about the future, regardless of age and income". Indeed, the subsequent Estonian governments have been benefiting from a patient population. In the words of an interviewee, "mainly, the ordinary people understood".

Lauristin (1997) discusses the 'paradox of unhappy transition', in terms of 'longing for stability and secure living conditions'. In a recent study, Kalmus and Vihalemm (2006) found evidence of nostalgia and disillusionment with the ideal of a Western state. However, an EBRD survey of 2007 shows a perception of improved economic and political situation compared to 1989. According to findings by Vihalemm and Kalmus (2009), reminiscence about the socialist past is high only among the elderly generation, non-Estonian pensioners in particular, while the vast majority of people still refuses to

return to the socialist past and is strongly motivated to closing the gap with Western standards of living. Unlike in other CEEC, such as Poland and Slovakia, which “have seen the development of visible protests against neoliberalism” (Stenning et al. 2010: 56), despite the harsh socio-economic consequences of radical economic policies no public protests have taken place in Estonia.

8.6.3 Estonia’s elitist transition

Numerous authors (Rajasalu et al. 2003; Adam et al. 2009) offer elitist transition as an explanation to the continuity of ultra-liberal policies, despite the frequent changes in government, which is supported by an interviewee:

“We came from a system where everything was state-controlled, everything was fixed, everything was regulated by rules and you had no freedom at all. And you wanted to move from one extreme to another.”

Although post-socialist Estonia had eleven administrations in nineteen years, this alleged political instability has not translated into economic instability, as the subsequent administrations managed to legitimise the ‘self-evident’ aims of economic growth through unrestrained free-market policies by downplaying the social consequences and projecting them as individual failures (Lauristin and Vihalemm, 2009). Ardo Hansson reflects on the steady course of liberal policies:

“It is a bit of a surprise to me that there was so much continuity across governments... Every time there would be this idea that the pensioners are in dire straits, in a difficult situation, there is temptation to say ‘let’s just raise the payroll tax a bit to raise pensions’ but it never happened, even when the government coalition was quite strong. you would have thought they would say ‘this is getting socially difficult, let’s take it easy’. It never happened.”

Estonia’s subsequent administrations have consistently pursued the neoliberal trajectory of economic austerity and limited scope for the role of the state (interviews; Mygind, 1997; Adam et al. 2009). Mart Laar, whose administration introduced the harsh shock therapy measures, remembers:

“...political parties with totally different slogans and promises when they came to power, they suddenly just started to follow exactly the same thing that we did before them.”

Erik Terk offers anticommunism as an explanation to the steady pursuit of neoliberal policies:

“...when the economy started to grow again, then of course there were alternatives but nobody would think about alternatives because there was this ideology that Mrs. Thatcher is the boss and we are the pupils of Mrs. Thatcher and all the people who spoke about other things are socialists or communists.”

According to numerous interviewees, the Estonia’s political parties range from “right of centre to right wingers” only. Adam et al. (2009) point to the neoliberal orientation of the Estonian elite, the lack of a viable political left and circulation of the same elite individuals among the key positions. Although young people have been recruited, they cannot be considered ‘new’, as they had occupied positions of some importance sharing similar ideological views, which were expressed in the slogans of ‘westernisation’ and ‘liberalisation’. The consecutive governments “continued after the elections with practically the same agenda” (Lauristin and Vihalemm, 2009: 11). A former cabinet member agrees:

“The politicians are continuing this right-wing propaganda that they are very liberal... they continued this hard core, liberal way.”

As Urmas Varblane added, the dominance of the neoliberal dogma “had to do with the preferences of Mart Laar and his advisors.” All these narratives testify to the local origin of Estonian neoliberalism providing further support to Larner’s (2000 and 2003) non-hegemonic view of neoliberalisation. Relying on popular support, the country’s successive administrations have steadily and willingly pursued neoliberal policies. As in the case of Poland and Slovakia, neoliberal policies “were not simply imposed from outside, but were embedded within the fabric of policy” (Stenning et al. 2010: 39-40) in Estonia. Due to its strict fiscal austerity, Estonia never borrowed funds from international organisations (Eesti Pank), aside “from a \$200 million as a reserve for the Estonian Bank, which Estonia didn’t use” (interview) in 1992 (Bennett, 1993). Thus attributing the diffusion of the neoliberal model to the “hegemony of international capital is too easy”. In Kelsey’s (1995: 17) words,

“(g)overnments of individual countries, especially those free from ‘conditionalities’ attached to loans, still had policy choices about which path to take and how far and how fast to move.”

The neoliberal model has been implemented and preserved by active local agency in Estonia and not due to “neoliberal imperialist strategies... articulated through a global network of power relations” (Harvey, 2007: 32).

8.7 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 underfunded, the physical infrastructure is also underdeveloped. As transit cargo is a major part of the Estonian economy, the transportation infrastructure plays a crucial role in the country's physical capital. However, the poor state of the physical infrastructure, including the road and railway networks, threatens Estonia's ability to attract foreign investment (Heinonen and Emmert, 2006). There are no motorways in the country. 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 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 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."

Estonian policy makers' conviction of the superiority of the 'invisible hand' conflicts with the economic development path of today's developed economies, as well as the experiences of the East Asian economies in the 20th century (Polanyi, 1944; Stiglitz, 2002). Whereas Wolf (2005) states that interventionist measures, such as the protection of infant industries retards new sectors at the expense of consumers and taxpayers, Chang (2002) disproves the neoliberal tenet that free national and international competition maximises consumer welfare by emphasising that almost all of today's developed economies had used protectionist measures and actively engaged in economic affairs in order to promote their development.

"In most of the now-developed countries the policies that were used are almost the opposite of what the present orthodoxy says the employed and currently recommends that the currently developing countries should also use." (Chang, 2002: 19)

Protectionism played a "critical role in the development of certain key industries" in the now-developed countries. The recommendations of "*laissez-faire* policies" and "international openness" of today's developed economies contradict their own path of economic development (p. 30).

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). However, the Estonian 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 Estonia's negligible 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."

One of the key architects of Estonia's post-socialist transformation, Mart Laar, who was awarded the Milton Friedman Prize for Liberty by the Cato Institute in 2006, in recognition of his courageous programme which created a 'Baltic Tiger', a "free and prosperous nation that is a model for the world to emulate". Mart Laar clearly expressed his liberal views in an article in the Washington Post (13.02.2009).

"We may hope that, even as we see several bad signs of neo-interventionist attitude, all the mistakes of the 1930s will not be repeated. ...the collapse of Wall Street in 1929 developed into a world-wide depression. It happened not thanks to market failures but as a result of mistakes made by governments, which tried to protect their national economies and markets. The market was not allowed to make its corrections. Government interventions only prolonged the crisis."

8.8 Conclusion

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. Estonia's ultra-liberal economic management has jeopardised the competitiveness of domestic firms placing domestic producers at a disadvantage both at home and the international marketplace. Although enterprise creation was relatively fast, the vast majority of businesses are micro-enterprises restricted by lack of capital inhibiting their ability to grow and absorb surplus labour.

Estonian labour markets underwent a very painful readjustment with increasing rates of unemployment, hidden employment and declining labour force participation levels. As a result of the sectoral shift, many jobs in agriculture and manufacturing were replaced by work places in services. However, the majority of new work places offer very low wages leading to the emergence of the working poor. The hands-off approach to enterprise development, which contradicts the development paths of the now-developed economies, has seriously disadvantaged domestic enterprises.

Estonia's post-socialist transition has been elitist with a small number of people circulating among key positions. Encouraged by the country's high economic growth rates and popular support, political leaders have been steadfastly and willingly pursuing

neoliberal policies strengthening Larner's (2000 and 2003) interpretation of neoliberalisation as a multifaceted non-hegemonic process.

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 has managed to catch up with other Central European transition economies in terms of income per capita levels, from a developmental point of view, it is lagging behind. Estonian policy makers have been confusing economic growth with economic development. By insisting on *laissez-faire* economic management they restrict people's economic opportunities and the very freedom that they have been trying to nurture. In their quest for 'perfect liberty' they have achieved a world of unfreedoms.

Chapter 9. Conclusion

9.1 The research

The aim of this thesis is to prove the central role of agency in the formation and implementation of neoliberal policies in a national economy. Although there are numerous quantitative studies and historical accounts of the country's economic transformation, none has analysed the neoliberalisation of Estonia from a qualitative point of view. This thesis proves the significance of active local agency using the example of the neoliberalisation of a post-Soviet country. Estonia's neoliberalisation provides a highly suitable focus of study due to its small size and the ultra-liberal nature of its post-socialist socio-economic policies, which made an examination of its adoption of neoliberal principles and identification of its political elite manageable.

This has been an interdisciplinary, qualitative and interpretive research, integrating the principles of economics, economic geography and international political economy. My philosophical stand-point is realist acknowledging the importance of both structure and agency. As my goal has been to prove local agency, I investigated the motives and the process of decision making by the formulators and shapers of Estonia's post-socialist policies. My objective was to see through the eyes of agents. I used semi-structured, in-depth, face-to-face interviews that allowed me to have lengthy conversations with these agents while observing their environment and watching for non-verbal clues, which helped me to understand their context.

The success of this research depended on the successful identification and cooperation of the country's political elite. Thus, the researcher's positionality in this research has been of utmost importance in gaining access and trust. My positionality can be labelled as 'concerned foreign friend'. Due to my personal links with Estonia and familiarity of its culture, economy and society, I am considered an insider. However, my status as a non-Estonian based in the UK also puts me in the light of an outsider. My dual positionality has allowed me to get their trust and respect while not presenting a threat to them.

This research contributes to theory on several levels.

9.2 Methodological and theoretical contributions

It is essential but challenging to gain access and establish rapport with the interviewees in elite studies. The researcher's positionality is a determining factor in both. An outcome of my primary data collection is that the researcher has considerable influence over his/her own positionality. Rather than being on an insider/outsider dichotomy, it evolves on an insider-outsider continuum. Through interaction with the participants of my research, I felt my positionality gradually shifting towards the insider position, as I became more familiar with their environment and their stories. Over the course of my research I have developed empathy, which has gradually turned into sympathy towards the interviewees. It is important to emphasise, though, that my sympathy extends to understanding of their motives for choosing neoliberal policies in the early years of post-socialist transition and not to preserving them. Whereas I understand why they were suitable in the early 1990's, almost twenty years later they should be discontinued as they outlived their usefulness.

The researcher's positionality is not structurally determined; agency on the part of the researcher is essential. Thorough and careful preparation, including knowledgeability of the background of the interviewees and their environment, and flexibility on the part of the researcher are crucial for successful elite interviews.

The neoliberal view of post-socialist transition presupposed a linear, unproblematic transformation leading to eventual economic convergence. The theory of neoliberalism as a hegemonic, top-down project exaggerates the role of 'Western neoliberal heartlands' in the diffusion of neoliberal ideology assuming a homogeneous periphery. Both theories ignore context and active local agency.

Structure placed considerable constraints on Estonian agency. To a large extent, the existence of a sovereign Estonian state was structurally determined. The failure of the Russian Provisional Government in 1917, the Bolshevik revolution and Lenin's recognition of the futility of defending Baltic territory against the German army created favourable geopolitical conditions for the creation of an Estonian state. The living memory of the First Republic with a relatively prosperous economy and high standards of living provided Estonians with proof of their ability to function as a sovereign nation

and experience in running a pluralistic market economy. It also lent legitimacy to their Soviet-era demands for political and economic independence. Gorbachev's non-interventionist policies in the internal affairs of the CEEC were significant contributors to the demise of state socialism and the emergence of strong nationalistic movements, which eventually led to the collapse of the Soviet Union. His policies of *perestroika* and *glasnost* allowed room for Estonian economic experimentation. The unsuccessful coup and Yeltsin's declaration of non-interference and support of Baltic separatism were crucial in creating an opportunity for regaining Estonian independence.

However, it was active local agency that made independent Estonia possible both in 1918 and in 1991 by recognising favourable opportunities and deciding to 'go for it' regardless of the consequences. The Estonian imaginary and self-image are crucial determinants of the political and economic decisions of Estonian policy makers. Centuries of foreign domination has instilled qualities of resilience, self-reliance and single-mindedness in them. Their collective memory of historical injustice has created a sense of abandonment and a 'go-it alone' stance that are compatible with the neoliberal values of individualism, personal responsibility and dependence on oneself.

Central planning, collectivism, limited autonomy, economic backwardness, Russification and dismal living standards in the Soviet era translated into strong anti-leftist sentiments emphasising total freedom and a minimalistic state. Soviet-era totalitarian rule meant total loss of political and economic sovereignty. Reliance on a totalitarian paternalistic state stood in stark contrast with Estonians' self-image of individualism resulting in a strong desire for the neoliberal utopia of 'total freedom'. Estonian agency was testing the limits of Soviet structure throughout the socialist era in the areas of economics, politics and culture. They took advantage of their favourable status within the USSR and their geographical proximity to Finland, which proved priceless in post-socialist transition. They exploited the opportunities created by Gorbachev's reforms by economic experimentation and encouraged public debates and participation. The goal of Estonian leaders was the creation of an active society based on personal initiative, which overlaps with neoliberal theory's strong emphasis on self-dependence and individual accountability. This supports Larner's (2000) argument that neoliberalism does have positive attributes that contribute to social progress.

Estonians' keen desire to escape the Russian sphere of influence amplified people's capacity for sacrifice providing the government with the 'benefit of the doubt'. Uncertainty regarding the future of the Soviet empire, the intentions of Russian politicians and army officers stationed in Estonia, and the disastrous economic situation necessitated speed. Urgency, self-reliance and inadequate skills were the order of the day calling for simple, easy-to-implement policies that would serve the objective of 'catching up with the west'. Estonian policy makers chose neoliberal policies because of their rules-based simplicity and their utopian vision of 'perfect liberty'. The population's patience, the elite's ideological commitment to neoliberal values and the need for simple policies contributed to the implementation of ultra-liberal economic programmes. These were not carefully designed, sophisticated macro-economic policies but *ad hoc*, satisficing decisions born under the constraints of structure and driven by Estonian agency with its goals of speedy economic restructuring and fast growth.

The continuity of ultra-liberal policies by the successive administrations and the circulation of key individuals in political life point to an elitist transition. As the Estonian elite was mostly educated in non-neoliberal schools, the theory of western-educated technocrats acting as change agents does not hold in Estonia's neoliberalisation. The origins of Estonian strategic policy-direction were indigenous; policy makers relied on external advice only in technical, operational matters. Defying the advice of international organisations, they rejected calls for a more gradual transition, regardless of the costs. Estonian policies, including overnight liberalisation of prices and trade and the introduction of a national currency, were the outcome of local agency. The international financial and political institutions not only had limited influence over Estonian policies but also gave advice that ran contrary to their usual recommendation of 'more market and less state' underlining the endogenous and ultra-liberal nature of Estonian policies. This also refutes the theory of hegemonic diffusion of neoliberalism and underlines the crucial role of local agency in the process of neoliberalisation.

Over the past years that have passed since regaining independence, structure has significantly changed. Estonia is a stable democracy with a stable economy with its sovereignty guarded by its EU and NATO membership. The country's internal economy

and the international geopolitical situation have dramatically improved removing the reasons behind the country's neoliberal policies. Two decades of neoliberalism have caused substantial disparities in income levels, employment opportunities and regional economic activity, and exposed the country's economy to external shocks. Continued hands-off economic management have adversely affected enterprise development and the country's infrastructure jeopardising its long-term attractiveness for investment.

The empirical contributions of this research are summarised below.

9.3 Key findings

1. The researcher's positionality is not solely determined externally. Rather than being on an ins-der/outsider dichotomy, it moves on an insider-outsider continuum.
2. The neoliberal paradigm and the theory of hegemonic diffusion of neoliberal policies both neglect context and local agency.
3. Neoliberalism is a complex multifaceted paradigm with negative, as well as positive aspects.
 - a. Its promotion of an active society has positively contributed to Estonia's relatively successful economic transformation.
 - b. Due to their simplicity, neoliberal economic policies are instrumental in providing a 'quick fix' in crisis situations. However, their long-term pursuit has adverse socio-economic effects.
4. The neoliberalisation of Estonia was an elitist domestic process, driven by active local agency with the tacit support of the population, and not a hegemonic project radiating from its Western European and North American centres. The domestic origin of Estonia's neoliberalisation refutes the view neoliberalisation as a hegemonic project emanating from its North-Atlantic heartland.

Neoliberalism is a complex process that originates from multiple centres and includes regressive as well as progressive reforms.

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Appendix A - List of Interviewees

Name	Position
Siim Kallas	Vice President, European Commission Prime minister of Estonia, 2002 – 2003 Minister of Finance, 1999 – 2002 Minister of Foreign Affairs, 1995 – 1996 President of the Bank of Estonia, 1991 - 1995 Chairman of the Central Union of the Estonian Trade Unions, 1989 – 1991 Chairman of the Central Authority of the Savings Banks, 1979–1986 Specialist at the Finance Ministry of the Estonian SSR, 1975 – 1979
Tiit Vähi	Prime Minister of Estonia 1990-1992 and 1995-1997
Mart Laar	Prime Minister of Estonia 1992 - 1994 and 1999 - 2002
Andres Tarand	Prime Minister of Estonia, 1994 – 1995 Member of the Estonian Parliament 1992 - 2004 MEP for the European Socialist Party
Prof. Jaak Leiman	Minister of Finance 1991-1992, 1996-1999
Jaak Jõerüüt	Member of the Supreme Council of the ESSR Minister of Defence 2004-2005 Represented the Republic of Estonia as Ambassador to the United Nations, Finland, Latvia, Italy, Malta and Cyprus, 1993-present
Prof. Erik Terk	Deputy Minister of Economy 1989 – 1992 Director of Estonian Institute for Future Studies
Dr. Ardo Hansson	Lead Economist, World Bank Advisor to the Estonian government 1991 - 1997
Dr. Margus Laidre	Represented the Republic of Estonia as Ambassador to Sweden, Germany and the UK, 1991-present.
Prof. Urmas Varblane	Member of the Supervisory Board of the Bank of Estonia
Professor Enn Listra	Member of the Supervisory Board of the Bank of Estonia President of the Eastern Economic Association
Kaia Jäppinen	Deputy Mayor of Tallinn Senior Consultant, State Chancellery of the Republic of Estonia, 1990 - 1994
Prof. Rein Ruutsoo	Former dissident, member of the Estonian Popular Front in the late 1980s and early 1990s
Edge Käärats	Deputy Secretary General on Labour Policy, Ministry of Social Affairs
Interviewee A	Senior Advisor, Office of the President of the Republic of Estonia
Interviewee B	Senior Official, Bank of Estonia
Interviewee C	Senior Consultant, Estonian Development Agency
Interviewee D	Senior Advisor Ministry of Social Affairs