

Estonia Moves to Liberty

by Norman Barry

We have read a lot about former Soviet regimes struggling to shake off the last remnants of communism. It has not been easy. Even Czechoslovakia (now the Czech Republic), when first led by the free-marketeer Vaclav Klaus, had difficulties with privatization (why were the banks left in public hands?), and Poland, despite successes, found itself with a reformed socialist party in charge.

Indeed, in most of these regimes the old communist parties simply changed their names and got back into power. But at least they were engaged only in simple rent-seeking (the acquisition of wealth through politics), rather than attempting to restore communism. All of eastern Europe is united in its contempt for anything approaching the “nationalization of the means of production, distribution, and exchange.”

As you might expect, the most successful of the “transition economies” is the one least talked about. I refer to Estonia, a tiny Baltic country, just opposite Finland, with a population of less than 1.4 million and a tragic history in which it was the plaything of two totalitarian superpowers, Nazi Germany and the Soviet Union. The loss in the twentieth century of Estonia’s liberty and indepen-

dence imbued its citizens with a determination to re-establish its own indigenous freedom. It is working spectacularly well.

A little bit of history is relevant here. Estonia is a separate country from the other Baltic states, Latvia and Lithuania, and has its own language, culture, and history. It was originally ruled by the Russian tsars, but between 1918 and 1939 it was an independent nation, precariously wedged after 1933 between the barbaric regimes of Nazi Germany and the Soviet Union. It was a victim of the cruel cynicism of the pre-war pact between these two and was occupied first by the USSR in 1939 and then the Nazis between 1941 and 1944. From 1944 to 1990 it was again the victim of Soviet communism. Nearly all the elements of the hitherto thriving Estonian civil society were repressed, and the country became little more than a province of the Soviet Union.

When the Soviet regime began to disintegrate in the late 1980s, Estonia was in the vanguard of the dissent. It had emotional, intellectual, and cultural capital that had not been entirely depleted by communism. And there was a touch of romance in its successful bid for freedom. In 1988 there occurred what became known as the “singing revolution.” Vast numbers of the inhabitants of this tiny country simply stood before the public buildings and other symbols of communism and sang their traditional songs. Had Gorbachev used Soviet tanks against such united opposition, one suspects they

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would have been powerless to preserve communism. Free elections were held in 1990, and a new constitution (based on earlier experiments in law and liberty) was formulated in 1991. Estonia adopted the German Civil Code, which is quite protective of property and contract. Estonia could now construct its own future. It chose liberty in its polity and in its economy too.

It quickly set about the task of dismantling the communist state. A more or less complete privatization had been achieved by the mid-1990s. There are competing political parties in the country, and there are fierce local battles between them, but there is no real division on the crucial issues. All agreed that Estonia must be a real market-based Western economy and have an independent judiciary determined to protect both economic and civil liberty. It has achieved those goals.

Economic Progress

For much of the postwar period, Estonia had been connected to the Soviet economy, but it quickly sloughed off these links. Those elements, industrial and agricultural, that depended on state support were left to survive on their own in the market. There are now no subsidies. Estonians quickly saw the advantages of free trade and opened up their markets to world competition. Free trade was established with the European Union (EU) in 1993, and two completely free ports were created, Munga and Sillamae. The connection with Europe proved particularly advantageous in 1998, when Russia defaulted on its debts. As we shall see, that connection has its downside, but for a nation newly emerging from communism, it was invaluable. Estonia now has one of the freest trading systems in the world. Apart from a period in the mid-1990s, it has enjoyed steady economic growth.

What was truly remarkable was Estonia's rapid adaptation to economic reality once the ruinous Russian inheritance had been shelved. The country has become much more of a service economy: taxes have been kept low, and economic interference has been virtually nonexistent. There is now a single personal

flat tax at 26 percent. A plan supported by all parties would reduce this to 20 percent by next year. Also, to encourage more foreign investment, all reinvested corporate profits were exempted from the corporate income tax beginning in January 2000. Without a repressive and exploitative tax system, the government has managed to balance its budget.

As a further gesture to modernity, virtually the whole country has become electrified.¹ Around half of the population has computers at home, and of those, nearly 75 percent have access to the Internet. Almost everybody in the country has easy use of modern communication methods. This makes Estonia's labor force highly mobile and adaptable.

All this has made Estonia a desirable place to invest. The growth rate now exceeds 6.4 percent per year, after falling back a little during the Russian financial crisis; unemployment is now 10 percent and declining. Labor is virtually free and ready to quickly take up new opportunities. Estonia is a member of the World Trade Organization, but one wonders why it bothered. The country had already done what all free-market theorists say a country should do: it simply declared unhindered commerce as its unbending policy. Per capita GDP is now \$5,000 (up from slightly under \$3,000 in 1997). That is not great, but it is very good by east European standards and comfortably ahead of Turkey (less than \$4,000), a country that has a much longer experience with a modern market economy.

All this progress by market methods has attracted little attention from Western observers, I guess because it was too simple and straightforward. The privatization process was much more transparent than the complex and only partially successful one in Czechoslovakia, and it had none of the crime associated with the Russian advance to capitalism. Estonia was undoubtedly helped by the fact that it is a small country with an integrated social structure, which provided informal constraints on excess. The country was recently ranked sixth out of 161 countries in the Heritage Foundation *Index of Economic Freedom*.

The free-market world might have been remiss in its attention to Estonia's unglamorous journey to freedom, but the (moderate) left has been predictably critical of some of its alleged failings. Naturally, social policy has drawn most of the fire. While unavoidably retaining elements of the Soviet welfare system, especially old-age pensions, the new free Estonia has not been at all extravagant in social spending. Hence, the critics. There was a complaint that only 1.5 percent of GDP was spent on children and the family, and critics argued that welfare payments in general were too low.² Apparently it lagged behind other eastern countries. It never crossed the critics' minds that Estonia's neglect of welfare may be one reason for its success.

An early European Commission report on the country praised its successful transition from communism, but commented on its backward level of social services and its poor record on gender-equity issues. Critics seem to forget that Estonia's small size and intricate and intimate social structure make self-help and communal spirit much more effective at ameliorating poverty and social deprivation than an expensive and inefficient welfare state. It is also probably learning from the West's mistakes.

Hidden EU Danger

All east European countries that successfully applied for membership in the EU in 2003 have approved of it by referendum. Estonia had a 66.84 "yes" vote in September, though there is evidence that support is deeper in the intelligentsia and the middle classes than in the working class. One can see why the politics of the EU should be superficially attractive to eastern Europe. These countries had been under Soviet tyranny, and, in some cases, Nazism, and one can appreciate their desire for security in a greater Europe. But there is a hidden danger in EU membership that will one day dampen the enthusiasm.³ Some of the regulations and social policies of the EU might put their newly won freedoms at risk. Of

course, the EU's regulatory socialism is a long way from communism, but its rigorous enforcement will delay the transition to a full-fledged market economy. It is too early to say what the effect will be.

The most dangerous feature of the EU legal structure is the enforcement of *aquis communautaire*, according to which new members are obliged to accept all its existing laws, regulations, and policies, as well as new ones. The new states of course had no part in the making of these, and they can only be altered by the unanimity of a treaty, an almost impossible task.

How will this affect Estonia? It is difficult to say, but things are not promising. The EU has the ludicrously inefficient Common Agricultural Policy, which shuts out cheaper foreign food and keeps some people tied to the land. Estonia does not have a large agricultural sector and may escape the worst of this. Then there is the European Social Policy, which contrasts markedly with Estonia's meager arrangements; as we have already noted, Estonia is under pressure to increase its welfare expenditure. There is also the future danger of tax harmonization, which would boost EU taxes way above Estonia's current levels.

The worst of the EU would emerge if its constitution were to be adopted because that would create a whole new set of "rights" (mainly welfare "rights" guaranteed by the state) and new stultifying regulations, and would abolish jurisdictional competition. However, the European constitution in its original form is virtually dead and, looking optimistically, the new member states may slow the union's progress toward statism and excessive regulation.

But it is never wise to be optimistic about Europe, and one day Estonians may come to regret the sacrifice of their burgeoning free market for an overvalued political respectability. □

1. See *Newsweek*, March 11, 2002.

2. "Gender and Social Policy: Comparing Welfare States in Central and Eastern Europe and the Former Soviet Union," *Journal of European Social Policy* (10) 2000, pp. 240–66.

3. See Norman Barry, "A Classical Liberal's Conception of Political Liberty: America and Europe Compared," *The European Journal*, vol. 9, no. 3, 2001, pp. 13–16.