

WITH Matt Laar,



Historian, twice Prime Minister of Estonia (1992-94 and 1999-2002), and current member of the Estonian Parliament, **Mart Laar** is widely recognized for his leadership in bringing his country from economic and social ruin under communism to being one of the most vibrant societies in the world today. When he first became Prime minister at age 32 he initiated wide ranging reform of the economy including privatization, unilateral free trade, a technology savvy government, and the world's first introduction of flat tax. He is now credited with Estonia's astonishing economic turnaround. Known as the Baltic Tiger, Estonia has consistently experienced 8% economic growth, dramatically reduced inequality, and is the home of world leading technology development, including the internet telephony service, Skype. Frontier Policy Analyst David Seymour caught up with Laar at a conference hosted by the Atlas Economic Research Foundation this August 2007 and asked him to explain more about the Estonian renaissance.

**Frontier Centre: Mart could you please give the people of Canada an overview of how you changed the government and economy in Estonia in your two terms as prime minister, and what have the results been for ordinary Estonians?**

**Mart Laar:** When we started, in 1992, our economic reforms, Estonia was in a state of economic collapse. Communism means a system which fails and the longer it lasts, the more it fails. The heritage of the communists is what we had, when my first government took power in '92 we had huge hyperinflation of 1000%, we had most of our industries and economy owned by the state, we nearly produced nothing that we could sell to the west, so we were dependent on the Russian market, and this was the worst. During the time of hyperinflation, social inequality and power inequality in the country raised tremendously. There was a small group of people motivated by the former communist regime who had access to the foreign currency, and during the hyperinflation, this was a source of very high inequality at the beginning of the reforms. And we had a very high poverty rate. So the task of the reforms was to really to get the country and the Estonian people out of this poverty. To do this, the only way was really a radical economic approach, starting with the macroeconomic stabilization, bringing the hyperinflation down and stabilizing the monetary system. And the last reforms were taking the power from the hands of the government to the hands of people. That was the main goal of the reforms because any government, any Prime Minister can't change the country, the people can. So the government's goal was to empower the people, and this was done by different reforms. Starting from the property reforms, privatization, liberalization of all of the economy, and the tax reform which was a very important part. We created the first flat tax in the modern part of the Western hemisphere.

**FC: Many Canadians would be surprised about flat tax reducing inequality. They generally believe that progressive tax gives more revenue to the government and makes sure that those who can pay more do so. What has been the Estonian experience of government revenue and equality with a flat tax?**

**ML:** It is not now, anymore, only an Estonian experience because a flat tax has worked so well in Estonia it is now copied by more and more countries. So every year we have the next one or two countries joining the club and they are not only small countries, among them are quite big countries. The experience is, nearly everywhere, the same. First of all what

happens is the government revenues will go significantly up. Lowering taxes often makes the economy grow, but especially the introduction of the flat tax, which makes the government revenue higher because progressive taxation with the huge amounts of exemptions is actually such a complicated tax system that it is very easy to avoid the taxes. Especially the very rich people can do this because they can hire the lawyers and tax experts, but for the poor people that is a possibility that doesn't exist. With the flat tax the tax system becomes simpler. It is easy to understand for the people but it is very easy to understand for the officials as well, so it is very hard to avoid. The results will be not only that you get more revenue but you get a lot more revenue. There is very clear evidence in all the countries that have introduced a flat tax, especially when we compare to the countries that have done this to the countries in the same region that have not done it. Then you see the real change and the real difference. Then you see what it means to move to the flat tax.

The second part is the social equality question. Actually when you analyze the flat tax, the first evidence is that in every country that has introduced the flat tax, the Gini coefficient, which has been the important measure of inequality has come significantly down, not up, in every country that has introduced the flat tax. The second part is that the poverty rate has gone significantly down as well, so it is very clear, the result. And now many mathematical studies have been done on the flat tax. It has been found, very interestingly, that in the most used form of the flat tax where there is one exception, so there are two levels of taxation, zero and the flat tax rate, which means that a lot of groups, the most poor part of society, are actually liberated from the taxes. And in this [flat tax] system, the progressivity of the system, is actually higher than in the progressive system. As I said earlier, it is fair. These people who use the exemptions [in a progressive system] are not the people to whom the exemption is targeted, and most exemptions are not reaching the groups they are there for, but they are used by the richer part of the population. Which means, actually, that this [flat] tax system is actually more [progressive]. And the studies are really proving that the progressivity of the [flat tax] system is actually higher than the progressive system due to the large exemptions. So it is a little bit of a paradox but, when you look at the system it is quite easy to understand how it works. It is just fair.

**FC: I didn't know that either actually, um, your government is famous for using the internet for internal operations and interacting with citizens, some people even call it E-Stonia. Can you tell us what the benefits of e-government have**

**been, and also how do you motivate your government employees to take on new technology?**

**ML:** We are not motivating, we have pushed them from the top. Then we let the people know that they can turn to everybody with email. The people have that because the use of internet has been declared, the right to use the internet, has been made one of the human rights in Estonia by the law. This means that we have a very large amount of free internet and we are now working very actively with the WiMax system to really pass through the very new and modern WiMax system III meaning costless internet for everyone in Estonia for everybody. I think that will be done in the coming years. When you empower the people they will deal with the state administration. What it gives, it gives first of all a government which is more lean, more effective, and more under the control of the people. It doesn't make the government more popular because all the misgivings are seen very fast, but I don't think the government's task is to be popular, I think the government's task is to work and work under the control of the people. The government is made very transparent, and the people are having the possibility to give their views before the laws are passed, not afterwards giving criticism. It makes the laws more effective and it makes all of the state work more effectively. So this transparency is very good. Of course, it is also cheaper and it is very environmentally friendly, when you look at the amount of trees that you have to cut to make all those stupid papers, it is a huge amount, and what is important is that it actually promotes direct democracy in Estonia, and we are the first country that has passed e-votes, and it makes the lives of the people easier in all fields of life and at the same time it promotes a new era of high technology industry. Largely thanks to this e-government industry, Estonia is famous for IT including the Skype telecommunication system, which was created in Estonia, and all other ideas which our companies are now exporting around the world starting from the mobile parking and ending with all other similar structures. So it has become very part of the economic result. When the people know how to use the computer it makes the economy more effective.

**FC: Picking up on the fact the Skype was generated in Estonia, a lot of people in some provinces of Canada, particularly Saskatchewan and Manitoba are concerned that free trade agreements, even with other Canadian provinces, will make local industries victims, can you tell us a bit about how a country that had previously been wrecked by communism is able to compete with Western Europe?**

**ML:** I think that was ... one part of our economic reforms, in 1992 we abolished all custom taxes, making Estonia a free trade area. A lot of managers from the former Soviet factories came to me and said that I would destroy Estonian industry. I said it must be a very weak and uncompetitive industry which needs to be destroyed. I think this is such a perception in the minds of politicians that, they know what is competitive industry and business doesn't know. It is not true. I think the task of the government is to create in your country the competitive industries which are really competitive, and free competition is the best source to do this. Estonia has been an excellent

example of how this kind of competition makes the economy stronger. Countries around us who have used different strategies have gotten significantly smaller growth and less prosperity than countries that have opened themselves and moved to free trade. Competition decides which industries are efficient and which are not, so you have the industries that really can compete all over the world.

**FC: About privatization, again, it is a big concern in Canada that if certain government businesses are privatized, our energy, our telecommunications, even, in some cases, transportation –if we privatized those then the companies would be run for the owners rather than the people.**

**ML:** Again, this is a very wrong perception because, if the [privatized] companies are not run for the people they are not competitive. Which means the private owners, these people are not stupid. They are not risking the taxpayers' money they are risking their own money. And, to earn the money they must provide the services, in the open theory of competition, if they are not doing this they will fail. Whereas when the government can risk the taxpayers' money and lose it, the private sector find they can't do this. So in most areas they are significantly more competitive and reliable than the government owned company.

**FC: Can you give us some examples of Estonian services previously owned by the government that are now privately provided?**

**ML:** Most, it's hard to say what services are not, we have now pushed very actively towards privatization. It is not politically popular, I must say, that is true. We have had some political setbacks and setbacks in this way as well but it is actually very good for the economy because things work better.

**FC: Is their political pressure to reverse the privatizations?**

**ML:** Sometimes yes, [one business] was reversed by one other government, actually, bought back, not nationalized. But now it is quite clear that this was one of the most stupid decisions. It will not be repeated, that sort of stupid decision, this is very clear. But in most areas we have gone through a very successful privatization, including of the water supply system, which has worked very well. And of course telecommunications, their privatization is absolutely crucial. Not privatizing your telecommunications system, in the modern world, this means trouble.

**FC: Two final quick questions, how hard is it to learn Estonian, and what is your immigration policy?**

**ML:** Estonian is a little bit different from the other European languages, like the Nordic languages mostly spoken by the Finns, Hungarians, Estonians, so it's complicated but it is absolutely doable. I have seen American Peace Corps members who have all learned within three months. The girls are beautiful and the beer is good, so it goes fast!

**FC: Well you might find you have a few more Canadians over there soon, thank you very much.**

**ML:** We have, we have, thank you.