



The Baltic Tiger – Estonian economic reforms

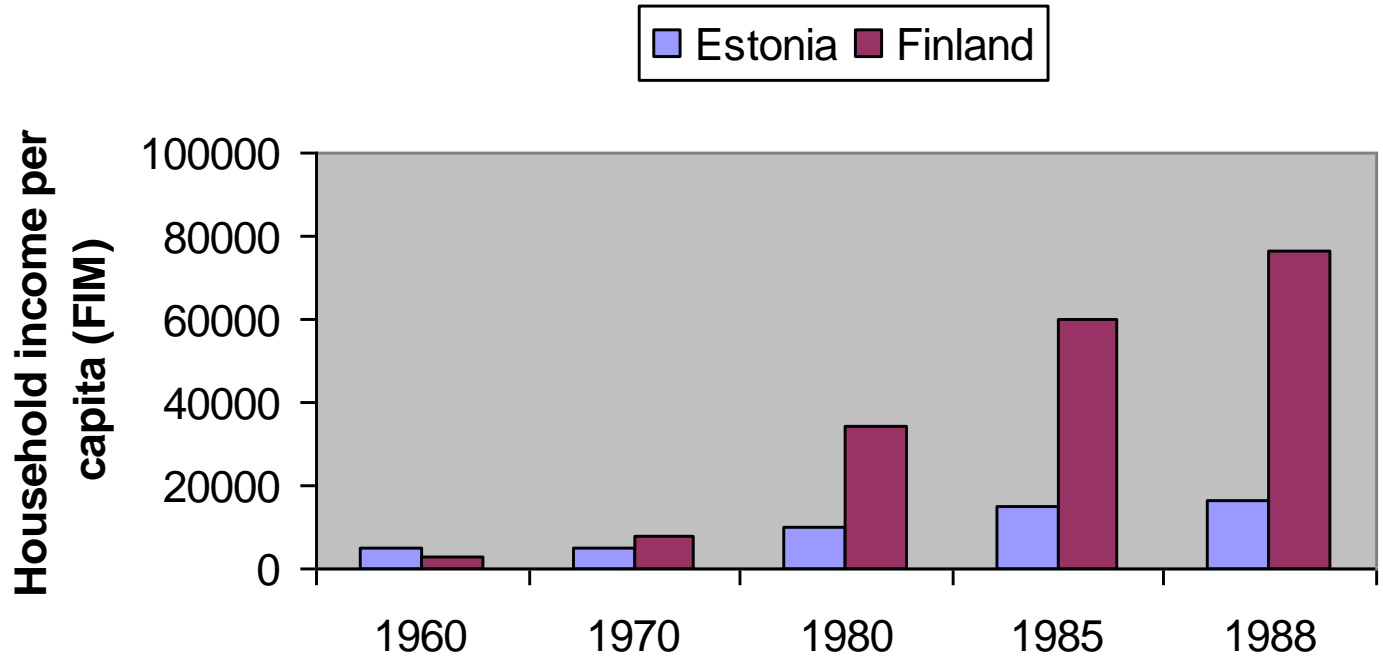
Fredrik Erixon

European Centre for International
Political Economy (ECIPE)

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Figure 1: Household income per capita 1960-1988

Source: Hagfors and Kuus (1993), p. 311



Early reforms 1989/1990

Perestroika

- Third way between capitalism and socialism
- Progressive price liberalizations (1989, 1990)
- Price subsidies – from 15 to 2 % of GDP
- Piecemeal privatization

The winter of discontent

- Russia was collapsing
- No immediate supply side effects
- Asset stripping

Figure 2: Estonia's economic development 1990-2004

(Source: World Bank world development indicators online)

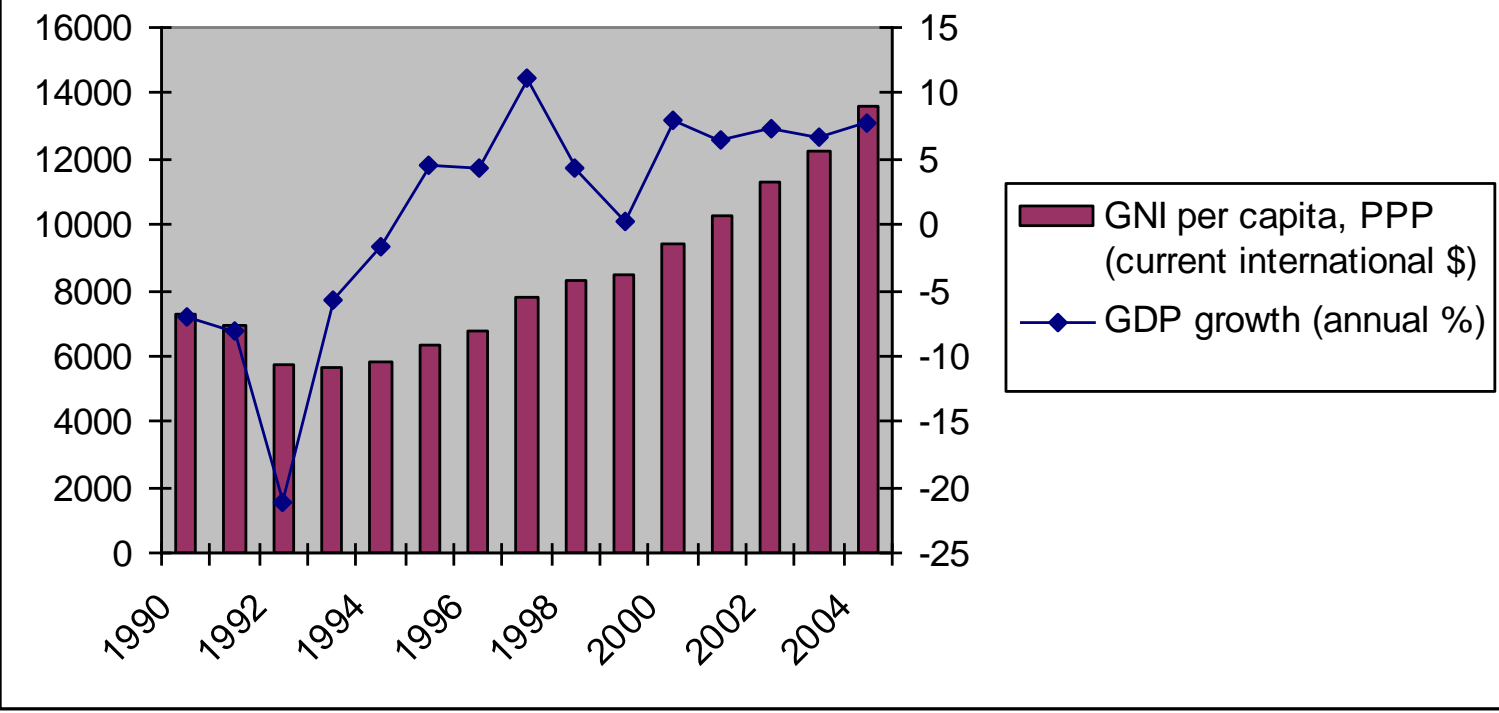
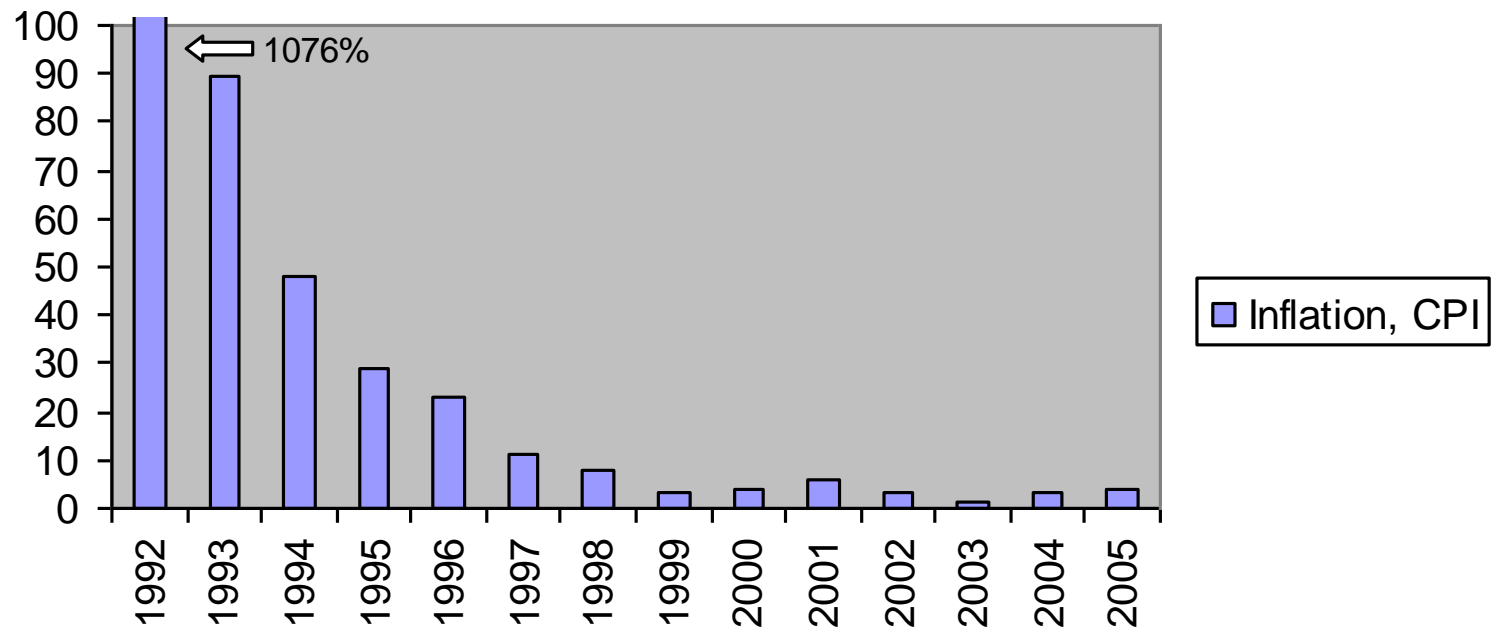


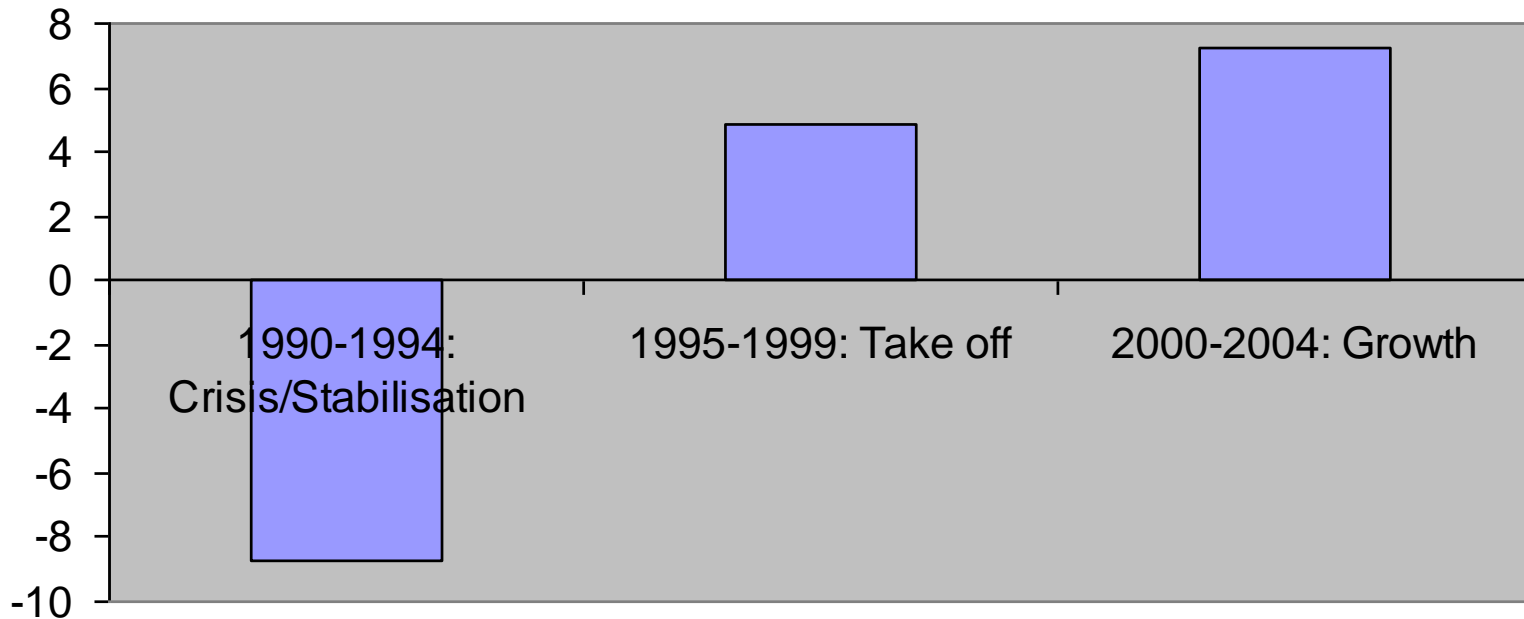
Figure 3: Inflation in Estonia 1992-2005

Source: Bank of Estonia



**Figure 4: Crisis, stabilisation, take off, and growth -
mapping Estonia's growth pattern**

Source: World Bank Development Indicators Online



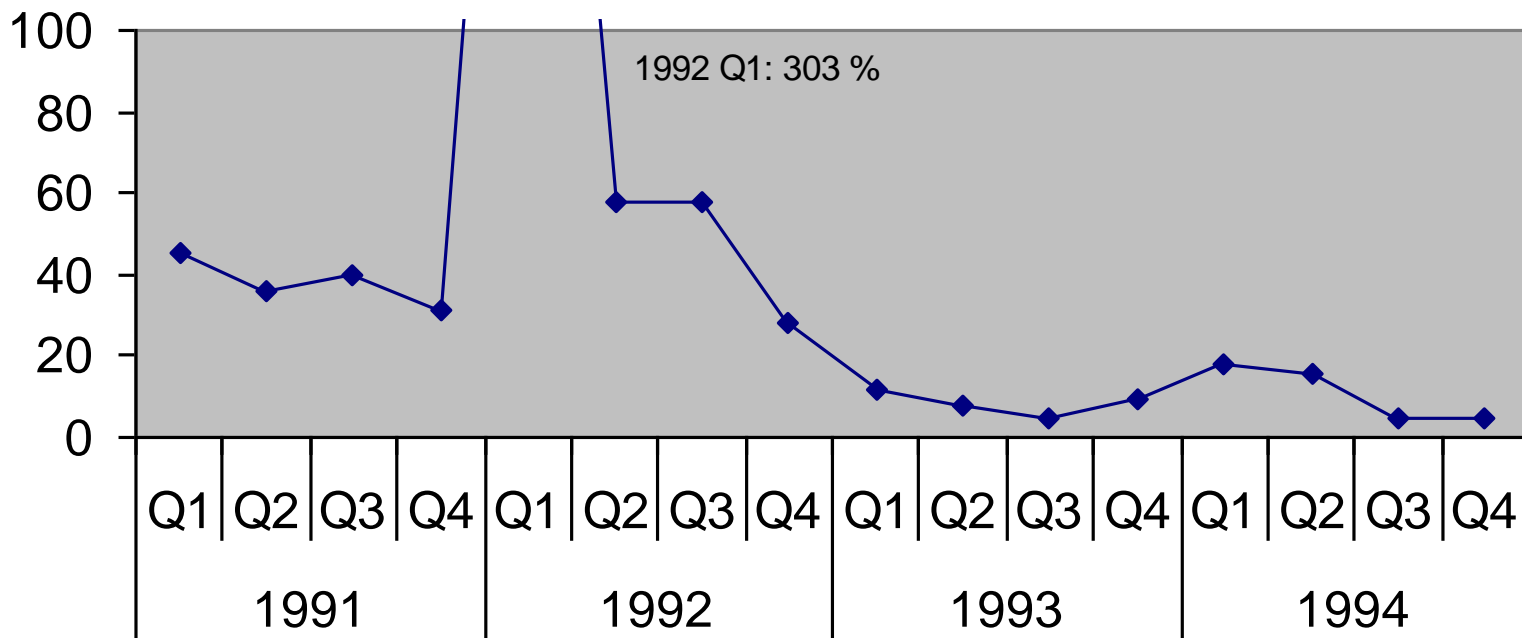


The great reform era: Monetary reform

- Estonia imported inflation from Russia and needed to leave the Ruble zone
- "Currency board" was established in 1992
- Macroeconomic stability: currency and inflation
- Impulses to fiscal policy
- Investment stability

**Figure 8: Estonian inflation 1991-1994
(CPI, quarter-on-quarter)**

Source: IMF European 2 Department's Database

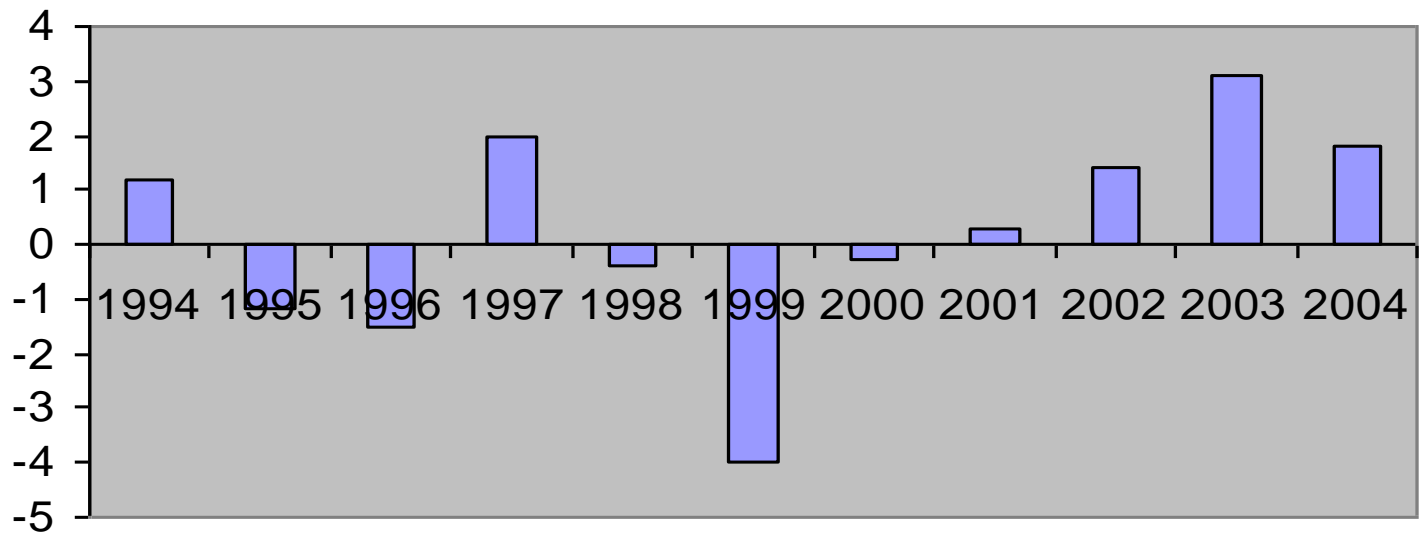


Inflation in open sector and sheltered sector 1992-1995

	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>
Inflation (CPI)	1076,5	89,8	47,7	29,0
Open sector	991,6	84,9	33,9	17,5
Sheltered sector	1702,7	149,3	89,2	52,1
Producer price index*	32,8	21,8
Export price index*	22,2	17,2

Figure 9: General government balance 1994-2004 (% of GDP)

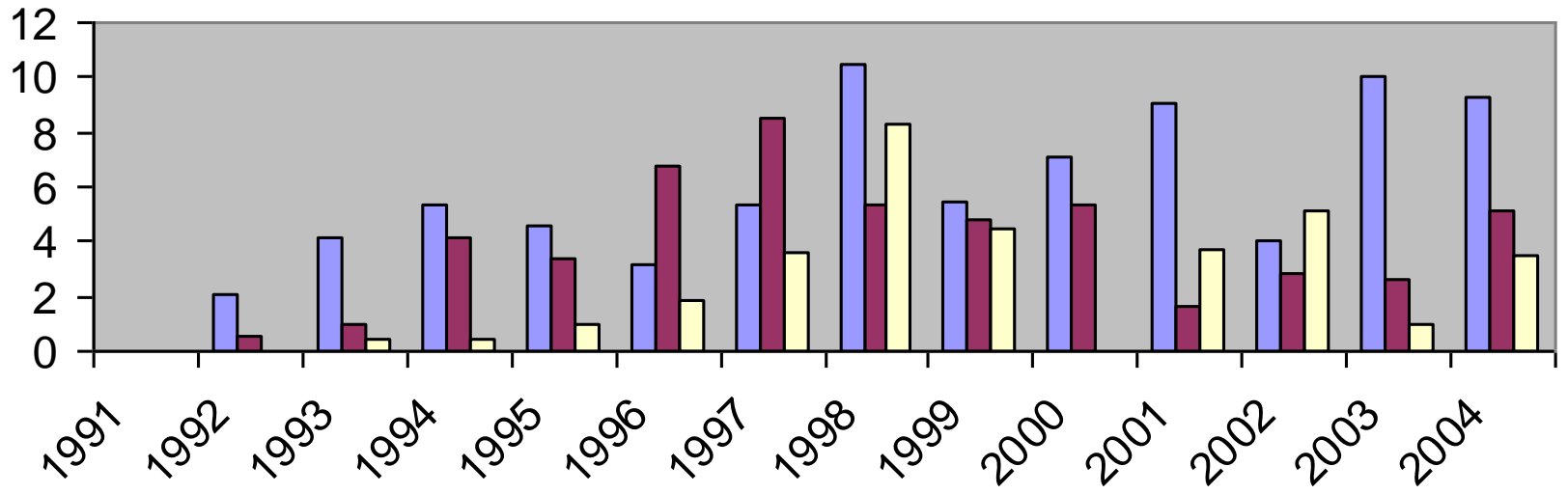
Source: EBRD (2006)



**Figure 10: Foreign direct investments
(net inflows, % of GDP)**

Source: World Bank World Development Indicators Online

■ Estonia ■ Latvia ■ Lithuania





The great reform era: trade reforms

- Intra-Soviet trade via CMEA
- External trade only 2-3 percent of GDP pre reforms
- From Soviet satellite to the Hong Kong of Europe
- Swift move to zero-tariffs – no tariffication!
- Liberalize, then negotiate!
- Trade agreement with the EU – WTO accession
- EU accession

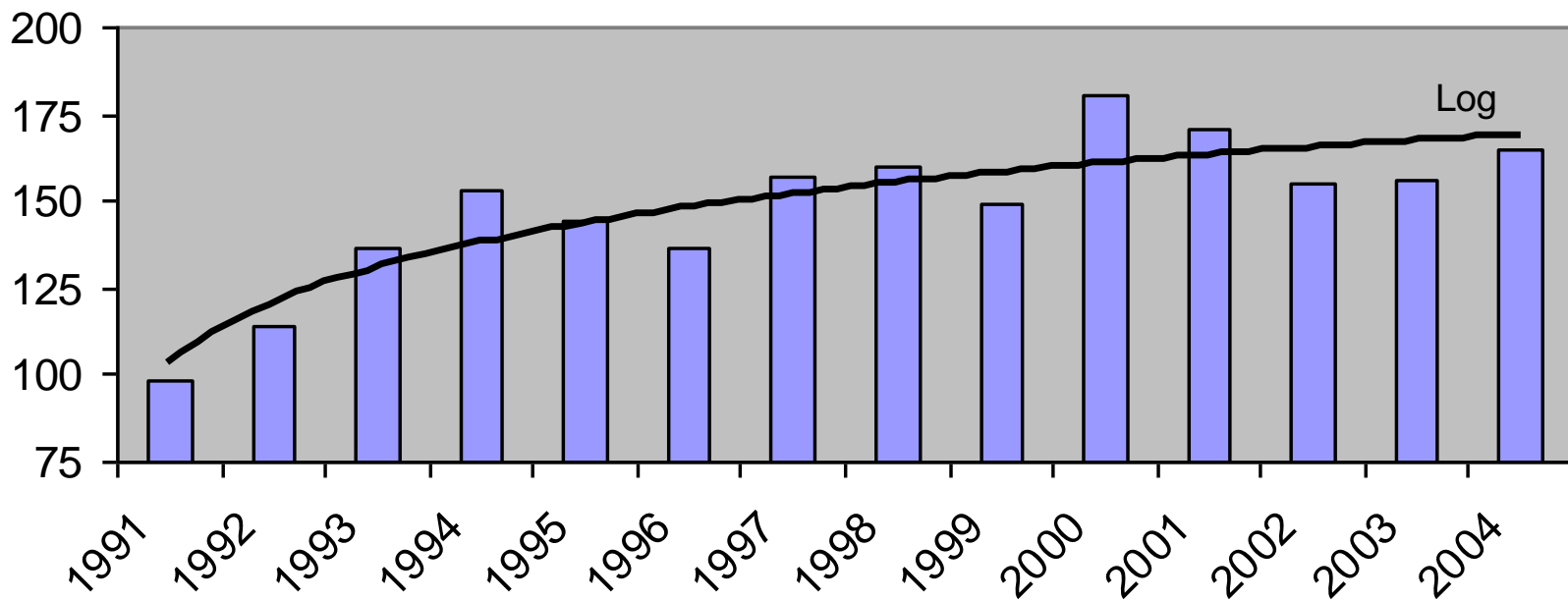


Average weighted tariff rates in selected transition countries

	<u>1993</u>	<u>1999</u>
Estonia	1,4 %	0 %
Latvia	3,4 % (1994)	5,3 %
Croatia	10 %	...
Czech Republic	5,7 %	6,8 %
Poland	11 % (industry); 18 % (agriculture)	11,6 %
Romania	11,7 %	23,8 %
Russia	14 % (1994) (also other means of protection)	...
Slovakia	5,7 %	12 %

Figure 11: Size of trade sector 1991-2004

Source: World Bank National Accounts Data





The great reform era: trade reforms

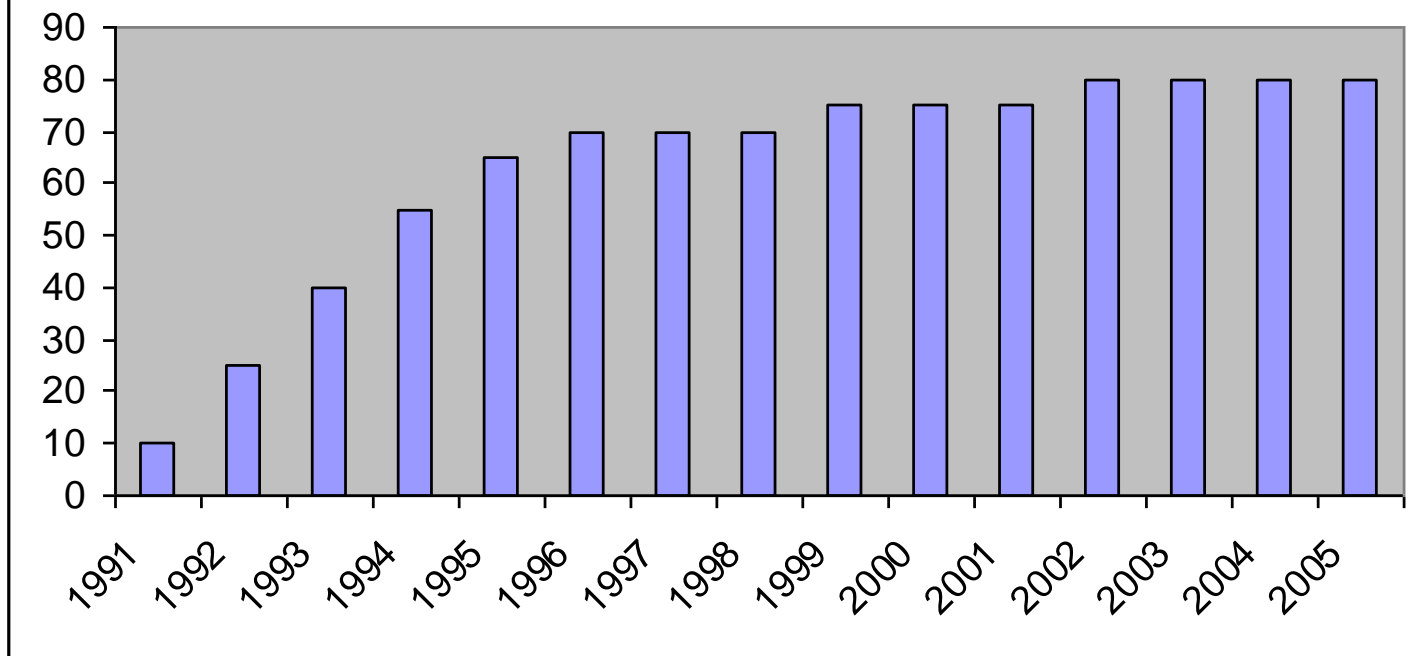
1. Classical liberal, "bottom-up" view of trade
2. Trade reforms a vehicle for other reforms
3. New tariff regime impractical
4. Crisis created an outward-looking orientation
5. Potentially blocking interest groups had been neutralized by privatization
6. New breed of civil servants with free-trade ideas

The great reform era: Enterprise reforms

- Privatization – but first institutional reforms (property rights, bankruptcy laws, etc)
- Privatization through *voucher system* and *Treuhand approach*
- International tenders and transparency
- A new stock exchange important for secondary trade in shares
- Explosion of new enterprises – from 10 000 in 1991 to 61 000 in 1996
- The important role of SMEs
- Flat tax reform in 1994 – 26 %

Figure 13: Private sector as share of GDP 1991-2005

Source: Åslund (2002), p. 279; EBRD (2006), p. 128



The Estonian reform story

- Reforms were swift and decisive – fast-and-furious – when the great reform era started in 1992
- Crisis – milieu conducive to reforms
- New political elite undertook the reforms; occupied the commanding heights of govt departments
- Reforms were “acts of faith”
- Simplicity and transparency in new policies
- Time is part of the essence
- Economic reforms accompanied by political and constitutional reforms