

How Estonia Did It

by Mart Laar¹

In a world where most decision-makers were fashioning their policies on the assumption that the socialist way of thinking and the Soviet Union are permanent fixtures on the planet, a few private-sector men of vision like Robert Kriebler and a few great political leaders like Ronald Reagan and Margaret Thatcher thought otherwise. They refused to be blinded by the Red Smog. They broke the back of the Soviet Empire in the Cold War, pressed the Soviet Union into the corner, and gave captive nations the possibility to destroy the Soviet Empire from inside.

The progress made by former socialist countries serves as testimony to the wisdom of those who fought the long Cold War against the “Evil Empire” that was the Soviet Union. The cause of freedom, however, has been sweeping not only Central and Eastern Europe, but around the world. Political authorities have found themselves increasingly accountable to those they govern, and economies have become increasingly subject to competition in a global marketplace.

This would not have been possible if the founders of the conservative revolution had not dreamed of individual freedom. They have shown us that seemingly impossible dreams can be achieved if only we pursue them with an attitude that accepts no defeat.

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Freedom, for the first time, a former communist country had a free economy. Even more remarkable, it was not only a “free economy,” but one of the freest in the world.

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This country is called Estonia, and I had the honor to serve two terms as its Prime Minister. Estonia’s ranking in sixth place in the *2003 Index of Economic Freedom* makes it one of Europe’s most free-market-oriented economies. Ten years ago, however, we were probably among the most “unfree” of the world’s economies.

Estonian history has not been easy. In 1940, independent Estonia was occupied by the Soviet Union, but we never gave up. We fought a partisan war for nearly 10 years and continued to resist in other ways. Along with mass deportations, Estonia lost one-third of its population as a result. We fought the Cold War together as brothers in arms with you, and we won it together. In 1991, the Empire of Evil ceased to exist.

But after 50 years of Soviet occupation, Estonia was in ruins. Our economy was a shambles, the spirit

of our people spoiled by the socialist heritage. Shops were empty of goods, and money no longer had any value. Fuel prices rose by more than 10,000 percent over one year, while inflation was running more than 1,000 percent per annum. People stood for hours and hours in lines to buy food.

Within 10 years, Estonia has changed beyond recognition. Sometimes it is hard even for us to remember how this country looked under the socialist system. Estonia is now a modern and vibrant young country, integrating with Western structures like the European Union and NATO with astonishing speed.

THREE KEY LESSONS

A large number of experts and politicians have asked how we did it. In planning our “jump to nowhere,” we tried to learn from the experiences of other countries that had undertaken a transition from left-wing socialist utopia to free-market economy.

Some key lessons emerged. One is to take care of politics first and then to proceed with economic reform. Don’t underestimate the importance of a new, modern constitution and democratic legislature with free elections.

In some transition countries, the importance of the rule of law has not been understood, and this has been a huge mistake. No kind of general understanding, best effort, or wishful thinking can replace a sound and constantly improving legal environment. There can be no market economy and democracy without laws, clear property rights, and a functioning justice system.

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The second lesson is summed up by a well-known advertising slogan: “Just do it.” In other words, be decisive about adopting reforms and stick with them despite the short-term pain they bring. To put it briefly: no pain, no gain. Of course, that is easy to say and hard to do.

The most basic and vital change of all, however, must take place in the minds of people. In the era of

socialism, people were not used to thinking for themselves, taking the initiative, or assuming risks. Many people had to be shaken free of the illusion—common in post-communist countries—that, somehow, somebody else was going to come along and solve their problems for them. It was necessary to energize people, to get them moving, to force them to make decisions and take responsibility for these decisions.

To achieve this change, we had to wake up the people. First, competition had to be supported. In 1992, Estonia abolished all import tariffs and became one big free trade zone. Foreign competition pressed local enterprises to change and restructure their production. At the same time, Estonia stopped all subsidies, support, and cheap loans to enterprises, leaving them with two options—to die or to begin working efficiently. Surprisingly, a lot of them chose the second option.

At the same time, we had to make clear that if somebody works more and earns more, he will not be punished for this. Radical tax reform was introduced, decreasing sharply the taxation level and introducing a flat-rate, proportional income tax. The flat-rate tax has been an important part of the Estonian success story. It is easy to collect and easy to control. The only losers of this kind of tax reform were the tax lawyers.

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We have abolished tax on corporate income that is reinvested in the domestic economy. This decision is quite unprecedented in the world. Reinvested earnings are not subject to taxation because, in our opinion, this is the money that goes to the creation of added value in our economy—something that Estonia really needs.

At the same time, countries in transition not only must deal with their current problems, but must have the courage to look into the future as well. If you are severely underdeveloped, you can make a tremendous leap to the future by moving immediately to the most modern technologies.

TRADE, NOT AID

To do this, one should not rely too much on foreign aid. Moreover, we realized quickly the danger of extensive reliance on aid. Shipments of outdated computers to any transition country can secure them a permanent seat in the Third World. “Trade, not aid,” was proclaimed by Estonia in 1993 and characterizes its forward thinking.

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As a result, Estonia has made a real jump to modern technology, and this gave us our advantage. The government uses no paper; all members of the government use computers during meetings and sessions. One-third of Estonians use mobile telephones, many of them made in Estonia, while 44 percent of our exports are electronics.

Estonia is ahead of many European Union countries in terms of Internet use. Estonians make a big part of their bank transfers through the Internet. You can send your tax declaration to the tax department electronically. I did this last week, and it took about five minutes to complete it. E-government can be a very effective tool in the creation of lean and open government.

Of course, to implement such changes is not easy. I can say to you: You will not be very popular with such politics. A government that implements such policy can become unpopular and be ousted from power. But this is not important. More important is that your country is changed beyond recognition. Looking back, you can say: This was a dirty job, but someone had to do it. The train that you pushed to start it moving will not be stopped, and this is actually the only thing that matters.

Followers of Ronald Reagan and Margaret Thatcher are not in power in too many places in the world. We still see failures and collapses; we are fighting together against terrorism; too many people in the world are hungry and unhappy. Sometimes it seems for us that nothing has actually changed.

But this is not so. Think about the world now compared to 20 years ago. Conservative governments have been defeated politically again and again; but their ideas, values, and dreams have won. It is important to have the dreams and do the right thing. And we see the world changing before our eyes.

There are a lot of people in the world who doubt that an individual can change the world. The only acceptable response to such thoughts is the one Robert Kriebel said to the naysayers who doubted him—to every obstacle that stood between him and his vision of great things that could be and should be: Yes, we can!

NOTES:

- 1 Mart Laar served as Prime Minister of Estonia from 1992 through 1994 and then again from 1999 until January 2002. He also has served as a member of the Supreme Council, Estonia’s highest legislative body in the years before the first independent parliamentary elections in 1992, and as a member of Estonia’s Parliament. This chapter is adapted from the text of the Fourth Annual Robert H. Kriebel Lecture delivered by Mr. Laar during the 25th Annual Meeting of The Heritage Foundation’s Resource Bank in Philadelphia, Pennsylvania, on April 11–12, 2002.