1. Introduction

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

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

Larner (2000, p. 9) assumes a "critical distance from the tenets of neoliberalism" on the part of governments when she asks "how is it that such a massive transformation in the policy-making agenda has been achieved"? However, Estonian policy makers, a senior advisor to the President of the Republic of Estonia included, make no secret of their endorsement of these policies. Enn Listra[2] proudly declared 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, p. 8). Unlike other Central and Eastern European countries (CEEC), Estonia's subsequent administrations have pursued the neoliberal trajectory continuously. Various economists (Feldmann and Sally, 2002; Rajasalu et al. 2003) point to Estonia's exceptionally high economic growth rate as proof of the nation's success (Statistical Office of Estonia). Estonian policy makers interviewed for this article unequivocally agreed that Estonia's transition was a "*big success*". Mart Laar went as far as stating that *"looking at the results of reforms there are no losers… This transition has*

[1] Prime Minister of Estonia 1990-1992 and 1995-1997
[2] Member of the Supervisory Board of the Bank of Estonia

been very successful". On a scale of 1 to 5, with 1 representing failure, none of them rated it worse than 4 minus. According to them, the country's post-socialist transformation has been *"extremely successful*" (interview).

In this paper I argue that while the neoliberal trajectory can be instrumental in the short term in turning a struggling economy around, in the long term it has an adverse socio-economic impact. Using the example of Estonia's post-socialist transformation, I distinguish between economic growth and economic development. I 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. At the beginning of the country's transition uncertainty regarding the economic and political survival of the nation required policies that were speedy and simple to implement and monitor. Neoliberal economic policies lend themselves to such situations as they are very simplistic. They do not require discretionary fine-tuning; they automatically follow a few economic targets, such as a nominal inflation rate and a balanced budget, and rely on a proportional tax regime. However, for a country with a stable and sovereign political and economic system the socio-economic merits of the steady pursuit of neoliberal policies are highly questionable. Exceptionally high growth rates do not necessarily mean prosperity for all.

The structure of the paper is as follows. The following section summarises the research project on which this article is based. In section 3, I critique neoliberal theory in view of its achievements and shortcomings. This is followed by an examination of the neoliberal nature of Estonia's post-socialist transition. The article then analyses the impact of continued neoliberal policies on the country's socio-economic development.

2. Researching Estonia’s socio-economic development

This paper integrates Estonian transition literature with information gained from key participants of the country’s post-socialist transformation. It is an outcome of a research project which analyses the motives and the rationale behind policy choices in post-socialist Estonia. Although there is ample literature (Lauristin and Vihalemm, 1997; Terk, 2000; Raun, 2001; Smith, 2001; Feldmann, 2013; inter alia) discussing Estonia’s economic transformation, a critical qualitative evaluation of the motives behind the country’s post-socialist policy choices is scarce. The goal of this qualitative and interpretive research has been to fill this gap.

Data has been collected with the use of 22 face-to-face, semi-structured interviews with leading policy makers and advisors who had a major influence on policy choices and/or were first-hand witnesses to decision-making in the early years of Estonia’s economic and political transition in the late 1980s and 1990s. Participants have been selected by purposive sampling using specific criteria from a hard-to-reach, specialised population. The interviewees can be characterised as political and economic elites. The respondents included every prime minister who served between 1991 and 1997, the President of the Central Bank who spearheaded Estonia’s monetary reform, along with three members of the Central Bank’s Supervisory Board, various economic and finance ministers, leading former dissidents, as well as lead officials and advisors to the Estonian government.

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

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

3. A brief critique of the neoliberal ideology

3.1 In praise of the free market

The significance of the freedom of individuals to participate in economic transactions and the achievements of the market mechanism are undeniable. "The market provides economic freedom" (Friedman, 1962, p. 15). Yet, the importance of free transactions, and "the development of free markets in general and of free seeking of employment… is often overlooked precisely because we take them for granted". The uninhibited operation of the market forces relies on voluntary participation, which precludes "labour bondage" and the "persistent denial of basic freedom to seek wage employment", such as prohibiting women to search for employment outside the family (Sen, 1999, pp. 112-115). Wolf (2005) argues that the market economy has been the only economic system in generating significant and sustained increases in per capita income levels. He (p. xvii) labels the market "the most powerful institution for raising living standards ever invented".

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

> "…progress around the world has been impressive… The world average Humand Development Index (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, pp. 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, p. 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, p. 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, pp. 272-278). The socialist economies were geared towards the accumulation of the means of production at the expense of consumption (Verdery, 1996). “Markets were simply ruled out in many fields” rendering prices ineffective (Sen, 1999, p. 114) to perform their functions of transmitting information about demand and supply, providing incentives to improve production methods and quality of output, and distributing income. The inherent inefficiencies of central planning ultimately “resulted in a debâcle” of the system (Gros and Steinherr, 1995, p. 54).

Larner (2000, pp. 12-13) emphasises the neoliberal conceptualisation of people as “entrepreneurial, enterprising and innovative … political subjects” as opposed to passive subjects of a paternalistic dictatorship:

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

She highlights neoliberalism’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, p. 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, pp. 20-22). They viewed economic liberalisation as reduced reliance on the state facilitating the establishment of “their own arrangements for internal governance” (p. 52). Indeed, the neoliberal paradigm encourages people to be proactive problem-solvers by emphasising the virtues of punctuality, frugality, and probity. As seen in section 4.2, deregulation and liberalisation led to the emergence of thousands of enterprises in the early 1990s in Estonia absorbing much of the surplus labour.

3.2 Economic growth versus economic development

Wolf (2005, p. 142) credits economic growth with falling global inequality and declining poverty – "it is the growth, stupid". However, assessing development in terms of economic growth rates is a very narrow view of progress because GDP includes goods and services that are exchanged in contractual transactions only. Schumpeter (1944, p. 6) assesses measuring total output as a "highly doubtful" but "sufficiently reliable" device, which only provides a "general idea" about economic activity. As value is determined in terms of price, which do not reflect social and environmental costs (Peet, 2007), measuring living standards and quality of life by a country's GDP levels is misleading because it excludes crucial factors, such as leisure, quality of the environment, the underground economy, crime rate, life expectancy, access to and quality of education and healthcare, the sale and purchase of second-hand goods and the upbringing of children. Voluntary jobs and work carried out outside of the workplace, such as do-it-yourself activities are not counted as productive activity.

Economic growth and economic development are not synonymous concepts. Economic development is a broad multidimensional phenomenon involving all aspects of society, which cannot be reflected with a single index (Stiglitz, 2006; Piketty, 2014). 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). In a paper exploring the two-way relationship between economic growth and economic development, Tavnet et al. (2010) argue that sustainable economic growth is contingent upon improvements in human development. 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.

Arguably, the free market achieves advancement in overall living standards through the ‘trickle-down effect’ whereby income generated by economic growth is supposed to reach all segments of society reducing poverty. However, in Stiglitz’s (2002, p. 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.”

Proponents of neoliberal policies underline a “strong and robust trend towards catch-up starting in the late 1980s and continuing till today” (Wade, 2009, p. 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, pp. 579 and 577). Although China’s economic growth rates have been extraordinary over the past three decades, its impressive economic growth and successful poverty reduction must not be attributed to neoliberal policies, as its “policy regime is too heavily managed to score well by globalisation or

Washington Consensus criteria". Once China is excluded from global income inequality measurements, income inequality indicators show a significant rise. "In short, no China, no overall catch-up" (p. 150). If India is also excluded, the gap is even bigger, denying the 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" (pp. 149-150).

Piketty (2014, p. 85), while acknowledging the merits of economic growth, such as improved social mobility, is critical of its presentation as a "marvellous instrument for revealing talents and aptitudes", as it "has all too often been used to justify inequalities of all sorts, no matter how great their magnitude and no matter what their real causes may be". He cautions that national accounts are an imperfect instrument, an estimate at best, which can become very useful only when complemented with historical and distributional data. Stiglitz (2006) considers GDP growth rate a crude measurement. He considers development successful if it leads to increasing living standards. As demonstrated in the following pages, Estonia's socio-economic development provides a case of divergence between economic growth and improvement in living standards.

4. Estonia's ultra-liberal transition to a market economy

4.1 Liberalisation overnight

The literature praising Estonia's post-socialist economic transformation is vast (Hoag and Kasoff, 1999; Panagiotou, 2001; Feldmann, 2009; inter alia). As Feldmann and Sally (2002, p. 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". 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; Eurostat). Since 2004, it has the most competitive economy among the Central and Eastern European countries (CEEC) (Global Competitiveness Report, 2014). The IMF has repeatedly praised the nation's "disciplined ... Thatcherite economic policies" (Raun, 2001, p. 24). For credit rating analysts Moody's (2007) "the country's success in economic stabilisation and structural transformation is unparalleled among transition nations". As recently as 2014, the country's economy had the highest ranking (11) among the CEEC on the Index of Economic Freedom (The Heritage Foundation). Estonian economic growth rates with the exception of the recession of 2008-2009 have been among the highest in the EU. In 2011, it ranked first with a GDP growth rate of 8.7 percent (Eurostat).

Estonia's post-socialist transition has been characterised by shock therapy (Lauristin and Vihalemm, 1997), a neoliberal transition strategy that dominated the political and economic transformation of the CEEC (Orenstein 2001). The goal of radical reforms was twofold: a "decisive break with the communist system" and the creation of a free-market economy. These consisted of the elimination of freeing up prices, fiscal and monetary tightening and the opening up of markets to free trade (Sachs, 1999, p. 45-51). Estonian policy makers proactively discarded the legacy of central planning in favour of a free market economy by emphasising values compatible with neoliberal theory, such as individual initiative, self-reliance, accountability, and a minimalistic state, that they claimed were the view of the good life that Estonians widely shared. The "all too visible hands of the party" were replaced by the invisible hand of the market (Verdery, 1996, p. 181) overnight. The immediate implementation of free trade measures without gradually decreasing tariffs and converting non-tariff barriers to tariffs distinguished Estonian reformers as the most liberal ever in any economy (Feldmann and Sally, 2002). According to Feldmann (2013, p. 494) Estonia's economy in certain respects is "more liberal than the classical LMEs" (liberal market economies).

Estonian economic development since 1991 exhibit classic neoliberal features. A cornerstone of the country'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 taxation that puts a heavy burden on the lower income segments of the population. Personal incomes and distributed corporate profits are subject to a proportional tax rate of 21 percent. In addition, all reinvested corporate profits are tax exempt (Estonian Investment Agency), reflecting Friedman's (1962) recommendations of the introduction of flat-rate tax and the elimination of the corporate income tax. Mart Laar (1996, p. 99) considers alternatives to proportional taxation "confiscatory". He underlines the advantages of proportional taxation of simplicity and lower disincentive effect. A senior economic advisor fully supports proportional taxation claiming that it "*has worked well so far*".

Prior to the country's EU accession Estonian policies were ultra-liberal to such an extent that international organisations, such as the World Bank and the EU, advised Estonia to 'de-liberalise' them. Indeed, Estonia's adjustment to the EU *acquis communitaire* actually de-liberalised 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[3] explained the process of de-liberalisation:

[3] Member of the Supervisory Board of the Bank of Estonia

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

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

Market attractiveness in order to attract foreign capital has played an important role in the Estonian economy from the very beginning of transition. Currency stability, low proportional tax rates, equal treatment of foreign and domestic capital, protection against expropriation and a guarantee of unrestricted transfer of profits have brought significant amounts of foreign direct investment (FDI) into Estonia. Their positive impacts were 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 state-owned enterprises (SOEs) (Liuhto, 1996; Faggio and Konings, 2003). Although initially Estonia's very low labour costs attracted mainly labour-intensive production, FDI represented a large portion of investment. In 2007, foreign investors were responsible for 78 percent of the nation's GDP, which is a significant figure considering the EU average of 40.9 percent. The same year Estonia ranked number 8 on the country rankings of Inward FDI Performance Index, which measures an economy's relative success in attracting FDI (UNCTAD). The stable macroeconomic environment and business-friendly climate made Estonia a very attractive destination for foreign investment within a few years of regaining independence (Raun, 2001).

4.2 Entrepreneurial spirit

The neoliberal 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. Having endured half a century of restrictions of central planning, many Estonians were eager to engage with this characterisation of human motivation. According to Rein Ruutso[4] "*the totally liberal discourse*" was accepted implicitly that "*proof of freedom is that the individual is able to take care of himself*", which was one of the main goals of Estonian policy makers, as Mart Laar admitted:

> *"One of the cornerstones of the policy was to get people used to the new situation where they just must decide who they are, what to do, what the responsibilities are, you need to activate them, to energise them."*

Estonia experienced a fast growth of entrepreneurial activity, which partially offset the job losses from the fast decline of heavy industry. While in 1991, 35,000 businesses were registered, the country had 83,000 enterprises the following year. The share of labour force employed by small and medium enterprises (SMEs) increased from 26 percent in 1992 to 40 percent in 1994 (Liuhto, 1996), and this was crucial in absorbing much of the surplus labour due to the fast contraction of output of SOEs. 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

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

employment levels (Saar and Unt, 2006). Although the inaccuracy of unemployment figures of the times and the lack of incentives for the unemployed to apply for benefits also contributed to lowering the official unemployment rate (Harter and Jaakson, 1997), the dismantling of SOEs should have resulted in a 15-20 percent unemployment rate, as opposed to official figures of between 2 percent (Liuhto, 1996) and 7 and 8 percent (Smith, 2000). Erik Terk[5] remembers:

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

4.3 Continued commitment to ultra-liberal reforms

Numerous authors, among them Kelsey (1997), Sachs (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. Advocates of shock therapy measures point to speed as essential to enable reform-minded governments to take advantage of the 'honeymoon' period. 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. In Estonia it was not lack of popular support but the dire economic situation and the uncertain political climate aggravated by

[5] Deputy Minister of Economy 1989 – 1992

the presence of Russian troops until 1994 that necessitated speedy reforms. Speed was essential, as Siim Kallas[6] explained:

> *"The main objective was, of course, to get the economy running. As soon as possible, to cut from rouble, to cut from Soviet system to get the environment where free entrepreneurship will operate."*

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. 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 commitment of the population to reforms was crucial. 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:

> *"I would like to stress that Estonian people, in order to become free, were able to give up many 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…"*

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[6] 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

Between 1991 and 2013 Estonia had eleven administrations consistently pursuing ultra-liberal economic reform emphasising economic austerity and limited scope for the role of the state (interviews, Adam et al., 2009). Unlike other 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). 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."*

The relatively frequent changes in administration were not accompanied by economic policy shifts but, according to Raun (2001, p. 25), were caused by various personal 'scandals' involving leading Estonian politicians. In essence, due to strongly popular anti-leftist sentiments, there is no significant political left in Estonia (Adam et al., 2009). 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).

Reflecting the heterogeneity of economic and political conditions of the CEEC post-socialist economic transformations "did not produce identical programmes" despite the uniformity of economic policy advice provided by international organisations (Stenning et al., 2010, p. 39). Poland introduced its 'big bang' reform, which was heavily influenced by the policies of the Washington Consensus, in 1989. However, it only lasted about one and a half years due to popular opposition caused by a sharp decline in the living standards of the majority of the population (Orenstein, 2001). Hungary, the Czech Republic and Slovenia chose the slower, gradualist approach (Stiglitz, 2002). Czech reformers intended to soften the impact of reforms and designed a ‘hybrid social liberal strategy’ for transition (Orenstein, 2001, p. 61). When compared to Estonia, Slovenia “developed completely different – in some aspects even diametrically opposite – regulative settings and socio-political arrangements”. Whereas Estonian policy formulators opted for radical reforms, in Slovenia gradual transition was managed by a ‘leftist-liberal’ camp (Adam et al., 2009, pp. 65 and 70).

Estonia’s unwavering neoliberal trajectory resulted in a successful economic transformation providing an exception to Orenstein’s (2001) findings that policy alternation seems to have greatly contributed to the most successful transitions in the CEEC. Lin and Rosenblatt (2012) argue that countries pursuing gradualist reforms have often performed better than those implementing the shock therapy. Based on economic indicators Estonia’s post-socialist transformation is among the few that has been achieved by shock therapy.

Ardo Hansson[7] offers his assessment of the country’s transition:

> *“…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.”*

[7] Advisor to the Estonian government 1991 - 1997

Although “the size and nature of the problems in the FSU are incommensurable with those in Central Europe” (Gros and Steinherr 1995, p. 231), Estonian economic indicators show a substantial improvement in terms of average income levels, as the following table demonstrates.

Table 1. GDP per capita in purchasing power standards (PPS). EU average=100

	1996	**2000**	**2007**	**2009**	**2012**
Czech Republic	73	68	83	83	81
Estonia	36	45	70	64	71
Hungary	52	55	62	65	67
Poland	43	48	55	61	67
Slovenia	75	80	93	92	88

Source: Eurostat

Estonia’s conditions inherited from the Soviet era were significantly worse than that of non-FSU transition economies, which explains its longer catch-up with CEEC income levels. The country’s transition underlines Frye’s (2010, p. 119) argument that “(r)ather than being doomed by their inheritance at the start of transition, countries can overcome institutional legacies with time”.

5. Growth without prosperity

5.1 Highly uneven regional development

However, average income levels do not seem to measure adequately socio-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. As an interviewee explained, “*Laar’s* *government's understanding was that it is not important, the social results*". Ardo Hanson labels the socio-economic impact of shock therapy "*pretty harsh*". Although the country's development has been impressive from a strictly output-oriented view, from a socio-economic perspective, the achievements have been more modest. The country's development model has been excessively competition oriented (Lauristin and Vihalemm, 2009).

Regional development in Estonia has been uneven; 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 (Statistical Office of Estonia, 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 (Estonian Investment Agency).

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

Table 2. GDP per capita by county, percentage of Estonian average

	2000	**2005**	**2007**	**2011**
Whole country	100	100	100	100
Harju county	150.0	154.2	153.7	153.3
Tallinn city	164.6	169.5	167.1	164.0
Hiiu county	78.0	63.4	58.5	56.3
Ida-Viru county	65.9	60.7	59.7	65.6
Jõgeva county	50.2	44.3	43.3	46.4
Järva county	71.8	54.2	63.7	58.1
Lääne county	67.4	61.3	60.7	59.6
Lääne-Viru county	77.1	70.4	68.1	67.1
Põlva county	56.2	46.8	49.3	47.1
Pärnu county	81.3	76.5	75.1	67.3
Rapla county	64.9	52.9	54.6	49.3
Saare county	67.3	68.1	67.4	64.7
Tartu county	77.5	89.5	89.5	87.2
Tartu city	n/a	105.6	106.7	86.7
Valga county	55.7	51.5	49.4	50.4
Viljandi county	61.4	57.2	55.9	58.3
Võru county	59.2	51.0	54.8	53.0

Source: Statistical Office of Estonia

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

As Piketty (2014) argues, socio-economic inequalities are determined by not just the state of the economy but social, political and cultural factors as well. Inequality reduction is not a spontaneous process but is contingent on public policies. Progressive taxation, which he considers (p. 493) a “major twentieth-century innovation”, played a crucial role in reducing inequality in the 20th century. The ultraliberal policies, including proportional taxation, have not alleviated disparities in income levels in Estonia, as demonstrated by the following table.

Table 3. Differences in disposable income in Estonia

	1996	**2004**	**2013**
Disposable income in the poorest county, as a percentage of national average.	74.8	74.9	73.9
Disposable income in the poorest county, as a percentage of the richest county.	63.0	64.0	62.5
Disposable income in the poorest county, as a percentage of the capital, Tallinn.	61.6	63.4	63.2

Based on the author’s calculations, using data from the Statistical Office of Estonia

Two decades of neoliberal policies in Estonia have led to exceptionally volatile economic growth rates. The restrictions on counter-cyclical instruments leave the Estonian economy crisis-prone through wide exposure to global economic fluctuations (Hoag and Kasoff 1999). The effects of the recent global depression caused a severe economic downturn in Estonia (European Central Bank), as the table below also demonstrates.

Table 4. Real GDP growth rate (in percentages)

	1996	2000	2007	2009	2014
Czech Republic	4.0	3.6	5.7	-4.5	2.0
Estonia	5.7	10.0	7.5	-14.1	2.1
Hungary	0.7	4.9	0.1	-6.8	3.6
Poland	6.2	4.3	6.8	1.6	3.4
Slovenia	3.6	3.8	7.0	-7.9	2.6

Source: Eurostat

Andres Tarand[8] criticised the priority of economic growth by providing an analogy:

> *"The main criteria all the time – only growth, 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…"*

He referred to the "deficiencies characterising Estonian policies and society, like the increasing social inequality…" (Adam et al. 2009., 71). Addressing the excessive social costs of the shock therapy was not high on the agenda of Estonian policy makers, 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… "*

Mart Laar explained the rationale behind his administration's policy choices:

[8] Prime Minister of Estonia, 1994 – 1995

> *"The idea… at that time was that everyone should be able at least to try to take care of yourself. Therefore only then when the citizens are strong, the society is strong."*

These narratives echo Bockman's and Eyal's (2002, p. 311) argument that "East Euroepan 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*". Strong 'anti-paternalistic sentiments' emerged as a backlash against the omnipresent paternalistic state under socialism.

The recent economic crisis hit Estonia particularly hard. The 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, p.181), the Estonian government actually cut its expenditure by 10 percent in 2009 (Statistical Office of Estonia), despite the small size of its government debt. Urmas Varblane underlines the priority of the country's administration to minimise government debt.

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

Meanwhile, Estonia's total expenditure on social protection has consistently been among the lowest in the EU. In 2011 it was the second lowest at 16.1 percent of GDP as opposed to the EU average of 29 percent (Eurostat).

5.2. 'The way human life goes' in Estonia

Poverty must be defined not only in terms of "the resources or income that a person commands" but in terms of "social and economic arrangements", which affect "quality of life… the way human life goes" (Sen, 1999, pp. 3 and 20). Lagerspetz (2001, p. 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, p. 1) lament that "beneath the surface of extraordinarily high economic growth, society is tormented by unresolved political, economic and social problems." They highlight the serious problems of inadequate and inefficient social spending and high levels of "social diseases, such as crime, drugs and suicides". Estonian poverty rates refute the Hayekian tenet of the 'trickle-down effect' that a growing economy reduces poverty (Macours and Swinnen, 2008).

Levels of social inequality have risen; the economic situation of families stagnated or worsened and proved very painful for much of the country's population by increasing income, wealth and social disparities (Adam et al., 2009). The Estonian Human Development Report (2013, p. 115) states that "Estonian society's sense of fairness has been offended". In 2008, 46.5 percent of households were in persistent-at-risk of poverty (Statistical Office of Estonia). The Gini coefficient of equalised disposable income has been among the highest in the EU, in 2013 it stood at 32.9 (Eurostat). In 2011, "68% of households said that they struggle to cover all necessary expenses, with 9% of them having great difficulties". These figures increased from 39 percent and 3 percent respectively in 2007 (Statistics Estonia 2013, p. 32).

In a survey only 15 percent of respondents thought that their situation has improved since 2006. Over two-thirds of them regarded government expenditure on education and healthcare as insufficient. 80 percent believed that the income gap between the rich and poor segments of society should be decreased (EBRD, 2011, p. 72). In another survey carried out in 2014, 23 percent of respondents thought that Estonia's social welfare system "provides enough coverage fairly well", whereas 55 percent responded that the provision was "fairly bad" (Eurobarometer 2014, p. 15).

Average life expectancy at birth in Estonia only reached 1989 levels by 2000, when it was the lowest in Europe. In 2007, it was still the third lowest in the EU (Eurostat). As recently as 2012, Estonian male life expectancy was among the lowest in the EU. Only Lithuania, Latvia, Bulgaria and Romania ranked worse on that index (Statistical Office of Estonia). 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, these are averages. Poverty levels have been uneven across the country, as demonstrated by Table 5.

Table 5. At-risk-of-poverty rate by county, 2011

Whole country	17.6
Harju county	13.1
Hiiu county	20.3
Ida-Viru county	28.9
Jõgeva county	23.0
Järva county	17.8
Lääne county	17.3
Lääne-Viru county	19.8
Põlva county	23.7
Pärnu county	18.7
Rapla county	17.4
Saare county	14.8
Tartu county	15.8
Valga county	25.7
Viljandi county	21.2
Võru county	23.8

Source: Statistical office of Estonia

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

5.3 Constrained business development

Whereas public funds have been used to create the infrastructure needed for the development of certain industries, such as information technology, telecommunications, and finance, investments in areas of basic physical and social infrastructure have been insufficient in Estonia (Eurostat). In addition to healthcare and education being under-funded, the physical infrastructure is also underdeveloped. Erik Terk portrayed the priorities of policy makers reflecting the neoliberal 'market knows best' paradigm:

> *"This new generation… 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[9] echoed 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… 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 this narrative:

> *"…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."*

[9] Deputy Secretary General on Labour Policy, Ministry of Social Affairs

Although deregulation has led to the creation of thousands of enterprises, the government's policy of non-intervention has been inhibiting their development. In the words of an interviewee, "*For small and medium size enterprises this is not a good system*". This is supported by Saar and Unt (2006), who find that 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. Smallborne and Welter (2010, p. 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 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..."*

6. Conclusion

Neoliberal policies can be an effective short-term remedy in critical economic situations, as was the case in Estonia in the early 1990s. Estonia managed to transform its economy and achieve high growth rates in a remarkably short period of time. The prevailing neoliberal paradigm also stimulated entrepreneurial activity. However, the continued pursuit of these policies has had adverse effects over the nation's socio-economic development. The proportional tax regime coupled with the strict adherence to a balanced budget hinders the government's expenditure on business development and social welfare. The socio-economic costs of Estonia's neoliberal transition have been high in terms of life expectancy, health care and social and spatial disparities in investment levels, employment opportunities and living standards. Whereas the country's accomplishments have been respectable in terms of economic growth rates and income per capita levels, from a developmental perspective it has been lagging behind. While in the short term the neoliberal trajectory may prove instrumental in turning struggling economies around, its long-term socio-economic consequences are dire.

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