ECONOMICS DISCONNECTED FROM ITS SOCIAL CONSEQUENCES – *THE NEOLIBERALISATION OF ESTONIA*

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Abstract

Neoliberal economic policies focus on supply-side measures emphasising the role of the market in efficient resource allocation. Neoliberal policies advocate the case for a minimalist, non-interventionist government, stating that social welfare can be best advanced by promoting individual entrepreneurial freedoms. The role of the state should be limited to providing and protecting the preconditions for economic growth and the unimpeded functioning of the market. Neoliberalism promotes a market-driven society where every person is a *homo economicus*. In competitive markets, the rational decisions of utility-maximising consumers and profit-maximising producers will lead to market equilibrium.

Since 1992, the development of the Estonian economy has been guided by neoliberal economic policies. Decision-makers and policy-shapers tend to measure good business environment with the extent to which neoliberal policies have been implemented. However, Estonia's exceptionally high economic growth rates have not been matched by substantial improvements in the quality of life. Although its economic development has been impressive from a production-oriented point of view, from a people-oriented perspective the achievements have been much more modest. It seems that corporate welfare has replaced social welfare as an economic objective.

The purpose of this paper is to critically analyse neoliberal economic policies and to demonstrate their adverse socio-economic effects in Estonia. This article addresses the issue of growth versus development.

Keywords:

Neoliberalism, Estonia, regional development, income inequality.

Introduction

Since Estonia regained its independence in 1991, it has undergone a triple transition – a significant economic, political, and social transformation. The Estonian Soviet Socialist Republic with a totalitarian one-party system became the fully independent Estonian state governed according to the principles of pluralistic democracy. The centrally administered planned economy has been transformed into a market economy (Gros and Steiner, 1995).

Estonian decision-makers and policy-formulators alike have been diligently following the advice of international financial institutions, such as the World Bank and the International Monetary Fund, which advocate supply-side considerations of growth, since the country's regaining of independence in 1991. These institutions view policies aimed at boosting demand as unsustainable due to their inflationary effects and the threat of increasing indebtedness (Ingham, 1995). The policies of such international institutions strongly reflect neoliberal thinking with its focus on the supply side. The economic crises of the 1970s marked the decline of the dominance of Keynesian macroeconomic policies and the emergence and implementation of neoliberal economic policies with the goals of liberating corporate power by introducing market reforms, including wide-scale deregulation and privatisation. Today international financial institutions as well as academic circles tend to measure good business environment with the extent to which neoliberal policies have been implemented (Harvey, 2005).

However, the achievements of neoliberal economic policies have been very modest at best. Whereas global economic growth rates averaged 3.5 percent in the 1960s and 2.4 percent in the 1970s, it subsequently decreased to 1.4 percent in the 1980s and 1.1 percent in the 1990s (Harvey, 2005). In Estonia, the high economic growth rates do not seem to be accompanied by similar improvements in standards of living. In 2000, average life expectancy at birth was the same as in 1980 at 65.4 years, the lowest in Europe (Eurostat).

By critically analysing the nature of neoliberal economic theory this paper will show that the transformation of the Estonian economy along neoliberal economic policies has had adverse socio-economic consequences.

A Brief History of the Role of the State in Economic Thought

Discourse on the role of government within the economy is as old as economic thinking (Samuels et al., 2003). Throughout history, the state has never been prescribed such a minimalist and hands-off role as in neoliberalist thinking. Initially, economics was a branch of philosophy with a focus on the prerequisities of a 'good life' (O'Bien, 2003). In ancient Greece commercial activity was frowned upon, it was considered a 'necessary evil' to ensure a reasonable standard of living. The governing authorities placed strict restrictions on commercial dealings. Restrictions included prohibition of lending at interest and statutory price fixing. Both Aristotle and Plato strongly advocated the regulation of economic activities (Medama, 2003).

The Scholastics in the Middle Ages looked at commercial activities from a Christian moral perspective, considering the 'economic problem' more favourably than Aristotle and Plato but still sinful. Although lending at interest was still supported by the early scholastics, such as St. Thomas Aquinas, interest was to be seen gradually as the opportunity cost of lending. Price controls were deemed necessary in order to minimize the adverse effects of the business cycles over the purchasing power the population. Both the Greeks and the scholastics viewed the promotion of self-interested behaviour incompatible with moral values thus requiring government intervention to minimize its harmful effects (Medama, 2003).

Mercantilist thinking was similar to that of the Greeks and the Scholastics. In their view uncontrolled pursuit of individual self-interest would be against national interest. Excessive consumption of both domestic and foreign goods harms the trade balance and the nation's stock of precious metals by increasing the price of domestic products and increasing demand for import. Economic policies were evaluated by their effect on the stock of precious metals of the nation. They included such measures, as import restriction, export promotion, protection of certain industries, subsidies to motivate workers to relocate to the industrial centers and providing enough currency to maintain national economic activity (Medama, 2003).

Unlike earlier economic thinkers, the classical economists held a consumption-oriented view. Self-interest was no longer deemed harmful, but beneficial for society. They regarded the role of the state as a facilitator of national wealth accumulation. The government's role was to promote national welfare and provide those institutions that cannot be provided by the private sector. Classical economics was not entirely laissez-faire; the pursuit of self-interest was to be channeled by a system of laws and regulations so that it would contribute to social welfare (Medama, 2003). The classicals were opposed to monopoly, and the regulation of prices as well as production. However, they were in support of the formation of trade unions, the public provision of medical care, and the regulation of prices charged by public utilities. Great emphasis was based on the 'coincidence of private and public satisfaction' (O'Bien, 2003).

The years following Word War II brought along a 'new world order' based on a compromise between capital and labour. Policy-makers were greatly worried that the demobilization of millions of soldiers would lead to a postwar recession, which they were ready to fight by stimulating demand. The Beveridge Report (1942) in Great Britain and the Employment Act (1946) in the United States served as blueprints for government intervention in the economy based on Keynesian principles (Hoover, 2003). New institutions, such as the United Nations, the World Bank, and the International Monetary Fund were founded with the objective to stabilize international relations. The General Agreement on Trade and Tariffs rounds of negotiation were aimed to encourage free trade of goods. In the Bretton Woods agreement a system of fixed exchange rates were established with the US dollar as the global reserve currency. The goal of the government was to provide full employment, economic growth, and social welfare (Harvey, 2005).

Macroeconomic policies were designed according to the principles of Keynesian fiscal and monetary policies. Keynes's conceptual framework was based on an aggregative analysis that clearly distinguished between microeconomics and macroeconomics. He determined aggregate output along Marshallian concepts of supply and demand. He brought attention to the possibility that aggregate supply and aggregate demand can determine levels of output at which factors of production are not fully employed. Keynes blamed the Great Depression on a drastic decrease in aggregate demand. In Keynesian economics fluctuations in aggregate demand is the cause of the business cycle. As money wages are sticky, government intervention is needed to help the economy out of recession and restore full equilibrium (Parkin, 2000). Keynes firmly believed that monetary and fiscal policies can successfully increase aggregate demand and decrease unemployment. Hicks's IS-LM model gave the 'canonical' representation of the mechanism of Keynesian economics. A horizontal shape of the LM curve and a vertical line of the IS curve implied that monetary policy is ineffective (Hoover, 2003).

Until the 1970s the postwar years were predominantly Keynesian, emphasizing fiscal policy over monetary policy (Hoover, 2003). The 1950s and

1960s brought along high rates of economic growth in the advanced capitalist countries. The state played an active interventionist role in the economy; collective bargaining was supported, mobility of capital was controlled, public expenditures were expanding, and economic development was planned to a certain extent (Harvey, 2005).

The 1970s put an end to the fast economic growth of the previous decades. Real interest rates were negative and profit rates were at very low levels. Decreasing tax revenues and increasing public expenditures created a fiscal crisis. The advanced capitalist economies experienced stagflation; high unemployment rates were coupled with high inflation rates. Keynesian economic policies did not seem to work anymore. By 1971 the Bretton Woods system of fixed exchange rates was abandoned, in favour of flexible rates. An alternative was the expansion of state control and more regulations over the economy that was advocated by European socialist and communist parties. Another option was to deregulate the economy, to substantially decrease state intervention (Harvey, 2005).

The University of Chicago has remained largely unimpressed by the Keynesian theories and kept on focusing on the role of money. The economic crisis of the 1970s helped the rise of monetarism. Milton Friedman was a prominent member and advocate of the 'Chicago School'. Their monetarist view emphasizes that efficient resource allocation is guaranteed by the free market and macroeconomic stability can be achieved by a stable money supply. The cause of the business cycle is fluctuations in the money supply (Parkin, 2000). Monetarists regard 'unintended monetary contraction' as the cause of the Great Depression. As markets automatically return to equilibrium levels in the long run, state interference is harmful and should be discouraged. In the short-term, cyclical fluctuations can be avoided by controlling the money supply by the monetary authorities (Hoover, 2003). Thus, it is crucial that monetary authorities remain independent of political control. In the long-term money is considered 'neutral'; changes in the money supply do not influence real variables (Mankiw, 2000).

The main differences between Keynesian and monetarist policies concern the length of deviations from equilibrium and the cause of these fluctuations. Monetarists believe in the self-correcting mechanism of the economy with relatively short-term deviations from the natural rate, unlike Keynesians who think that these fluctuations need demand-side government intervention due to the long time that adjustments take. Both sides agree on the important effects of monetary policy in the short run. The main disagreement is about whether active involvement in the economy is needed (Hoover, 2003).

Gradually, most policy-makers and economists around the world have come under the influence of monetarism. In 1976, Milton Friedman received the Nobel Prize in economics. Monetarism would also become symbolic of the conservative economic policies of the Thatcher government (Hoover, 2003).

Since 1992, the development of the Estonian economy has been guided by neoliberal economic policies. The only exception occurred in June 1992 when the Estonian government opted out of the rouble zone and introduced a new currency, the Kroon. The measure was taken despite reservations expressed by representatives of the IMF, who worried about the country's ability to accumulate the resources needed to sustain its own currency. IMF and EU officials were also concerned with Estonia further severing its ties with Russia and the disruption of trade between them. Estonia was vindicated the very next year by the run-away inflation in the rouble zone (Smith, 2001).

Gilpin (2001) provides the following definition of neoliberalism:

"Neoliberalism refers to the application of the principles of neoclassical economics to economic development and other aspects of economic affairs."

In order to understand the economic policies pursued by the authorities in independent Estonia, a brief examination of the principles of neoclassical economic theory is unavoidable.

Neoclassical Economic Theory

The microeconomic foundations of neoclassical economic theory can be traced back to Paul Samuelson's *Foundations of Economic Analysis* (1947). Over the past half a century, it has not only become the basis for all areas of economics but has been used increasingly in other social sciences, such as sociology and political science (Samuels, et al. 2003). This book along with the writings of other neoclassical economists signalled a methodological shift from literary to formal analysis and has drastically changed economic thought and methodology. Mathematical formal analysis has replaced literary and descriptive methods. The method for solving economic problems, such as market equilibria and resource allocation, is based on 'constrained optimisation' with scarcity as the constraint (Rizvi,. 2003). Abstract modelling and formalisation meant that any problem impossible to model was to suffer neglect (Gilpin, 2001). Complex economic models using advanced calculus incomprehensible to ordinary individuals are presented as undisputable proof of neoliberal theory.

Neoclassical economic thinking is founded on the assumption of rational decision-making despite its unrealistic criteria. The foundations of this assumption are the notions of *completeness* and *transitivity*. An individual has well-defined and stable values, tastes, preferences, and beliefs, according to which he/she has a clear preference between choices. These choices are non-dynamic, always consistent. Each person is aware of all the choices available to him/her, has all the relevant information needed to construct alternative options and is able to evaluate the consequences of the various courses of action. Having compared the options, the decision-maker selects the one that offers the maximum set of benefits (Klein, 2002).

Due to the scarcity of resources, 'choices must be made among a limited set of possibilities' (Baumol, Blinder, 1998). Consumers and producers alike make optimum decisions; they choose the one that is actually best for them. Neoclassical economics centres on the role of the market in allocating factors of production efficiently. The forces of demand and supply will result in a market clearing equilibrium, at which the quantity demanded and quantity supplied of a good or service are equal. Due to the forces of the market mechanism, neither shortages nor surpluses can last (Ingham, 1995). In perfect competition, the *invisible hand* of the market ensures efficient allocation of resources on its own automatically and without the need for any government intervention. In competitive markets the price of a resource equals its marginal product; in other words, factors of production get rewarded according to their respective levels of productivity (Baumol, Blinder, 1998). The allocation of factors of production, goods, and services are rationed according to individual preferences and relative incomes. Consumers vote with their purses and wallets for the commodities that they want. Goods and services will be assigned to those who are willing and able to pay the highest price for it (Parkin, 2000). Although the market mechanism ensures efficiency, it does not guarantee income equality, nor does it provide satisfactory answers to it (Ingham, 1995).

A utilitarian approach dominates neoclassical economics, where social welfare is a function of individual utilities. Every decision is taken with a view to the sum of total utilities that it generates without considering the distribution of aggregate utilities among people (Sen, 1999). Distributional considerations are addressed in the concept of Pareto optimality. A Pareto improvement is possible when a person can be made better off without making someone else worse off. Hence, in a Pareto optimum no improvement is possible without making someone worse off; the poor and the destitute can only be improved by adversely affecting the more affluent segments of society. Therefore, a non-interventionist view is preferred by neoclassical economists (Ingham, 1995).

Neoclassical economics recognises that the market is not perfect; it has shortcomings, which lead to misallocation of resources. However, market imperfections are best remedied with the aid of market forces because governments do not have all the information needed for appropriate market intervention and because special interest groups may bias their decisions (Baumol, Blinder, 1998).

The Rise of Neoliberalism

Giroux (2004) defined neoliberalism as "*economics disconnected from its social consequences".* The rise of neoliberal theory can be traced back to the Friedrich von Hayek and the 'Mont Pelerin Society', which was founded in 1947. Whereas the neoliberal movement remained marginal, by the 1970s it gained a significant influence both over economic policy and in academic circles. Its growing importance was symbolized with the establishments of various think-tanks, such as the Cato Institute, the Institute of Economic Affairs, and the Heritage Foundation. In 1974, Friedrich von Hayek won the Nobel Prize in economics. Over the past thirty years, neoliberal policy advocates have been occupying influential positions in academe, the media, executive boards of large corporations, financial institutions, government ministries, central banks, and even international monetary institutions, such as the IMF and the World Bank around the world (Harvey, 2005).

In Great Britain, in 1979, the government of Margaret Thatcher abandoned Keynesianism in favour of monetarist policies. Her neoliberal agenda characterized by supply-side economics signaled a substantial reduction in state intervention (Hoover, 2003). This shift was followed by measures to create a more favourable business climate, such as privatization of public organizations and tax reduction. In the United States, deregulation of the economy began during the Carter presidency. In October, 1979, the nomination of Paul Volcker as Chairman of the Federal Reserve of the US marked a dramatic change in monetary policy. A year later Ronald Reagan, the newly elected president of the USA continued deregulation of the economy and implemented further tax cuts. In both countries, the Keynesian macroeconomic objective of full employment has been replaced by the goal of currency stability and fiscal and monetary discipline (Harvey, 2005). The collapse of the Soviet Union and the centrally planned economic system in the late 1980s and early 1990s strongly reinforced belief in the virtues of the free market. Supply-side economics became the standard blueprint for the economic restructuring of the newly emerging market economies of the countries of Central and Eastern Europe.

Neoliberal thinkers advocate the free-market principles of neoclassical economics and the case for a limited, non-interventionist *laissez-faire* government. They strongly opposed theories that supported state interference in the market (Harvey, 2005). In order to maintain the market's ability to transmit correct signals about demand and supply through price, governments should refrain from interventions and rely on the market forces whenever possible. Direct interference in the market, such as subsidies, tariffs, price floors and ceilings lead to misallocation of resources. For instance, as income differentials reflect differences in productivity, high statutory minimum wages distort incentives (Ingham, 1995). The welfare of society can be best advanced by motivating free enterprise and entrepreneurship. The role of the state should be limited to providing and protecting the preconditions for economic growth and the proper functioning of the market. Neoliberalist theory advocates deregulation of industry, privatization of state-owned organizations, and the withdrawal of the state from many areas of social provision. It underlines the importance of market-based contractual relations (Harvey, 2005).

The onus is clearly placed on the individual. Every person is responsible for her/his own welfare and standard of living through personal success or failure. As factors of production are rewarded according to their productivity, owners of those resources must focus on increasing productivity levels, which in turn will raise their living standards. Poverty can be best eliminated through free markets and free trade. Labour is treated as a mere commodity, the flow of which should be free and unimpeded. Outside interference, such as trade unions, are deemed undesirable, as they decrease efficiency by distorting market forces. Over the past thirty years, the power of trade unions was significantly curbed. Flexibility is recommended both in skills, careers and jobs. As such, short-term employment contracts are preferred. The outcome is lower wages in terms of purchasing power, job insecurity, reduced benefits and job protection (Harvey, 2005). 'Company man' has been replaced by 'spider woman'; people no longer can assume to ascend on the corporate ladder in the same organization. Instead, they must be ready to take on short-term projects, switch jobs and even professions (Magala, 2005).

Failure is personal; if the conditions of some people deteriorate it is because they are not competitive as a result of inadequate investment in their own human capital. An increased gap between rich and poor is unavoidable and necessary to encourage entrepreneurial risk and innovation (Harvey, 2005).

Financial deregulation started off a wave of innovations in financial services, such as new kinds of financial markets. With new inventions in information technology and free mobility of capital, immobile resources – countries and their populations – have to compete increasingly for the mobile resource – capital (Gilpin, 2001). As a result, capital's return of income has significantly increased compared to labour's return of income, leading to greater social inequality.

The real business cycle theory goes as far as denying that involuntary unemployment exists. It posits that unemployment is voluntary; the quantity of labour supplied depends on the their compensation. Workers compare the current return on their labour with their expected return. When real wages are temporarily low they withdraw their labour. This allocation of work hours across time is called *intertemporal substitution* (Parkin, 2000). The rational expectations theory states that deflationary policy can actually be painless, as long as the authorities announce it in advance and that employees and employers alike believe the warning. Under the assumptions of rational expectations interventionist governments can do very little (Mankiw, 2000). The Chicago view of the economy goes even further by considering monopoly a transitory market structure, a result of an efficient response to market conditions that was facilitated by the state. High levels of industrial concentration are not regarded harmful, as the 'rivalrous behaviour of a few firms can mimic the results of competition'. As such, these market failures do not necessitate government intervention. Even the inability of the market mechanism to provide public goods is questioned (Medema, 2003). Neoliberalist policies make society market driven.

Economic Growth versus Economic Development – The Neoliberalisation of Estonia

Free market philosophies have permeated Estonian society over the past fifteen years. Under neoliberalism politics and economics are interwoven; democracy and unimpeded free markets are considered inseparable (Giroux, 2004). Neoliberalism is presented as the champion, the exclusive guarantor of individual freedom, in the promotion of which the market is deemed instrumental (Ingham, 1995). Any intrusion of the state is considered an attack on individual freedom and opportunities. As such, it easily lends itself to political movements that attach high values to individual liberty (Harvey, 2005). Capitalism is not considered a social construct that can take many different forms. Neoliberalism is viewed as the natural and inevitable result of economic development.

Fifty years of sovietisation have left serious political and economic legacies in Estonia. The Soviet regime's objective was to erase all traces of the independent Estonian republic. The Soviet policy towards nationalities was influenced by the desire to bridge nationalistic and ethnic differences. The USSR was a federal union between the fifteen republics. Shaw (1995) describes this union as “federal colonialism”, whereas Smith (2001) uses the term “ethnoterritorial federalism”. The Party Programme of 1961 referred to the peoples of the Soviet Union as ‘united into one family’ (Shaw, 1995). Khruschev spoke of a merger between the various peoples of the USSR ultimately leading to the emergence of the *homo sovieticus,* the new Soviet citizen. All throughout the Soviet era, Estonians kept a very strong feeling of national identity. As in the eyes of Estonians Estonia has never been legally part of the Soviet Union, there was no formal declaration of independence in 1991. Instead, according to the ‘principle of legal continuity’, they declared the end of the Soviet era and the beginning of a transition period during which independence was to be restored. De jure Estonia remained an independent state during the Soviet era; on 20 August 1991, the first freely elected parliament formally announced de facto independence from the USSR (Smith, 2001).

It is questionable, how Estonian Estonian neoliberalism is. On the one hand, the international monetary and financial institutions have had significantly influenced the transformation and neoliberalisation of the Estonian economy. A number of Estonian policymakers and technocrats had been educated in Western academic institutions where they acquired neoliberal ways of thinking. On the other hand, there does not appear to be any popular resistance to the neoliberal economic policies of the successive governments. Despite the adverse effects of these policies, which are detailed below, no public discourse of economic alternatives seems to be taking place.

In Estonia the market is deemed as the key factor in economic growth. It is considered to have a ‘moralising effect’ (Ingham, 1995), as it encourages people to be proactive problem solvers. It installs the virtues of punctuality, frugality, and probity. It has disrupted the status quo of the socialist era. Policy makers in Estonia have the conviction that the market plays a crucial role in promoting personal liberty. Political and economic freedoms are considered interdependent. The country’s development has shown the features of outward looking policies, such as efforts to maximise foreign trade, to create a favourable climate for foreign investment, to follow liberal trade policies, and to take extreme measures to aid the competitiveness of producers (Ingham, 1995). Overall, Estonian development policies have followed a normative economic approach.

Over the past fifteen years, all the standard stabilisation measures necessary to create a market economy were duly taken, including structural measures, such as the creation of a market environment, restructuring of industries, and the launching of privatisation. The country’s economy had been subjected to a ‘shock-therapy’ (Lavigne, 1999). By 1992, prices were liberalised. By the late 1990s, privatization was completed. State monopolies were restructured, sold off or closed down. Stringent banking and monetary reforms gradually brought inflation under control. As part of its economic stabilisation process, in 1992 Estonia introduced its own currency, the Estonian Kroon (EEK). It subsequently established a currency board system and pegged the Kroon (EEK) to the German mark (DM) at a rate of 8 EEK – 1 DM (Smith, 2001). As a small economy with a limited domestic market, Estonia relies on foreign trade to a great extent, therefore in order to foster economic growth, all export and import restrictions were completely abolished. Trade has been successfully reoriented from east to west. In order to attract foreign direct investment, the subsequent Estonian governments have done their outmost to create a business-friendly environment. The country boasts some of the lowest income tax rates in the world – a proportional rate of 20 percent that the government intends to decrease further in the next few years. There is no corporate tax on reinvested profits (Estonian Investment Agency). In order to maintain fiscal discipline, the country’s constitution of 1992 requires the government to maintain a balanced budget. This obligation can only be amended by a two-thirds majority vote in parliament (Smith, 2001).

The Estonian economy’s transformation is considered a success story. The efforts of the country’s transformation were recognised when Estonia joined the European Union (EU) along with seven other former Soviet block countries in May 2004. The Estonian economy has consistently achieved annual economic growth rates in excess of 6 percent since 1999 (Statistical Office of Estonia). Its economy is made up of efficient industries and enterprises. Estonia has enjoyed a large inflow of foreign investment; foreign capital participation affects over one third of Estonian enterprises (Bank of Estonia). By 2004, it had the most competitive economy among the nations that have recently joined the European Union. The same year, Estonia ranked number 4 on the Index of Economic Freedom Ranking (The Heritage Foundation) behind Hong Kong, Singapore and Luxemburg. In 2006 it had the highest ranking – 20 – among the Central and Eastern European countries on the World Competitiveness list.

An important goal of the country’s authorities is the earliest possible accession to the Eurozone. Economic policy decisions have been in accordance with the restrictive convergence criteria in mind. The original target date for accession was 2006. This had to be postponed due to the high rates of inflation (Bank of Estonia).

Estonian households, overall, have been enjoying an improvement in their living standards. Between 1997 and 2004, the average annual disposable income per household member increased by 36 percent in real terms (Statistical Office of Estonia). However, income does not seem to measure adequately economic development, as the fruits of economic transformation have not been shared equally by all segments of Estonia's population. The economic shock therapy, the fast-paced privatisation, and the restructuring of the economy have put an enormous strain on society. Although the country's development has been impressive from a strictly goods-oriented view, from a people-oriented perspective, the achievements have been much more modest. The exceptionally high economic growth rates have not been matched by

Another significant problem is the polarised nature of regional development. There are significant differences in levels of economic activity, employment rates, and income levels between urban and rural areas, and between the capital Tallinn together with its hinterland, Harju County, and the rest of the country. As part of macroeconomic restructuring, a serious structural shift has taken place, leaving vast labour surpluses in regions with a concentration of heavy industry, such as the north-eastern part of the country. In 2002, per capita income tax revenues in north-eastern Estonia were only half of that of Northern Estonia. Estonia's richest district, Vim's valid in Northern Estonia boasted per capita income tax revenues 14.06 times higher than that of Piirassaare municipality in Tartu County, the poorest municipality in the country (Statistical Office of Estonia). However, despite the high levels of income inequalities and the vast disparities between the country's regions, there does not appear to be any resistance to the neoliberal economic policies of the successive governments.

Estonia has evolved into a two-tier economy. Local businesses with foreign participation benefit from the transfer of technology and best practices. They achieve higher rates of productivity, efficiency and competitiveness enabling them to pay above average efficiency wages. Organisations having these advantages can afford to offer higher wages with which they dominate the primary labour market. Purely domestic enterprises make up the lower tier of the economy with low productivity rates, outdated technology, and inadequate access to resources. The lack of capital puts domestic enterprises at a great disadvantage. As banks mostly consider fixed assets and not earning potential when providing loans, these organisations have very limited access to capital. Although they employ the bulk of the labour force, they are greatly constrained in their ability to provide competitive wages, training, and attractive career opportunities.

Whereas public funds have been used to create the infrastructure needed for the development of certain industries, such as information technology, telecommunications, and finance, investment in areas of basic physical and social infrastructure has been insufficient (Eurostat). In addition to healthcare and education being under-funded, the physical infrastructure is also underdeveloped. Although transit cargo is a major part of the nation's economy, the road and railway networks are in a dilapidated condition. There are no motorways in the country. The underdeveloped state of the physical infrastructure also threatens Estonia's ability to continue attracting foreign investment. However, the limited amount of tax revenues seriously hampers efforts to fund development projects. The available resources are insufficient to cover the expenses of much needed improvements. Large amounts of EU structural funds have flown into the country over the past few years, however, Brussels is reluctant to channel financial aid to an economy with such low levels of proportional tax rates (Euronews).

The ultraliberal, overly business-friendly policies of the successive governments over the past one and a half decades have led to the economic and social stratification of Estonian society and the emergence of high levels of income inequalities. As businesses enjoy tax exemption on reinvested profit, many households feel that they bear the brunt of economic transformation (Ehin, 2002). The implementation of neoliberal economic policies has had adverse effects over the welfare of Estonian society. Decision-makers and policy advisors seem to confuse economic growth with development.

Conclusions

Throughout the history of economic thinking philosophers of ancient times, scholastics, mercantilists, classical as well as Keynesian economists assigned the state an active role in the economy. In the post WWII 'new world order' the objective of the government was to provide social welfare, full employment, and economic growth.

The emergence and spread of neoliberal economic policies in the 1970s reduced the role of the state to maintaining the preconditions to economic growth. According to neoliberal thinking any government interference in the workings of the economy is harmful as it leads to misallocation of resources. The neoliberal macroeconomic objectives are currency stability, monetary and fiscal discipline and the preservation of a free-market economy dominated by market based contractual relations. At the centre of neoliberal theory stands the proactive and perfectly rational *homo economicus.*

In the post-socialist era neoliberalism with its emphasis on individual freedom and a minimalistic government appears very attractive as a policy option. The transformation of the Estonian economy along neoliberal principles has led to the creation of an overly business friendly free-market economy. However, the country's exceptionally fast economic growth has not translated into an overall improvement in living standards. All socio-economic indicators point to a decline in social welfare. As a result of the neoliberal economic policies of the past fifteen years, corporate welfare has replaced social welfare in Estonia.

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