

Estonia

Status Index (Democracy: 9.40 / Market economy: 9.18)		9.29	Management Index		7.35
HDI	0.853		Population	1.4 mn	
GDP per capita (\$, PPP)	13.539		Population growth¹	- 0.2 %	
Unemployment rate	N/A		Women in Parliament	18.8 %	
UN Education Index	0.97		Poverty	N/A	
			Gini Index	37.2 (2000)	
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹ Annual growth between 1975 and 2003.					

A. Executive Summary

As one of the most successful EU accession states, Estonia completed the main thrust of transition toward pluralist democracy and a 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 short, but relatively severe deprivations of transition and imbue its management with a strong sense of purposefulness. Furthermore, the advantageous initial framework conditions for a market economy, such as the process of EU accession and the Baltic Sea as an economic growth region, consolidated the political process. These conditions also constituted a strong disincentive to an escalation of the main challenge to state and nation-building by either the nation-state nation or the post-imperial minorities: the integration of the Russophone population.

References to an idealized status quo ante (without substantial minorities) in the interwar period have been instrumental in justifying the exclusion of ethnic minorities from the body politic. At the same time, within the ethnic Estonian nation-state such references to the interwar republic 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 courageously and pragmatically.

Estonia's EU accession on May 1, 2004, formalized the successful completion of post-communist transition. The current problems and structural challenges faced by the Estonian leadership are by and large similar to those faced by any Western

democracy and post-industrial welfare state; reform of the pension system, bridging the gap between the complexities of political decision-making and the political apathy of the populace, reconciling global competitiveness with the struggle against a widening of social disparities. Leftovers from transition include some infrastructure deficits (roads, railways), structurally high unemployment in some regions, over-centralization of state institutions and business in Tallinn as well as the privatization and restructuring of the last state-owned companies. Currently, the real short-term risk is an overheating of the economy in terms of credit expansion and real wage increases.

Estonia's success in the socioeconomic realm has helped increasingly de-ethnicize the problem of the Russophone minorities. The conflict potential in the structurally weak regions in eastern Estonia has been increasingly tackled and perceived as an issue of regional development rather than ethnopolitics. Conversely, the ethnic Estonian population – one of the oldest in Europe – increasingly accepts the Russian populace as an irreplaceable labor force for the national economic boom.

B. 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 Moscow's reform tendencies, 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, transformation actually started as a movement for Estonian state- and nation-building. Some steps were taken toward democratization and economic liberalization in the late 1980s, but the transformation process began in earnest with the declaration to begin a process toward independence (30 March 1990) and the actual restoration of Estonia's state independence (20 August 1991).

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 pre-1940 Republic. Since this legitimized the new institutional set-up as a return to the well-functioning pre-war parliamentary system (prior to a shift to authoritarianism in 1934), the country benefited from quickly establishing institutions and procedures with a high degree of legitimacy and consolidation. At the same time, because 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. However, restorationist policies were never (except for some property restitutions) implemented against the logic of the market. Whereas Soviet-era 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 or cities.

In hindsight, there were two related key assets in Estonia's transition management: a unique sense of determination and purpose, and political courage and readiness for innovative approaches. The national consensus on transition partly excluded the Russian minority and was partly a reaction to Russian obstruction (locally and internationally). Despite the perceived restoration of a pre-Soviet Estonia, most policies were remarkably innovative and future-oriented. Earlier than most other post-communist countries, Estonia was tackling "post-modern" developments and phenomena such as democratic apathy, EU skepticism, de-industrialization, globalization and an aging population. Conversely, political centralism, regional policy and ethnopolitics remained rather conservative.

C. Assessment

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, but 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 never been endangered. Arguably, the deficits in the functioning of a system of regional self-government might be seen as a slight drawback in overall democratization.

1.1. Stateness

State identity: For a variety of reasons, the only potential threat to the state monopoly on violence, arising from communist and Russian political organizations, never crossed the threshold to secessionism or political violence. Even the elites within the Russophone community dropped secessionism and autonomy as a mobilizing rhetoric by 1993. Therefore, there is no restriction to the state's monopoly on the use of violence.

Conversely, the definition of the demos of the Estonian state has been one of the most controversial and thorny issues of the 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 (or descendants of those citizens) in 1940 when the U.S.S.R. annexed Estonia. In practice, however, the concept of the illegality of all post-1940 immigration excluded predominantly Russians and other Russophone immigrants from the Soviet period, thus rendering approximately one third of the population 'non-citizens' in the legal sense. This concept was reconfirmed in the constitution of June 1992 and in the electoral and citizenship laws. Apart from naturalization and integration, a number of specific measures (e.g. active voting rights in local elections) have partly alleviated this democratic deficit. Meanwhile, however, most debates and controversies around the issue of citizenship have shifted to the application 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 potential to destabilize and cause conflict. In this respect, the less-than-inclusive definition of citizenship does not imply a corresponding, fundamental disagreement in practice. A rule-of-law implementation of this questionable principle has certainly contributed to the legal security of the Russophone population. Without changing the principle, the Estonian government has recently demonstrated its commitment to decreasing the number of non-citizens, via naturalization and unlike Latvia has taken the edge off the issue of non-citizenship e.g. by providing local voting rights.

During the Soviet era, worship was forbidden, provoking a secularization of the population. Now less than one-fourth of the population is religious, mostly Lutheran. Currently, religious freedom is guaranteed, although the government is not officially tied to a particular religion. The same applies largely to the Russian minority and the Orthodox Church. The state has been careful to maintain its neutrality, even in recent conflicts between Orthodox churches. Thus, since the organization of the state is determined by the protestant Estonians who are highly secularized, and also 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.

Barring its deficiencies, Estonia's administrative structure would qualify as differentiated and effective in the allocation and extraction of state resources throughout the country. However, the reform of local and regional administration remains unfinished, as still shown by the inefficiently high number of minute communities.

1.2. Political participation

Barring the exclusivist citizenship policies noted above, the rulers in Estonia are determined by free and fair elections. The most recent parliamentary elections in March 2003 were fully transparent and uncontroversial. Similarly, the elected rulers have effective power and no institutional or regional veto powers and/or political enclaves exist. The northeastern 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.) In addition, the Public Assemblies Act prohibits any public assembly that incites racial, religious or political hatred, violence or discrimination between the social strata. The constitution also provides for freedom of association (Article 48). The right of association does not require formal registration by a public authority. Within the basic democratic order, there is no ban on groups that mobilize along ethnic or religious lines. Thus, no undue restrictions apply to the freedom of association and assembly in Estonia; the usual restrictions are applied without much restraint. No relevant incidents were reported in recent years.

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, again within the basic democratic framework. 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 in only a few cultural and educational publications but they enjoy full editorial independence from the authorities. Economically, the big media organizations are sound, but there is a growing tendency towards concentration of ownership. Since independence, the state monopoly of printing and distribution has been abolished. The government's commitment to providing the populace with Internet access underlines the fact that freedom of media and information has long ceased to be problematic in Estonia.

1.3. Rule of law

As a parliamentary democracy with a strong independent constitutional court, Estonia demonstrates no significant restrictions regarding the separation of powers with a functioning system of checks and balances.

Correspondingly, the reform of the judiciary (reform of the court system and criminal law in 2003) has resulted in a differentiated legal system, as attested by

the 2003 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 nineteen judges. The Chief Judge of the Supreme Court is appointed by the parliament after 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 the 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; procedures to guarantee political accountability and to counter conflicts of interest exist. Recent cases have demonstrated that, in general, corrupt officeholders are prosecuted under established laws. Due to some recent high-profile corruption scandals involving prominent politicians, public perception of corruption has increased significantly. However, no evidence supports there being an actual increase in corruption in the public administration.

Civil rights and freedoms are guaranteed by a principled and robust rule of law and no restrictions apply except for the issue of the stateless non-citizens. They are disenfranchised from the democratic process, and are banned from holding public office, e.g. in the executive, in political parties, but also in trade unions. Legal prosecution of human (and/or property) rights violations has become rare in recent years. However, some former state and party officials have been sentenced where they were involved in the direct persecution or deportation of other citizens. Whereas the laws excluding ethnic minorities from civic rights may be seen to constitute a restriction on 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 (favoring ethnic Estonians) took precedence over re-distributive considerations (to all citizens). There were incidental reports of police mistreatment in 2003 and despite improvements prison conditions remain poor.

1.4. Stability of democratic institutions

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 its EU entry 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 system's acceptance and consolidation. Nevertheless, the volatility and instability of the party-political landscape accounts for some friction between the executive and legislative branches. No potentially significant veto actors exist; all relevant actors accept the democratic institutions. Even controversies on the issue of non-citizens' rights do not pertain to the legitimacy of the institutions as such; this controversy has become integrated into the political process and handled by the rule of law mechanisms. Despite or due to the frequent changes of government, party-political blockades in the legislative process are rare.

1.5. Political and social integration

There has been significant fragmentation and fluctuation in the political-party landscape for the last decade, with 8-18 parties competing for the voters' favor. In all four parliamentary elections (1992, 1995, 1999 and 2003), the 5% hurdle has reduced the number of parties in the Riigikogu to between six and nine. 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. The second-tier parties have been constituted by the mostly agrarian People's Union and the social democratic moderates (each averaging around 8-12% of the vote). The official name of the moderates is now the Social Democratic Party of Estonia. Overall, in the last four elections five parties have always accounted for the vast majority (<80%) of seats in the Riigikogu. Party membership is relatively high in Estonia, in total, some 5% of eligible voters, and 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 socioeconomic interests rather than positions on the issue of nation- and state-building, as was the case in the early transition period. One consequence is an increased volatility shown by voters from one election to the next if the expectations of a coalition's constituency are not met.

As is typical of small countries in transition, strong ties exist between political elites and civil society (organizations). Estonia has quickly developed a vibrant civil society with 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 non-profit 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 thousands of registered non-profit organizations are involved in charity or advocacy issues. The Estonian state explicitly and practically stimulates the growth of civil society organizations and networks. It does so by providing a beneficial legal and fiscal framework, as well

as by enhancing cooperation between state institutions and NGOs, and without bias towards organizations of a certain political leaning nor undue political interference in NGO activity. Specifically, in order to remedy the relative weakness of civil society organizations and recognizing them as a potential asset, the parliament adopted a government-initiated Civil Society Development Concept in November 2002.

Although political apathy is recently increasing in the election process, basic trust in a number of democratic and/or public institutions remains relatively high. Serial polls on trust in institutions indicate the stable rating of key institutions (the president, the defense forces, the media and local administration) all achieving 60+% trust. Overall, 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 resulted in no significant anti-democratic reactions or mobilization on the part of the Russophone population in recent years. Typically, political protests (often channeled into lawsuits) 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 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 distributed unevenly throughout the country (e.g. with a stark urban-rural disparity). Some law cases against former communist leaders charged with violation of basic human rights occurred in the early 1990s. With some exceptions, the involvement of civil society organizations in the policy process is still quite limited, which may also be seen as an indication of the capability and responsiveness of governance.

2. Market economy

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 96% overall educational enrolment). Gender empowerment (2002) is 0.592 (out of 1.0 and rank 36, a UNDP indication of active involvement of women in political and economic life) and the Gender-related Development Index is 0.592. Poverty, however, is a relative problem with only a minute proportion of the population living below the

official poverty line and 18% below the line of four U.S. dollars per day. Nevertheless regional, linked to ethnic, income disparities are substantial: Net monthly wages (3Q 2004) range from 6568 EEK in Tallinn to 3885 EEK in Põlva county. The Gini coefficient of inequality was 37.2 for 2002 placing 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 currently 24% and later possibly 20% versus a progressive tax rate) is still undecided.

2.2. Organization of the market and competition

Soon after independence, Estonia adopted an economic strategy of maximum liberalization that began with trade in 1990. By 2001, 75% of GDP came from private companies. In June 1992, currency convertibility of the Estonian Kroon was introduced, 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 between economic actors apply in Estonia. If there is currently 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 concerns equal opportunities for all participants. Estonia's ratings (Freedom House) for privatization as well as micro- and macroeconomic policy have invariably been high.

The Competition Board of the Republic of Estonia is in charge of the implementation of anti-cartel legislation. Since October 2001, a third Competition Act has been in place with provisions on prohibited agreements, abuse of dominant position, merger control and state aid. Harmonization with the relevant competition legislation of the European Union has taken place. In some major cases, significant sanctions were enforced, although overall court enforcement is the weakness concerning anti-monopoly policy. Indicative of anti-etatist and anti-monopoly strategies are the independent regulators for telecommunication and electricity. One of the last remaining monopolies concerns electricity, where privatization of the country's main electricity plants in Narva failed in January 2002. Unbundling has started in 2004, but full privatization of Eesti Energy seems unlikely.

Liberalization of foreign trade began with the abolition of the state trade monopoly in December 1990 and the last tariffs/non-tariff trade restrictions fell in late 1993 and early 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. Dependency on foreign capital and external factors remains a risk. Apparently, the size and growth of the foreign-owned banks tend to act partly beyond the control of Estonia state supervision. Estonia's ratings in the EBRD rankings for reform of the banking sector and financial institutions are 4 and 3.3 respectively (2004). There are no state-owned banks remaining and the share of non-performing loans has fallen from 4% in 1998 to 0.5% in 2003.

2.3. Currency and price stability

Estonia has introduced a currency board, from the start pegging the Kroon to the DM from June 1992 with a high degree of success. Consumer prices saw a period of high inflation in the early 1990s and relatively modest rates since then; for 1998-2002, the average was 4-5%. The independence of the central bank was granted in May 1993 and never seriously challenged by the successive governments. The role of foreign lending has increased tremendously in Estonia's economy over the past few years. Because of the small size of the economy, the capital markets' actual resilience in the face of speculative investment remains an open question. Since national law prescribes a balanced state budget, the government's set of instruments in monetary policy is extremely limited (too limited according to some analysts), but 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 legal obligation to balance the state budget each year. General government debt in 2003 was below 6% of GDP and the 2003 budget deficit was actually a surplus 3.1% of GDP. So far, successive governments have been reluctant to increase state spending on demand of pressure groups, e.g. for social-welfare schemes, regional policy or infrastructure. The current account deficit, however, increased from 5.4% of GDP in 2000 to an estimated 10.2% in 2002 and external debt increased to \$5 billion (2003, estimated).

2.4. Private property

At a very early stage in its transition, Estonia established the framework conditions for private property in a market economy. State intervention in private property is not only regulated by law, but Estonia has 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 in 1991 to 1992. Although vouchers (and restitution) were also used, sales privatization soon became the preferred method. Estonian industrial privatization largely followed market procedures. However there were 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 such as Ida-Virumaa.

2.5. Welfare regime

In line with a neo-liberal approach to the transition to a market economy, reform of the social security net was not a priority in the early stages. Only from 1998 were unemployment and pension reforms enacted. Estonia is moving away from the Soviet system and building up a modern three-tier pension system that is much needed for a society with the oldest population in Europe. As of 1998, the pension age was gradually raised and pensions became indexed to inflation. 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, which is indicative of the people's general market orientation, and the prosperous economic outlook. By European standards, legal protections of employees and the role of the trade unions is limited. Public spending on health care is only 4.3% of GDP.

Estonian traditions and Estonia's substantial progress toward a market economy have meant that gender and social background are not significant barriers to equality of opportunities, as compared to other European countries. In 2001, for instance, the mean school-life expectancy for females was 14.6 years, i.e. one year more than the male average. Instead, 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.

2.6. Economic performance

The indicators for the output strength of the economy demonstrate high, sustainable growth with a GDP per capita at PPP of \$12,300 (2003 est., growing about 5% or more annually for five consecutive years) and investment at 30% of GDP (2003) and a current account deficit of 11% 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 66.9% of GDP and 89.7% of exports in

2002 to 70.5% and 93.6% respectively in 2003 (est.). The unemployment rate of around 10% (2003 est.), on the one hand, and the excessive regional differences in economic development, on the other hand, are caveats in an overall positive economic outlook. Paradoxically, there is increasing talk of a shortage of qualified labor in Estonia. Many industrialists have started calling for the import of skilled labor from other (Third World) countries to offset the general aging of the population and ensure long-term sustainable growth.

2.7. Sustainability

As the Estonian economy is increasingly service oriented and has a low population density, environmental concerns are of limited importance. Agriculture accounts for some 4% of gross value added (2003, est). Conversely, pollution is a serious problem in the restructuring of the old industrial Soviet era industrial plants, predominantly located in the northeastern part of Estonia. The level of environmental pollution and health risks are high, but some industrial activities are considered vital to the national economy, such as energy production from oil shale, which provides 90% of the electricity and serves to reduce dependency on Russian energy resources. In addition, some of these industrial activities are considered vital to the socioeconomic survival of the northeastern region of Estonia with a large minority population. However, air-borne sulfur dioxide pollution from oil-shale burning power plants has fallen steadily. Overall, the environment has profited from the significant decline of heavy industry production following the transition as well as from the improvements to agricultural production and waste disposal. 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 already reached 7.4% of GDP in 1999-2001 (UNDP ranking right after the Scandinavian countries). A high density, and high quality, of communications infrastructure has been set up. Research and development are prioritized. The so-called “tiger-leap” project geared toward IT-related economic activities also indicated governmental awareness of human resource and modernization issues.

3. Management

3.1. Level of difficulty

Due to the purposeful and successful transformation management of the first decade, the level of difficulty for the Parts government elected in March 2003 was moderate: low risks of state capture and high economic sustainability. Despite political rhetoric to the contrary, relations with Russia are no longer a key factor for Estonia politically or economically. Even the issue of the Russophone non-citizens has been successfully contained and defused. Three structural challenges remain for Estonian policy makers: Firstly, to gradually adapt the political rhetoric and visions to the realities of a bi-national society. Secondly, to reduce the regional disparities between the boomtowns of the Baltic Sea coast, on the one hand, and the industrial Northeast and the rural Southeast of the country, on the other hand. Thirdly, to resolve the problem of the aging and shrinking population in order to uphold a critical mass for a sovereign state and a productive national economy. The ethnic Estonians constitute one of the smallest nations in Europe with full sovereignty (ca. one million) and statistically the oldest population of the continent. Most of these challenges, however, are not qualitatively different from those facing any Western state: multicultural society, shifting regional disparities, and an aging population. Overall, the challenge is to move from a relentless and successful, but exclusivist transformation process to integrationist consolidation, in social, regional and ethnic terms.

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. Nevertheless, compared to other post-communist states and certainly compared to post-Soviet republics, Estonia's civil society traditions are quite strong and manifold. With recurrence to the interwar period, civil society has indeed reestablished a moderate participation in public life and a stable trust in institutions.

Although political apathy is recently increasing in the election process, basic trust in a number of democratic and/or public institutions remains relatively high.

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 one-third share of minority population. The difficulty relates not so much to the presence of a minority population as such, but rather 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 (neo-liberal) transition strategies. The 2003 elections have demonstrated that right-wing parties legitimized by the exclusivist agenda of ethnic democracy are losing their constituency. In fact, leftist and ethnic-Russian parties never had much of a mobilizing potential based on the non-citizenship ticket. Regional and ethnic disparities are gradually de-politicized, even though their actual solution is a long-term process.

Profile of the Political System

Regime type:	<i>Democracy</i>
System of government:	<i>Parliamentary</i>
1. Head of State:	<i>Arnold Rüütel</i>
Head of Government:	<i>Siim Kallas</i>
Type of government:	<i>minority coalition</i>
2. Head of Government:	<i>Juhan Parts</i>
Type of government:	<i>coalition majority</i>
3. Head of Government:	<i>Andrus Ansip</i>
Type of government:	<i>coalition majority</i>
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints to executive authority; c_i is the share of parliamentary mandates controlled by party i. Effective number of parties denotes the number of parties represented in parliament.</p>	

3.2. Steering capability

After the successful completion of post-communist transition and EU integration, there are some indications in recent years that the absolute consensus among

political parties across the political spectrum has reached a natural end. Political infighting is increasing to some degree. Not only the integration of the Russophone minorities, but also the shift from a neo-liberal to a more socially responsible economic strategy are increasingly controversial. In recent years, 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. Democracy and market economy, however, remain the unquestionable norms for the political debates, shared by all relevant actors. The debate under the Parts government was the tension between the acknowledged need to increase government investment in education and healthcare, while sticking to a conservative budgetary policy. By and large, the relevant international organizations confirm the government's success in prudently balancing these two conflicting objectives.

As far as the reform objectives of market economy and pluralist democracy, it is fair to say that Estonian governments *have* largely achieved their reform goals before the period under discussion. Their political management in dealing with reform policies of the next generation is largely effective and purposive. The recent project of transforming the health care system was praised as exemplary by the WHO.

As the examples of citizenship policy and economic policy indicate, the Estonian leadership has demonstrated a high ability and flexibility in adjusting policy objectives and instruments to changing circumstances. More importantly, for Estonia the point is not in debunking a failed policy, but rather in sequencing policies to create the framework conditions for a new policy first and to accommodate to new requirements and windows of opportunity. Complex learning is certainly a quality of Estonian transition management. In 2004, Estonia substantially increased allowances for young families to counter the trend of an ageing society and projected labor shortages.

At the same time, tax rates were reduced to stimulate domestic investment and consumption. Flexibility concerns both the interaction with potentially radical groups within the own state, and pressures from the international community. For example, when party politics in the coalition blocked the tax reduction for 2005, the government decided to raise the tax-exempt income rate and to channel the additional tax revenue specifically to young families, education and local government. The policy concerning naturalization is a prime example of flexibility combined with consistency in objectives shown by the Parts and preceding governments: Estonian public opinion makes a cancellation of the non-citizens' policy politically impossible. Successive governments in Tallinn (unlike their counterparts in Riga) have been quite successful in accommodating the pressure from international organizations in a gradual and unobtrusive manner.

The requirements for naturalization have been lowered incrementally, funds for the Estonian Integration Program were again increased in 2004 and by late 2004, 81% of all residents held Estonian citizenship (68% in 1992) and statelessness has been reduced to 12% without recent political upheaval.

3.3. Resource efficiency

The efficient use of the state budget is partly determined by the legal requirement of a balanced budget. In terms of human resource management and efficiency, the small size of the country and of the population combined with the fact that most Soviet era structures were eliminated rather than reformed, all means that the risk of an oversized bureaucracy can be minimized. Typically, the bright economic prospects prevented the educated elites from entering state service in excessive numbers. To a high degree public services provided by the government are geared toward the developmental needs of business and society in terms of education, healthcare and infrastructure. Regarding economic and state budget planning, targets have generally been on the cautious side and overall estimates were accurate.

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; up to now reforms in this field have failed, resulting in an excessive number of local administrations without the financial and human resources needed resulting in 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 effort by the Laar government in 2000-2001 to carry out territorial-administration reform failed. Estonia still needs to decrease its number of municipalities from some 240 to more in the line of 100. Due to incompatible positions within the Parts coalition, the new government has refrained from major initiatives (except for increased government funding for local government institutions in the 2005 budget).

Overall, the reform process of the past two years continued to be effective and coherent. As noted, the challenges shifted to other post-transition policy fields, and the strategies changed from breakthrough and exclusion to consolidation and inclusion. Abstracting from Estonian cultural and political traditions and constraints, it might be argued that the strategy ought to have been inclusive from the very beginning. The sequence of events, however, has produced the results the current policies can be based on. Part of the effectiveness is a certain degree of patience in postponing issues that are not yet ready for a sustainable political compromise. This is exemplified by the tax reform issue: Politicking within the

Parts coalition in 2004 did not allow for an implementation of the tax reform as originally agreed, but gradualist steps and flanking measures were introduced to achieve some of the original objectives by other means. .

Partly in line with Scandinavian traditions, Estonia has a positive record in terms of transparency of its public administration, and concerning the degree of political corruptibility. An independent judiciary and a pluralist, independent media system have contributed to a low level of corruption, ranking 31 with a score of 6.0 out of 10 in the 2004 TI Corruption Perceptions Index. Due to some recent corruption scandals, public perception of corruption is far higher than actual data on its occurrence in public administration would seem to warrant. The recent adoption of a National Anti-Corruption Plan, combined with new legislation and new regulations for the financing of political parties, are all intended to curb corruption in democratic institutions.

3.4. Consensus-building

All major political actors agree on market-based democracy. As in any pluralist democracy, the balance between social protection and economic competitiveness is increasingly subject to regular political debate.

As the reform process has been completed and is definitely irreversible, no relevant veto actors exist that need to be co-opted. During the relevant period, the process of co-opting more and excluding less of the Russophone minority continued in line with the 2000-2007 Integration Plan.

Although social and regional disparities have not been substantially reduced over the past two years, politicians are alert to the problem. These disparities, however, have not developed into cleavages in the sense of being reflected in the divisions of the party system. It is an open question to what extent the non-escalation of the potential cleavages is due to the prudence of Estonian policies, and to what extent to the political apathy and lack of alternative options, and strong mobilizing leadership on the part of the Russophone population. The continuous rule-of-law approach to individual citizenship disputes and the gradual, but perceptible, reduction of citizenship hurdles for Russian non-citizens have deflated the mobilizing potential of the ethnic citizenship issue. Most Russian and pro-integrationist politicians have acquiesced in the gradualist approach by the Parts and previous governments supported by a large majority of ethnic Estonians.

The state support program for civil society organizations exemplifies increasing awareness on the part of the government concerning social capital and civic-mindedness. Societal solidarity is probably the key challenge for the current and upcoming governments after an initial neo-liberal market-oriented strategy of

transition. Tax reform toward either a progressive tax or a further reduction of the current flat-rate tax will test solidarity. 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-oriented, and thus integrationist, strategy by the government.

The political leadership takes into account and accommodates the interests of civil society, but is quite reluctant to further involve NGOs and think tanks in the preparation of policy-making. The official role of economic representatives such as trade unions in the policy process is relatively meager. Some efforts have been positive, such as the project 'Täna otsustan mina' [Today I will decide] as well the THEMIS system of NGO consultation. In addition, research institutions such as PRAXIS have raised the level of policy culture. However, these outlets have yet to be durably institutionalized.

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, moral justice and/or societal reconciliation remain. A new need to integrate the Russophone population has been acknowledged not only to comply with European standards for human and minority rights, but also to guarantee the availability of human resources needed 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. There are still few indications of the state's readiness to encourage re-examination of the past and thereby a more balanced view of past injustices. One such indicator is the introduction of Holocaust day in 2004. The issue of the past is also very much tied to relations between Estonia and Russia. On this level, it is very difficult for Estonia to do anything without constructive policies and goodwill from Moscow.

3.5. International cooperation

The effective completion of post-communist transition and EU integration is the conclusive answer to the quality of Estonia's effective use of international

assistance and cooperation with partners in the reform process. One recent example concerns the cooperation of the Parts government with the European Environment Agency to introduce ecological concerns in Estonia's timber industry and to push organic farming in peripheral regions of Estonia.

In 2004, not only international financial institutions but also the EU have praised Estonia's business environment in terms of economic liberty and rule of law. Standard & Poor's 2004 decision to upgrade Estonia from A- to A, because of its robust GDP growth and prudent fiscal policy, is a further illustration. Policy assessments and macroeconomic projections by the Estonian state have been remarkably realistic, more so under Parts than under his predecessor Laar, whose plans to introduce the euro before EU accession have now been replaced by consistent efforts to meet all criteria by mid-2006. Overall, international entities have long accepted Estonia as a competent and reliable partner.

Reliable political and administrative institutions and a high degree of liberalization have created optimal conditions for international co-operation. Regional cooperation among the Baltic States had suffered due to the competition for EU accession, but in recent years regional ties are improving again. The Council of Baltic Sea States and the Northern Dimension are considered constructive and flexible instruments for regional co-operation within a European context. The trilateral co-operation between the Baltic States, and particularly the co-operation between the three capitals, was consolidated by new agreements, e.g. on joint EU projects in the field of competitiveness, in early 2005. The countries of the region have discovered real common interests in relation to Brussels as well as concrete shared economic interests. On September 14, 2003, 67% of Estonians voted in favor of EU membership.

4. Trend of development

4.1. Democratic development

Despite some political scandals and a certain decrease in trust in some political institutions, the democratic system in Estonia is well-established and transparent. Elections fulfill the highest standards. The party landscape is consolidating; it increasingly represents groups in society and their interests.

4.2. Market economy development

Economic development is positive in most macroeconomic indicators, with the

exception of the somewhat high unemployment and a rise in current account deficit. The institutional framework was already in place by 2001, projections for GDP growth are between 5% and 6% for the next few years. The fact that Estonia is already preparing for the euro (aiming for 1 January 2007) and almost meets the stability criteria today, is an indicator of the solidity and prospects of Estonia's transformed economy. In a longer perspective, GDP per capita has doubled since 1993 and has reached 45% of the EU average (in 2003, in PPP).

Table: Development of macroeconomic fundamentals (2000-2004)

	2000	2001	2002	2003	2004
Growth of GDP in %	7.8	6.4	7.2	5.1	5.5
Export growth in %	28.3	-0.2	0.6	6.0	na
Import growth in %	28.3	2.1	5.4	9.0	na
Inflation in % (CPI)	4.0	5.8	3.6	1.3	3.5
Investment in % of GDP	27.9	29.2	31.8	31.1	na
Tax Revenue in % of GDP					
Unemployment in %	13.6	12.6	10.3	10.0	na
Budget deficit in % of GDP	-0.3	0.3	1.8	3.1	0.3
Current account balance in billion \$	-0.294	-0.339	-0.716	-1.199	-1.200

Source: EBRD, Transition report 2004

D. Strategic perspective

Now a full EU member, Estonia's potential future developments are no longer comparable to those of countries in transition or developing countries. There are four recommendations relevant to the framework of the overall "trends" of well-established democratic procedures, culture and sustainable economic growth.

A key factor in Estonia's future economic development will be the optimum use of EU funds to reduce extreme regional disparities within the country. Doing so would include for example, improving infrastructure and transferring some state institutions and economic activities to the east. The Estonian economy's current boom poses some medium-term challenges. Controlling wage increases to prevent the economy from overheating is one such challenge. Another challenge is to stem the increasing demand for inexpensive Russian and other foreign labor, which could facilitate tensions in an aging ethnic Estonian society.

Estonia should further develop a functional democratic system of regional self-government. Reducing the large number of minute communities without the requisite administrative capacity or scale for effective governance should also be a political priority.

In general, Estonia should continue integrating the Russophone minority via naturalization and gradually eliminate discriminatory laws. Furthermore, the Integration Plan should be redefined so as not to place all responsibility for integration on the shoulders of the “immigrants.” As a de facto multiethnic society, Estonia requires integrative efforts from both communities. Revisiting the controversial past in less moralistic terms should become a medium-term objective in education, for example.