

Estonia

Status Index (Democracy: 4.8 / Market Economy: 4.7):		9.5	Management Index		7.9
System of Government	Parliamentary Democracy		Population	1.36 Mio.	
Voter turnout	58 % (2003)		GDP p. c. (\$, PPP)	10,940	
Women in Parliament	17.8 %		Unemployment rate	10.4 %	
Population growth	-0.2 % (2001)		HDI	0.826	
Largest ethnic minority	35 %		UN-Education Index	0.95	
			Gini-Index	37.6 (1998)	
<small>Figures for 2002 – if not indicated otherwise. ^{a)} Annual growth between 1975 and 2001. Sources f. ex.: UNDP: Human Development Report 2003.</small>					

1. Introduction

As one of the most successful EU accession states, Estonia has gone through the main thrust of transition towards pluralist democracy and market economy in the first half of the 1990s. The societal mobilization and political consensus against the preceding Soviet regime in the national economy and government proved to be resilient enough to outlast the deprivations of transition and imbue its management with a strong sense of purposefulness.

The advantageous initial and framework conditions (e.g. EU accession and the Baltic Sea as an economic growth region) for a market economy, moreover, consolidated the political process and constituted a strong disincentive to an escalation of the main challenge in state and nation building; the integration of the Russophone population.

Conversely, whereas legitimizing references to an idealized status quo ante in the interwar period had done much to aggravate the exclusion of ethnic minorities from the body politic, *within* the state nation such references reinstated an integrationist political system with a maximum of democratic control. Meanwhile, the reform strategy for the national economy hardly referred to the first independent Estonian Republic (1918-1940), but typically tackled the strategic challenges and opportunities of a post-industrial world economy.

The report on the evolution of transition in the past five years encompasses a period with three governments: the left-right Siimann cabinet of 1997-1999, the center-right Laar government of 1999-2002, and finally the “left-right” outgoing Kallas cabinet (following elections in early March 2003).

The decision of the Copenhagen European Council (December 2002) to offer Estonia full EU membership by 2004 symbolically marks the completion of the main transition process. Consequently, the time span from 1998-2003 coincided with the accession negotiations for EU membership, which implies, on the one hand, that the key challenges in economic and political transition had been mastered earlier, and, on the other hand, that the *acquis communautaire* guided and informed the remaining transition management. The time span, therefore, is not characterized by qualitative leaps towards market economy and democracy.

The transition management for the Kallas government is correspondingly difficult to assess, as the main challenges predate its term of office and as it was basically a care-taker government between the end of the Laar coalition in January 2002 and the regular parliamentary elections in March 2003, shelving most of the controversial policy decisions.

2. History and characteristics of transformation

The beginning of the economic and political transformation process in Estonia coincided with Gorbachev's perestroika and glasnost. Whereas the Communist Party of Estonia and the government resisted the reform tendencies from the Moscow center, local leaders used perestroika and glasnost to mobilize the population on a range of issues, including Russification, industrial pollution, the constant influx of Russian workers, and economic degradation. Overall, although economic and democratic considerations did play a role, the transformation actually started as a movement for Estonian state and nation building.

Some steps were taken towards democratization and economic liberalization in the late 1980s, but the transformation process began in earnest with the declaration to begin a process towards independence (30 March 1990) and the actual restoration of Estonia's state independence (20 August 1991).

The *democratic transformation* was characterized by an ideology known as *legal restoration*, which declared the independence process not the beginning of a new era of statehood, but rather as a restoration of the same statehood and legal continuity of the previous pre-1940 Republic. Since this included a return to the well-functioning pre-war parliamentary system (prior to a shift to authoritarianism in 1934), the country benefited from having a set of institutions and procedures with a high degree of legitimacy and consolidation quickly in place. At the same time, as a consequence of this restorationist approach, all post-1940 immigrants (mostly Russophones) were excluded from citizenship and democratic participation unless they were naturalized. Likewise, *economic transformation* policies referred to the liberalized market-economy of the interwar period, but never (except for some property restitutions) were restorationist policies implemented against the logic of the market. Whereas, Soviet-times heavy

industry was largely abandoned (with the exception of oil shale), export-oriented service industries, biotechnology and IT industries were strongly promoted. As a result, the small country soon reached a critical mass of economic development, even though it was strongly concentrated in certain sectors and regions/cities.

3. Examination of criteria for democracy and market economy

3.1 Democracy

As part of its democratic transformation Estonia has created an institutional arrangement that meets the highest standards of rule of law, democratic control, and political representation – at least for its *citizens*, and not for the substantial category of *non-citizens*. Despite frequent changes of government and delays in the consolidation of a party landscape the functioning of the political system has at no point been endangered. Arguably, the lack of a system of regional self-government might be seen as a slight drawback in overall democratization. Among the EU accession states Estonia has set some high marks in terms of democratic procedures and practice as well as political accountability and transparency.

3.1.1 Political organization

(1) *Stateness*: For a variety of reasons, the only potential threat to the state monopoly on violence – the communist and Russian political organizations – never crossed the threshold to secessionism or political violence. Therefore, there is no restriction to the state's monopoly of violence.

Conversely, the definition of the *demos* or *ethnos* of the Estonian state has been one of the most controversial and thorny issues of post-Soviet transition. Strictly speaking, the concept of the state was not based on ethnicity, as citizenship was automatically granted to all those who had been citizens in 1940 when the USSR annexed Estonia (or descendants of these citizens). In practice, however, the concept of the illegality of all post-1940 immigration excluded predominantly Russians and other Russophone immigrants from the Soviet period. In surveys, moreover, a majority of Estonians indicated that voting rights ought to be restricted to ethnic Estonians (40 %) rather than 1940 citizens and their descendants (3.5 %) (Baltic Barometer 1999).

These concepts of a nation state and an ethnic democracy *de facto* disenfranchising approx. one third of the population as “non-citizens” were reconfirmed in the constitution (June 1992), the electoral and citizenship laws. From 1992 onwards, when non-citizens (i.e. all legal residents for 5 years) were granted active voting rights in local elections, a number of specific measures have

partly alleviated this democratic deficit by naturalization and integration, but without revising the basic principle of statehood. Therefore, significant aspects of citizenship were withheld from a major part of the population. Meanwhile, however, most debates and controversies around the issue of citizenship have shifted to the applications of the respective laws and programs for the integration and naturalization of minorities. The fundamental opposition to the concept of the state and the category of “non-citizens” seems to have lost most of its dynamism. In this respect, the less than integrative definition of citizenship does not imply a corresponding, fundamental disagreement in practice.

During the Soviet era, worship was forbidden, provoking a secularization of the population. Now, less than one-fourth of the population is religious. Most of those who are still religious attend the Lutheran Church. Currently, religious freedom is guaranteed, although the government is not officially tied to a particular religion. The same applies to a large extent to the Russian minority and the Orthodox Church. Thus, as the organization of the state is determined by the protestant Estonians with a high degree of secularization and with reference to the interwar Estonian state in which a strict separation of state and church had already applied, Religious dogmas and church leaders have no influence whatsoever on national politics or the legislative process.

Estonia’s administrative structure would without restrictions qualify as differentiated and effective in the allocation and extraction of state resources throughout the country.

(2) *Political participation*: With the fundamental qualification of the exclusivist citizenship policies noted above, the rulers in Estonia are determined by free and fair elections. Similarly, the elected rulers have effective power and no institutional or regional veto powers and/or political enclaves exist. The northwestern Ida-Virumaa region with an 80 % Russian majority and its main cities with over 90 % “minority” population nevertheless function fully within the governance structures of Estonia.

Article 47 of the Constitution provides the right of assembly in Estonia. This right may be restricted in the usual cases (e.g. to ensure national security, public order, morals, etc.) Additionally, the Public Assemblies Act prohibits any public assembly, which incites racial, religious or political hatred, violence or discrimination between the social strata. The Constitution also provides for the freedom of association (Article 48). The right of association does not require formal registration by a public authority. There is no ban on groups that mobilize along ethnic or religious lines, within the basic democratic order. Thus, no undue restrictions apply to the freedom of association and assembly in Estonia, as the usual restrictions are applied with much restraint.

The mass media were privatized at an early stage of democratic transition: Both the constitution and the plurality of media outlets guarantee a free expression of opinion in the press, within the basic democratic order. Estonia has three Estonian-language and two Russian-language independent dailies, private radio stations and commercial TV stations with public programs. The government holds a stake only in a few cultural and educational publications but they enjoy full editorial independence from the authorities. A few parties have tried to publish their own papers but only one has really broader circulation. Economically, the big media organizations are sound, but there is a growing tendency towards concentration of ownership, especially by foreign owners (Norway, Sweden). There is also increasing sensationalism in some news reporting. Since independence, the state monopoly in printing and distribution has been abolished, and printing has been diversified between two privately owned plants in Tallinn and Tartu.

(3) *Rule of law*: As a parliamentary democracy with a strong independent constitutional court, Estonia demonstrates no significant restrictions in the separation of powers with a functioning system of checks and balances. Its Freedom House rating for the rule of law is 2.13 (2002).

Correspondingly, the reform of the judiciary has resulted in a differentiated legal system as attested by the 2002 EU Progress Report and an independent judiciary in line with the 1992 constitution. The highest judicial authority of Estonia is the Supreme Court, *Riigikohus*, and has seventeen judges. The Chief Judge of the Supreme Court is appointed by the Parliament on nomination by the President. Lower-court judges are appointed by the President of the Republic on the proposal of the Chief Justice of the Supreme Court. Judges may not hold any other elected or appointed office. The Constitutional Review Chamber exercises the function of constitutional review assigned to the Supreme Court by the Constitution and is entitled to interpret the Constitution and other laws only through adjudication of concrete cases. Overall, effective safeguards against unconstitutional intervention and guarantees for judicial review are in place.

Estonia has no reputation for excessive political corruption, and procedures to guarantee political accountability and to counter conflicts of interest exist. Recent cases have demonstrated that as a rule corrupt officeholders are prosecuted under established laws.

Civil rights and freedoms are guaranteed by the rule of law and no restrictions apply except for the issue of the stateless non-citizens, who are disenfranchised in the democratic process and are banned from holding public office, e.g. in the executive, in political parties, but also in trade unions. Although the preceding Soviet regime is defined by the current Estonian state as a foreign occupation, legal prosecution of cases of human (and/or property) rights violations has become rare in recent years, but some former state and party officials have been

sentenced where they were involved in the direct persecution or deportation of other citizens. Whereas the restrictions in the law may be seen to constitute a restriction to civil liberties, no restrictions apply to the subsequent court procedure. Typically, as far as redress from previous Soviet violations of civil liberties is concerned, only the restitution of property rights took precedence over re-distributive considerations.

3.1.2 Political patterns of behavior and attitudes

(1) *Institutional stability*: Democratic institutions in Estonia, including the administrative apparatus and the system of justice, perform together effectively and efficiently. The fact that over the past five years the Estonian state completed the gargantuan legislative and political task of adopting and implementing the necessary legislation for the EU-acquis is prime proof of its performing capabilities. Major controversies over the procedures of political decision-making are rare, which can be seen as indicative of the acceptance and consolidation of the system.

Nevertheless, the volatility and instability of the political party landscape accounts for some friction between executive and legislative institutions. No substantial (potential) veto actors exist and all relevant actors accept the democratic institutions. This last sentence is a bit cryptic. Even controversies on the issue of non-citizens' rights do not pertain to the legitimacy of the institutions as such, as this controversy has become integrated into the political process. Despite (or due to) the frequent changes of government, party-political blockades in the legislative process are rare.

(2) *Political and social integration*: Despite significant fragmentation and fluctuation in the political-party landscape over the past decade, with 8-18 parties competing for the voters' favor, the 5 %-hurdle has in all four parliamentary elections (1992, 1995, 1999 and 2003) resulted in 6-9 parties sharing the 101 seats in the Riigikogu. Typically, the Centre Party, the ProPatria Union, and the Reform Party together accounted for 38 %, 55 %, and 40 % of the votes in the last three elections respectively. A second tier of parties has been constituted by the mostly agrarian People's Union and the social democratic Moderates (each averaging around 8-12 % of the vote). Thus, Estonia consistently ranked high in the Freedom House Democratization Index (2.10-1.94).

Overall in the last four elections five parties always accounted for the vast majority (<80 %) of seats in the Riigikogu. Party membership is relatively high in Estonia, totally some 5 % of eligible voters, and an excessive polarization of the party system has been avoided: No left or right wing extremist parties play a noticeable role in Estonian politics. Parties increasingly represent socio-economic group interests rather than (as they did in the early transition period) positions on

the issue of nation and state building. One of the consequences is an increased volatility of voters from one election to the next if a coalition fails to satisfy the expectations of its constituency. As is typical of small transition countries, strong ties between political elites and civil-society (organizations) exist.

Estonia has quickly developed a vibrant civil society and a dense network of cooperative associations and interest groups between society and politics. Although many of these organizations still rely on foreign assistance and guidance, sustainability is growing both in terms of human and financial resources and in terms of domestic grassroots. In the past ten years the original mass movements have disintegrated or dwindled away to be replaced by many smaller nonprofit organizations. Typically, the managerial skill and resources for civil-society development are largely concentrated in the political center of Tallinn. Only a minor part of the registered 14,000 non-profit organizations (2001) are involved in charity or advocacy issues. (A large percentage of these organizations are apartment cooperatives.) Popular participation in voluntary organizations is limited partly because of the legacy of the Soviet period with its obligatory civil-society organizations. An estimated 40 % of the population nevertheless engages in one or more nongovernmental group, whereas a large part of NGOs act with minimal membership.

The Estonian state explicitly and practically stimulates the growth of civil society organizations and networks by providing a beneficial legal and fiscal framework as well as by enhancing cooperation between state institutions and NGOs, without bias towards organizations of a certain political leaning or undue political interference in NGO activity. Specifically in order remedy the relative weakness of civil society organization, recognized as an asset, in November 2002 the parliament adopted a government-initiated Civil Society Development Concept.

Although political apathy is recently increasing in the election process, basic trust in a number of democratic and/or public institutions remains relatively high. In a 1999 survey more than half of the Estonians indicated a low interest in politics, but substantial trust (on a 1-to-10 scale) for the president (7+), for "green" groups (7-), for the churches (7-), whereas trust in political parties (4-) was low. Serial polls on trust in institutions indicate the stabile rating of key institutions (the president, the defense forces, the media and local administration) all achieving 60+% trust since 1998. More political posts, such as the prime minister, the government or the parliament, have seen their support waver, depending on political moods. Overall, however, no significant pockets of anti-democratic mobilization or opinion exist, with the possible exception of part of the elderly non-citizen population. The 1999 Integration Program for the years 2000-2007 provided a strategic framework for comprehensive (socio-economic, legal-political and linguistic-cultural) integration in Estonian society. Overall, Estonia's restrictive citizenship policies never resulted in any anti-democratic reactions on the part of the Russophone population in recent years. Typically, political protests

are directed against specific legislation or political practices and, most likely, against the political elite, but not against the constitutional framework.

Most of Estonia's 14,000 non-profit organizations are in fact self-help organizations without political, awareness-raising or advocacy objectives. The density of the network in relation to the population of 1.4 million is certainly unevenly distributed over the country (e.g. with a urban-rural disparity). Some law cases against former communist leaders charged with violation of basic human rights occurred in the early 1990s.

3.2 Market economy

3.2.1 Level of socioeconomic development

Although Estonia's transition to a market economy in the past ten years has been highly successful, the price has been a high level of social and regional disparity within a small country. Typical for a post-Soviet state, social exclusion is only marginally linked to education (99.8 % adult literacy and 86 % overall educational enrolment). Gender empowerment ranking (2000) is 27 (0.568) GDI index N/A. Poverty, however, is a relative problem with no significant proportion of the population living below the official poverty line. Nevertheless, regional and (linked to that) ethnic income disparities are substantial: Disposable income per household member in a year (2002, with a country average of 30,000 EEK) ranges from 37,700 EEK in Tallinn (+26 %) to 19,600 EEK in Jõgeva county (-35 %). The Gini coefficient of inequality was 37.6 for 2001 and the ratio of the GDP share of the 10 % richest and poorest citizens (29.8 % and 3 % resp.) also places Estonia at the lower end of the equality scale among the 2004 EU accession states. Enhanced efforts to improve redistributive policies (the 2002 start of unemployment insurance, reform of the pension system, etc.) indicate that the government has recognized this priority, although the reform of the income tax (a reduction of the flat tax rate from 26 % to 20 % versus a progressive tax rate) is still undecided.

3.2.2 Market structures and competition

Estonia soon after independence adopted an economic strategy of maximum liberalization. Correspondingly, trade liberalization began in 1990. By 2001 75 % of GDP came from private companies, and currency convertibility of the Estonian Kroon was introduced in June 1992 together with a DM currency board. By 2001 only 28.9 % of prices were state-administered, representing 2 % of the EBRD-basket. In sum, few restrictions to the functioning of a free market-economy and no relevant forms of discrimination apply in Estonia. If there is any debate on economic strategy, it concerns a too limited role of the state as a mere guarantor

of the rules of the free economic game and equal opportunities for all participants. Estonia's ratings (Freedom House) for privatization as well as micro- and macroeconomic policy have invariably been high: 1.75, 2.00 and 2.00 resp. in the year 2002 and even more markedly in the Heritage ranking: 4th out of 155 countries surveyed. The World Economic Forum similarly ranked Estonia 27/29 out of 75 market economies as the most competitive East Central European states.

The Competition Board of the Republic of Estonia is in charge of the implementation of anti-cartel legislation. Enforcement of competition and anti-monopoly laws began in late 1993, but was slow in being fully implemented. Since October 2001 a third Competition Act is in place with provisions on prohibited agreements, abuse of dominant position, merger control and State aid. Harmonization with the relevant competition legislation of European Communities has taken place, but secondary legislation has only gone halfway so far, as it is changing in the EU itself too. 102 cases were brought to the attention of the Competition Board in 2000, two thirds of them investigated. In some major cases significant sanctions were enforced, although overall court enforcement is the weakness of anti-monopoly policy. Indicative of anti-etatist and anti-monopoly strategies are the independent regulators for telecoms and electricity. One of the last remaining monopolies concerns electricity, as privatization of the country's main electricity plants in Narva failed in January 2002 and as the social and political costs of a free market (that would replace expensive domestic production with imports) are considered unbearable.

Liberalization of foreign trade began with the abolishment of the state trade monopoly in December 1990, followed by the abolishment of the last remaining tariffs in November 1993 and non-tariff trade restrictions some months later. Thus, tariff revenues as percentage of imports has gone down to 0.1 % and Estonia reached a high of 4.3 on the EBRD index of foreign exchange and trade liberalization in 2001 (and already 4.0 in 1994).

Similarly, the general economic strategy has produced excellent results in the banking sector, although it took a banking crisis in 1992/1993 and some scandals to achieve a fully reformed banking sector and liberalized capital market. The system has also benefited from a great deal of liquidity offered by the foreign (Swedish) owners of Estonia's two main banks.

3.2.3 Stability of currency and prices

Estonia has introduced a currency board, pegging the Kroon to the D-mark right from the start in June 1992 with a high degree of success. Consumer prices have seen a period of high inflation in the early 1990s and relatively modest rates since: average 4-5 % for 1998-2002. The independence of the central bank was granted in May 1993 and never seriously challenged by the successive governments. In its

2002 Progress Report, the EU Commission concluded “Estonia's efforts should now focus on guaranteeing the full institutional and personal independence of the Central Bank and its members of the Supervisory Board by adopting amendments to the law on the Central Bank of the Republic of Estonia.” The role of foreign lending has increased tremendously in the Estonia economy over the past few years. Because of the small size of the economy, the capital markets’ actual resilience to cope with speculative investment is still an open question. As the constitution prescribes a balanced state budget, the government’s set of instruments in monetary policy is extremely limited, the results therefore have a high degree of credibility.

The strongest government signals in favor of macroeconomic stability are the key institutional self-constraints: the currency board and the constitutional obligation to balance the state budget each year. State debt has sunk below 5 % of GDP and the actual budget deficit has been less than 2 %. So far the successive governments have been reluctant to increase state spending on demand by pressure groups, e.g. for social-welfare schemes, regional policy or infrastructure. Overall, Estonia would actually qualify for the Euro introduction in terms of convergence criteria.

3.2.4 Private property

At a very early stage in transition, Estonia set the framework conditions for private property in a market economy with a law on ownership reform (June 1991), private ownership and tradability of land (June/Oct. 1992) and a law on property rights (June 1993). State intervention in private property is not only regulated by the law, but Estonia also developed a strong culture of property rights.

Private property is not only permitted, but also strongly encouraged. Small- and large-scale privatization started early (Dec. 1991 and Nov. 1992). Although vouchers (and restitution) were also used, tender privatization soon became the preferred method. Estonian industrial privatization largely followed market procedures, with some exceptions concerning unwelcome foreign (i.e. Russian) investors, scandals concerning some non-transparent privatization procedures and social concerns in privatizing larger plants in hard-hit regions like Ida-Virumaa.

3.2.5 Welfare regime

In line with a neo-liberal approach to the transition to a market economy, reform of social safety was not a priority in the early stages. Only from 1998 onward unemployment and pension reforms were enacted. Estonia is building up a modern three-tier pension system, much needed for a society with the oldest

population in Europe, to get away from the Soviet system. As of 1998, the pension age was gradually raised and pensions made inflation-indexed. In 2002 an intermediate, state/private tier of the pension system came into effect, which will supplement both state pensions as well as purely private pension schemes. Public acceptance of the new system is high, indicative of the people's general market-orientation (and prosperous economic outlook). Whereas by European standards legal protections of employees and the role of the trade unions is limited, a new unemployment insurance scheme was enacted in 2002, paid by both employers and employees.

As is typical of European post-Soviet societies and in combination with Estonian traditions and its substantial progress towards a market economy, gender and social background are not significant barriers to equality of opportunities in a European comparison. In 2001, for instance, the mean school-life expectancy for females was at 14.6 one year more than the male average. Rather, regional disparities are substantial, the capital, the harbor cities on the Baltic Sea coast and the university city of Tartu have higher indicators than the rural and industrial periphery in the Northeast and Southeast. Access to advanced education and high-quality employment is more limited in these regions.

3.2.6 Strength of the economy

The indicators for the output strength of the economy demonstrate high, sustainable growth with a GDP per capita at PPP of 9,800 USD (2001, representing 42.3 % of EU-15 average, growing 5 % or more annually for four consecutive years) and 2,084 million Euro FDI per capita (or 8.1 % of GDP for 1997-2001) and a current account deficit of 6 % of GDP. The trade balance is negative, but not overly so with exports and imports growing more or less in parallel. External debts have grown from 55.5 % of GDP and 70.9 % of exports in 1997 to 59.6 % and 65.5 % resp. in 2001. The unemployment rate of around 10 % (2002) and the inflation of 5.6 % (2001), on the one hand, and the excessive regional differences in economic development, on the other hand, are caveats in an overall positive economic outlook.

3.2.7 Sustainability

As the Estonian economy is increasingly service-oriented and has a low population density (31 per square kilometer) environmental concerns are of limited importance. Agriculture accounts for some 5 % of gross value added (2001).

Conversely, pollution is a serious problem in the restructuring of the old industrial Soviet-times industrial plants, predominantly located in the Northeastern part of

Estonia. The level of environmental pollution and health risks of the population are high, but some of the industrial activities are considered to be of vital importance for the national economy (e.g. the production of energy from oil shale, which provides for 90 % of electricity and serves to reduce dependency on Russian energy resources) as well as for socio-economic survival of the Northeast Estonian region with its dominant minority population. However, air polluted with sulfur dioxide from oil-shale burning power plants has fallen steadily.

The emissions of 2000 were 4.6 times smaller than in 1980; the amount of unpurified wastewater discharged fell 20 times in 2000 compared to 1980; in connection with the start-up of new water purification plants, the pollution load of wastewater has decreased further. Overall, the environment has profited from the significant decline of heavy industry production in the transition as well as from the improvement of agricultural production and waste disposal. A green movement was part of the national mobilization under perestroika and environmental protection has remained an issue on the policy agenda, e.g. in co-operation with the World Bank as well as in the creation of a Ministry of Environment and an Environment Information Center (established in 1989!). In many respects, the structural conflict between economic growth and environmental costs is not a major one in Estonia.

Education and research have been a high priority in the Estonian strategy for economic transition. The high level of education has been recognized as a key asset for making Estonian export-oriented and innovative as well as an attractive location for foreign investment. Public education expenditure reached 7.2 % of GDP already in 1995-1997 (UNDP 21st ranking right after the Scandinavian countries) and 25.5 % of total government expenditure (with 18.5 %, 50.7 % and 17.9 % shares for primary, secondary and tertiary education respectively). 77 % secondary enrolment and one-third of all tertiary students enrolling in technical disciplines illustrate an inclination towards higher education and technology. A high density and high quality of communications infrastructure has been set up (with 28.4 Internet hosts per 1000 people in 2000). Research and development are prioritized with 0.8 % of GDP (1990-2000) and 2,164 scientists/engineers per million people. As a result, high technology exports constitute 30 % of manufactured exports (2000). The so-called "tiger-leap" project geared towards IT-related economic activities also indicated government policy awareness of human resource and modernization issues. A year ago a quarter of Estonia's residents in the age group of 15-74 years had a computer at home, while today the share is one third.

4. Trend

As Estonia is one of the most advanced new members of the EU, minimum requirements for democracy are no longer an issue. Even arrangements concerning the non-citizens have been accepted by European organizations, not as an optimal solution, but as a compromise fulfilling minimal requirements in terms of stateness, political participation and the rule of law. Conversely, political participation (in elections) has declined in recent years, from 68-69 % in the 1992 and 1995 to 57-58 % in the 1999 and 2003 parliamentary elections, with the 2002 local election turnout of 52 % as an all-time low. In sum, the quality of democracy is at a very high level, but its inclusiveness for all inhabitants remains a fundamental flaw. Without addressing the core issue of the flaw of ethnic democracy, some specific policy measures have alleviated some of the consequences.

Similarly, institutional stability has remained on the same high level, but political and social integration (countering ethnic divides) have improved somewhat, even though the integration process in the country with one-third ethnic minorities is still largely seen as a unilateral process of adaptation.

Estonia's level of development has continued to improve greatly, the HDI has reached 0.826 (no comparable data are available for 1995, but HDI has gone up by 0.02 since 1990), but strong economic (GDP p.c. in PPP) growth over the last few years and improvements in redistributive policy fields (social security, regional policy, etc.) suggest a significant positive change in the HDI.

As the EU Progress Report for 2002 indicates, Estonia qualifies as a market-economy, able to withstand the pressures of the common market within the European Union. Improvements in the past five years have been relevant, but limited.

Economic performance has become solid and sustained, as is indicated by the continuous high growth rates after a period of radical economic transition and full liberalization. Overall, the qualitative leaps occurred prior to 1998. The relative ease with which Estonia handled the 1998 ruble crisis and the global IT crisis of 2001-2002 is indicative of the diversification and solidity of the national economy: In recent years domestic demand has grown markedly despite unfavorable international circumstances. The economic growth over the period 1998-2003 reached 5.5 % annually (nominal, in USD) or 7.4 % annually (GDP per capita in PPP). Similarly, in five years real production grew by 46.7 % in industry, declined by 3.4 % in agriculture, while the real net income grew steadily by some 8.5 % annually.

5. Transformation management

5.1 Level of difficulty

The 2001 GDP of 3 988 USD p.c. places Estonia in the middle-income category of the World Bank. The educational component of the HDI is 0.95 (2000).

For various reasons, the issues of the Russophone minorities, their citizenship, and the ethnic concept of democracy in Estonia have a low potential for actual conflict, as the developments in the past fifteen years have demonstrated. The heterogeneity of society and political exclusion do have a substantial ethnic dimension and, vice versa, the status distinction between majority and minority has strong ethno-political dimensions and thereby socio-economic consequences. On the other hand, the Russophone population (i.e. those with citizenship) has few relevant ethnic parties; rather, Russophones are increasingly being included in specific Estonian political parties. Similarly, day-to-day discrimination and conflict are not a key factor.

An extremely high level of difficulty and limited political management options result from the presence of one-third minority population. The difficulty relates not so much to the presence of a minority population as such, but to its past as a colonial nation, both in its self-perception and in the perception of the new state-nation of Estonians. The problem is further complicated by the Russophone minority's concentration in specific geographic regions and economic sectors. Due to this concentration, they are predominantly among the victims of transition and early transition strategies.

Taking 1997/1998 as a starting point, a vibrant landscape of civil-society organizations and NGO was already in place. High score for rule of law and institutional stability.

5.2 Reliable pursuit of goals

Although the key strategic paradigms of Estonia's transformation were defined and largely implemented before 1998, successive Estonian governments over the past five years have demonstrated the ability to identify strategic priorities in the transformation process. In a substantial part of the issues, the identified priorities have resulted in corresponding policy decisions. Clearly, since the Luxemburg EU Council, the accession negotiations and the *acquis* have significantly guided the reform process. In recent years, however, the fluctuations in government coalitions and the consolidation of post-communist reform process have resulted in a higher degree of short-term expediency in political decision-making and thus some backlogs in the reform agenda.

Each government has gone on record with a number of relevant reform measures, particularly in the field of social and ethnic integration as well as in economic modernization. Thus, Estonia has in many respects already passed the stage of high, immediate social costs in combination with unequally distributed and long-term benefits. Strategic trade-offs are no longer vital to the reform process as such. The benefits of past reform efforts have created a solid and consistent base, allowing for increasing options in current reform-policy choices.

Although trust in politicians has recently been damaged by a number of scandals, social and economic actors are by and large convinced of the reliability of the political system and project their expectations and individual/corporate plans accordingly.

5.3 Effective use of resources

The efficient use of the state budget is partly determined by the constitutional requirement of a balanced budget. Public debt, as a consequence, is decreasing from 6.7 % of GDP in 1997 to 4.6 % in 2001. Foreign debt runs to 60 % of GDP, while the debt service ratio declined to 7 % of exports (2001). In terms of human resource management and efficiency, the small size of the country and the population in combination with the fact that most Soviet-times structures were eliminated rather than reformed, the risk of an oversized bureaucracy could be minimized. Typically, the bright economic prospects prevented the educated elites from entering state service in excessive numbers.

Conversely, the centralized character of the Estonian state has so far blocked a reasonable devolution process towards regional and local layers of (self-)government. The weakness of local self-government institutions is one of the key deficits of the Estonian transition and up to now reforms in this field have failed, resulting in a far too large number of local administrations (247!) without the financial and human resources needed and thus high degrees of inefficiency. In general, the government makes efficient use of available human, financial, and organizational resources.

The government can largely achieve its reform goals. The public services provided by the government are to a high degree geared towards the developmental needs of business and society in terms of education, health-care and infrastructure.

Partly in line with Scandinavian traditions, Estonia has a positive record in terms of transparency of public administration and political corruptibility. An independent judiciary and a pluralist, independent media system have contributed to a low level of corruption, ranking 29 with a score of 5.6 out of 10 in the 2002 TI Corruption Perceptions Index.

In the early phase of transition, political elites strongly targeted political-historical motives for transformation mobilization, in nation and state building as well as in market-economy and democratic reform. References to interwar Estonia in reverse got in the way of a possible integrationist strategy for the Russophone population based on shared objectives. In addition to historical symbols of democratic and economic practice, European integration became a major shared value “instrumentalized” in the early phase. Meanwhile, the references to ethnic and historical symbols have faded away in policy debates and the European symbol has also lost part of its unifying power in the year before actual EU accession. In sum, the efficient choice of cultural legacies to highlight in early transition has seriously constrained options for redistributive and integrationist policies in a later phase. On the contrary, a reform strategy based on integrationist concepts would have been weighed down by incompatible reform concepts at an early stage. [1-2-3]

5.4 Governance capability

Room for complex learning and policy adjustments increases as Estonia has passed the phase of key “principled” reforms. Trade liberalization, privatization, constitutional reform, and a general reduction of state interference in the economic and civic spheres has been tackled and mastered at an early stage (1990-1995). The individual positions of the relevant political parties are rarely incompatible in principle. Estonia has seen a number of cases of policy adjustment and innovation. In two key policy fields, remarkable examples of complex learning are evident.

(1) In the handling of the Russophone population, the a-priori choice of an ethnic-democracy approach precluding integration has been gradually replaced by a more integrationist approach. The change of policy was determined by the persistent and massive international pressure and the correct assessment that after 1994-1995 the substantial outflux of Russian had ended as well as the fact that the aging Estonian population urgently needs the Russian labor force for further economic growth. Incremental concessions (e.g. voting rights at the local level, social security rights, reduction of hurdles for naturalization, etc.) have contributed to trust-building in Estonian state institutions and a normalization of inter-ethnic relations. The comprehensive integration program for 2000-2007 adds a new strategic dimension.

(2) In economic policy, the dominance of neo-liberal strategies in the early phase has been supplemented recently by redistributive and socially-oriented policies, e.g. in the reform of social security, the pension system, but also in a higher prioritization for regional policy, societal solidarity, infrastructure and a more prominent role of the state and the state budget. Again, comprehensive strategies

have been developed and implemented to counter recognized negative tendencies in the economy and society – a clear sign of capable transition management.

Overall, the fragility of government coalitions is more of a problem than societal acceptance of the executive. Some reform dynamics have recently been lost due to party-political blockades.

Overall, government policies improve the allocative efficiency of the market by providing reliable frameworks. Conversely, in terms of social and regional redistribution as a strategic government objective, “misdirecting” economic resources might even be rational from a state perspective.

Policy management is overall on a high level that is partly related to the on-going process of acquis adoption. Estonians have generally made excellent use of available opportunities, and political projects failed due to external factors rather than societal or political opposition, e.g. in the case of the energy privatization that ended the Laar government in early 2002. From a transformation efficiency perspective, the Estonian model has a high degree of strategic quality in terms of priority setting and sequencing.

5.5 Consensus-building

All major political actors across the political spectrum agree on the objective of a market-based democracy, and no relevant veto-powers exist. The “naturalization” of democratization and market reform as an unquestionable objective to which there are no alternatives and which thus does not even require substantial “legitimizing” efforts on the part of the transition managers is typical for the Estonian case.

In principle, the reforms have radically excluded potential veto-powers or opponents of market-economy and democracy with early strategic decisions on citizenship and voting rights. This exclusion, however, has been eased by the introduction of so-called “social citizenship” for non-citizens, in that such permanent residents have been guaranteed a wide range of continuing social benefits such as health care, child welfare payments, state pensions and unemployment insurance. These efforts can largely be understood as a successful strategy to induce the potential veto-power of the non-citizens to comply with the new constitutional rules. As no anti-democratic actors with strong organizational capabilities ever emerged in Estonia, the reformers’ strategic astuteness for consensus building in this direction has never been put to the test in earnest. Conversely, and partly in contrast to neighboring Latvia, the transition managers in Estonia steered a middle course between Western normative prescriptions and Estonian public and political consensus by offering the Russophone minorities local voting rights, social security, etc.

Recent governments have managed the cleavages skillfully enough to avoid irreconcilable conflicts, although the citizenship and redistributive strategy decisions will remain on the agenda as key issues. Good governance, however, has prevented both issues from escalating beyond the normal democratic framework. Eventually, even the citizenship issue has been captured in legal and democratic procedures. As an indicator of good governance, the governments have openly addressed the key issues and formulated comprehensive programs to deal with the issues, setting clear priorities in terms of resource allocation, e.g. for societal integration, education and R&D or pension reform.

Societal solidarity is probably the key challenge for the current and upcoming governments after an initial neo-liberal market-oriented strategy of transition. The reform of the tax system either toward a progressive tax or a further reduction of the current flat-rate tax will put solidarity to the test. Tax evasion is low in Estonia and although the current debate on a reduced flat tax rate versus a progressive tax rate concerns a fundamental issue of solidarity, the actual political outcome is not likely to have a major impact on societal attitudes. Economic growth has created the necessary political leeway for a more social-security and thus integrationist strategy by the government.

Reconciliation between victims and perpetrators can be understood in a collective and in an individual sense. Fundamentally, the citizenship concept upholds the moral divide between Estonians as victims and Russophones as (collaborators of the) perpetrators. As the juridical phase of coming to terms with the Soviet past has long been completed (although several former Soviet secret police officials have gone on trial in Estonia charged with deporting more than 400 Estonians to Siberia in the 1940s as late as 2002), what remains is moral justice and/or societal reconciliation. A new need to integrate the Russophone population has been acknowledged not only in order to comply with European standards for human and minority rights, but also to guarantee the availability of the human resources to perpetuate economic growth and social cohesion. In Estonia, the issue is not so much an unwillingness to address historical acts of injustice, but rather a more fundamental process of reconciliation, after a thorough (and partly unjust) strategy to remedy past injustice and punish the main perpetrators had been executed.

5.6 International cooperation

From the very start, Estonia has cooperated effectively with international organizations, donors and bilateral partners to further transformation. In contrast to neighboring Latvia, Estonia has been more astute and diplomatic in handling the controversies concerning its minorities' and citizenship policies vis-à-vis the international community, partly by providing the right concessions at the right moment (e.g. voting rights in local elections for 5-year residents without the right to run for public office, 1992) and partly by less offensive diplomatic engagement.

The Council of Baltic Sea States and the Northern Dimension are considered constructive and flexible instruments for regional co-operation in a European context.

Reliable political and administrative institutions and a high degree of liberalization have created optimal conditions for international co-operations. The proximity of the Nordic states has added to the upsurge of international co-operation. Furthermore, Estonian FDI in neighboring countries is rapidly increasing and adds to the basis for regional cooperation: In 2001 Estonian companies invested 3.2 billion EEK in Latvia and Lithuania.

Regional co-operation among the Baltic states has suffered somewhat in the mid-term due to the competition for EU accession, but in recent years regional ties are improving again. The countries of the region have discovered real common interests in relation to Brussels as well as concrete shared economic interests (75 % of FDI in Estonia comes from the Nordic countries and 40 % of foreign trade). Estonia, conversely, has also “instrumentalized” the international (EU and OSCE) pressure on the citizenship issue to generate public acceptance for gradual changes of policy as a price to be paid for EU membership. On September 14, 2003, 67 % of the Estonians voted in favor of an EU membership.

6. Overall evaluation

The transition to a market-based democracy in Estonia has been characterized by a number of decisively advantageous initial and framework conditions that offset a number of specific disadvantages due to astute and strategic management. Strategic choices and a sequencing of reform steps has produced and aggravated some of the disadvantages that are now back to haunt the reforms. The fruits of early transition, however, outweigh the disadvantages of the breakthrough strategy and create the resources necessary to tackle the previously ignored issues.

The advantageous initial and framework conditions include the proximity of the boom-region of the Baltic Sea, the small size of the Estonian economy, the consensual determination of the population and its politicians to transform Estonia into a prosperous market-economy and a modern democracy, the availability of the pre-war First Estonian Republic as a framework of reference, legitimization and mobilization, and, last but not least, the prospect of EU and NATO membership. The disadvantageous factors include the presence of a large Russophone minority, partly concentrated in a peripheral region and partly opposed to the strategy of Estonian state and nation building as well as major socio-economic disparities within the country, partly coinciding with ethnicity.

This initial constellation and the strategic choices made propelled the transition process by reinforcing each other. Excluding the Russophones ensured strategic

consensus and determination, but it also excluded other options of transition. The quality of transition management is to be found in the selective reference to pre-war Estonia (e.g. as a political, but not as an economic model), the inclusive concept of “social citizenship” for non-citizens, and the instrumentalization of the indispensable international cooperation and pressure to prevent an ethnic escalation.

7. Outlook

The current macroeconomic projections offer a sustainable and solid basis for the future, with declining unemployment, stable GDP growth, a controlled state budget, real booms in FDI and domestic demand. A poll held in Estonia late 2002 (Emor survey) showed that optimism in Estonia had increased: 44 % of the people expect 2003 to be better than last year, 45 % expect it to be the same as 2002, while only 9 % expect it to be worse. There was no noticeable difference between Estonian and non-Estonian respondents, but the younger people were much more optimistic about the future than the older residents (53 and 35 % respectively).

The challenges Estonia faces today relate to the choices of the early transition period: For a true integration of Estonians and Russophones the 1999 Integration Plan is only a beginning, but symbolically relevant, even though it stresses integration as a unilateral duty for the Russophones. The redistribution of the fruits of transition to peripheral regions and other social groups requires a further redefinition in specific policy fields that has already begun in the late 1990s, all the more so as surveys currently indicate high correlations between income level and trust in government institutions as well as EU accession. The successful completion of transition also requires a consolidation of the political set-up. Frequent mid-term changes of government coalitions tend to postpone strategic decisions and hard choices for the sake of party politics. No doubt, however, in two years time Estonia will no longer be considered a country in transition, but rather a full-fledged member of the European Union.