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Foreword

The publication you are currently reading is the third issue of the *Baltic Journal of European Studies* (BJES), the direct successor of the peer-reviewed journal *Proceedings of the Institute for European Studies, the Journal of Tallinn University of Technology* (IES Proceedings), published by the Department of International Relations of the Tallinn University of Technology.

The essential significance of the articles published in this spring issue of BJES lies in a new perspective given to the key issues in the field of economic policy of the European Union, as well as of Estonia as a Member State. This volume offers challenging studies on perspectives of the EU economy by Alari Purju and Rünno Lumiste. Gabriel Hazak presents an article about the EU's legal status, and Lehte Roots discusses aspects of citizenship. Several papers of the volume address legal ethnic and cultural identity aspects highlighted by case studies on Georgia, Latvia and Estonia.

Last but not least, we incorporated into the current journal issue a special section to celebrate a significant milestone in the academic life of Estonian scientists—the 80th birthday of Dr Ülo Ennuste this spring. Professor Ülo Ennuste, DSc is one of the leading economic scientists in Estonia and has been successfully working at the Tallinn Institute of Economics of the Estonian Academy of Sciences and at the Tallinn Technical University. He has authored and co-authored 15 books and more than 160 research articles of wide acclaim. Professor Ennuste is an outstanding man whose personal contacts in the international arena and widespread cooperation have strongly contributed to the dissemination of economic science in Estonia. Dr Ennuste's current article in BJES enriches the Estonian economic science with a discussion about resources on macroeconomic knowledge in order to facilitate the 'European Semester' processes. Its main message is that the quality of the agents' knowledge structures may play the basic role and importance in reaching effective equilibrium.

We hope that the readers of the journal's spring issue will find it both informative and full of fresh ideas that are expected to have a positive impact on their way of thinking and cooperation in the European Union.

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Professor **Ülo Ennuste**, DSc has successfully worked at the Tallinn Institute of Economics of the Estonian Academy of Sciences, at the Tallinn University of Technology (TUT) and the International University Audentes (IUA). In 2007, Ülo Ennuste was conferred the degree of Honorary Doctorate in the field of international economics by the International University Audentes. Since 2008, Ülo Ennuste has served as member of the Editorial Board of the Baltic Journal of European Studies [BJES, former Proceedings of the Institute for European Studies (IES Proceedings)]. His main fields of interest have been in the theory of economic systems and planning under incomplete information. His latest publications include: *'Dual market transition in Estonia 1987–2006: Institutional mechanism analysis approach,' Europe after historical enlargement, IES Proceedings, IUA, 2007, no. 3;* *'Synthetic Conceptions of Implementing Mechanisms Design for Public Socio-Economic Information Structure: Illustrative Estonian Examples,' IES Proceedings, IUA, 2008, no. 4,* and *'Estonian hyper-crisis lessons confirm importance of more effective high quality coordination/regulation and harmonisation: Mechanism design theoretic approach,' IES Proceedings, TUT, 2009, no. 6.*

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on Growth and Development, The World Bank, Working Paper no. 25, 2008 (with R. Lumiste and R. R. Pefferly).

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Euro Crisis, Old and New Trilemmas and Estonia's Position

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Abstract: *The euro crisis created a possibility for the violation, in one way or another, of the one basic condition of the European Union (EU) and the European Monetary Union (EMU)—that each Member State is responsible for the condition of its public debt. This has introduced the need to discuss the next possible steps of adjustment to this new policy request. The old macroeconomic trilemma states that no country can enjoy at the same time free capital flows, stable exchange rates and independent monetary policy and its impact on creation of the monetary policy of the EU is a starting point of the article. Then there is the EU impossibility trilemma, which means that the three general rules of the euro area—that every Member State is responsible for its public debt, there is no co-responsibility of other members of the euro area and the no-monetary financing rule—could not be applicable at the same time. This means that in developing a certain new set of institutions, which are targeting the change of basic general economic policy rules, the regularities of economic activities render only a certain combination of tools effective. The paper discusses the possible choices that are determined by applied arrangements, private and public agents' reactions to them and by the general conditions for policies applied on national and the EU level. The set of possible new regulations will determine the basic features of the EU in the future, though this process may have several possible outcomes. Estonia's position in this discussion and the impact of possible EU level outcomes on Estonia's economic policy is examined.*

Keywords: *EU institutions, Estonian economy, institutional economics*

1. Introduction

The euro is based on three general rules: each Member State is responsible for its public debt, there is no co-responsibility of other members of the euro area, and the no-monetary financing rule.¹ The global economic crisis boosted the public sector deficits on the level that financial markets refused to purchase state securities of countries like Greece, Ireland and Portugal.

In spring 2012, also Spain and Italy had to fight for credibility of credit markets, the state of this fight was reflected in the interest rates of government securities. The possible bankruptcy of these states raised the question of cost benefit analysis of outcomes of the full-level insolvency versus some type of involvement of the EU institutions and other Member States in providing temporary support to these states. The EU Treaty and other regulations do not foresee involvement. The participation of the EU institutions and other Member States in designing respective policy tools and providing funding for them at the same time further develops the EU integration. The theory of optimal currency area (OCA) developed by Mundell, and his well known trilemma, according to which no country can simultaneously enjoy free capital flows, stable exchange rates and independent monetary policy, has been used as a starting point of analysis.²

The paper discusses the choice, activated by the euro crisis, combining together the pairs of possible options which are interdependent but at same time not all applicable. The EU impossibility trilemma means that in developing a certain new set of institutions, which are targeting reinterpretation or change of these basic general economic policy rules, the regularities of economic activities render only a certain combination of tools efficient. The possible choices are determined by applied arrangements, private and public agents' reactions to them and by general conditions for policies applied on national and the EU level. The set of possible new regulations will determine the basic features of the EU in the future, though this process may have several possible outcomes. The final part of the article examines Estonia's position in this discussion and the impact of possible EU level outcomes on Estonia's economic policy.

¹ EU Treaty Articles 123, 125.

² The principles are described in Mundell, 1961; 1963.

2. Mundell–Fleming trilemma, OCA and the creation of euro

The meaning of Mundell's trilemma, according to which no country can simultaneously enjoy free capital flows, fixed exchange rates and independent monetary policy, is that if some state would try to apply these three conditions at the same time, the adjustment of economic agents would eliminate the impact of economic policy measures. If the country, for example, applies free capital flows, then to have independent monetary policy, the country should apply a flexible exchange rate. If there is an OCA, which in this context means that a member of the countries belonging to the OCA has a fixed exchange rate, it has no possibility for exchange rate adjustment. If the country still wants to have an independent economic policy, it should control inward and outward capital flows. If the country applies, as Estonia did quite soon after the introduction of the kroon, free capital flows and a fixed exchange rate, then the country does not have an independent monetary policy and its scope of activities should be limited only to fiscal policy.

In the EU, the vision of common currency was developed from the very beginning as some ultimate goal. The Werner Report was adopted in 1970 and laid out a step-by-step approach to monetary integration with the goal of monetary union in 1980. The members of the European Community (EC) would gradually increase coordination of their economic and fiscal policy, reduce exchange rate fluctuations and, finally, fix their currencies. Two oil shocks and the stagflation of the 1970s made this goal impossible. In 1979, the European Monetary System (EMS), to which all EC countries were members, and optional Exchange Rate Mechanism (ERM)³ were started. In the framework of Mundell's impossible trinity, the ERM members were looking for exchange rate stability and policy independence with capital controls. Monetary independence meant first of all the possibility for different inflation rates. The next target was to harmonise inflation, which meant to bring it down to the level of country with lowest inflation, which was Germany. The conflict between responsible monetary policy oriented countries such as Germany targeting low inflation and restrictive measures if necessary and more labour market and low unemployment oriented countries such as France made common policy very complicated. The liberalisation of capital markets reduced possibilities for independent monetary policy. The capital controls were formally banned in July 1990. The new

³ The ERM was the only meaningful part of the EMS and rested on four main elements: a grid of agreed-upon bilateral exchange rates, mutual support, a commitment to joint decision of realignments and the European Currency Unit (ECU); see Baldwin and Wyplosz, 2004, p. 314.

regime with still different inflation levels put pressure on fixed exchange rates on hold. The German reunification brought big extra budget expenditures and fast adjustment of prices and wages in Eastern Germany with an outburst of inflation. The Bundesbank responded to this with a sharp raising of the interest rate. Other ERM members followed the German policy, which was too tight for very many other ERM members. Several countries had to devalue their currencies after spending big amounts of foreign currency reserves on markets defending the exchange rate.

The main lesson of this experience was that although the inflation was successfully reduced among the ERM countries, which is a result of harmonised monetary policy (less independence), the differences between the countries were still big and speculative attacks on currency were possible. The free movement of capital was achieved and the result was that even the reserves of large countries were too small to protect the currency's exchange rate. Monetary integration with separate currencies was realised to be very risky and the monetary union was considered as one option (see also Baldwin & Wyplosz, 2004, pp. 317–322).

The Delors' single market programme framed further monetary integration. This programme was based on Lord Cockfield's 1985 White Paper, which listed 300 measures necessary to transform the common market into the single market. By summer 1987, all members had adopted the Single European Act and the Treaty entered into force. The creation of the European Monetary Union was envisioned to be achieved in ten years, by 1999. This was also planned as a gradual process in three stages towards closed economic cooperation among the EU members with binding constraints on the Member States' budgets and a single currency. The independent European Central Bank (ECB) was designed to be responsible for the EU level monetary policy with the stable price level being the main policy goal.

The OCA theory prescribes characteristics required for a geographic area to obtain maximum economic benefits from using the same currency.⁴ The conditions are also vicarious: for example, a flexible labour market would absorb risks related to differences in production. A critical issue is that the OCA should be similar enough to apply similar policy reactions to internal and external shocks. The different production patterns together with rigidities of the labour market were probably the most critical factors why the EU is not the OCA. There are also general fiscal transfers missing; nevertheless, the structural funds' transfers

⁴ The general requirements are related to the homogeneity of preferences, production diversification, trade openness, labour mobility, fiscal transfers and communality of destiny; see Baldwin and Wyplosz, 2004, pp. 329–356.

partly fulfilled this function. These circumstances support the critique of authors who underline that the emergence of problems evidenced a dozen years after the start of the euro in 1999 is not an accident or a result of bureaucratic mismanagement but the inevitable consequence of imposing a single currency on a very heterogeneous group of countries, a heterogeneity that includes not only economic structures but also fiscal traditions and social attitudes (Feldstein, 1997; 2011; 2012). Others, like De Grauwe (2003), believed that if all costs and benefits would be taken into account, the balance would be positive.

It could be quite realistic to assume that the EU monetary integration policy was not a result of detailed economic analysis and rigorous realisation of this plan but the outcome of political compromises and geopolitical developments like the German reunification in October 1990. This provided the political push for the Maastricht Treaty. That Treaty laid the legal foundation and detailed design for today's euro area. The political imperative for launching the euro by 1999 required that the political compromises rather than the theoretically unambiguous rules made up the framework for the euro.⁵

The EMU membership criteria were determined by the Maastricht Treaty and consisted of numerical reference values.⁶ However, these criteria were softened by the additional interpretations. Article 104c of the Maastricht Treaty stated that countries could exceed the 3 per cent target if “the ratio has declined substantially and continuously and reached the level that comes close to the reference value” or “excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value”. The 60 per cent target for public debt was softened by stating that the countries could exceed the limit if “the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace” (*The Maastricht Treaty*, 1992). Bergsten and Kirkegaard (2012) assume that one possible reason for this was that it was politically inconceivable to launch the euro without Italy, the third largest economy in

⁵ The OCA theory and the earlier Werner's and Delors' reports had been explicit about the requirements to complement a European monetary union with a European economic union with binding constraints on the member states' behaviour. Political realities in Europe, however, made this goal unattainable within the timeframe dictated by political leaders following the German unification (Bergsten & Kirkegaard, 2012).

⁶ The actual reference values to Article 104c of the Maastricht Treaty were in a protocol on the Excessive Deficit Procedure to the Treaty (*The Maastricht Treaty*, 1992). The reference values are 3% limit on general government annual deficit, 60% limit on general government gross debt limit, inflation should be within 1.5% of the three EU countries with lowest inflation, long-term interest rates should be within 2% of three lowest rates in the EU and the country should participate for two years in the ERMII +/- 2.25% band of fluctuation of the currency's exchange rate.

continental Europe, or Belgium, home of the European capital Brussels. Both countries had the debt level of more than 100 per cent of GDP. The fundamental outcome was that the membership of euro was not objectively determined by the fundamental economic strengths of the country, but by political considerations (Bergsten & Kirkegaard, 2012, pp. 3–4). That historical experience plays a role in the positions of participants, negotiating the new set of rules.

The Excessive Deficit Procedure (EDP) based on the Treaty was complemented in 1997 by the Stability and Growth Pact (SGP), which requires the Member States to produce stability or convergence programs (of euro-area Member States and to other Member States, respectively), and to aim at budget positions of close to balance or surplus in the medium term (Korkman, 2005). The SGP was intended to safeguard sound fiscal policy. However, after breaching the 3 per cent deficit limit in 2002–2004, France and Germany pushed through the new interpretation of the SGP rules in March 2005 so that the interpretation of the SGP started to be even more flexible and wholly political (EU, 2005). As Bergsten and Kirkegaard sum up,

the euro area by 2005 was, as a result of numerous shortcuts taken to achieve and sustain a political goal, a common currency area consisting of a very dissimilar set of countries without a central fiscal authority, without any credible enforcement of budget discipline and without any real deepening of economic convergence (Bergsten & Kirkegaard, 2012, p. 4).

The European policymakers' initial denial of problems and optimism was coupled with financial markets' failure to assess the risks related to different euro area countries and reflected by the convergence of state securities' interest rates to the level very close to the German interest rates. The result was that when the crisis hit in 2008–2009, the public and private debt overhang created due to a possibility to finance themselves at very low credits and those not related to economic fundamentals together with the weak EU institutions deepened the crisis even more. This was a starting point for the new challenges the euro area policy-making has to meet when first Greece and afterwards Ireland and Portugal lost access to financial market to finance their government debt.

3. Three general rules and the EU institutions

3.1. No co-responsibility for public debt

The no co-responsibility rule means that each Member State is responsible for its public debt and there is no co-responsibility of other members of the euro area. This principle is known as the “no bailout clause” and fixed in Article 125 of the EU Treaty.⁷ The aim of this Article was to declare very clearly from the beginning that the public debt belongs to the respective government and fiscal rules are to be followed. This was also targeting the moral hazardous attitude of governments and market agents. The market-based financing of public debt was foreseen. During the crisis, the unanswered question started to be what happens to the government if it loses access to market. Pisani-Ferry (2012) claims that there are at least three different possible interpretations of the treaty: (1) the country has to restructure its public debt (which could be interpreted as a default in one or another form), (2) the country has to turn to the IMF and be subject to standard procedures for conditional support or, if needed, insolvency, (3) despite the lack of an instrument, the other euro-area Member States would find a way to provide temporary conditional assistance (Pisani-Ferry, 2012, p. 5). As was mentioned above, the market did not differentiate between euro-area borrowers and did not take into account the possibility of default. The Greece, Ireland and Portugal cases forced to look for a clear solution to such problems.

3.2. No-monetary financing

The no-monetary financing condition is stated by Article 123 of the EU Treaty.⁸

The article prohibits direct purchases of the ECB but leaves open the option to

⁷ The Article says: “The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project”.

⁸ Article 123 states that “Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as “national central banks”) in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments”.

buy government bonds on the secondary market. That possibility was first used in buying Greek and Portuguese governments' securities in the framework of Security Markets Programme (SMP) launched first in May 2010. Later in August 2011, the securities of the governments of Italy and Spain were purchased. These purchases formally did not break the law but were indicative of broader monetary policy discussion, especially regarding the separation between the fiscal and monetary policy in the EU.

Pisani-Ferry comments the ECB's decision in the framework of mandate of the ESCB, stated by paragraph 5 of Article 127 of the EU Treaty.⁹ According to this comment, the reason given by the ECB for the launch of the SMP was not the preservation of financial stability, but rather the prevention of disruption to the proper transmission of monetary policy decisions.¹⁰ The ECB provided also liquidity to commercial banks initially through short-term debt instrument, but starting from December 2011 the credits up to three years with 1 per cent interest rate were provided. That created also additional source for government debt purchases by commercial banks. This step was also discussed from the point of view of the ECB mandate, what is the price stability.

3.3. Bank–government interdependence

The issue here is that while the euro area is monetarily integrated, banking system is still largely national. States are individually responsible for rescuing banks in their jurisdiction. The critical problem is that some banks—especially if they have more intensive cross-border activities—are very large in comparison with the GDP or tax revenues of a respective state.¹¹ Banks also purchased public debt. These purchases would not be a threat if the banks portfolios of

⁹ Paragraph 5 of Article 127 stipulates the mandate of the ECB to “contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system”.

¹⁰ Pisani-Ferry (2012) also argues that several central banks have been given an explicit financial stability mandate and as wholesale securities purchases by the central bank are seen by the market as implicit insurance to the government debt. Central banks generally maintain that they would not preserve the sovereign from funding crisis in case of unsustainable fiscal policy but that they would act to prevent self-fulfilling debt crisis. In comparison with the other central banks, the ECB is a very special type of central bank and is constrained in purchasing of state securities (Pisani-Ferry, 2012).

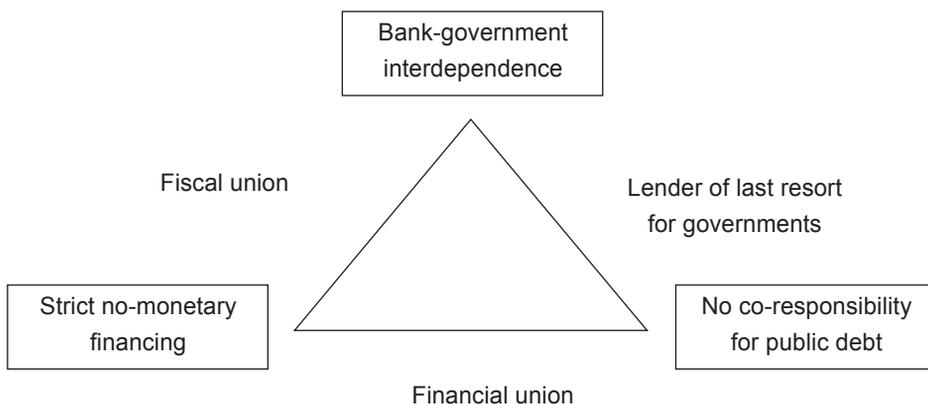
¹¹ For example, in Ireland, the total banks' assets amounted to 45 times the government tax revenues. Although Ireland had a very low government debt burden before the crisis in 2007 (around 25% of GDP), the banking crisis and the government decision to re-capitalise the banks with public money brought along a full public debt crisis and Ireland has to apply for a support package of the EU and IMF.

government securities were diversified. The problem is that there is still a strong home country bias in these purchases and a respective government having financial problems would be very critical for the banks of this country. In summer 2011, the domestic banks hold the following proportion of the total amount of securities issued by a respective country's government: Spain 28.3 per cent, Italy 27.3 per cent, Germany 22.9 per cent, Portugal 22.4 per cent, Greece 19.4 per cent. That proportion was much lower in Anglo-American countries: in the UK 10 per cent, the USA 2 per cent (Bruegel, cited in Pisani-Ferry, 2012, p. 8).

4. The new trilemma

The coexistence of these three interrelationships describes the basic choices that should be considered in building up a working set of the EU institutions. The components of the trilemma have been described below (see Fig. 1).

Figure 1. The components of the trilemma



Source: Bruegel (Cited from Pisani-Ferry, p. 8)

Pisani-Ferry argues that the impossible trinity renders the euro area fragile because adverse shocks to sovereign solvency tend to interact together with adverse shocks to bank solvency, and because the central bank is constrained in its ability to provide liquidity to the governments in order to avoid the self-fulfilling debt crisis (Pisani-Ferry, 2012, p. 9). In plain English this means that if the government has problems with financing budget deficit then that will become a problem for the commercial banks because part of their revenues

are dependent on interest rate payments and payment received for matured securities. If also the central bank were prohibited from providing liquidity to the system, the result would be the default of the government, but also massive bankruptcy of the banking sector.

The possible EU level solutions would mean the following composition of aggregates.

The fiscal union solution means that there is still no-monetary financing and bank-government interdependence, but the no co-responsibility for the public debt condition is excluded from the system. The fiscal union idea is related to a tighter common fiscal framework and a mutual guarantee of a part of the public debt. The possible eurobonds is one important step in this direction, but that would constitute a complicated trade-off between the influence on the EU level and the country level policy-making. Countries with good credit ratings (such as Germany) would lose economically through distribution of risks with the lower credibility countries. As compensation, they would like to get some control over the fiscal decisions of these lower credibility countries. The EU level response in this direction has been a set of legislative acts based on proposals by the European Commission and adopted by the European Parliament and the European Council on 16 November 2011 and which started to be effective from the beginning of 2012. The new regulations made possible preventive actions against budget deficits, set requirements for the national fiscal frameworks, introduced a 0.5 per cent of GDP limit for public deficit in structural terms and tightened the enforcement through a change in voting rules from consensus to the qualified majority rule.¹² A more substantial problem related to the fiscal union solution is that the EU has very limited tax base for common needs and politically it would be very complicated to adopt solutions which will widen this tax base.¹³

The financial union solution means that there is still no-monetary financing and no co-responsibility for public debt, but bank-government interdependence is

¹² The United Kingdom and the Czech Republic decided to stay out of this regulation which made it impossible for these countries to adopt it in the form of a treaty. It was adopted as an intergovernmental agreement.

¹³ “European institutions do not rest on the same degree of direct democratic legitimacy as the US federal government. Crucially, this makes the collection of direct taxes to fund a large centralized European budget (similar to the US federal budget) politically impossible. The relatively high willingness of Europeans to pay taxes does not “extend to Brussels”. The designers of the euro area were consequently compelled to create the common currency area without a sizable central fiscal authority that would have the ability to counter region-specific (asymmetric) economic shocks, or re-instill confidence through the deployment of large fiscal resources to private participants in the midst of a crisis” (Bergsten & Kirkegaard, 2012, p. 3).

excluded. The EU level financial mechanisms would use respective instruments to handle problems should they emerge. That solution would assume the EU level supervision and inspection of the European banks. Pisani-Ferry's argument is that such reforms amount to fundamental transformation of the mostly bank-based financial systems of the euro area, where the government bonds have been considered as an ultimate safe asset for respective country's banks. Diversification of the banks' portfolios of government securities would make the default of one government less vulnerable for the banking system (Pisani-Ferry, 2012, p. 11). The second aspect of this problem is related to the European-level rescue schemes solving in this way the mismatch between tax revenues of a respective country versus the state's potential responsibilities in the case of banking crisis. The proposal is to create the European-level fiscal capacity with assigning to the European Financial Stability Facility (EFSF) the responsibility for backstopping the national deposit insurance schemes and to create a permanent European Deposit Insurance Corporation financed by banks (Véron, 2011). The euro area levy taxes with the limit of 1 or 2 per cent of the GDP are proposed to finance this solution (Marzinotto, Sapir & Wolff, 2011).

The lender-of-last-resort solution for government means that there is still bank-government interdependence and no co-responsibility for public debt, but the ECB will be given the role of lender-of-last-resort for governments. This solution means that the ECB could lend to a government for a limited period at a rate that is above the risk-free interest rate but below the market interest rate or could provide the credit line to the public entity (for example the EFCF) (Gros & Mayer, 2011). This proposal has been intensively discussed and has been seen by several commentators as a single credible solution to the euro area crisis.¹⁴ The resistance of Germany to this solution has been crucial. This would be against the basic conditions, which framed the foundations of the ECB.¹⁵

¹⁴ Nouriel Roubini argues that "the ECB should not just stop rate hiking, it should cut rates to zero and make big purchases of government bonds to prevent Italy or Spain losing market access—the outcome of which would be a truly major crisis" (Roubini, 2011). Wolfgang Münchau states: "The ruling leaves the post-Stark ECB as the sole backstop that could prevent a break-up of the eurozone" (Münchau, 2011a; 2011b).

¹⁵ The US Federal Reserve is quite different in these terms. The commercial banks in the USA hold very little federal debt, the Reserve would be able to intervene to avoid the federal government losing access to markets and the federal government, not the state governments, is responsible for rescuing the banks. The Troubled Asset Relief Program (TARP) was passed in close cooperation of the US Treasury, Federal Reserve and the Federal Deposit Insurance Corporation and stabilised the situation after the critical period of September–October 2008 in March 2009 (Bergsten & Kirkegaard, 2012; Pisani-Ferry, 2012).

Another imminent problem is the moral hazard phenomenon closely connected to interrelationships between the additional funding available for markets reflected in prices of government securities and the willingness of governments to initiate necessary reforms. This has been also closely related to the bargain between the ECB and the euro-area governments about the responsibility of one or another participant in dealing with the crisis.¹⁶

5. Steps up to this day, interpretations and probable outcomes

5.1. A short overview of steps

The EU could provide assistance to the Member State in extreme circumstances. The European Council could then take a respective decision proposed by the European Commission (EU Treaty, Art. 122, § 2). During the economic crisis, which started in 2008–2009, several institutions were used and created to deal with the problems. The European Financial Stability Mechanism (EFSM) has the financial capacity of up to 60 billion euros, the loans are provided under the condition that the EU and the IMF are supporting the loan program. The EFSM funding comes from the EU budget and is targeting financial stabilisation. The EFSM has borrowed 22.5 billion euros to Ireland and 26 billion euros to Portugal at the end of 2011.

The Greece Loan Facility (GLF) was created in May 2010 with the total capacity of 110 billion euros, 80 billion euros being the EU support and 30 billion euros came from the IMF. The Facility covers financial resources paid out by Member States on the basis of bilateral agreements with Greece.

The European Financial Facility (EFSF) was founded in May 2010. It is a private agency which provides loans under economic policy programs, adopted by the respective borrowing countries. The EU governments guarantee the EFSF liabilities up to 780 billion euros and the Facility could provide loans up to 440 billion euros (EFSF, 2012). The EFSF emits long-term securities and finances governments from money borrowed from markets. The liabilities related to the first Greece package and supported by the GLF were transformed into the EFSF as a second loan package to Greece. Also credits to Ireland and Portugal are paid out from the EFSF.

¹⁶ Bergsten and Kirkegaard (2012) sum up the process on the example of the initial Greek crisis in May 2010: The ECB agreed to set up the Securities Market Program to purchase from secondary market the governments' securities and euro area governments produced the 440 billion euro EFSF in resources to deal with the crisis. This agreement produced strong commitments for structural reforms in Spain and other states.

The European Stability Mechanism (ESM) was founded in October 2010 and is a permanent mechanism which will start to operate in the middle of 2012 and will take over liabilities of the EFSF. The Member States have to purchase their share in five years and the total amount of the capital of the ESM will be 80 billion euros. The ESM total loan capacity will be 500 billion euros. The resources would be purchased from financial markets for emitted securities.

The ECB founded the Security Markets Programme (SMP) in May 2010 and started to purchase from secondary market first the Greece and Portugal governments' securities and later in August 2011 also the securities of the governments of Italy and Spain. In December 2011 and late February of 2012, the ECB provided in the framework of Longer-Term Refinancing Operation (LTRO) 1.2 trillion euros as three year loans to commercial banks. The funding was widely used by banks to purchase domestic government securities and was called "backdoor quantitative easing". There is a threat that due to this program pressures on governments for fiscal and structural reforms and for banks to restructure their balance sheets has lessened (Milne, 2012).¹⁷ Euro-area inflation stayed at 2.6 per cent in February and March 2012, well above the 2.0 per cent target level.

In November 2011, a set of five regulations and one directive ("Six Pack") was proposed by the European Commission and adopted by the European Parliament (EC, 2012).

The new legislation became effective as of 1 January 2012. The new legislation introduced preventive actions about fiscal deficits, set minimum requirements for national fiscal frameworks, toughened sanctions against countries in excessive deficit and tightened enforcement by a change in the voting procedure. Other important changes in regulation were the following: adopted newer rules on balanced budgets in structural terms, based national budgets on independent forecasts and for countries in excessive deficit procedure, and allowed examination of draft budgets by the European Commission before they are adopted by the parliaments. Afterwards, the European Commission proposed

¹⁷ "While banks have used the money for a variety of purposes including refinancing their debt, they have also clearly stocked up on state paper. Spanish banks, for example, increased their holdings of Madrid's state bonds by 29 per cent in December 2011 and January 2012 to reach 230 billion euros, Italian banks boosted their domestic purchases by 13 per cent over the same period to 280 billion euros [...] Under the so-called carry trade, banks get the money at 1 per cent from the ECB and invest in higher-yielding securities. Two-year yields for Italy have fallen from 4.6 per cent to 2.5 per cent and for Spain from 3.4 per cent to 2.5 per cent so far this year [the end of March 2012]" (Milne, 2012).

a new legislation that requires the Member States to give the Commission the right to assess and request revisions to draft national budgets before they are adopted by the parliament. In December 2011, the EU heads of states committed themselves to introduction of fiscal rules, stipulating that the general government deficit must not exceed 0.5 per cent of the GDP in structural terms, that the new treaty would allow automatic sanctions for countries whose budget deficits are over 3 per cent of the GDP limit. Sanctions are recommended by the European Commission and will be adopted unless a qualified majority of euro-area Member States is opposed (Pisani-Ferry, 2012, p. 2).

The Treaty on Stability, Coordination and Governance (TSCG) is an agreement of the heads of states on Euro Summit from 9 December 2011 and will be adopted if all national parliaments will ratify the agreement (the United Kingdom and the Czech Republic are left out). The European Stability Mechanism (ESM) Treaty was agreed on same summit and will be also adopted when the euro-area parliaments will ratify the treaty (EC, 2011).

5.2. Interpretations

The interpretation could be separated to short- and long-term parts. In short term, the governance structures have been improved by very fast actions dictated by developments on financial markets, rapidly changing negotiation conditions and political events in particular countries. Pisani-Ferry, Sapir and Wolff (2012) examine in their recent paper how the new regulations (six-pack and two-pack regulations and two agreements) have made the decision-making much more complex. Also they underline that the gap between the euro area and non-euro area would widen while all these new regulations would be adopted. Their examples are the following:

- 1) The Stability and Growth Pact (SGP) in principle applies to all 27 EU members. However, sanctions are foreseen only for euro-area members. Only euro-area members can vote on Excessive Deficit Procedures' (EDP's) steps that involve only euro-area members;
- 2) Most of the so-called Six-Pack Reforms are based on the Lisbon Treaty and make a clear distinction between the euro area and non-euro area. In particular, Regulation 1176/2011 on the prevention and correction of macroeconomic imbalances applies to the whole EU but the alert mechanism, which is part of the regulation, is, in accordance with the paragraph 3 of Article 121 of the new TFEU, discussed in the euro group for the euro-area countries. Also the so-called Scoreboard, which forms the basis of the alert mechanism, distinguishes between euro area and non-euro area, etc.;

- 3) The Treaty on Stability, Coordination and Governance (TSCG) has two main elements: the so-called Fiscal Compact, which requires the main elements of the SGP to be transposed into national legislation at a constitutional or equivalent level and establishes the regular Euro Summits. The new treaty renders the tension between the national sovereignty and the logic of supra-national intervention clearly visible. Overall they conclude that the EU can be characterised by an increasing legal, institutional and policy divide between the euro area and non-euro area, increasing variable geometry blurring the euro area and non-euro area distinction, high complexity and lack of clarity and increasing tensions between the demands of national sovereignty and euro-area sovereignty.

5.3. Probable outcomes

The financial crisis has forced the EU institutions to apply emergency measures, which have been limited by the existing legal framework; also, the loopholes and borders of several regulations have been examined. Parallel to this the new regulatory instruments have been developed. These new instruments have been worked out sometimes ad hoc, very often as compromises following severe political discussion and under immense pressure of financial markets. At the same time these instruments reflect on a very basic level threats and expectations of different governments participating in this process.

In terms of the trilemma discussed above, the solutions target fiscal union and financial union type of the EU. In short-term, however, the crisis management issues are on the table and the outcomes depend heavily on domestic debates and cost-benefit analysis from the donors' side, in terms of how much additional resources would be needed, and from the receivers' side, in terms of how many reforms they are ready to apply and how much loss of national sovereignty is acceptable for the public.

Pisani-Ferry, Sapir and Wolff (2012) designed three scenarios: (1) A two-speed EU, with a coherent euro area; (2) A fragmented EU, with fragmentation even within the euro area; (3) A generalised variable geometry even within the euro area. Only the first scenario develops the EU integration further, leaving out the non-euro members of the EU. This scenario would apply that the euro area evolves from a monetary union with some fiscal rules to a full-fledged monetary union with a fiscal and banking union. It would have a strong, democratic political centre able to impose on national budgetary decisions, a federal budget with direct access to tax resources providing some degree of stabilisation to the national entities and a public debt management capacity. It would also have

a banking supervisor, a banking deposit insurance mechanism and a banking resolution agency. It will also apply that the euro area becomes de facto a political union. That would provide a smaller EU (Marzinotto, Sapir & Wolff, 2011). This means, first of all, financial union type of integration and is, of course, a possible long-term development. Other two scenarios would bring along in one form or another the marginalisation of the EU as a whole and respective policy agendas will be taken over by the leadership of large Member States, probably becoming the local centres for its satellites.

6. Estonia's position

Estonia is a small open economy and influenced by external developments. Estonia's pre-crisis boom was a source of great concern at consolidation steps and afterwards brought along deep economic decline and large-scale unemployment. The consolidation measures, however, were in line with the respective EU policy targets, first of all fixed in the SGP. Estonia's GDP growth was 7.6 per cent in 2011 and is expected to be 1.7 per cent in 2012 after a 17.5 per cent decline during 2008–2009. The unemployment rate increased from 5.7 per cent in 2008 to 14.4 per cent in 2009 and to 17.6 per cent in 2010 and amend down to 12.9 per cent in 2011. The budget deficit is expected to be 2.6 per cent in 2012.

Estonia's general position regarding the EU declares that Estonia is interested in the strong EU which is open and developing, Estonia is interested in bringing a new area under competence of the EU and in deepening the already existing EU competences. Estonia is interested in strengthening the euro area, the common financial market and competitiveness of the EU.

Economic and financial policy of the EU should be sustainable and the Member States should fulfil the requirement of the SGP (*Estonia's European Union Policy 2011–2015*, 2011). Estonia ratified the EFSF agreement in the parliament without painful political discussion, although the Minister of Finance Jürgen Ligi had to answer questions regarding Estonia's liabilities in the case of realisation of the worst scenarios. Estonia does not participate in the Greece Loan Facility because Estonia joined the EMU only at the beginning of 2011.

Estonia is looking forward to that the budgetary rule introduced by fiscal compact will support the achievement of EU priorities. Estonia is preparing the ratification of the ESM and the fiscal treaty (submission to Parliament in May

2012 as well as the introduction of the fiscal rule in budget framework law (Ligi, 2012).¹⁸

The EU Estonia's officials have been quite cautious in expressing political positions regarding Estonia's priorities regarding one or another potential development pattern of the EU. In an interview to the *Riigikogu Toimetised* (in English *The Journal of Estonian Parliament*), Ligi was very critical regarding the possibility that the EU would purchase government securities and abolished Estonia's support to the EU based lender-of-last-resort for governments. The strict no co-responsibility for public debt and restrictive measures for the Member States who cannot finance their public debt and are not able to balance their budgets, is also a position of current Estonia's government. Regarding the possibility of a fiscal union, the position is that the political steps in deepening cooperation in fiscal matters are welcomed, but the closer future fiscal integration is a long-run issue. If the possibility of fiscal union is discussed, then the position has been that the EU tax system is uncompetitive and Estonia is interested in sustaining its tax system, which is very strongly biased toward indirect taxes, there is a proportional income tax and retained corporate profits are taxed with zero per cent corporate income tax. At the same time, Estonia is interested in harmonisation of rules for value-added tax and excise tax (elimination of exceptions) and some kind of harmonised tax base for corporate income tax, operating on the EU market (Tupits, Bahovski & Ligi, 2011). Estonia, Sweden, Finland and Luxembourg were at the end of 2011 the only members of the EU to which the European Commission had not started the Excessive Deficit Procedure.

7. Conclusions

The trilemmas examined in the article mainly describe parameters related to fiscal and monetary policy and their impact on framing the future of the EU. The short-term financial crisis targeting measures and long-term design of the EU is overlapped and complicates the picture. It could be assumed that if adopted by the national parliaments, especially decisions taken by heads of governments on 9 December 2011 would develop the fiscal integration of the EU. At the same time, several authors (the Bruegel scenarios) emphasise that the new regulations increase the gap between the euro area and non-euro area members. The

¹⁸ In the last week of April 2012, Estonia's Chancellor of Justice raised the question about the conformity of the ESM to the Estonia's Constitution. The Supreme Court of the Republic of Estonia is supposed to discuss the issue during the spring of 2012.

outcomes depend heavily on domestic debates and cost-benefit analysis from the donors' side, in terms of how many additional resources would be needed, and from the receivers' side, in terms of how many reforms they are ready to apply and how much loss of national sovereignty is acceptable for the public. The development toward fiscal and financial union could be considered possible, but at the same time the number of states which would be ready for deeper integration is open. The regulatory framework between the groups of countries with different level of integration is a big question mark. The discussion did not cover directly structural reforms, which are crucial for long-term sustainability of the euro area, and the EU. Estonia's position demonstrated the attitude of an EU and EMU member who has been rigorously fulfilling the SGP requirements. Supporting integration in the name of a deeper and wider common EU market, the country is interested in some harmonisation of the fiscal area but is eager to sustain some specific features of its tax system.

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How Expensive Is It to Support Renewable Energy in Estonia?

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Abstract: *Climate change is forcing countries to seek new solutions for the energy sector instead of using fossil fuels. Among the solutions are the production of energy from renewable sources, the rising efficiency of existing technologies and energy consuming devices and buildings. The European Union and its members play an active role in the process of climate protection. The European Commission and European Parliament have started several legal initiatives. The goal is to have 20 per cent of energy from renewable sources by the year 2020. A change in national legislation and the rising energy prices channelled substantial investments into renewable energy sector in European Union and globally in the mid-2000s. Both public and private sources funded intensively renewable energy firms and research projects.*

Various legal initiatives and especially implementation of feed-in tariffs have had a big impact on the sector. Feed-in tariff is money that is paid for the production of energy from renewable sources. The money comes from all electricity users via raised electricity price. Very generous tariffs created big returns in the initial period. The big growth attracted a second wave of investors but at the same time caused caution of authorities. In several cases feed-in tariffs were reduced and in some cases even cancelled.

Similar changes took place in the Estonia's energy policy. Oil-shale based power station has been the cornerstone of Estonian energy for a long time. Approximately 90 per cent of electricity is still produced from oil shale (2011). With the adoption of different incentives the use of renewable energy has started to grow. The legislative goal of producing 25 per cent of energy from renewable sources will be definitely met by the year 2020. However, several issues related to the energy sector such as participation in pan-Baltic nuclear plant, the

future of energetics and economy in general remain. Boom tendencies and a high interest of investors has been also evident in the Estonian energy sector during the last five years. According to the analysts of the Competition Board of Estonia some investors received even 40 per cent of yearly return from invested capital.

Keywords: *energy policy, Estonia, feed-in tariff, renewable energy*

1. Introduction

The United Nations Framework Convention for Climate Change, adopted on 11 December 1997 in Kyoto, gave a big push for the adoption of renewable energy technologies. A decade after the adoption of the treaty, a large number of states have signed the protocol. European Union members and then future members signed the protocol mostly in 1998 and ratified in national parliaments in 2002. Estonia signed the Kyoto Protocol on 3 December 1998 and the Parliament ratified it on 14 October 2002. One of the main obligations of the protocol was the reduction of the emission of greenhouse gases. The main methods to reduce greenhouse gases emissions are to modernize existing energy generation, raise energy efficiency of buildings and adapt new renewable energy production methods.

Big goals for the renewable energy are definitely beneficial for the environmental protection but at the same time they guide several economic and social problems. The main problem is that energy generated from renewable sources is now more expensive than energy produced from fossil fuels. The gap between higher production cost and lower sales price is compensated from the pocket of other energy consumers.

Compensation of renewable energy has not yet been a subject of major parliamentary disputes in Estonia (April 2012). However, several parliament members, cabinet members and former parliament members have expressed their cautious opinion towards the existing support schemes.

Scepticism towards the high level of support could be justified. One particular sector of economy has become dependent on public subsidies that are in conflict with market economy and free competition. Deutsche Bank's Climate Change Advisors even noted that the share prices of publicly listed companies (renewable energy sector) depend mainly on government support policies and sector consolidation in 2012 (Deutsche Bank, 2012).

As an example, generous tariffs for photovoltaic panels in the United Kingdom caused a boom of new instalments and thereafter pressure on electricity price. The government was forced to cut subsidies, which in turn brought along court appeals and frustration of investors.

The current article analyzes the adoption of renewable energy support mechanism and especially feed-in tariffs in Estonia. Examples for comparison are taken from Germany and the United Kingdom. The article analyzes the factors related to the adoption of feed-in tariffs in Estonia. Among the factors of interest there are the participation of different interest groups in renewable energy, impact to the electricity price and the growth of renewable energy related technology sector.

2. Current level of support

There are a number of ways to deal with climate change in terms of policy. The Deutsche Bank Group Climate Change Advisors listed 414 binding and accountable climate policies in their database. During 2011, the Deutsche Bank specialists tracked an overall total of 55 policies: 2 emission targets, 10 mandates and 43 supporting policies (such as feed-in tariffs, direct public funding and tax incentives). Included in this count were 49 positive,¹ 2 neutral, and 4 negative policy announcements in 2011 (Deutsche Bank, 2011).

The support mechanisms for renewable energy are given in Table 1. We will not discuss indirect support mechanisms and voluntary schemes. Regulatory direct schemes could be divided into two categories: investment-focused (fixed cost) and generation-based (both fixed and variable cost).

The main support mechanism for renewable energy is feed-in tariff (FIT). Feed-in tariff means a guaranteed price for electricity generation. The principle of the adoption of feed-in tariffs is clear: they must compensate the higher cost of generation of energy from renewable resources. However, several side questions appear in this process: how fast should investments into renewable energy be compensated, what is a socially acceptable level of support for renewables, and how does FIT benefit technological innovations and others?

The quick adoption of support mechanisms, the global economic crisis, and even the price volatility of silicon wafers, which are a major input for solar panels, made the finding of consensus difficult and sometimes even unpredictable.

¹ Positive for the generation of renewable energy.

The common expectations that legislation and tariffs would remain relatively stable for a certain period of time were not realized in this case. Caused by the above-listed factors, clauses allowing a fast change of legislation and adjustment (lowering) of tariffs were written into the legislation. In some cases the authorities have stated that there could be a need for a quick change of policies. (HM Treasury, 2011)

Table 1. Fundamental types of promotional strategies of renewable energy generation

		Direct		Indirect
		Price-driven	Quantity-driven (quotas)	
Regulatory (obligated)	Investment-focussed	<ul style="list-style-type: none"> • Investment subsidies • Tax credits 	<ul style="list-style-type: none"> • Tendering system 	<ul style="list-style-type: none"> • Environmental taxes
	Generation-based	<ul style="list-style-type: none"> • (Fixed) Feed-in tariffs • Fixed Premium system 	<ul style="list-style-type: none"> • Tendering system • Tradable Green Certificate system 	
Voluntary	Investment-focussed	<ul style="list-style-type: none"> • Shareholder Programs • Contribution Programs 		<ul style="list-style-type: none"> • Voluntary agreements
	Generation-based	<ul style="list-style-type: none"> • Green tariffs 		

Source: EWEA, 2005

3. The history of FIT and FIT levels

Paying feed-in tariff was first adopted in German Renewable Energy Law (EEG) in 1991. Since that time several countries, the Canadian province of Ontario, the States of California, Florida, Hawaii, Vermont and Maine in the USA, and various territorial units have adopted feed-in tariff (*Climatepedia*, 2011).

It is difficult to describe energy policies behind the different legislative acts but there are some universal principles that are followed by several countries. The European Union's energy portal (*Europe's Energy Portal*, 2012) gives an overview of energy prices, feed-in tariffs and other energy-related indicators, but the data are to a large extent outdated and seriously incomplete. Fragmented data of the UK's feed-in tariffs and Germany's feed-in tariffs is provided in Appendixes 1 and 2 (see pp.40–41).

The primary principle of feed-in tariffs is that they must promote the adoption of new renewable energy installations. There is a first mover advantage that benefits companies who invested first with higher tariff level. When the technology picks up and several installations are built, the tariff level is lowered (Kreycik *et al.*, 2011). Different countries have their own lowering formulas and sometimes it seems that budgetary constraints force for the lowering of tariffs. Legislation determines the period when installation could receive support.

The second principle is that legal acts first take into account particular technology such as wind, solar, tidal, and other types of energy. Technologies that are given higher priority in national agenda receive higher support. The third principle is that the laws differentiate between support given according to the size of installation. Smaller installations receive a higher level of support and bigger installations a lower level.

In the UK, a distinction is made between buildings, such as the new and old (retrofit) buildings, on which solar panels are installed (UK Energy Act) and the payments depend on the energy efficiency of the building on which solar panels are mounted.

Different tariffs could also depend on the social dimension and the purpose of the building. For example, in France, solar panels installed on hospitals, schools, and buildings of architectural value receive higher tariffs.

The number of solar installations owned by a single legal entity (institution) has had an impact on the photovoltaic panels in the United Kingdom.

Stand-alone installations could form a different category for tariffs. Germany's tariffs system makes a distinction between land plots on which photovoltaic panels are established. The purpose of the distinction is to protect agricultural land and to promote the installation of the panels in industrial locations and next to motorways (Baker & McKenzie, 2011).

Countries like France could differentiate the tariffs according to more favourable and less favourable regions, depending on the intensity of solar radiation.

In general, the reduction of tariffs is accompanied with the establishing of additional clauses.

4. Feed-in tariff in Estonia

The Electricity Market Act was adopted by the Estonian Parliament on 11 February 2003. In 2008, a specific numerical values of tariffs were added to the legislation. Since that time the basic tariffs have been set on **0.0537** euros per kWh when the energy is produced from renewable sources and on **0.032** euros per kWh when efficient combined heat and power (CHP) production was used. Since 2008 several amendments to the Act have been made. The Ministry of Economic Affairs and Communications have launched initiatives to link the support for renewable energy with current electricity price (E24, 2012).

Estonia's Electricity Market Act has less differentiation of feed-in tariffs than German Energy Law (EEG) or the United Kingdom's Energy Act. There are approximately 50 different tariff numbers in EEG, around 20 in the United Kingdom's Energy Act and 5 in Estonia's Electricity Market Act. German Energy Law differs in generation methods such as hydropower; landfill gas, sewage gas, and mine gas; biomass, geothermal, onshore wind, offshore wind, and solar radiation.

The UK's Energy Act confines the payment of feed-in tariff support to hydropower, solar radiation, and wind energy. In 2011, the Renewable Heat Incentive promoting was initiated.

In the period from 2010 to 2011, the biggest receivers of feed-in tariff were biomass burning companies with up to 70 per cent of the total sun and wind energy parks with up to 20 per cent in Estonia. Different law provisions and lower-level legal acts deal mainly with CHP plants. There also are provisions for peat and oil shale.

Currently (on 15 March 2012), there is a Bill on Amendments to the Electricity Market Act in the works in Parliament (Estonian Parliament, 2012). Amendments proposed by the Ministry of Economic Affairs and Communication link feed-in tariff payments to electricity price in the Nordic Electricity Stock Exchange. According to the Ministry's proposals, current feed-in tariffs are unnecessary from the economic point of view and in contradiction with the interests of consumers. According to the Ministry's explanations, the Republic of Estonia can achieve year 2020 goals with smaller payment of feed-in tariffs.

The proposal of the Ministry is to pay for the energy produced from renewable sources (except hydro) in devices smaller than 10 MW the price difference between 0.086 euro ct/kWh and the average price in electricity stock exchange. Different lower category tariffs are proposed for other categories.

Several upper limits for payments have been proposed. Keit Pentus, Minister of the Environment, has expressed opposition to the provisions to the Bill of Amendments to the Energy Act (*Delfi*, 2012).

5. Community participation

In Germany and Denmark, communities, citizens and private individuals actively participate in renewable energy. Farmers who themselves possess biomass and land resources form an especially active group.

For the Estonian Ministry of Economic Affairs and Communication, the main economic goal has been keeping the energy price low. This price-lowering strategy tends to favour bigger enterprises. There is also no category like citizens (or individuals) in Estonia's Electricity Market Act.

During the period from 2010 to 2011, four biggest recipients with their subsidiaries and technology partners received 94 per cent of the total renewable energy support. Those five recipients are: the state grid Estonian Energy Ltd.; Finnish Fortum Oy subsidiaries; Energy of Four who is a combination of Norwegian Power company with financial institutions, management and local investors; and the Tallinn Power Plant which had MBO from Veolia Environment. The 44 remaining firms distributed the remaining 6 per cent of support money. Among those 44 smaller firms, 11 had reference to hydro-energy in their names.

Compared to Germany and Denmark, farmers are an especially neglected community. This problem is related to the general problems of agriculture and rural communities in Estonia. Agricultural enterprises and farming communities lack capital to invest into renewable energy. Taking into account geographical conditions, the number of livestock and other factors it is clear that the participation of agricultural firms in the adoption of renewable energy is invisible or nearly non-existent. Among the receivers of feed-in tariff only one firm had a distinctive name referring to agriculture: Valjala Seakasvatuse OÜ ('Valjala Pig Farm' in Estonian). For example, on the list of biogas installation firms in the Federal land Mecklenburg-Vorpommern in Germany there are several common names like: *Rinderzucht ... KG*, *Agrarprodukte GmbH...*, *Schweinemastanlage...e.G.*, *Landwirtschaftliche Milcherzeuger Genossenschaft e.G.2* (MV-Statistik).

² *Rinderzucht ... KG* – Cattle ... Kommanditfirm, *Agrarprodukte GmbH* – Agroproduct Ltd., *Schweinemastanlage ...e.G.* – Cooperative Pig Fattening ..., *Landwirtschaftliche Milcherzeuger Genossenschaft e.G.* – Cooperative dairy producers (translations from German).

6. Impact to the electricity price

With the adoption of renewable energy there are expectations that medium-term difficulties such as the electricity price rise will be compensated with long-term benefits such as cleaner environment and energy security. In addition, there are expectations that with economies of scale production of energy devices come cheaper and technology improvements make the generation of kW competitive.

Every electricity consumer supports the adoption of renewable energy via electricity bill: the historical price rises in Germany and in Estonia are given in Tables 2 and 3. The sensitivity of consumers to electricity price rises depends on consumer spending structure, VAT level, environmental awareness, and several other factors.

Table 2. Increase (surcharge) in electricity price caused by the support for renewable energy in Germany

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013p	2020p
EEG-Umlage [ct/kWh]	0.41	0.58	0.68	0.88	1.02	1.12	1.13	2.047	3.530	3.592	3.66-4.74	Around 5

Source: BMU, 2009; EEG/KWK-G, 2012; German Energy Blog, Saarbrücker Zeitung, 2011

Approximately 13 billion euros were paid to the energy companies for production of electricity from renewable sources in Germany in 2011.

Table 3. Increase in electricity price caused by the support for renewable energy in Estonia

	2007	2008	2009	2010	2011	2012	2013 p	2014p	2015p	2020p
ct/kWh	0.139	0.194	0.387	0.81	0.61	0.97	1.12	1.28	1.38	1.67

Source: Elering Ltd.; Estonian Competition Authority, 2010

Estonian power transmission company Elering Ltd. paid energy producers 16.8 million euros in 2009; 42 million euros in 2010 and 57 million euros in 2011. (Elering Ltd.)

7. Pro and contra arguments for the support of renewable energy

Contra arguments

There have been different arguments by several groups arguing against the wide promotion of renewable energies by public support. The first of these is the denial of climate warming effects at all. Renewable energy is raising energy prices because renewable energy is more expensive to generate than energy from fossil fuels.

The main argument against the support of renewable energy projects is that subsidies unproportionally benefit the well-off people in society. People who can afford to buy a house are also receiving subsidies for electricity generation. Money is taken from other (underprivileged) people and given to the rich (Price, 2012).

It is not a real Schumpeterian innovation. According to Schumpeterian innovation process, there is supposed to exist creative destruction and new entrants bring new technologies and products to the market. It is difficult to imagine that big investments from the existing oil and energy companies take technological risks and change the principles of the game. The existing energy giants rather use their dominative market power and create barriers for new entrants. Opponents argue that support is more an administered process scheme that creates bubbles and misuse of public funds. The main object of criticism is the US President Obama's renewable energy initiatives as a result of which some companies have gone bankrupt with a major budget loss. Active critics are also the Republican Party members before the 2012 presidential elections.

Tariffs create dependents who could not survive without public support. The rapid cutting of tariffs could bring along job cuts and court appeals. Currently (in March 2012) there is a court appeal against the UK Government for the cutting of solar tariff (BBC, 2012). Until now, some consumer protection groups, budget officials and analysts from oil exporting countries have shown opposition to renewable energy tariffs.

Pro arguments

There are several arguments which favour the spending of renewable energy. The first is, of course, fulfilling international obligations and compliance with the Kyoto protocol.

Renewable energy is lowering electricity price in medium and long term (Raukas & Siitam, 2011).

When well-managed, the tariffs could boost technological development, create local jobs and benefit citizens, farmers, communities, and several social groups. On the state level, there is increased energy security and technological security vis-à-vis nuclear energy.

Among the big proponents of renewable energy there are part of the NGO sector, Green parties and other environmental groups.

8. Conclusions

The adoption of feed-in tariffs is a big step forward towards the protection of climate change. Feed-in tariff is the most common way to accelerate investments into renewable energy sector. Germany is a frontrunner in the adoption of feed-in tariffs and also a pioneer in developing several technologies and adopting of renewable energy in its own territory. This process gives Germany a strong competitive advantage and huge sums of tariff money circle inside the own state. Other countries in Europe have followed the German example and adopted feed-in tariffs. In some cases this has caused unexpected payment levels for the electricity consumers.

Estonia adopted feed-in tariff in 2008. Since that period big investments into wind parks and CHP plants have been made. The main goal for the state (the Ministry of Economic Affairs and Communication) has been cutting the electricity price raise through economies of scale. Renewable energy is a tool for increasing energy security in Estonia.

Tariffs are an object of political will and negotiations and therefore there is a need for political consensus. Wider participation of communities in this process could raise public acceptance. A holistic view to the community development requires closer interaction with other sectors of economy. Special schemes benefiting small wind, solar energy, fermented bio-waste and other technologies could be an option.

Links between feed-in tariff and creation of new jobs are indirect. During the last years there has been definite growth of employment in the production of wind installations and photovoltaic devices in Estonia. However, the operations of these enterprises are mostly globally oriented rather than oriented to the local market.

Despite the influence of European Legislation (2001/77/EC and 2009/28/EC) on the local legal acts, countries have their own different agenda in mind.

German electricity consumers pay a high price but most of the installations are locally made and support local employment and the competitiveness of export companies. For the UK's legislators, fair business conditions and consumers' welfare are major goals. For the Estonian legislators, the major objective is to fulfil the legal EU requirements at optimal electricity price level.

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Appendix 1. Feed-in tariffs in the United Kingdom (several provisions are excluded)

Feed-in Tariffs - FITs Table of rates	Scale	Feed-in Tariff pence/kWh	Feed-in Tariff pence/kWh from 1 August 2011	Feed-in Tariff pence/kWh from 12 Dec 2011	Tariff lifetime in years
Anaerobic digestion	<250kW	11.5	14	14	20
Anaerobic digestion	<500 kW	9.0	13	13	20
Anaerobic digestion	>500 kW	9.0	9.4	9.4	20
Hydro electric	<15 kW	19.9	19.9	19.9	20
Hydro electric	<100 kW	17.8	17.8	17.8	20
Hydro electric	<2 MW	11.0	11.0	11.0	20
Hydro electric	>2 MW	4.5	4.5	4.5	20
Photovoltaic	<10 kW	37.8	37.8	21	25
Photovoltaic	10-100 kW	31.4			25
Photovoltaic	>100 kW	29.3			25
Photovoltaic	<4 kW		43.3	21	25
Photovoltaic	4-10 kW		37.8	16.8	25
Photovoltaic	10-50 kW		32.9	15.2	25
Photovoltaic	50-150 kW		19	12.9	25
Photovoltaic	150-250 kW		15	12.9	25
Photovoltaic	250-5000 kW		8.5	8.5	25
Wind	<1.5 kW	36.2	36.2	36.2	20
Wind	<15 kW	28	28	28	20
Wind	<100 kW	25.3	25.3	25.3	20
Wind	<500 kW	19.7	19.7	19.7	20
Wind	<1.5 MW	9.9	9.9	9.9	20
Wind	>5 MW	4.7	4.7	4.7	20

Renewable Heat Initiative (RHI) table of tariffs – Phase One for non-domestic sectors

RHI non-domestic	Scale	RHI tariffs pence/kWh	Tariff lifetime in years
Ground source heat pumps	up to 100 kW	4.5	20
Ground source heat pumps	over 100 kW	3.2	20
Solar thermal	up to 200 kW	8.5	20
Solid biomass	up to 200 kW	7.9	20
Solid biomass	200-1,000 kW	4.9	20
Solid biomass	over 1,000 kW	1.0	20
Biomethane	All scales	6.8	20

Note: RHI rates published by Ofgem, June 2011—the rates change with inflation each year.

Appendix 2. Feed-in tariffs in Germany February 2012 (several provisions are excluded)

Hydropower (§ 23 EEG)	ct/kWh
<i>General rates (according to share of capacity)</i>	
share of capacity	
Up to 500 kW	12.70
Up to 2 MW	8.80
<i>Facilities of up to 5 MW (new build, extension)</i>	
share of capacity	
Up to 500 kW	12.70
Up to 2 MW	10.31
Up to 5 MW	8.47
<i>Yearly degression for hydropower plants</i>	
Rate	1.0%

Landfill gas, sewage gas and mine gas	ct/kWh
Landfill gas (§ 24 EEG)	
<i>Share of capacity</i>	
Up to 500 kW	8.60
Up to 5 MW	5.89
Sewage gas (§ 25 EEG)	
<i>Share of capacity</i>	
Up to 500 kW	6.79
Up to 5 MW	5.89
Mine gas (§ 26 EEG)	
<i>Share of capacity</i>	
Up to 1 MW	6.84
Up to 5 MW	4.93
Over 5 MW	3.98
<i>Bonuses for landfill and sewage gas</i>	
maximum rated output 700Nm ³ /hour	3.0
maximum rated output 1,000Nm ³ /hour	2.0
maximum rated output 1,400Nm ³ /hour	1.0

Biomass (§ 27 EEG)	ct/kWh
<i>Basic tariff</i>	
<i>Share of capacity</i>	
Up to 150 kW	14.30
Up to 500 kW	12.30
Up to 5 MW	11.00
Up to 20 MW	6.00
Tariff biowaste installations and small manure gas	
Biowaste fermentation up to 500 kW _{el}	16.00
Biowaste fermentation up to 500 kW _{el} to 20 MW _{el}	14.00
Manure biogas up to 75 kW _{el}	25.00

Geothermal (§ 28 EEG)	ct/kWh
<i>Basic fees</i>	
<i>Share of capacity</i>	
Basic tariff	25.00
Increase due to utilisation of petrothermal technology	5.00
<i>Bonus</i>	
For facilities with petrothermal technology	5.00

Onshore wind (§§ 29, 30 EEG)	ct/kWh
<i>Basic fees</i>	
Initial fee (first 5 years from start of operation; plus extension formula time*)	8.93
Base fee	4.87
Small-scale up to 50 kW	8.93
<i>Bonuses:</i>	
System service bonus	0.48
Repowering bonus	0.50
Degression rate	1.5%

* Depending on coverage of reference yield, extension of initial tariff pursuant to Section 29(2) EEG

Offshore wind (§ 31 EEG)	ct/kWh
<i>Basic fees</i>	
Initial fee (first 12 years of operation; extension for remote/deep water installations)	15.00
Initial tariff in acceleration model	19.00
Basic tariff	3.50
<i>Degression</i>	
until 2017/from 2018	0.0%/7.0%

Solar radiation (§§ 32, 33 EEG)	ct/kWh
<i>Roof-mounted facilities</i>	
<i>Capacity</i>	
Up to 30 kW	24.43
Up to 100 kW	23.23
Up to 1 MW	21.98
Over 1 MW	18.33
If generated electricity is consumed within immediate vicinity of building/facility by operator or third parties for installations up to 500 kW: Payment of feed-in tariffs for consumed electricity, but the applicable feed-in tariffs will be reduced by EUR 0.1638 for up to 30 percent of the generated power and by EUR 0.12 for the remaining power	
<i>Freestanding facilities</i>	
Conversion/Sealed Areas	18.76
Other Qualified Areas (additional requirements apply)	17.94

The European Union—A Federation or a Confederation?

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Abstract: *The question about the essential nature of the EU (a federation or a confederation?) is a fundamental yet controversial issue, which has provoked plenty of debate. The fact that different attitudes are frequently accompanied by equivocation and manipulation with concepts and terms, which carries an undisguised political (more often than not a populist) connotation, is particularly annoying. The article seeks to analyse, primarily from the legal point of view, the current developments in the EU, first and foremost in the light of institutional competence. There is an obvious trend towards increased competence of the Union which makes it possible to conclude that the European Union is moving towards a federation, being more a federation than a confederation even today. Taking into account the understandable interest of the nation states, the EU could be called the United National Democratic States of Europe in the future. It would definitely not refer to a classical model of a federal state (à la the USA). Naturally the peculiarities, culture and traditions of a nation state—the national identity as a whole—could not be ignored. It unarguably is a phenomenon the novelty and many-sided essence of which deserve consistent and thorough scientific analysis, in spite of the relative delicacy of the problem. Therefore it has quite often been carefully alleged that the EU is a “union of states which lies between confederation and federation” (Laffranque, 2006, p. 151).*

Keywords: *competence of the Union, European Union, federation and confederation, sovereignty*

1. Introduction

This rhetorical and in many respects over-politicised issue becomes topical, time and again, for different reasons or occasions. Estonia experienced it at the end of the 1990s and the beginning of this century, when the long and complex negotiations on Estonia's accession to the European Union were underway (1998–2002). The issue culminated before the referendum held on 14 September 2003, when two thirds of the voters said 'yes' to the accession and relevant constitutional amendments, but one third was negative towards the EU. The threat that Estonia, which had recently restored its independence, would be deprived of its sovereignty again was the sceptics' main argument. The fiercest critics of the movement even threatened that the former dictate of Moscow would be replaced by the Brussels' one. Why could Estonia not be a truly independent and sovereign country, such as Switzerland, for example, or why could it not follow either Norway or Iceland as a role model—were the most often asked questions. The author's answer would be: unfortunately Estonia is neither Switzerland nor Norway: its level of development compared to either of these countries is very dissimilar due to several reasons. The geopolitical location of Iceland, compared to that of Estonia, is completely different (the distance from the main continent provides certain advantages and also audacity which, by the way, manifested itself in the act of recognising the newly restored independence of Estonia). Furthermore, the probability that any of the abovementioned countries would deem it necessary to join the EU one day cannot be excluded either.

With regard to the particular dispute—a federation or a confederation—the importance of the formal meaning of concepts (names) should not be overestimated. For instance, the official name of Switzerland is Swiss Confederation but in reality it is a typical federation (26 cantons and a bicameral federal parliament). The Soviet Union considered itself as a federation which consisted of union republics but, as a matter of fact, it was a unitary state based on a single-party political system. The problem lies in the whole essence and organisation of the state, not in its name.

In the debate about Estonia's accession to the EU—whether the decision was a right one or not—the author's own preference has always been, and he has also encouraged everyone else, to approach the issue as a dilemma: if it was not a right decision, what could have been a reasonable alternative? The emphasis has been placed on the word *reasonable* here. Regrettably, there have not been any sensible or well-reasoned answers yet.

Without letting himself to be disturbed by the pre-election tactics of different political powers or other narrow interests, including psychological-emotional means of influencing (a fear of being deprived of statehood, a threat of being controlled by foreign powers again, etc.), the author is trying to objectively analyse the principal characteristics of a federation and confederation—their essence in terms of differences and similarities from institutional as well as functional aspects. A unitary state and a classical international institution will be excluded, as it is evident that regarding the structure and relationship between its constituent countries the European Union is neither of them. It is essential to get to the heart of the problem and comprehend where the union, which had only six founder members in 1952 (currently 27), is heading for, and which way should this structure be seen and evaluated as a whole. The question which option is better—a federation or a confederation—should be discarded here, as the answer always depends on specific circumstances which could be entirely different in time and space. In the author's opinion federations can be totally different in terms of internal coherence, and the same applies to a confederation. Some contrasting examples could even be given: in the USA, which is a federation, the capital punishment, the death penalty, is applied in 37 states out of 50; at the same time all the EU Member States have signed up to the European Convention on Human Rights, which has abolished the capital punishment.

A few concepts, closely related to the topic, should also be clarified before dealing with the main issue: a state's *sovereignty* and *independence*.

Pursuant to Chapter I, Section 1 in the Constitution of the Republic of Estonia, the country is an independent sovereign democratic republic wherein the supreme power of the state is held by the people; Section 2 stipulates that Estonia's independence and sovereignty is interminable and inalienable.

Estonian Encyclopaedia refers to sovereignty as absolute political (involving domestic as well as foreign policy) independence from other countries (EE, 1996). One can conclude here that independence and sovereignty are the same, as if they were synonyms. However, in Chapter I of the Constitution of Estonia these concepts are used separately. Therefore a certain inconsistency can be identified here. What do these two concepts actually mean, where does their difference lie?

According to classical theories, a present-day state as a differentiated organisation has three characteristics: a territory, nation and organisation of public power. Actually, the fourth characteristic has increasingly often been mentioned in the field-specific literature—an actual ability to be a full subject of international communication, that is, a subject of international law.

The concept of sovereignty has not been explicitly included in the Constitution of the Estonian Republic but the meaning has been hidden in the first paragraph of Chapter I, which stipulates that the supreme power of the state is held by the people. The sovereign of a country is people as the supreme power—people as citizenry, not as population, ethnics or just a big crowd of people.

Sovereignty could principally be approached in two dimensions: internally, inside the country it refers to the monopoly of the public power, which manifests itself in the establishment of relevant rules which apply to every person who is lawfully staying within their territory. In other words, a state has established the legislative, executive and judiciary power. It has a head of state and requisite inspection mechanism, including state audit office, legal chancellor, ombudsman, etc. These institutions enable a country to execute itself as a state. That kind of internal dimension of sovereignty is a country's independence.

However, an independent country also executes itself externally: diplomatic relations, participation in international organisations, etc. Herein the independent sovereign states respect other countries' independence, their sovereign rights and interests; they possess equal rights to conclude agreements with them, etc., which all represent the external dimension of sovereignty—a country's independence. This is a country's ability to execute its independence as independently from external factors and influences as possible. Internationally, sovereignty indicates a country's immediate subordination to international law exclusively, not to any other subject of international law (a foreign country or international organisation). Although it should be admitted that in the present day world not a single state, including the superpowers, can enjoy absolute independence. Everything is increasingly interconnected: energy resources, environment, climate changes, security and demographic problems, the influence of mass destruction weapons (who starts first will die second), etc.

In the light of the aforementioned considerations it can be concluded that Estonia's decision to join the EU (on 1 May 2004), the primary law of which—the founding treaties and treaties of accession, also legislative acts of institutions and the judgements of the European Court of Justice, are much more binding (superiority and direct applicability) documents than any other external communication—actually refers to the fact that Estonia voluntarily and legally abandoned a part of its sovereignty, which definitely sets limits to the country's independence as well.

At this point one cannot ignore a significant aspect: in addition to the issue about the EU accession, the referendum also involved some amendments to

the Constitution of the Estonian Republic. The bill included four articles; two of them were given more weight, the rest had a more procedural meaning. Article 1 of the amendments stipulates that “Estonia may belong to the EU on the assumption of adhering to the underlying principles of the Constitution of the Estonian Republic”, which refers to the principles stated in the preamble, and also in Chapter I of the Constitution of Estonia. It is a so-called protection clause, a kind of “tranquiliser”, which was targeted at the euro-sceptics and, first of all, the undecided voters to influence them before the referendum. At the same time, Article 2 of the amendments provides that “upon Estonia’s accession to the European Union the Constitution of Estonia is applied taking into consideration the rights and duties arising from the Treaty of Accession”.

Immediately before the referendum on accession to the EU the author argued that

there is a certain variance between the aforementioned two Articles. As to its essence, Article 2 will prevail, as the underlying document for the accession treaty is a principal article of the agreement establishing the European Economic Community (Treaty of Rome, 27 March 1957), Article 10 (formerly Article 5), which stipulates: “Member States shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community. They shall facilitate the achievement of the Community’s tasks. They shall abstain from any measure which could jeopardise the attainment of the objectives of this Treaty”.

This Article is considered to be the strictest one in primary law and pursuant to that Article the Constitution of Estonia will be applied. The European Court of Justice will be the exclusive authoritative interpreter of the law and assess whether a Member State has acted in accordance with the objectives set by the Union. If there appears to be a legal non-compliance with the objectives set by the Union and a Member State does not take appropriate measures, the European Court of Justice may apply sanctions on the basis of the proposal from the European Commission.

Naturally, we are not entering a unitary “super state”, with which those who say ‘no’ to Estonia joining the EU to frequently frighten people. The EU has never been and will never be a unitary state. It has been excluded as well by the founding treaty as by the treaties of accession, and also considering the composition and structure of the European Union. Indeed, if most people

vote ‘yes’ in the referendum, we will join a composite state, which has long democratic tradition and respect for human dignity (or anyway it is the union which is striving for that). It would be strategically wrong to wait for the “next train” (Bulgaria and Romania in 2007), because we would lose valuable time and eventually arrive at the same station. My idea is that those who say ‘yes’, and those who say ‘no’ should, as much as possible, avoid tendentiousness and ambiguity in reasoning. Not only tactics with a taste of propaganda but a future oriented promising strategic decision, critical for Estonia, is at stake. Indeed, any citizen who respects him/herself should not abstain from making that decision.

A few years later (on 11 May 2006) the Constitutional Review Chamber of the Supreme Court presented an opinion on interpreting Article 111 of the Constitution of the Republic of Estonia. The issue arose due to the alleged need for holding a referendum on euro adoption. The opinion of the Supreme Court declares that the EU law is applied in the areas over which the EU has an exclusive competence or a shared competence, if there is an inconsistency between the Estonian laws, including the Constitution of Estonia, and European Union law. In other words, there prevailed the position of a clear majority of the Constitutional Review Chamber of the Supreme Court (two judges were of a different opinion), which suggested that the Constitution of the Estonian Republic will be applied only to extent not inconsistent with the EU law (RT, 2006).

The decision is entirely logical as all the European Union legal acts include a clear principle: the EU law is superior to the national law, including the constitution of a Member State. However, in practice there has not been any precedent yet that the European Court of Justice has proclaimed an article of a Member State constitution to be inconsistent with the principles of the EU legislation. Perhaps, that may also result from the delicacy of the issue. At present, the reader would be interested in the past and future development of the EU, rather than its titles, the system of symbols, or some other exceptional phenomena.

2. The development of the EU—a federalist trend

Today’s EU has not been created out of nothing. The idea of unifying Europe resulted from the sad consequences of the World War I and World War II. In 1923, the Austro-Hungarian count and diplomat Richard Coudenhove-Kalergi initiated the pan-European movement with an aim to create the United States of Europe (excluding Great Britain and Russia). In 1929, the Foreign Minister of

France Aristide Briand put forward an idea of a European Federal Union within the framework of the League of Nations. The idea also attracted some interest in Estonia where the slogan of a literary group *Noor Eesti* ('Young Estonia'), "Let us be Estonians but also become Europeans," became widely known (decades later the idea was often repeated by Estonian President Lennart Meri). Kaarel Robert Pusta, Johan Laidoner, Ants Piip and other Estonian state officials were involved in the activities of the "Estonian Society of Paneuropean Union". The UK Prime Minister Winston Churchill's speech delivered on 19 September 1946 in Zurich, where he clearly voiced that a kind of union should be created in Europe, was definitely a significant landmark in the development of the EU.

The idea of the union became much more explicit when the then French Foreign Minister Robert Schuman presented a declaration on 9 May 1950, which included a proposal to found a European Coal and Steel Community (ECSC) with an obvious intention to subordinate the essential warfare industries to an authority higher than a state. Today, Europe Day is annually celebrated on the 9th of May, which can also be regarded as the date of birth of the European Union. The treaty, which became effective in 1952, was concluded for 50 years but it has already ceased to be valid due to the greatly changed nature of the European Union. A Frenchman, Jean Monnet, who was an intellectual father of the Schuman's plan, and who became the president of the High Authority of the ECSC, also played a significant role in the pre-history of the EU. The next important milestone were the treaties concluded on the initiative of the Benelux countries in 1957 that gave birth to the European Economic Community (EEC) and to European Atomic Energy Community (Euratom)—the treaties of Rome, which became effective on 1 October 1958.

The three communities were known as the European Communities (sometimes referred to as the European Community or EC). All three were established by the same six founder members—France, Germany, Italy, Belgium, the Netherlands and Luxembourg. Former enemies in war stretched out their hands for reconciliation, buried the hatchet and started to collaborate. It was a decisive turning point in the European history, which were followed by extensive quantitative (enlargement) as well as qualitative (collaboration and deepening of competence) developments. In 1973, the United Kingdom, Ireland and Denmark (the referendum in Norway was against), in 1981 Greece, and in 1986 Spain and Portugal joined the Union. In 1987, Single European Act entered into force, common institutions, which had been established for 12 Member States, became increasingly efficient and more and more organisationally and legally binding.

In 1992, the Maastricht Treaty was concluded; a pause occurred after that. Only

after the positive decision of the Federal Constitutional Court of Germany and the support provided by the second referendum in Denmark the treaty became effective on 1 November 1993. The community also earned a new name—the European Union. Shortly after that, in 1995, there was a new wave of enlargement when Austria, Sweden and Finland joined the Union. Norway had a second try, but people voted against the EU once again. The most extensive enlargement took place on 1 May 2004 and involved the accession of ten new Member States—Hungary, Czech Republic, Poland, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Cyprus and Malta. Three years later, Bulgaria and Romania followed. A promissory note has been given to Croatia, and there are more candidate countries in the waiting list. Turkey's accession is a more complex issue: first of all it is related to human rights' violation.

In parallel with the EU enlargement process, constant qualitative changes were underway, which was an indication of developments towards more intensive and efficient cooperation. European Parliament introduced direct election in 1979, which can be considered an important milestone in the EU development. The Single European Act (1987) marked a start towards a political union by changing the decision-making procedures in the EU institutions; it increased adopting decisions by qualified majority voting instead of unanimity. The same act also created the foundations for the Court of First Instance (CFI).

The Maastricht Treaty made the EU operate as a building which is covered with the same roof and supported by three pillars: I – European Communities, II – Common Foreign and Security Policy III – Justice and Home Affairs. While the first pillar involved the competencies the Member States had handed over to the supranational institutions—the ones which had become the exclusive competence of the union (EC, ECSC, Euratom, etc., the EU founding treaties and treaties of accession)—then the second and third one rather represented the cooperation between the Member States themselves. It is also notable that the Maastricht Treaty provided the citizens of the EU Member States with an additional common citizenship institution, created the position of European Ombudsman, set up the Committee of the Regions and led to the creation of the single European currency, the euro.

The Treaty of Amsterdam (1997) incorporated judicial cooperation in civil matters, also asylum procedures and immigration policy into the first pillar of the EC, that is, they became an exclusive competence of the Union.

The Treaty of Nice (2001) brought along crucial institutional changes, which made preparations for the biggest wave of enlargement (2004). Together with

the Treaty of Nice the Charter of Fundamental Rights of the European Union was signed, although it was not given legally binding status first. However, referring to its content is was a constitutional act. The Nice Treaty also reformed the jurisdiction—it provided an opportunity to establish specific judicial panels to exercise judicial competence in certain specific areas. The need to regulate the competence between the Union and Member States more specifically became more urgent, the need to elaborate a Constitution for the European Union was more and more heard (Laeken Declaration of 15 December 2001).

On 28 February 2002, an inaugural session of the Convention on the Future of Europe was held. Differently from previous intergovernmental conventions, the delegates of national parliaments and the European Parliament, also the EU candidate countries, including members of the Estonian government and parliament, participated in this event. The work of the convention was intensive, lasted for several years and was concluded by the Treaty establishing a Constitution for Europe (actually a constitution), which was signed on 29 October 2004. The treaty proposed a number of changes, including the weightiest ones: the treaty introduced the EU citizens' initiative and an option to leave the European Union; a proposal to create a position of EU President and Minister of Foreign Affairs was made there; it launched the European Neighbourhood Policy; legal regulations acquired new forms—European laws and framework laws; a proposal was made to include the supremacy of the EU law imposed by the practice of the European Court of Justice in the treaty; it adopted double majority voting rules for adopting decisions in the European Council; it strengthened national parliaments' involvement in the legislative process. There was no doubt that the ultimate aim of the signed treaty was to pave the way for the European Union as a federation.

Unfortunately not all the Member States were ready for that kind of radical changes. The referenda held in France and the Netherlands in 2005 responded negatively to the Treaty establishing a Constitution for Europe. Most of the Member States ratified the treaty in their parliaments (Estonian Riigikogu on 9 May 2006). In addition, the referenda in Spain and in Luxembourg responded positively. Although the constitutional treaty that had provoked a lot of discussions still failed in its final stage—the treaty would have been effective if all the Member States had unanimously approved it. New opportunities and compromises had to be found.

The intergovernmental conference, which started on 27 June 2007, adopted a decision to continue efforts to reach an agreement: a Reform Treaty was a goal at that time. The agreement was reached on 18–19 October and the document, officially known as the Treaty of Lisbon, was signed on 13 December 2007.

Once again, the Member States faced a ratification process in their national parliaments, and a need to conduct a referendum. The majority of the states said 'yes' (Estonian *Riigikogu* ratified the Treaty on 11 June 2008; there were 91 affirmative votes and 1 negative vote). A day later the Treaty of Lisbon failed at a referendum held in Ireland (53.4% of the voters opposed). As a double referendum upon the same issue could not be conducted within a year, there was a delay again. Consultations continued and in the repeat referendum held on 2 October 2009 in Ireland the majority (67.13%) supported the Treaty. The last obstacle had to be removed: President of the Czech Republic, Vaclav Klaus, an outspoken opponent of whatever centralisation, made several efforts to jeopardise the ratification in national parliament, and delayed signing a relevant law. In the morning of 3 November, the Constitutional Court of the Czech Republic announced that the treaty was in conformity with the constitution of the country; the president signed the law on ratification the same day and also promulgated it. Now the road was open. The Treaty of Lisbon became effective on 1 December 2009.

The Treaty of Lisbon is made up of a consolidated version of the Treaty on the European Union (preamble and 6 divisions, 55 articles in total), and a consolidated version of the Treaty on the Functioning of the European Union (preamble and 6 parts which are divided into titles, 358 articles in total). The Treaty also contains 37 protocols and 2 annexes which are an integral part of it. There are 55 declarations annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon on 13 December 2007. In addition to the two abovementioned treaties, a consolidated version of the Euratom Treaty is also applicable as one of the Union's founding treaties (Laffranque, 2010, pp. 13–22).

The development trends in the European Union will be covered below, the competences of the institutions, the Union and Member States are also analysed.

3. The main characteristics of a state and the EU institutions

A classical approach regards three common elements—a territory, population and institutions of power—as characteristics of a state. In the current context a reader's primary interest is a state as an institution, as a political subject regarding the aspects of communication, both internal and external; it even does not matter whether it is a unitary or a federal state, the constituents/federal states, states or cantons of which have different levels of sovereignty. In addition to *krais* and oblasts, the composition of the Russian Federation comprises several

republics, such as the Republic of Tatarstan (Tartarstan), the Chechen Republic, the Republic of Dagestan, etc.

The article presents a comparative analysis of a federation and a confederation; its purpose is to identify differences between these two, and to provide an answer to the question about the essential nature of the modern-day European Union.

First, the territory. Obviously no one will argue that the territory of the EU is a clearly defined geographical space with fixed and strictly guarded frontiers (including the terrestrial borders, waters, and airspace as well). Within the Schengen Area the borders between the Member States have been completely abolished.

Every person holding the nationality of a Member State is a citizen of the Union. Therefore the people as citizenry have also been clearly defined. In addition to free movement of persons, all citizens are eligible to vote in the elections to the EU Parliament and to the local authorities in the Member States.

With regard to institutions of power, the legislative, executive and judicial authorities of the EU can be distinguished according to several specific differences.

European Parliament, which is directly elected every five years by the EU citizens (currently the number of deputies is 735, plus the president), is like a parliament of a federal state—all the components are represented as proportions of the population, the deputies are organised into fractions and committees according to their functions (fields of activity). It is true that the Parliament has not fully exercised its legislative competence to the Treaty of Lisbon. The situation has been referred to as a “deficit of democracy”, though there is a clear trend towards the elimination of this shortcoming as the percentage of legislative acts adopted under Ordinary Legislative Procedure, former Co-Decision Procedure (jointly by both Parliament and the Council) is steadily increasing and approaching 95 per cent of all legislation across 84 policy areas (Hardacre, 2011, p. 86). The Parliament appoints the Commission, expresses a lack of confidence in it (or in a member of the Commission) if necessary, approves the EU budget, and exercises the function of political control and consultation as laid down in the founding treaties.

A **European Ombudsman** is elected by the European Parliament and is empowered to receive complaints from any citizen of the Union or any natural or legal person residing or having its registered office in a Member State concerning instances of maladministration in the activities of the Union institutions, bodies, offices or agencies (with the exception of the Court of Justice of the European

Union acting in its judicial role). He or she examines such complaints and reports on them. The Ombudsman is elected for five years and submits an annual report to the European Parliament on the outcome of his inquiries. The Ombudsman is completely independent in the performance of his/her duties. In the performance of those duties he/she neither seeks nor takes instructions from any government, institution, body, office or entity, strictly following the EU law. In many ways the EU Ombudsman can be compared to the relevant positions in the Member States (Chancellor of Justice in Estonia) in terms of their functions and competence.

The **European Council** provides the necessary impetus for the development of the EU and defines its general political direction and priorities. Unlike in the past, the competence of the Council includes making legally binding decisions, although the Treaty of Lisbon clearly states that the European Council does not have legislative function. The Council comprises the heads of states or government (decided by a Member State) alongside its own president and the president of the Commission. The High Representative of the Union for Foreign and Security Policy, the Foreign Minister for the EU is also involved in the work of the European Council, the heads of the Member States are accompanied by their foreign ministers.

The European Council is usually summoned four times a year by the president, an extraordinary session is held, if necessary. If it is not indicated otherwise in the founding treaties, the Council takes decisions by consensus. The Council elects the president by qualified majority for the period of two and a half years, renewable once. He/she chairs the European Council and drives forward its work and ensures its continuity. After each of its meetings, he/she presents a report to the European Parliament and represents the Union on issues concerning external communication (Common Foreign and Security Policy) without prejudice to the responsibilities of the Minister for Foreign Affairs. The President of the European Council may not hold any national mandate at the same time. The Belgian Prime Minister Herman van Rompuy was chosen to be the first permanent President of the European Council. Figuratively speaking, the European Council could be regarded as a collegiate president of the European Union.

The **Council of the European Union**, which is composed of several configurations of national ministers, one from each Member State, (the exact membership of the configuration depends upon the topic under discussion) actually represents a legislative institution. It has passed (increasingly under co-decision with the Parliament) regulations and directives that Member States are obliged to transform into national law. The number of votes each minister holds depends on the population of their Member State.

The **European Commission** is set up for five years. The Commission is headed by the president (José Manuel Barroso since autumn 2003), which can be compared with a position of a Prime Minister in a government. Members of the Commission (commissioners, including the deputy presidents) are in charge of relevant policies and can be compared with ministers. They are attended by main directorates (the ministries). A general director's position would be comparable to a chancellor of a ministry. The Commission makes legal proposals to the Council that will review them (increasingly along with the Parliament) and make the final decision. The Commission reports to the Parliament. The decisions are adopted by majority vote. Therefore, it is quite obvious that the status, competence and functions of the Commission as a whole are in many ways comparable to the competence and functions of the government of a federal state.

The **Court of Justice of the European Union** has been made up of the Court of Justice and General Court (previously known as Court of First Instance), since the Treaty of Lisbon became effective. The courts are composed of one judge per Member State. In addition, alongside the general court it also comprises the Civil Service Tribunal as a specialised court (7 judges), which as a first instance court is called upon to adjudicate in disputes between the European Union and its civil service.

The Court of Justice can sit in chambers (3 or 5 judges), Grand Chamber (13 judges) or it may decide to sit in full, if the issues raised are considered to be of exceptional importance (e.g., removal of the Ombudsman or a commissioner). Sitting as a Grand Chamber can happen when a Member State or a Union institution so requests, or in particularly complex or important cases. The Court of Justice gives rulings on the cases brought before it (actions for failure to fulfil a Member State's obligations, actions for the annulment of a measure adopted by an institution, actions for a failure to act on the part of a Union institution, appeals on judgments given by the General Court). The Court has a special role in giving preliminary rulings to the national courts of the Member States in disputes with regard to the interpretation and implementation of EU law. With this function the Court ensures uniform implementation of the Union law in all Member States; if the national court does not take the preliminary ruling into account, due to the complaint the dispute will eventually reach the judicial decision made by the Court of Justice. National courts, understandably, try to avoid that kind of precedents. Therefore, giving preliminary rulings serves as an efficient instrument for ensuring uniform legal system throughout the EU.

In addition to the abovementioned functions, the Court of Justice has the exclusive power to interpret the EU law which will create common legal space within the Union. Therefore it can be contended that, figuratively speaking, the Court of Justice is like a 'state within a state', a guarantee of consistent legal space, which is an important characteristic of a unitary state. At the same time, harmonisation of laws regarding different legal policies, such as strengthening budgetary discipline, improving cooperation on transnational criminal justice, speeding up legal proceedings, and also unifying and harmonising substantive law, are still underway. The issues about criminalising certain acts within the EU, such as establishment of minimum rules for defining criminal offences and imposing penalties on dangerous transnational crimes, including drug-related crimes, firearms smuggling, money laundering, corruption, counterfeiting legal tender, child abuse, cybercrime, and organised crime have also been brought forward.

The **European Central Bank** and the national central banks of the Member States constitute the European System of Central Banks (ESCB) which defines and implements the monetary policy of the EU. The primary objective of ESCB is to maintain price stability and support general economic policies of the Union. The European Central Bank has the exclusive right to authorise the issue of banknotes within the euro area. The Bank is independent in executing its responsibility, which the institutions, bodies and establishments and the governments of Member States honour. The Governing Council of the European Central Bank comprises all the members of the Executive Board and the presidents of the national central banks of those Member States which have adopted the euro. The Executive Board of the Bank comprises the President, the Vice-President and four other members, who are appointed by the European Council by qualified majority voting on a recommendation from the Council of the European Union after it has consulted the European Parliament and the Governing Council of the European Central Bank. The term of office for the members of the Executive Board is eight years and it is non-renewable. The Central Bank annually reports to the Parliament, Council and Commission on the ESCB activities and monetary policy in the current and previous year.

The **Court of Auditors** is in charge of auditing the EU and it was created in 1975. The Court is composed of one citizen from each EU state. Any member of the Court of Auditors is independent in fulfilling their responsibility. They are appointed on a recommendation of their Member State by the Council of the European Union, after it has consulted with the European Parliament, for a renewable term of six years. The Court checks all the revenue and expenditure accounts, receipts to account and legality of expenditure. On-the-spot checks in

Member States are also carried out in cooperation with local auditing institutions. At the end of the budget year the Court submits a report which is distributed among the relevant institutions of the Union. The Court assists the parliament and the Council in exercising their authority to check the implementation of the EU budget. The functions of the Court of Auditors are actually comparable with relevant controlling bodies in Member States, including the National State Audit Office.

In addition to the main institutions, there are also advisory bodies in the EU, first of all the European Economic and Social Committee and Committee of the Regions. All Member States are represented in them (public organisations in the first one; representatives of regional and local authority in the second). Both committees advise the Parliament, the Council and the Commission and are independent in their responsibilities.

4. The competences of the European Union and the Member States

The Treaty of Lisbon underlines universal principal values and the values of the European Union, which the Union follows in order to achieve its objectives—enhance peace, its own values and prosperity of its people. These values are: freedom, democracy, equality and rule of law, human dignity, respecting human rights, pluralism, justice and solidarity.

The Treaty unarguably strengthens the European Union—it is provided with legal capacity, it is a uniform legal entity that can enter into agreements, join international conventions or become a member of an international organisation. Pursuant to the Treaty a legal basis has been formed for joining the European Convention on Human Rights, which means being bound up with the European Court of Human Rights. Full acknowledgement to the European Charter of Fundamental Rights, which has been granted equal legal force compared with the founding treaties, is also of great significance. Hence, for a first time in the history, an integral European system for the protection of human rights has been created, which provides each citizen with an opportunity to appeal to the European Court of Human Rights to fight any unlawful action of EU institutions.

The Treaty of Lisbon (as a treaty for the EU's functioning) stipulates the competences of the Union and the Member States. The EU has exclusive competence in the following areas: the customs union; competition laws to regulate internal market; monetary policy within the eurozone; the common

fisheries policy to protect the biological resources of the sea; concluding international agreements according to a legal act of the Union or for enabling the Union to exercise its internal competence, and also if concluding an agreement may influence common rules or change their scope of application.

The Union has a shared or joint competence with the Member States, if the founding treaties grant the competence to the Union, which neither falls under exclusive competence nor the principle of subsidiarity. The Union and the Member States' shared competences cover the following areas: internal market; the social policy arising from the European Social Charter (Torino 1961) and the Charter of the Union regarding the employees' social rights (1989); economic, social and territorial cohesion; agriculture and fishing (excluding the part under EU exclusive competence); environment; consumer protection; transport; pan-European networks (in the field of the infrastructure of transport, telecommunication and energy); energy; the area grounded on freedom, security and justice (the Union ensures the absence of border control and provides common asylum, immigration and external border control policies, and other law enforcement policies, which are based on the solidarity of the Member States); common public health prevention measures. It is important to mention that the Member States exercise their competences only insofar as the Union has not exercised its competences.

The Member States' exclusive competences include protection and improvement of human healthcare, industry, culture, tourism, education, professional training, youth and sport, civil protection, administrative co-operation. The fact that the Union may provide support and co-ordination or improvements for the European aspects of the abovementioned areas should be accentuated.

How to assess the relations between the competences of the Union and the ones of the Member States in the light of the Treaty of Lisbon? On the one hand, attention has been paid to the importance of the role of the Member States and citizen initiative. The treaty does not involve delegating new exclusive competences to the Union, the principle according to which the Union is not entitled to extend its competences, is still effective. Contrariwise, the Treaty on European Union (Article 48) states that the competences can either be increased or reduced. For the first time a Member State's right to withdraw from the Union (pursuant to their national constitution) has been regulated (Article 50). The withdrawal agreement between the Union and a Member State should be concluded and negotiated according to specific procedures.

In addition to increasing the role of the EU Parliament in co-decision procedures the Treaty of Lisbon also includes the obligation of national parliaments to

observe how the Union follows its competences, first and foremost the principle of subsidiarity. The parliament of any Member State may, within eight weeks from the date of transmission of a draft legislative act, in the official languages of the Union, send to the President of the European Parliament, the Council and the Commission a reasoned opinion stating why it considers that the draft in question does not comply with the principle of subsidiarity. If a significant number of national parliaments (at least one thirds) oppose, the draft has to be reviewed.

The amended Treaty on European Union, in certain cases, enables citizens (public initiative) to make proposals for a legal act. Support from at least one million EU citizens, who represent a significant part of the Member States, is required.

Although these are comparatively soft measures, yet they represent an attempt to somehow balance the relation between the EU competences and the Member States' competences.

At the same time, compared to the previous ones the Treaty of Lisbon comprises several changes towards the increasing scope of competences of the Union. As it has already been mentioned, the European Council also has a full-time President who is appointed for a two and a half year term. Previously, the President was changed every six months, and the position was held by the leader of the presiding Member State. Furthermore, a new position was created regarding the Common Foreign and Security Policy—The High Representative of the Union for Foreign and Security Policy (Foreign Minister), who *ex officio* serves as one of the vice presidents of the Commission. The new position was first fulfilled by a British politician Catherine Ashton, the former Commissioner for Trade. It is quite obvious that these high positions indicate increasing centralised authority within the EU.

The special provisions on common foreign and security policy of the Treaty on European Union stipulate that all the issues regarding foreign and security policy, including the gradual formulation of common defence policy which could lead to common defence, are the competence of the European Union. In Article 24 of the same document it is stipulated that the Member States cooperate in order to enhance and develop mutual political solidarity. They refrain from any action which is contrary to the interests of the Union or likely to impair its effectiveness as a cohesive force in international relations.

However, emphasis should be laid on the fact that the decisions adopted with regard to foreign and security policy are made unanimously by the European Council and the Council of Europe, unless the Treaty provides otherwise;

adoption of legislative, i.e. legally binding acts is excluded. The amendments made to the voting procedures related to decision-making refer to simplifying the process of exercising the EU competences. There is a trend towards replacing the unanimity requirement (right of veto) by qualified majority voting (e.g., the articles regarding checks at external border and right of asylum, also setting up special courts, including the civil service court, etc.).

In several parts the former standard procedure (summoning a convention or intergovernmental conference) has been replaced by an ordinary legislative procedure (consensual decision of the European Council), which currently applies to the whole internal market (e.g., free movement of goods, persons, services and capital) and to legal regulation on common policies (e.g., agriculture, environment).

The mechanism of voting regarding the decisions adopted by the Council has evoked a lot of arguments throughout history (just here the interests of larger and smaller states often collide). It is a very delicate issue. Pursuant to the Treaty of Lisbon (Protocol No 36 on Transitional Provisions) the following procedure is valid until 31 October 2014: when a decision has to be adopted on the proposal from the Commission, at least 255 votes in favour are required from the total 345, and at least 14 Member States (18 countries, if the proposal has not been put forward by the Commission), who represent at least 62 per cent of the EU population, have to be in favour of it. In other cases a decision is adopted by 255 positive votes, which represents at least two thirds of the Member States. When a decision is to be adopted by the Council by a qualified majority vote, a member of the Council may request verification that the Member States constituting the qualified majority represent at least 62 per cent of the total population of the Union (approximately 310 million). If that condition is shown not to have been met, the decision in question will not be adopted.

According to the Treaty on the EU (Article 16) from 1 November 2014, a qualified majority is defined as at least 55 per cent of the members of the Council representing the participating Member States, comprising at least 65 per cent of the population of these states. A blocking minority must include at least four Member States, which failing the qualified majority is deemed attained. These amendments indicate that the Union, on the one hand, makes an attempt to take into account the interests of different Member States trying to balance them as much as possible, yet, on the other hand, the procedure of adopting a decision has become more simple—in place of the present three criteria, in the near future there will be only two to be met (the majority of Member States and their population or double majority).

The fact that while any references to the constitution for the Union (the Treaty establishing a Constitution for Europe had failed!) and the official symbols of the EU (the flag, anthem, Europe Day, motto “United in diversity”) were excluded from the textual part of the Treaty of Lisbon, a legal basis was created for establishing the EU Prosecutor’s position (dealing with offences against the EU’s financial interests) refer to a similar attitude. Unquestionably, the aforementioned efforts demonstrate the EU’s pursuit, hesitancy, differences of opinion, and also difficulties reaching a compromise, which could serve as a basis for consensus. It is obvious that the Member States do not want to give up their sovereignty, national-cultural identity, their status of being a subject of international law, and many other values which are very sensitive due to their historical-traditional and psychological-emotional essence, and truly important to people.

Nevertheless, anyone can realize, either independently or all together, that the sustainability and development of the European Union will gain more efficiency if the union as a whole is stronger and more competitive. That presupposes solidarity and unitedness. The financial and economic crisis, enormous debts and budget cuts in recent years have had a strong impact on millions of Europeans’ mental and material well-being, which inevitably has provoked pessimism and criticism of the EU. Still, is there anyone who could propose a reasonable alternative to the strong and unitary European Union? The author does not see any realistic alternatives. On the contrary, the EU is moving towards tightening the control over the Member States’ budget policies (European Stability Mechanism becomes operational on 1 July 2012). Furthermore, the prospect that one day there will be a need for more tightly regulated and uniform tax and social policy cannot be excluded, either. These would doubtlessly be very hard decisions. Foreign and security policy also fall under that category of decisions. Fortunately, there is no doubt that it is necessary to maintain and promote every nation’s cultural legacy, their language, ethnic peculiarities and uniqueness.

The interests of a whole and any single part of it can never completely overlap, although according to the author there is no insuperable conflict between them, either. Time has qualitatively changed: the world is much more compact and interconnected at global and regional level than it used to be, and many concepts and notions have acquired a new meaning. Although, priority should always be given to developing modern democracy—these principles should be observed in any society.

Dr iur Mario Rosentau, a teaching staff member at the University of Tartu, has discussed the same issue in his essay ‘Sovereignty in the European Union’,

which might be of interest here. He has classified the difficulties in perceiving the phenomenon of the European Union into the real ones (caused by the complexity of the phenomenon itself), and the conceptual ones. He writes:

The conceptual difficulty lies in the fact that the conventional and partly obsolete conceptual apparatuses encumber understanding the phenomenon of the European Union. For example, European president does not signify a head of the state; the European Commission does not represent a government, neither is the sovereignty of the EU national sovereignty, etc. However, can we be sure that traditional concepts will not transform in that kind of a situation? Is it possible that, all of a sudden, the head of a Member State, its government and sovereignty no longer carry the meaning which they used to have? It is worth pondering that national sovereignty might mostly be restricted by not understanding the new status: when an illiterate person, who was free among his/her peers, happens to be among the literate people, he/she can become free only by learning to read and write.” (Rosentau, 2003, p. 12)

And:

Already today the European Union represents a new model of interstate relations. The process of shaping the Union should also be continued in the same novel way. It is not important whether we call it a confederation or not. Condo democracy of the European nations or national states seems to convey the essence of the Union rather well. It is more or less certain that a conventional federation, which is characterised by exclusive competences of the central power, and the limited competences of the subjects of the Union, is suitable neither for Europe, which has been divided on national–territorial basis, nor for the possible future world order. (Rosentau, 2003, p. 15)

While reading the last paragraph, the author, on the one hand, spontaneously visualises the Russian Federation which has been divided on national-territorial basis and where the central power excludes any other structural organisation (separatism is the cruellest enemy of a state). On the other hand, he totally agrees that what really matters is the essence, the meaning of which does not change much depending on the form, or how we call it. It is also important that the form should be in harmony with its real essence, so that the general public could clearly and adequately comprehend both the form and the name. The author is mostly vexed by deliberate ambiguity, political manipulation with different

concepts, terms and other words. People (populace) should not be considered stupid, as if they did not understand the real situation and were not prepared to listen to the truth. It is definitely not so. Everything should be simply, logically, judiciously and, most importantly, honestly explained. This is what the people understand; it does not matter whether there is a period of economic growth or recession. Actually, it is obvious that the major part of the Constitution of the Republic of Estonia also needs revisions.

Finally, to answer the question formulated in the title of the article the author suggests that the reader should consider the possible answers below:

The European Union is:

- 4) a confederation with many/a few characteristics of a federation;
- 5) a federation with certain characteristics of a confederation;
- 6) not a confederation anymore, and not a federation yet—the EU is a supranational organisation;
- 7) a confederation which will never develop into a federation;
- 8) heading for a federation, being rather more a federation than a confederation even at present;
- 9) an organisation a proper name of which could be: the United National Democratic States of Europe.

The author himself would prefer points 5 and 6.

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European Union Citizenship or Status of Long-Term Resident: A Dilemma for Third-Country Nationals in Estonia

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Abstract: *The European Union has created long-term resident status which is an option for a third-country national to have similar rights as an European citizen. In Estonia, there is a relatively high number of third-country nationals that hold the status of long-term resident and who do seek to obtain the Estonian citizenship. This article is looking for an answer to the question whether the Estonian citizenship is attractive enough to third-country nationals residing in Estonia through which it is possible to get access also to European Union citizenship. After the transformation of the EU directives into the Estonian legislation, Estonian permanent residents have been granted the status of a long-term resident which is one step back from the development of getting closer ties with the country of residence. Citizenship is creating a division between categories of people but it also confers duties that can be avoided by non-citizens. The Lisbon Treaty has not changed much in the European citizenship notion, although, for example, diplomatic protection for the EU citizens should be provided and measures on how to achieve the goal are introduced by the Lisbon Treaty.*

Keywords: *citizenship rights, directives, EU citizenship, Estonian citizenship, Lisbon Treaty, long-term residents, migration*

1. Introduction

European citizenship can grant some rights that might be in the scope of interest of some persons to obtain. At the same time the status and rights of long-term residents who are third-country nationals (TCN) has also been established in EU and the rights are approaching the same level as those granted to European citizens.

The classical approach to citizenship is very much connected to a legal and political bond, which is determined through the mutual rights and obligations of the state and people (Craig & de Búrca, 2008; Barnard, 2007; Bauböck *et al.*, 2009). As a consequence, the citizenship is creating divisions between categories of people. Citizenship also confers additional rights and duties, which are not applicable to those who are non-citizens.

The original European Economic Community Treaty granted a right to reside in other Member States, together with a right to equal treatment with host state nationals, only to those nationals of Member States who migrated in order to pursue an economic activity. It was a very limited way of extension of rights. At that time, as a result, non-economic inter EU migrants were not protected by the Community law. When the EU citizenship was first created by the 1993 Treaty on the European Union, its significance was far from clear. The provisions gathered in the EC Treaty were essentially a combination of pre-existing rights (specifically the right to free movement) and new rights that would be of limited relevance to the great majority of citizens who continued to reside within their state of nationality (such as the right to vote or stand in local and European elections throughout the Union). In this respect, the bare Treaty provisions on Union citizenship offered little to disturb the dominant ‘market-oriented citizenship’ model that had emerged in EC law. The rights were primarily attached to the exercise of economic activities with a cross-border dimension.

Now European Union citizenship gives several rights and therefore it is supposed to be an “interesting investment” to obtain a citizenship of one of the European Union states.

There were three residence directives for EU citizens that granted a conditional right of residence to those who had sufficient means to support themselves, including students and pensioners.

Article 20 of the Treaty on the Functioning of the European Union (TFEU) says that every person holding the nationality of a Member State shall be a citizen

of the Union. Citizenship of the Union shall be additional to and not replace national citizenship. Therefore Estonian citizens, just as any other citizens of the EU Member States, are also considered to be EU citizens. But is the status of EU citizenship sufficiently attractive to obtain Estonian citizenship?

Estonia is one of the few countries within the EU where there is a very high number of long-term residents compared to the number of Estonian citizens (Hallik, 2000; 2006a; 2006b; 2010; Kalev, 2006).

This article argues the pros and cons for obtaining the Estonian citizenship in order to obtain also the EU citizenship by looking as a comparison the status of the long-term resident in the EU. Estonian citizenship does not seem to be very popular among third-country nationals residing in Estonia. Not all are able to apply for the citizenship (Ruutsoo, 2000; Ruutsoo & Kalev, 2005).

In 2010, the Government gave Estonian citizenship to 1,184 persons, which is the lowest number ever after the re-independence of Estonia. On 1 January 2011 there were 1,221,472 persons with Estonian citizenship (Masing, 2011).

What are the benefits which the long-term residents will miss by not obtaining the Estonian citizenship? As a principle there are several ways to acquire citizenship: at birth, by naturalization, or by marriage. The article focuses primarily on citizenship obtained by birth, more precisely, the bloodline principle (*ius sanguinis*), and to the EU citizenship as a special arrangement that is related to the EU Member State citizenship and because Estonian citizenship is only obtainable by the *ius sanguinis* principle and in some case by naturalization (see further Järve & Poleschuck, 2010).

2. European citizenship after the Lisbon Treaty

European citizenship is automatically granted by obtaining citizenship of one of the EU Member States. The Lisbon Treaty has not made any major changes to the concept of European citizenship. Article 20, paragraph 2, of the TFEU states that citizens of the Union shall enjoy the rights and be subject to the duties provided for in the Treaties. They shall have, inter alia:

1) Right to move and reside freely within the territory of the Member States;¹

¹ Article 45 of TFEU also provides free movement right to the workers and it does not specify whether it is a worker who is EU citizen or can it be also a worker who is not EU citizen. It is left completely open.

- 2) The right to vote and to stand as candidates in election to the European Parliament and in municipal elections in their Member States of residence, under the same conditions as nationals of that State;
- 3) The right to enjoy, in the territory of a third country in which the Member States of which they are nationals is not represented, the protection of the diplomatic and consular authorities of any Member State on the same conditions as the nationals of that State;
- 4) The right to petition the European Parliament, to apply to the European Ombudsman, and to address the institutions and advisory bodies of the Union in any of the Treaty languages and to obtain a reply in the same language. These rights shall be exercised in accordance with the conditions and limits defined by the Treaties and by the measures adopted thereunder.

The Lisbon Treaty brought two new ideas to the Treaties. TFEU Article 25, paragraph 2, tells us that the Council, acting unanimously in accordance with a special legislative procedure and after obtaining the consent of the European Parliament, may adopt provisions to strengthen or to add to the rights listed in paragraph 2 of Article 20. Nevertheless the provisions adopted under Article 25 of TFEU will enter into force after their approval by the Member States in accordance with their respective constitutional requirements.

The other novelty after Lisbon is related to the diplomatic protection provisions, which should be adopted by the Council acting in accordance with a special legislative procedure and after consulting the European Parliament. It should be adopted in the form of a directive and should establish coordination and cooperation measures to facilitate the diplomatic protection of an EU citizen in the territory of a third country in which the Member State of which he is a national is not represented. The protection will be given by the diplomatic or consular authorities of any Member State, on the same conditions as to the nationals of that State.² So the EU citizens have a right to turn to any embassy or consular representation of an EU Member State when they need it in third countries. This type of protection is not available for the third-country nationals who are long-term residents in the EU.

Article 21 of TFEU gives the Union citizens a right to move and reside freely within the territory of any of the Member States subject to the limitations and conditions contained in the Treaties and secondary legislation. There is no economic limitation given in the Treaty as it used to be in the past. The concept of Union citizenship has been filled with much greater substantive content

² Art 23, TFEU.

through the interventions of the Court of Justice (ECJ). The ECJ has played a decisive role by broadening the limited version of the citizenship rights based on the economic rights. In a series of cases, the Court positively moved away from the limited vision of market citizenship by establishing the connection between economic activity and the enjoyment of rights.

It was in 1990 when the three residence directives were adopted. These were Directive 1990/364 on a general right to residence³, Directive 1990/365 on retired persons⁴ and Directive 1993/96 on students.⁵ The right of residence was conditional according to two criteria: first, the non-economic migrant needed to have comprehensive medical insurance; second, he needed to have sufficient resources so as not to become a burden on the social security system of the host Member State.⁶ The introduction of the European Union citizenship together with the development of the Court's decision ended up in a situation of an outdated legislation. Therefore, in 2004 the specifics of the EU citizenship were written down in the so-called citizenship directive.⁷ It repealed and replaced most of the relevant secondary legislation that existed before to provide a single and coherent framework detailing the Union's citizen's rights.

ECJ has in its decisions protected EU citizens' rights on non-discrimination,⁸ the right to reside,⁹ the right to move and reside freely within the territory of the Member State.¹⁰

In the case of *Martínez Sala*, a Spanish citizen living in Germany was denied child raising allowance on the grounds that she was not a German national and did not have a residence permit. The Court recognised her right not to be discriminated in respect of the allowance, even when she was not considered to be a worker. The Court explicitly did not give direct effect to Article 21 of TFEU, although the principle of non-discrimination and equal treatment was recognised.

The right to reside and move freely within the EU and equal treatment are the most interesting rights that third-country nationals who are long-term residents

³ Council Directive 2000/43/EC, p. 26.

⁴ Council Directive 2000/43/EC, p. 28.

⁵ Council Directive 93/96/EEC, p. 59.

⁶ Students only needed to assure the national authorities that they have sufficient resources to avoid becoming a burden on a state.

⁷ Council Directive 2004/38/EC, p. 35.

⁸ *María Martínez Sala v Freistaat Bayern*, 1998.

⁹ Cases *Rudy Grzelczyk v Centre public d'aide sociale d'Ottignies-Louvain-la-Neuve*, 2001 and *Baumbast and R v Secretary of State for the Home Department*, 2002.

¹⁰ *Baumbast and R v Secretary of State for the Home Department*, 2002, § 81.

might want to enjoy by obtaining the citizenship of one EU Member State. The article elaborates further on the rights of long-term residents under the EU law.

3. Long-term residents

Long-term residents can be third-country nationals who have lived in one EU Member State for more than five years. It is required that a person moves within the EU in order to practice his EU rights. The Treaties in case of the long-term residents have given some rights to third-country nationals who do not move from one state to another. For example, Article 227 of TFEU on the right to petition the European Parliament and Article 15 of TFEU on access to documents are enjoyed by those who are legally resident, irrespective of nationality. Some TFEU articles apply to everyone and the individual even does not need to be a resident—for example, Article 157 of TFEU on equal payment for men and women and Article 169 of TFEU on rights of consumers to information. Furthermore, most of the rights enumerated in the Charter of Fundamental Rights are conferred on all persons regardless of their nationality or place of residence. The so-called equal treatment directives¹¹ apply to all persons, irrespective of nationality or residence. The details of the long-term resident status are regulated by the Council Directive 2003/109/EC of 25 November 2003 concerning the status of third-country nationals who are long-term residents. The aim of the directive is to establish a common status of long-term resident for those third-country nationals who have resided legally and continuously in the territory of one EU Member State. After five years of legal residence in a Member State, a person has a right to apply and by fulfilling all the conditions laid down in the long-term residence directive get the long-term residence right. It basically gives a person similar rights as EU citizens have. The third-country national should have adequate resources and sickness insurance to become a long-term resident. The EU citizens who have obtained permanent residence in another EU Member State nevertheless do not need to fulfil this requirement any more.

It is important to know what has been the status of an applicant of the long-term residence status before becoming a long-term resident. There is different treatment even of family members and it depends on who is the sponsor, whether the sponsor is an EU citizen or a refugee or a third-country national who is a worker, student or researcher. The directive promises that persons who have

¹¹ Council Directive 2000/43/EC; Council Directive 2000/78/EC.

acquired long-term resident status will enjoy equal treatment with nationals. The third-country national should have access to paid and unpaid employment, equal conditions of employment and working conditions, education and vocational training, recognition of qualification and study grants, welfare and social benefits, family allowances and sickness insurance, tax relief and access to goods and services, also freedom of association and union membership and freedom to represent a union or association, and also free access to the entire territory of the EU country in which they obtained the status.

In certain cases, EU countries may restrict equal treatment with nationals with respect to access to employment and to education (e.g., by requiring proof of appropriate language proficiency). In the field of social assistance and protection, EU countries may limit equal treatment to core benefits. This cannot be done for the EU citizens who have obtained the permanent residence right after five years of residence.

Long-term residents with the long-term residence permit and their families enjoy the rights of free movement to other Member States. But the family reunification directive 2003/86/EC limits the access of family members of the long-term residents. It says that long-term resident “with reasonable prospects of obtaining the right of permanent residence” will also enjoy the right to family reunification. So in case the long term-resident can prove that he has a prospective of obtaining the right of permanent residence he can apply for the family reunification. Afterwards when the family is reunited in the country where the long-term residence has been granted, the long-term resident has a right to move around EU together with his family members. An EU citizen, on the contrary, has a right to reunite with his family member in any EU Member State.

Long-term residents as EU citizens enjoy enhanced protection against expulsion. The condition on which expulsion decisions are based must constitute an actual and sufficient serious threat to public policy or public security. Expulsion decision cannot be founded on economic decision in the case of a long-term resident as it also applies in the case of the EU citizen. EU countries are also allowed to issue permanent residence permits which are more favourable than those set out in the directive but these types of residence permits do not give the right of residence in other EU countries. The right of residence in another EU country is limited to three months. It is similar to the EU citizen’s right to reside in another EU Member State but it is connected to the practice of economic activity as an employed or self-employed person or to studies. Guild (2000, p. 63) argues that as third-country nationals do not, as a rule, have a right

of admission or protection from expulsion as a matter of EU law, the rights of the state to ensure security take precedence over the rights of the individual. Therefore, the third-country nationals can be subjects of expulsion outside of the EU but this cannot happen to the EU citizen. EU citizens can be expelled only to their home country which is in any case an EU country, and for that reason they would not face the problem to be sent out of the EU. In the Presidency Conclusions, the European Council considers

that the priority for the coming years should be to focus on the interests and needs of the citizens and other persons for whom the EU has a responsibility. The challenge will be to ensure respect for fundamental rights and freedoms and integrity while guaranteeing security in Europe.

The policy document does not focus only on the EU citizens but on all other persons including third-country nationals. Long-term residents are therefore no exception. It shows that the EU has no intention to treat long-term residents in a less favourable way than it does in the case of EU citizens.

It is not easy to become a long-term resident of the EU as many countries require third-country nationals to comply with integration conditions¹² before becoming long-term resident, and thus tests are applied (Groenendijk, 2007). These tests are usually reserved to granting an individual citizenship of a state, not merely long-term residence status. Therefore it can be claimed that there is not really a big difference between those persons who are considering applying for the long-term residence status and those looking for a citizenship of a concrete EU Member State.

4. Estonian citizenship

The current Estonian Citizenship Act is based on the act adopted in 1995, just some years after Estonia re-declared its independence. The first Citizenship Act was adopted in 1992, shortly after the 1991 singing revolution (Kalev, Ruutsoo, 2009). The 1938 Citizenship Act was readopted and as a consequence “almost exclusively” granted Estonian citizenship to those who were citizens before 1940 and their descendants. This can be seen as one of the reasons for the high number of non-citizens in Estonia. The huge number of persons who arrived during the Soviet occupation period were not granted automatic citizenship

¹² Council Directive 2003/109/EC, Art 5(2).

as it was the case in Lithuania. This political decision of Estonia (and Latvia, respectively) not to grant automatic recognition to all persons living on the territory of Estonia, of Estonian citizenship, has created the long-lasting situation of some persons who according to the international law live in the condition of statelessness.

Nevertheless, the majority of those persons used to have a permanent residence permit in Estonia that is now called long-term residence status with the permit to live and right to return to Estonia. The switch from permanent residence permit to the residence permit of a long-term resident happened when Estonia implemented the long-term residence directive. It was decided that the permanent residence permit should be abolished and it was replaced with the EU long-term residence permit. Therefore, now the number of long-term residence permits can be easily measured by the numbers of persons without any citizenship. Estonian legislation does not identify these persons as stateless but as persons with undefined citizenship. There are several practical and non-practical reasons why these persons with “grey passport”¹³ (persons with undefined citizenship) have not applied for Estonian citizenship. Quite a big number of these persons can never obtain Estonian citizenship as they are related to the Soviet Army and are considered as a public threat. Others do not want to apply for the citizenship because of emotional reasons or fear of failing the state exam and language test.

Estonian citizenship can be acquired by birth, naturalisation or resumed by a person who has lost the citizenship as minor or who lost the citizenship through release from or deprivation of Estonian citizenship or upon acceptance of the citizenship of another state. Acquisition of Estonian citizenship is regulated by the Citizenship Act.

In order to get the citizenship by birth at least one of the parents of the child has to hold Estonian citizenship at the time of the birth of the child. Also in the case when the child was born after the death of his or her father and if the father held Estonian citizenship at the time of his death. There seems to be a small discrimination as in the case when the mother dies and the father does not have Estonian citizenship the child may not get the citizenship of Estonia. Also if the child is found in Estonia and it is not clear who are the parents of the child, the child will get Estonian citizenship by birth unless it is proved to be a citizen of another state.

¹³ A ‘grey passport’ will be issued to person with non-defined citizenship according to the provisions laid down in § 2 p 5 of the Identity Documents Act, 1999.

In order to acquire Estonian citizenship by naturalisation the person has to be at least 15 years old and is required to have stayed in Estonia permanently on the basis of long-term residence permit for at least five years prior to the date on which he or she submits an application for Estonian citizenship and for six months from the day following the date of registration of the application for the naturalisation.

All persons who wish to acquire Estonian citizenship by naturalisation have to reach a certain level of Estonian language competence; they must have permanent income which ensures the subsistence of him/herself and the dependants. Persons who have acquired basic, secondary or higher education in the Estonian language are not required to pass the language test. So therefore the problem for young persons who have finished Estonian-language schools is solved. Also the loyalty for obtaining the citizenship is required and the oath of loyalty has to be taken. The problem of statelessness mainly applies to the older generation who came to Estonia during the Soviet period. A person cannot be released from Estonian citizenship if the person will become stateless, has unfulfilled obligations before Estonian state (for example, men have an army training obligation) or is in active service in the Estonian Defence Forces.

The Estonian journalist with Russian ethnic background Sergei Stadnikov (2011) asks in his article a question as to why the holders of “grey passports” no longer want Estonian citizenship? The article claims that the number of persons holding a valid residence permit or a residence right dropped to less than 100,000 persons.¹⁴

Another news piece from 13 October 2011 states that the number of persons with undefined status has decreased to 98,500 persons. And the number of new Estonian citizens has increased by 1,072 persons in 2011.¹⁵ In 2010, Estonian citizenship was granted to 1,100 persons but the highest number of persons—22,700—goes back to the year 1996, shortly after the new Estonian Citizenship Act was introduced in 1995 (Järve & Poleshchuk, 2010).

A significant trend is also highlighted by the Estonian news portal, claiming that several Estonian citizens are giving up their Estonian citizenship in order to apply for a citizenship of another country (BNS, 2011). In 2011, during a nine-month period, 78 persons were stripped of Estonian citizenship and they acquired mainly the citizenship of the Russian Federation but also Finnish, Ukrainian, Danish, Belarusian, German, Swedish, Dutch, Lithuanian citizenship or that of the United States.

¹⁴ The total population of Estonia is about 1.3 million.

¹⁵ The available statistics date from 13 Oct 2011 and the number may increase by the end of the year.

Estonian citizenship is not granted or resumed to a person who submits false information upon application for Estonian citizenship or a false document certifying Estonian citizenship. Similarly, Estonian citizenship is not granted or resumed to a person who does not observe the constitutional order or any other Legal Act of Estonia, who has acted against Estonian state and its security, who has committed criminal offence for which a punishment of imprisonment of more than one year was imposed and whose criminal record has not expired, or who has been repeatedly punished under criminal procedure for internationally committed criminal offences, who has been employed or is currently employed by foreign intelligence or security services, who has served as a professional member of the armed forces of a foreign state or who has been assigned to the reserve forces thereof or who has retired there from. Estonian citizenship cannot be refused because of a person's beliefs. From the legislative perspective, those who were working in the armed forces of the USSR or KGB and were not benefiting from Estonian citizenship because of the *ius sanguinis* principle cannot acquire Estonian citizenship and their only alternative is to apply for the long-term residence status. Which most of them have.¹⁶ Marko Pomerants (2011), former Minister of Internal Affairs, has written in his statement that Estonia does not have an intention to change its citizenship rules as it is a fully sovereign right of the state to decide how the citizenship will be granted. It seems to be common political view of all Estonian parties that Estonian citizenship and immigration rules should be rather restrictive and should be a control based system. As it follows, not all persons can apply for Estonian citizenship even when they fulfil the language requirement.

5. Long-term residents in Estonia

Those who used to have a permanent residence permit after the introduction of the EU directive of long-term residents into Estonian legislation lost the permanent residence permit as all of them were granted the status of long-term resident of Estonia according to the Article 230 of the Aliens Act. The same Article states that the long-term residence permit gives the person a right to arrive to Estonia and live here without time limitation. It can be argued that basically the essence of the new type of permit that was introduced due

¹⁶ In 2009, the number of persons was 70, in 2008—65, in 2007—38, in 2006—54, in 2005—75, and in 2004—56 persons were released from Estonian citizenship. The number was the highest in 2000 when 350 persons were released from Estonian citizenship.

to the need to transpose the directive does not diminish the rights or ideas that the permanent residents of Estonia used to have. Nevertheless, the word ‘permanent’ which gives a feeling of being part of the society eternally has been changed with the word of ‘long-term’ which leaves more options to think that the status is not for infinity.

The Aliens Act that was valid before the transposition of the long-term residence directive gave a definition of a permanent resident in the following way: “Permanent resident in Estonia is Estonian Citizen or an alien living in Estonia with a permanent residence permit” (Aliens Act, Article 4, RT 1993). Article 12 of the Aliens Act from 1993 stipulated that the permanent residence permit can be issued to the alien who has lived in Estonia for three years with temporary residence permit during a five-year period and who has a living place and employment or other legal income to sustain his living. Article 231 of the Aliens Act which is currently applicable refers to the 3rd chapter of the 2003/109/EC directive which means that one has to open the directive in order to understand what rights a long-term resident has in Estonia. It is definitely not a good example of transposition of a directive as the main principle is that the Member State legislation should transpose the directive in a manner that the results and intentions of the directive would be achieved. Referring to the directive article should not be considered a proper transposition as there might be changes in the numbering or content of the EU legal act which makes the reference done in that way inappropriate. An alien who has a long-term resident status does not need to apply for the work permit nor ask for a permission to engage in business activities.¹⁷

It is of course arguable whether the word ‘permanent’ has the same meaning as that of the long-term resident in the EU legislation.

6. Conclusion

EU citizens have more rights than the long-term residents and it is a demonstration of the fact that citizenship is one of the possibilities to segregate a population. It allows discriminating on the basis of not belonging to the group of persons with rights of the EU citizenship. Long-term residents face in some cases a possibility of expulsion that is not possible to enforce on an EU citizen. The EU citizen’s right to stay in the territory of the EU might be a good reason for the long-term residents in Estonia to acquire Estonian citizenship. Estonian citizenship would

¹⁷ Aliens Act, Art 231 §3

give them the status of an EU citizen with the right to stay in Europe or, in rare cases, to be sent back to Estonia but not outside of EU.

The rights of migrants at the EU level are highly fractionalised and as the article shows the rights of a third-country national are not the same as the rights of an EU citizen although the idea of the directive was to bring the rights of long-term residents closer to those that are enjoyed by the EU citizens.

EU citizens have voting rights, the right to be elected to the EU Parliament and the right for the consular protection as an EU citizen by any other EU Member State consular representation. The right of protection in a third country, of the long-term residents who have acquired the status in Estonia, is not currently available for all long-term residents. Consular protection in another third country is nevertheless interesting for persons who are travelling.

Estonia issues Aliens Passport (the so-called “grey passport”) to persons who do not have any citizenship. These people have an EU long-term residence status and are protected only by the EU law when they exercise their EU rights as it derives from the Levin or Singh case (*Levin v Staatssecretaris van Justitie; The Queen v Immigration Appeal Tribunal and Surinder Singh*). Therefore, the rights of all third-country nationals with the status of long-term resident who live in Estonia are not always followed or protected by the EU law. Nevertheless, not all long-term residents residing in Estonia are in this type of situation as some of them have the citizenship of the Russian Federation, Ukraine or any other country (Gelazis *et al.*, 2000). These people are entitled to consular protection from their state of citizenship.

A problem remains for those who are persons with undefined citizenship and who have the Aliens Passport. In the case of Estonia, the collapse of the USSR and the Communist regime created the statelessness problem and the national interest to preserve the language and culture of the small nation has reduced the desire to solve the problem. The Soviet emigrants who came to Estonia during the Soviet occupation can be considered forced migrants. As stated above, not all of them have a right to acquire Estonian citizenship and can only have a long-term residence status. There is nevertheless a big group of persons who have not tried or who still have not been granted Estonian citizenship and their rights are not the same as those of EU citizens. Estonia has partly solved the statelessness problems by giving those persons residence status and special passports that are issued to persons with undefined citizenship that allows them to travel (Ruutsoo & Kalev, 2005). Also, the EU legislation on the long-term residence (Council Directive 2003/109/EC) has increased the rights of those stateless persons who

are considered to be long-term residents in Estonia. Even when they do not have a status they should have similar rights as citizens and should be respected according to universal human rights.

Granting citizenship is still the sovereign right of a country—not much has been passed for the competency at the EU level in this regard. Nevertheless, as far as it is differentiated within the EU Member States, acquiring the EU citizenship still stays diverse within the EU as it is directly related to the citizenship requirements of the concrete Member State.

Finally it can be said that for some third-country nationals based in Estonia there is even no dilemma, and they are just being deprived of the EU citizenship because they cannot apply for Estonian citizenship. This nevertheless does mean that in case they fulfil the conditions of any other EU Member State to become a citizen of that state, they might still become an EU citizen with full rights and obligations that the status entails. The EU citizenship can be the carrot for the long-term residents but probably not for those who do not plan to use their EU citizens' rights and as the rules of acquiring citizenship are diverse and depend on a specific state it might be useful first to check the requirements of other EU Member States before applying for Estonian citizenship.

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Georgia and the European Union from the Mediterranean Perspective

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Abstract: *The aim of the article is to highlight Mediterranean identity and its role in the European Union, as well as its importance in European integration for Member and non-Member States. The research is divided into two parts: (1) studying the issues of Mediterranean identity inside the European Union and (2) exploring the importance of this identity in Georgia's Europeanization.*

By analyzing the similarities between Georgia and Mediterranean countries, as well as evaluating the membership of these states in the EU, the article tries to draw perspectives for Georgia to become a Member State, possible negative and positive aspects of this membership for the country, as well as for the EU. What role Georgia's links to Mediterranean identity might play in this process and which are the most important elements of such progression.

Keywords: *EU membership, European integration, European Union, Georgia, Mediterranean identity.*

1. Introduction

The following paper is about *Mediterranean identity* and its role in the European Union, as well as its importance in European integration for Member and non-Member States. The research is divided into two parts: (1) studying the issues of Mediterranean identity inside the European Union and (2) exploring the importance of this identity in Georgia's Europeanization.

The first part is about Spain, Italy and Greece inside the EU, starting with an overview of the history of these countries since they applied to join the Union until they joined. Especially in the cases of Greece and Spain this part of the paper describes in detail the enlargement process, the main problems and the main benefits for both sides. Later, the study follows with analyzing the role of these countries since they joined the EU, their main contributions to the EU building process and the main problems created by them inside the Union. Then the study focuses on the importance of the Mediterranean countries as a whole for the society, analyzing the history, politics, geography and economy, with an emphasis on their Mediterranean character. Also it analyzes the Mediterranean identity as a bigger identity than the national one, but smaller than the European identity—a bridge between the two. The importance of this Mediterranean identity in the context of the European integration is about the identification of the people of Europe with the European building process. As the authors believe in the idea of a future development of the organization in a more federal way, combining different strategies from intergovernmentalism, neofunctionalism and federalism, the problem of the identity of the people of Europe is very important. The result of the integration process anyway would be some kind of a European state, with the main need to transfer loyalty of the European people from the national level to the European one. Hence, the enlargements of the Union should take into consideration not just the political or economic points, but also the social affinity of the people. This paper intends to analyze the Mediterranean identity as part of the European identity and hence receiver of European loyalty. The methodology of this part of the paper is based on the comparison of the situation in the three countries, describing and analyzing the different situations presenting a common approach.

The second part of the paper continues the discussion of Mediterranean identity and how important a role it could play in the EU, with its possible importance for Georgia. It tries to show the power of this identity in Georgia, previously a part of the Soviet Union and therefore influenced by the post-Soviet identity. The paper tries to figure out if Georgia can be included in the Mediterranean identity or the

post-Soviet identity, or both of them. The post-Soviet identity could be also used as a way to integrate Georgian people into Europe, creating another identity above the national level but under the European identity, sharing it with other European people such as Estonians, Latvians or Lithuanians. This part discusses the history of Georgia—EU relations, the state position of Georgia towards the Union and recent developments in this way—trying to show the perspectives of the EU–Georgia’s cooperation, the possible negative and positive sides of Georgia joining the Union, and the importance of Georgian identity, being close to Mediterranean one, for this process. Mediterranean identity being ‘middle-level identity’, thus above national identity and below the European one, can become a significant aspect of a country’s adaptation and its integration into the European community, making its way smoother.

2. Mediterranean states inside the European Union: Italy, Greece and Spain

Italy was a founder member of the European Communities since the creation of the European Coal and Steel Community (ECSC) in 1951. France and Germany mainly led the first Community; the other members had little influence in the negotiations. The Benelux countries depended on France and Germany in their economies, so they could not afford to be out of a process of integration. Italy, on the other hand, was a country divided between the north and the south. The north was more developed than the south, more Central European than Mediterranean, it was heavily industrialized and was interested in the integration process as a way to integrate with the main economies of Europe, as a way to reach the markets of the main economies of Europe (Fabbrini & Piattoni, 2007, p. 97). Nevertheless, the whole Italy won stability in its political system, supporting democracy versus different attempts of some Italian political actors, something seen also in the other Mediterranean Member States (EU, 2011a; c).

The next step in the European integration meant the establishment of the European Communities, especially the Common Market. It allowed people’s movement from Italy to other Member States without discrimination, helping to solve the long-term unemployment problem. Furthermore, European funds helped Italy to try to close the enormous economic gap between the north and the south. The European Communities were acting as a mirror of modernity for the Italians, being a model to imitate, a reference for the modernization of the country. The Italian miracle after the World War II, especially in the

northern part of the country, can not be understood without the influence of the European Communities, the Common Market, the exchange of the ideas and goods, being nowadays the seventh economy of the world and the fourth largest of Europe. Another important fact, especially for southern Italy, was the Common Agricultural Policy (Carello, 1989, p. 98). This European policy is still organized in different sectors and provides different levels of protection depending on the kind of production, as direct payments, minimum prices, import tariffs and quotas from outside the Union. The benefits for Italy and especially for the Mediterranean production were huge, because it gave free access to the European market to sell its production, and preference over other Mediterranean producers from both sides of the sea (Knudsen, 2009, p. 76). It meant a privileged position in the market similar to a monopoly with all its benefits for the Mediterranean agriculture of Italy (EC, 2008/2009).

Greece was the next Mediterranean state to become a member of the European Communities in 1981. Joining the Communities meant a step forward, blocking possible regression to previous situations or potential Communist domination. The Greek agriculture obtained similar benefits as the Italian one. The European Communities also helped the modernization of Greece, starting an amazing period of stability and economic growth for the country; once again, Europe was the image to follow (Tsalicoglou, 1995, p. 91). The case of Greece is important in the sense that it was the first member of the Community that could be considered relatively poor and put an end to the idea of the Community being a club of rich states (EU, 2011b).

Spain joined the Communities in 1986; the country came from under a long dictatorship of Franco and still there was a threat of going back to another military government. The European Communities supported the democracy of Spain against reactionary forces (Preston, 1996, pp. 25–34). The idea was simple: Spain needed to join the Communities in order to develop and this could only happen by being a democratic state. Agriculture, an important sector in Spain, also obtained benefits such as free access to the European market. Due to different climate areas in Spain, there are also different agricultural productions, including continental productions. Thus, Spain also got direct payments to its agricultural sector helping the country to maintain the sector, which was suffering from international competition. It was also important to keep the population in rural areas and decrease migration from the countryside to the cities.

The modernization of Spain was huge and a wave of reforms shook the country. The sacrifices were accepted by the society, being the requirements to join the Communities, the paradigm of progress and development wished by the

Spanish. The industrial restructuring meant an important step to modernize the country; the previous political regime led by Franco promoted the creation of large industries as a measure of economic autarky because of the isolation of Spain from the world politics. This system could just work having a monopoly over the Spanish market, but once in the European Communities, these big industries could not compete with their European partners and thus disappeared. The social cost of this reform was huge but affordable, as Brussels was asking for it (Elorza, 1990, pp. 254–263). Finally, tourism in the country boosted after the enlargement. Already before it was an important economic sector, but it grew faster, year after year, following the enlargement, bringing numerous economic benefits (Martinez, 2002, pp. 56–79). Even now, it still is, with 57 million tourists in 2011, the main economic sector of Spain, acting as the motor of the economy during the current crisis (EU, 2011d).

3. Positive effects of the Mediterranean countries on the European integration

The positive effects of the Mediterranean countries when they joined the Communities, since its creation until 1986, were numerous: first of all, supplying with cheap labour for the main European economies, first with emigration and later moving the production to the Mediterranean countries with lower labour costs in production (Martin & Ross, 1999, p. 40). Their membership also meant a support to the European integration, before it mainly focused on the Western Europe and rich countries. The enlargement to Greece and Spain showed that relatively poor European states could also join the organization, thus the organization was open to any European country as long as it fulfilled the requirements.

Furthermore, Mediterranean countries gave a bigger dimension to the European Communities increasing its area of influence and providing it with wider borders; the enlargement gave a huge new frontier to the Union, the north shore of the Mediterranean Sea and the geopolitical sphere of influence of the Communities became more important, strengthening the international role of the organization, which had previously focused on the Franco-German axis (Kavakas, 2001, p. 90). Italy, Greece and Spain were important markets for European companies, especially in Germany, whose economy had mainly been focusing on exports. Here, it is important to mention the principle of solidarity, as otherwise the EU would be just a free trade area with benefits for stronger states and losses for

the poorer ones. The funds of solidarity come from the Union's own resources that are calculated according to the economic activity of its members. Germany provides more funds because its economic activity is higher, but in return it is higher because Germany has access to the European market (McGee, 1998, pp. 12–27).

In terms of integration, the inclusion of Mediterranean countries into the European integration process meant more supporters of the European dream. As these countries were less developed, the idea of Europe was the paradigm of society and the support to the European integration was stronger with a more idealistic approach, with bigger acceptance to further integration. There are many examples of such support of the Mediterranean states to the European integration—such as the founding father of the federalist movement in Europe, the Italian Spinelli, or the support of the Italian government to the European Defence Community and the European Political Community in the 1950s, or the role of the Italian Foreign Minister Emilio Colombo in the Genscher-Colombo report, or the role of the former Prime Minister of Spain Felipe González Márquez in the creation of the European citizenship, or the outstanding supporters of the European building process such as the Spanish philosopher José Ortega y Gasset, or the humanist Salvador de Madariaga, founder of the College of Europe, or the wide support to the new Treaties are all examples of the Mediterranean contribution to the European integration (Brown Wells, 2007, p. 34).

4. Negative effects of the Mediterranean countries on the European integration

The Mediterranean states are known in Europe as more corrupted, at least before the last enlargements of the organization to Central and Eastern Europe. The corruption related with European funds was notorious in different fields, such as agriculture, plus bad implementation by the Mediterranean governments of European legislation in order to favour their economic actors (for example, the Bresciani case in Italy, Greece with the case of the tourist guides, or Spain with the environmental legislation). In terms of Italy, it is influenced by different criminal organizations and in terms of Greece—the state often being a main actor in the “wrongdoings” (Della Porta, 1997, pp. 35–45; Vannucci, 1997, pp. 50–60).

In economic terms, the Mediterranean countries, after a significant development and economic growth, currently have bad economic performances, being

a threat to the stability of the eurozone. However, their importance to other economies of Europe makes unlikely a bigger crisis that could lead us to the end of the common currency. Greece could abandon the euro, but Spain and Italy are too big to fall and therefore are united with the fate of the euro. As their economic performances were not sufficient and the governments did not follow the common rules, more and more people are now supporting the creation of a common economic government in Europe—thus, deeper European integration—to avoid this situation in the future.

Additionally, the social system of Mediterranean countries are a threat to their economic stability and thus to European stability. At the moment we can find four social models inside the EU: the Scandinavian model, the Continental model, the Anglo-Saxon model and the Mediterranean one; being unsustainable, the Mediterranean model is currently held by Italy, Spain and Greece. The reform of these models could result in the adoption of the Anglo-Saxon model in the Mediterranean countries in a long term, but the more active social actors in those states will make the transition difficult unless it is done with a big social pact between the main social powers, the government, business associations and trade unions (ETUC, n.d.; Bosch, Lehndorff & Rubery, 2009, p. 69).

5. Mediterranean identity

Construction of Europe needs the integration of its people. After years of economic integration, the political integration should be the next step in the process. In order to achieve a deeper political integration, the people of Europe should share a common identity respecting the national identities of the Member States at the same time. It is not the people against the state, rather it is more of creating a new political organization on the European level, where the political power of the citizens will come from being Europeans, not from belonging to any European nation. As it has been pointed out by most scholars involved in the European integration after the World War II, such as Altiero Spinelli, Salvador de Madariaga, Jean Monnet or Robert Schuman, the nations were the source of the conflict because it was a confrontation of nations against each other. The idea of national state and belonging to a society just as a member of the nation implies the concept of the nation as the last and sole entity holding the sovereignty of the people. It is an idea against the humanistic ideas of the French Revolution, the *Social Contract* of Rousseau, the ‘perpetual peace’ of Kant and those of many other European philosophers. The European integration does not

necessarily mean destroying in any way European nations, but it will take away the political power, the sovereignty from a nation, giving it to a new political organization based on citizenship rather than nationality.

There are different levels of integration, such as family, town, county, region, nation and state. The Mediterranean identity is between the state identity and the European identity and thus it could help integrating the people of Europe. The Mediterranean identity is wider than the national identity of the Member States, because it also includes different areas of other states, such as southern Portugal or southern France, plus other Member States such as Cyprus or Malta. The Mediterranean level of identity could act as a bridge between the state identity and the European identity, making the process of political integration in Europe easier. People all over the northern shore of the Mediterranean feel what Fernand Braudel (2002) defined as a cultural highway in his book *Memory and the Mediterranean*.

Mediterranean identity is based on different aspects, such as social behaviour, family, the role of mothers, food, religion, language originating in Latin or using the phonetic characteristics of Greek language, sports with a predominance of football and some ethnical traces, even though the Mediterranean are a mix of many different folks and people. These are trivial facts treated individually, but if combined they create a strong identity in the Mediterranean. The Mediterranean identity has been barely expressed in political terms inside the Union or in the Mediterranean countries, but we see very similar models of social policies in all Mediterranean countries whose roots are based on a common identity.

In the EU, we find some common issues for the Mediterranean states, such as immigration. It is the consequence of the geographical position of the Mediterranean Member States of the Union forming the Union's southern border. The Mediterranean states are willing to increase cooperation in this topic and normally act as a whole, inside the Community (Caldwell, 2010, p. 89). But these are rarely exceptions to their approach to the European Union issues, where we do not see often any common position from the Mediterranean states, acting as a bloc. It leads us to see the Mediterranean identity as a bridge between people, not between the states, and that is important step in the creation of the European identity (Lonni, 2003).

6. Georgia and the European Union

Georgia is a relatively small country in the Caucasus region of the Far East Europe, country with a long and “colourful” history. Being on the border of Europe and Asia meant that for Georgian society and a country as whole, the question whether to belong to Europe or not was always very topical. But integration to Europe and developing towards Europe has always been a priority (Müller, 2011). Georgia is thought to be a key geographical point in human migrations to Europe and hence it played a major role in the colonization of the European continent. For example, genetic analyses have suggested that most probably the original inhabitants of Spain, the Iberians, came from the region of Abkhazia in Georgia (Valera, 2007, p. 54). The Caucasian ethnic group is the majority of the continent nowadays and link somehow common the ethnic roots to Georgians and the rest of the Europeans (Baum, 2008, p. 87).

In 1918, the head of Georgian government Noe Zhordania used political unrest caused by the Bolshevik revolution in Russia to declare the country independent. The priority for the Georgian government was integration to the European political world in a way to reassure the country’s recent independence. He started establishing closer cooperation with European states. Later on, Zhordania explained: “Soviet Russia offered us [a] military alliance, which we rejected. We have taken different paths, they are heading for the East and we, for the West.” (Kirchick, 2010) Georgia’s independence lasted for three years and the country regained its independence only after the collapse of the Soviet Union in 1991, thus Tbilisi’s European plans had to be postponed until this time. The Soviet influence played a major role in the Georgian society: first of all, changing the link with religion, it closed the area to the other Mediterranean countries in a physical way, making almost impossible any cultural exchange, destroying the Mediterranean link established during centuries of constant cultural and economic exchange (Mamaladze, 1981, pp. 98–120). The influence of the Soviet Union increased after the World War II and it meant the imposition of Bolshevik standards in an area more influenced by Mensheviks and small plots of private property. The Bolsheviks’ idea—the necessity to destroy the society in order to build a new one—had an important cultural influence over many territories and nations under the Soviet Union and created some kind of a common identity, destroying previous links.

Soon after achieving independence, Georgia faced a series of huge problems, including wars in its breakaway regions of South Ossetia and Abkhazia, civil war and heavy corruption.

By 2003, the reform momentum sputtered to a halt, and Georgia was a near failed state. Political power was increasingly fragmented, corruption and crime were rampant, there were massive arrears in pension payments and teachers' salaries, and infrastructure was in a state of near collapse... (World Bank, 2009, p. 1).

It can be said that during this period, the stronger identity of Georgia was united with the post-Soviet identity. The example of other post-Soviet states, such as Estonia, cannot be applied in the case of Georgia—first of all, because the Russian influence during the occupation was stronger in Georgia than in Estonia, because of the German influence over the Baltic region. Also Estonia used its independence between the two world wars to get closer with its European partners. Finally, because of geographical reasons: Estonia is located very close to European areas such as Finland, and the Baltic Sea worked as a communication channel. The Black Sea and the Mediterranean did not exert similar effects on Georgia and the geographical isolation of the country in European terms did not help to improve the situation.

The difficult situation in the country described above led to the Rose Revolution in November 2003, when young Mikheil Saakashvili and his political partners overthrew President Eduard Shevardnadze, former USSR Minister of Foreign Affairs (Coppieters & Legvold, 2005, pp. 274–290). Revolution meant a great deal for Georgia, it brought to the country a young and pro-Western government, which, with a new style of politics, managed to pass very painful but long-needed reforms, significantly reduce corruption, establish a very business-friendly environment, etc. The trust and support of Western partners returned, investments started to flow in and the country's economic situation started to improve tremendously (Coppieters & Legvold, 2005, pp. 274–290). One of the tasks of the new Georgian government was also to shift the identity of Georgia from post-Soviet to European, following the example of other former socialist states.

When it comes to fighting corruption, the country's success has been also acknowledged by the civil society organization Transparency International. The organization reported that after the Rose Revolution, the new government engaged in “large-scale reform, resulting in an almost complete eradication of petty bribery” and even though “its actions at times have been drastic—take, for example, the decision to disband the entire traffic police force—but the results are impressive” (Transparency International, 2011). In the organization's Corruption Perceptions Index, Georgia ranked 124th back in 2003 scoring 1.8 on a scale of 10 to 0, while in the following years the country's results have been improving and in 2011 Georgia ranked 64th scoring 4.1 (Transparency

International, CPI, n.d.). In contrast to its neighbours, Azerbaijan and Armenia who are constantly trying to keep the balance between their relations with the EU and Russia, in Georgia, not only the government and the ruling party but also the opposition are united behind the pro-European way of the country (Cornell & Nilsson, 2009). The EU itself becomes more concerned in the region of South Caucasus, engaging in different cooperation programmes to support necessary reforms (Chochia, 2012). Since the first day after coming into the power, Mr. Saakashvili and his government have been pointing out that the main goal of the country is to join the European community and develop towards the West (Georgiev, 2008, pp. 34–51). As a symbolic fact, European Union flags were introduced, and still are raised, on every government building and main state institutions. The new government also started to work on the new Georgian identity by changing the understanding of the Soviet past of the country and underlining its disastrous effect on the Georgian nation. Soon after Saakashvili came to power, the Soviet occupation museum was opened in the capital Tbilisi, and many similarities could be drawn with other former Soviet states who went through similar process of re-defining the past.

English became the main foreign language in the country's educational system instead of Russian, and obtaining a degree from European or American universities was widely promoted (Rubdy & Saraceni, 2006, p. 64). All this led to a change in the country to focus on European matters, free from the influence of Russia. Cooperation with the European Union deepened and improved (EU, 2006) and the process has been actively promoted by the government in the media, thus the Georgian society became more aware of the European Union, its way of development, its values (Müller, 2011). But the Georgian government focused more on the leading states of the Union, such as France and Germany, as the mirror for Georgia.

Georgia has faced serious problems during recent years, including a heavy defeat in the war of summer 2008 against Russia over Georgia's small break-away republic of South Ossetia, as Russia tried to keep control in the region, which it considers to be within its sphere of interests (Chochia, 2009). The war almost destroyed the country's economy, and even though the situation was saved by a huge post-conflict aid package of 4.5 billion USD from the Western countries, the effect of a global economic crisis was very heavy on Georgia, as all its economic indexes went significantly down (World Bank, 2009). There were demonstrations against the government and many thought Saakashvili would not be able to hold power; however, he remained in power, mainly due to the opposition's disunity and incompetence, and started to make reforms to improve the country's situation. But the situation in the country remains quite

difficult as unemployment and inflation is very high (World Bank, 2009; World Bank Indicators, n.d.), and poverty rate has increased (UNDAF, 2011). The much promoted European orientation of the country suffered a setback in terms of politics, but still the population is focused on the Europe as the mirror of progress and as a social model for the Georgian society. Nevertheless, the focus was again on economic terms, mainly the modernization of the country, and not much effort was made in terms of culture. Many things have changed in Georgia during last decade, but one thing has certainly not changed—the Georgian society's and the whole country's preferences to develop and move towards the West and particularly towards Europe (Müller, 2011). On the other hand, the European Union itself shows support to Georgia and the recent developments have confirmed this fact.

7. Negative and positive aspects of Georgia joining the European Union

Georgian government has clearly defined pro-European ideas; it clearly sees the European Union as a main partner and future destination for the country (Piris, 2010, pp. 301–314). Cooperation with the EU is a priority and Tbilisi is trying to show its commitment to the cooperation. Georgia understands that the EU would mean a huge modernization for the country, development in such fields as human rights protection, social mobility, environmental protection and domestic politics. The government advertises among the people the idea that being closer to the EU, or in the best-case scenario, joining the Union, would mean a huge development for the country and would stand for its absolute and total modernization. Many reforms are taken with the reasoning that these steps would bring the country closer to the EU and the idea is very much accepted by the people (Staab, 2011, pp. 64–67). This shows that the government will be able to introduce and implement sometimes painful reforms which will be required by the EU.

Georgia clearly sees the European Union and belonging to a genuine pluralistic security community and its value system as a guarantee for the security and stable development, country's international leverage (Staab, 2011). On the other hand, the EU High Representative for Foreign Affairs and Security Policy and Vice President of the European Commission, Catherine Ashton once more underlined EU's full support and its "strong commitment to strengthening relationship with Georgia", when she visited the country in July 2010 for Association Agreement

negotiations. Baroness Ashton called the European Neighbourhood as a top priority and Georgia an important partner, as she said:

Today, we are building on already strong foundations to bring Georgia closer to the EU. We remain fully committed to supporting stability, democratic development and economic development in Georgia... stability and prosperity here enhances stability and prosperity in the European Union (EU, 2010).

The political stability in Georgia is a very important fact in this regard. One of the issues Saakashvili's government has been criticized for was the constitution and the switch of power to president after the revolution. Tbilisi, which tries to improve its relationship with Europe after it has been damaged due to the 2008 war, started the constitutional reform in order to change the political system and shift more power from the presidency towards the parliament and the government. Tbilisi even invited the Venice Commission to review the reform, which mostly had a positive feedback on the amendments, even though criticizing the aspect of the difficulty of removing the Prime Minister. The stability of institutions guaranteeing democracy is a core political element when the country joins the European Union, thus Saakashvili's such a strong personal position (of course, if he, by a stroke of luck, is to become Prime Minister) will surely be a problem. Saakashvili does not jail his opposition, like some other leaders in the post-Soviet area, but conditions of the opposition and freedom of the media stay as points to be concerned and worried about (Cecire, 2011). Furthermore, the system of elections in Georgia remains poor, as voters are mostly not offered a clear ideas about the policies, thus the candidates are identified whether being on one side of a political frontline or another. The EU is used as a paradigm of political standards, while Europe acts as the catalyst for the democratization of Georgia, as it did in the case of Greece and Spain, when both countries after their respective dictatorships became democracies, and supported the political reforms on European standards.

A true democratization of Georgia is and will be a challenge for the European Union and Georgia. It should do all it can do ensure that reforms in Georgia will continue (Mitchell, 2008, p. 89). As a chairperson of one of the leading Georgian NGOs, Georgian Young Lawyers Association, explained:

For us, EU integration means democratization, economic standards and security, but on the democracy side, the EU is not utilizing all its leverage the way it could. For instance, the huge economic assistance after the war should have been used to ask for democratic reforms. The EU is focusing on free trade agreements, economic

harmonization, but there are no benchmarks on the rule of law and the respect for human rights. (Pop, 2011)

Another important field is the existence of a functional market economy and the capacity to cope with competitive pressure and market forces. And when it comes to Georgia, it should be mentioned that the country's economy is struggling. In a successful scenario, Georgia might be a new, stable and profitable market, which EU is probably always looking for, but for this to be the case, there is still a very long way to go and definitely more actions and efforts are required from the both sides. Economy also means a change in the mentality of the people, changing the economic model from a post-Soviet situation where the market is a jungle to a social market, where there is freedom, but also the rule of law and social policies decreasing the negative effects of pure capitalism. In this case, we do not see any similarity with the Mediterranean states, which are very generous in their public social subsidies, and Georgia is closer to the Anglo-Saxon model. It can be compared to other ex-Soviet Republics, such as Estonia, where the social model is also similar to the Anglo-Saxon, with the state acting as a supervisor of the free market, against the Mediterranean style of controlling the market. Thus, we can affirm that the identity of Georgia in this field is more linked with its Soviet past than with its Mediterranean identity (Mikhalev, 2003, pp. 107–123).

Agricultural sector, one of the main sectors of the EU cooperation, is extremely weak in Georgia. Saakashvili's government put the sector high on the agenda, but the actions remain very questionable. As a senior fellow at the country's leading think tank, Dr. Vladimer Papava said:

When the Minister of Agriculture talks about developing agriculture through the export of frog legs, developing crocodile farms in west Georgia, and bringing South African farmers to the country, a few simple questions comes to mind—has he got any idea about agriculture? (Papava, 2010)

When talking about the Mediterranean context, Georgia's agriculture can be considered as so-called Mediterranean agriculture, thus the experience that the Mediterranean countries had in this field will be very useful (Iglesias *et al.*, 2009, pp. 267–290). The European Union will definitely bring a huge positive impact on Georgia's agriculture, allowing it to modernize its production, which is very much needed in the country. As a post-Soviet country, Georgia's agriculture very much needed a modernization after the collapse of the Soviet model of farming, but due to continuing wars and destabilization in the country, as well as a high level of corruption, especially before the Rose Revolution, the country practically never managed to modernize its agriculture in the way that

it would be competitive. Georgia's agriculture is able to grow various produce, including wheat, vegetables and fruits, but still due to the lack of modern production systems, the country needs to import agricultural products from the neighbouring countries, mainly Turkey. Furthermore, special attention should be paid to Georgian wine and the country is still struggling after its wine production was banned from Russian markets. Since then Georgian government has tried to improve the production, as well as to advertise it more in order to be able to sell it elsewhere and of course in the EU, as wine still remains the country's main product. Having more possibility to sell wine in the EU would solve the problems in the field. Therefore, the EU would definitely bring improvement in the sector, by modernizing it and of course allowing the country to have free access to European markets and sell its production in the EU with import barriers, such as quotas, taxes, etc. The Mediterranean agricultural production of Georgia is strongly linked with those of Greece, Spain and Italy, and it has a cultural expression in many folk traditions linked with harvest, food, dietary habits, etc. Georgia could become a competitor to the Mediterranean states of the Union, as its production is similar, and thus it could raise some suspicion among the farmers of these states. As the Common Agricultural Policy supports mainly the continental production and gives preferential access to the Mediterranean products, the impact in terms of money will not be huge in Georgia, but it will open a market full of consumers for the Georgian production and therefore it will push for a better use of the current economic system in agricultural terms (Fennell, 1980, pp. 149–190).

The social system is also a very important field, as in Georgia it is quite unstable and will definitely be a challenge for the EU. Georgian side, on the other hand, should also keep in mind the immigration issue, as the country might experience possible exodus of a very high percentage of its population, which was a case for previously accepted (to the EU) Eastern European countries (Pollard, Latorre & Sriskandarajah, 2008; see also Kelo & Wächter, 2004). Even though the Common Market would allow Georgia to lower its unemployment rate, which is one of the most problematic issues in the country and has been such since its restoration of independence. Georgia would mean cheap labour, making the situation similar as it was in case of Italy and Greece.

Another issue is European Union's energy policy. If it is in Europe's interests to reduce its energy dependence on Russia, then protecting peace and stability in Georgia, therefore, protecting oil and gas pipelines crossing through the country, should be a priority for the EU and reaching this goal will definitely turn into a huge success for the Union, its world position and its overall objectives. But here the issue of EU–Russian relations comes up and the Caucasus region is

a sensitive topic in those relations. Russia definitely sees the region as in its sphere of influence and has made attempts to rebuild it. It is under the post-Soviet influence of the Russian model of society, different from the European understanding of society (Duffield & Birchfield, 2011, pp. 169–186). However, when it comes to the Mediterranean issue in this case, it is important to underline Italy's friendly relations with Russia, which makes it very unlikely that it would fully support any alternative routes, excluding Russia.

The internal conflicts of Georgia are probably the most problematic and challenging issues when it comes to EU–Russian relations. After the August war of 2008 and recognition of two separatist regions by Russia, the EU Monitoring Mission is the only international monitoring body in the conflict zone, as soon after the war Russia vetoed the extension of UN and OSCE monitoring missions in the area. The EU was very slow to engage itself in the problem and devote more attention to these conflicts before the war and now it spends huge sums of money to keep the monitoring mission and try to control the situation in the conflict zone. The situation itself is risky and the tension between the countries remains very high, so the EU needs to stay engaged and try to keep the situation under control, using its diplomatic tools (Popescu & Wilson, 2009). The EU High Representative for Foreign Affairs and Security Policy and Vice President of the European Commission, Catherine Ashton has confirmed EU's position concerning the issues during her visit to Georgia in July 2010 and said that the European Union

welcome[s] Georgia's commitment to solving the conflict only through peaceful means and diplomatic efforts... The EU will remain fully engaged in conflict resolution efforts, using the variety of tools at our disposal. The EU Monitoring Mission remains an indispensable factor for stability. (EU, 2010)

The successful outcomes of close EU engagement will certainly benefit the Union and will increase its significance as a global political actor, however, the challenges of such close involvement are very clear. When it comes to the Mediterranean countries, Spain's internal problems mean its solidarity to Georgia in this case; as for Greece, expelling ethnic Georgian population from Abkhazia and South Ossetia, as well as mass deportation from Russia, draws parallels with the migration of ethnic Greeks after the conflict with Turkey.

8. Conclusion: Mediterranean identity vs. Georgian identity

Analyzing the similarities between Georgia and the Mediterranean states inside the EU, positive and negative effects of Georgia's possible integration into the EU can be found. Georgia could supply the EU with cheap labour, including the localization of European companies there to lower production costs. Georgia could also increase the EU's role on international level, as the country is located at a crossroads of civilizations (King, 2009, p. 86). But at the same time, it is also a disadvantage, because of the possible confrontation with Russia. Georgia itself, due to its size, cannot be as important in market terms for the EU as are Italy and Spain, but the possibilities of further opening of the markets of Central Asia and to some extent to the Middle East, could supply the EU with a robust presence in these markets with the consequent economic benefits (de Waal, 2010, p. 145). Finally, following the example of Greece, Italy and Spain, Georgia is a fervent believer of the European integration and would like to take part in it.

There are also parallel negative effects for the Union in case of Georgia's accession, similar to those of other Mediterranean countries. First of all, corruption that will increase the level of corruption in the EU and generate the same problems as in the Mediterranean Member States. Second, Georgia, as a less developed country, will generate economic tensions inside the EU. The problem could not be big, due to Georgia's size, but in the current economic conditions even that is important as it could mean further economic challenges. Finally, the Mediterranean identity is strong in Georgia and it could help in the European building process, contributing to deeper integration. As we have seen, in order to have any kind of state, even if it is a supranational state, the link of the people with the political structure is needed. There has to be some kind of identification and thus political loyalty of the people. The European identity above the national identity (never to be eliminated) is needed in order to establish stable political institutions on the European level and the Mediterranean identity could help serving as a bridge between these two levels of identification. In the case of Georgia's accession to the EU, the Mediterranean identity will be stronger, helping to develop the desperately needed European identity.

The implication of Georgia in the EU from a more domestic perspective shows that Saakashvili's government is driven more than ever by the ideology, the country's policy is very pro-United States and pro-European (Wheatley, 2010). The goal is to join the European Communities and NATO: this is seen as the best and may be even only way of development, protection and solving the problems (Jacoby, 2006, pp. 101–130). This ideology is widely shared by Georgian society

and there has not been a serious alternative in the minds of Georgians to the way towards joining the European family. Georgians consider themselves as Europeans, especially when it comes to identity—the Mediterranean identity is seen as something very similar to Georgian one. Connections are especially tight with Greece, sharing one religion (considering the fact that Georgians are very religious and the Orthodox Church is seen as a very influential body), many traditions, minority related connections (many Georgians living in Greece and a huge number of Greeks who have lived in Georgia for a very long time). And, of course, the history, starting from the legend that every Georgian is very proud of—the legend known primarily from Greek mythology about the Golden Fleece and Jason, together with Argonauts travelling from Greece to ancient Georgia to seize it from Colchis.

The main concern will be whether Georgia can or cannot join the organization or what kind of relations is it going to have with the EU. Its future in a way depends on the relations of Turkey and the EU, because of the obvious geographical reasons and here the Mediterranean identity plays a major role. Turkey as a Mediterranean state has been involved in the development of the cooperation in the Mediterranean area, acting as a key player, leading somehow the Muslim Mediterranean states in its relations with the EU, promoting a new Ottomanism and, at the same time, acting as a partner of the Union. The future of the enlargement to Turkey will define its ambiguous position—if the country joins the organization it should forget its imperialistic approach based on religion, if it does not, the relations of Turkey with the EU would be done via the Union for the Mediterranean. Currently this organization is empty and without any influence, but it could be the future vehicle of the relations between Turkey, the EU, the eastern and southern shores of the Mediterranean. Here, the Mediterranean identity of Georgia could play a key role in its relations with the EU, including the country in the association and thus developing stable relations with the European Union.

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The Internationalization of Estonian Higher Education: How the Estonian Cultural Context Impacts the Experience of Foreign Students

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Abstract: *The publication of The Erasmus Student Network survey put Estonia on the map of the most desirable places for international students to study by giving Estonia the highest mark of all 25 countries covered. As a result of this becoming widespread information, Estonia has become recognized as a very desirable place for international students to study. Maintaining the ranking that Estonia enjoys amongst international students has partly resulted from recognizing that attention needed to be paid to the adjustment challenges faced by international students while studying in Estonia's unique cultural and climate context. This was first recognized by Loone Ots over two decades ago.*

This paper takes into account that in order to continue enjoying the high ranking of international students, university officials must demonstrate increased cultural competence and cultural awareness by effectively managing the adjustment process of international

students. This premise is consistent with the data collected by the research team at the Department of Economics of the Tallinn University of Technology. The results of the research have strengthened the research team's conviction that Estonian educational authorities best fulfill the proposed internationalization plan for 2006–2015 by both managing the challenges of the internationalization of university level education in Estonia as well as researching the particular problems international students have in adjusting to higher education in the Estonian cultural context.

Keywords: *cultural adjustment, cultural fatigability, cultural shock (CSH), self-identification*

1. Introduction: the internationalization of higher education

The concept 'university' implies that the scope of the university community is itself international. This is based on the premise that reliable knowledge cannot be produced in local isolation but can only be obtained by an open and honest inquiry that is international in its scope. That is, the nature of today's global reality necessitates structuring the higher learning experience so that it prepares the student to deal with the globalized world and with global interdependence. The main aspect of these modern developments, as far as domestic centers of higher education are concerned, is the internationalization of educational services and educational institutions. Internationalization is driven by national, regional and global forces pressuring universities to engage and attract international scholars, plus engage and attract international students as the means of raising their reputation to international standards by engaging in reliable knowledge exchange with international partners.

Famed consultant on organizational behavior Peter F. Drucker (1999, p. 61) points out that the internationalization of organizations (due to the impact of globalization) accentuates the necessity of making global competitiveness a strategic goal for all institutions. He stresses that universities, as well as all other current organizations, cannot compete/survive unless they measure up to international standards set by the leading universities (anywhere in the world).

The Erasmus Student Network recently published a new survey for 2010. This new survey reveals that, when asked to rate the overall level of satisfaction with their experience as an international student studying abroad, visiting international

students gave Estonia the highest marks of all 25 countries covered (*Study in Estonia*, 2010). Estonia's reputation as a study center has been influenced by this becoming widespread information resulting in increasing numbers of international students deciding to study in Estonia. Consequently, Estonia is witnessing an increase in students coming from such exotic and sunny places such as the Caribbean, the Mediterranean, and South East Asia. Although this poses an opportunity for Estonia, it also poses a tremendous challenge. The challenge lies in keeping in mind that the high ranking Estonia enjoys cannot be maintained without considering the adjustment challenges that students face when studying in the Estonian cultural and geographical climate.

There are a growing number of research articles pointing out the challenges university systems face connected with the increasing internationalization of education. According to the Estonian Higher Education Strategy 2006–2015, the Estonian Ministry of Education, for example, acknowledges that for several reasons (including its demographics) it is necessary to plan an effective response to the demand for the internationalization of its university programs (*Estonian Higher Education...*, 2006). In relation to the Eurostudent report, the most prominent mobility of the students can steadily increase because in the European Higher Education Area students have had a study or training period abroad (Orr, Gwosć & Netz, 2011).

However, the European Commission has stressed in its 2011 Communication to the European Parliament and other institutions that the fact of Estonia enjoying an increase in the influx of international students within itself is not enough. In other words the increased number of international students attracted to studying in a particular locale must be matched by the center's effort to improve the outcomes and overall conditions of the international student (EC, 2011). In other words, according to Drucker (1999, pp. 58–60, 80–81), staying ahead of the rapidly changing conditions of today's globally networked information economy demands continuous performance improvement in ways that will result in the continuous satisfaction of clients and stakeholders.

Accompanying the need for research on managing the challenges of the internationalization of university-level education in Estonia is also the need for research on the particular problems students have in adjusting to the internationalization of higher education in the Estonian cultural context. This corresponds with the admonition of Loone Ots based on earlier research on the experience of international students studying in Estonia (Ots, 1998, p. 376). Loone Ots began to observe over two decades ago that there was already a growing interest amongst foreign students for studying in Estonia. Ots thought

the increase could be due to “[a]n attraction to what appears to be an exotic place, a general desire to become acquainted with former socialist countries and an interest in visiting as many other different universities/countries as possible.” However her article also highlighted the fact that almost all foreign students were reporting having cultural shock as a part of the adjustment to studying in Estonia (Ots, 1998, p. 376).

This article explores the challenges connected with the internationalization of higher education in Estonia; however, the primary concern is on facilitating internationalization in a way that enhances the learning experience for students in international programs. This article is based on a quantitative measurement of the need to address the adjustment challenges students face when studying at the Tallinn University of Technology. In this respect the article examines the adjustments necessary because of the culture shock that students experience in an unfamiliar cultural environment.

The first segment of the article reviews the research done on the adjustment challenges international students face when studying in a new cultural environment. Much of the research describes this adjustment process as cultural shock. Thus, the article introduces and describes the role of culture shock in the adjustment efforts of international students and introduces why it is a factor in the adjustment process of foreign students. The second segment of the article describes current research done on the adjustment of international students. The emphasis here is on the type of things a university must keep in mind to better facilitate the transition of its international students. The third segment of the article quantitatively measures the features of culture shock on the experience of foreign students participating in the English-speaking International Program at the Tallinn University of Technology. The final section of the article summarizes the significance of facilitating the adjustment process of international students as part of the internationalization planning of institutions of higher learning.

2. Literature review

Multiculturalism, increased diversity, immigration and student mobility are some of the factors that challenge programs of higher learning to facilitate a greater number of international students. Estonia, for example, is enjoying the reputation of being an attractive place for international students to study. Thus, as a result of Estonia attracting larger numbers of international students

it is also a good place for doing research on the experience of international students studying in the unique Estonian cultural context. In accordance with this Estonian higher educational authorities are increasingly recognizing the value of research on the unique experience of international university students who study in the Estonian cultural context.

The internationalization of higher education has increased the challenge that students face in adjusting to unknown cultures. These challenges have been studied by specialists analyzing different aspects of the educational process and the impact that internationalization has on the educational process. Their careful analysis reveals that one of the difficulties that students face in adjusting to studying abroad is culture shock (occurs when an unfamiliar culture has a stressful influence on a person, sometimes described as cultural fatigability or just stress). The term 'culture shock' was introduced by Kalervo Oberg in 1960 (Oberg, 1960) when he noticed that entering a new culture can be accompanied by a number of unpleasant feelings. Nowadays it is considered that the experience of culture shock is stressful because it is unexpected, on the one hand, and can lead to a negative evaluation of the new culture, on the other. The stressful impact of a new culture on a person is called culture shock, or stress, or marginal stress, or cultural stress fatigue by contemporary scholars.

Most people who have changed their place of residence to a new culture suffer from some degree of culture shock. Culture shock has psychological and physical consequences that play a role in the adjustment to new situations. Today, local centers of higher education enjoy a vast increase in the number of foreign students but if institutions of higher learning fail to take cultural competence into consideration, students can be left with various unpleasant emotions connected with adjusting to an unfamiliar culture (Nekrassova & Matveeva, 2010, pp. 4–12). Students can face adjustment difficulty that is felt as culture shock and such unexpected experiences may lead to a negative appraisal of the culture and the educational experience.

Culture shock can be defined as an unpleasant and extreme reaction during the common process of adaptation to new conditions. But in spite of the stress, the person adjusting to new cultures is becoming enriched and more developed due to enhanced cultural knowledge and competence. Since the 1990s this common experience is typical to people and is often identified as 'acculturative stress' rather than culture shock (Berry, 2006, pp. 43–57). Helen Spencer-Oatey and Peter Franklin (2009) explained that culture shock can occur in one or all of the following ways: pressure because of the efforts applied to an attempt at psychological adaptation; a sense of loss in relation to friends, status, profession

and possessions; a feeling of isolation in a new culture which can turn to an unpleasant experience in the unknown culture; confusion of role expectations and the feeling of self-identification; anxiety passing into indignation after the comprehension of cultural differences; a feeling of inadequacy because of the inability to cope with the situation.

The main reason for culture shock is that experiences and interactions in the new cultural setting do not conform to an individual's psychological expectations. Every culture has its own unique set of symbols and images, expected patterns of behavior and interactions that are common to various situations within the culture. The environment of a new culture makes the individual's habitual system of orientation inadequate because it is based on a different representation of the world, different norms and values, plus different perceptions of behavior, and different behavioral expectations. Interacting in a culture that one is habituated in means that the person can behave without thinking about the existence of a majority of factors that lie beneath appearances (see the 'cultural iceberg theory' in Trompenaars, 1998). In other words, as Trompenaars points out, there is a whole realm of significant information about a culture that is not apparent, resulting in a hidden system controlling behavioral norms and values. Thus, when a person has contact with an unknown culture he or she can feel psychologically and sometimes physically uncomfortable. This feeling of discomfort is the result of culture shock.

The level of intensity, duration, and need for adaptation due to cultural shock depends on many factors. One of the most important factors is the previous experience of living in an unknown cultural environment. The more exposure a person has had to diversity the more the person is prepared for a better adjustment. However all of the factors can be divided into two categories: internal (personal) and external (group). In the first category of ones the most important factors that need to be taken into consideration are the individual characteristics of a person—such as gender, age and personal traits.

Gender influences the process of adaptation and duration of culture shock (hereafter CSH). Research on what is involved in adapting to new cultural settings states that the process of adjustment to a new environment is more complicated for women than it is for men. However this is most common when women come from traditional cultures where their life is limited to activity around the home. As for women from developed countries these differences are blurred and research indicates that women can be as successful as men in adapting to new cultural settings.

The **age** of a person is considered to be a significant adjustment factor in the process of adapting to an unknown community. The older the person is, the more difficult the adjustment to a new cultural system, it is harder and takes longer to overcome CSH, and older people more slowly overcome the difficult challenges that patterns of an unknown culture pose for them.

Educational factors are more and more becoming a considerable adjustment factor, the more educated the person, the more successful his or her adaptation. Education, even without taking into account its cultural content, expands the internal resilience potential of a person. The more complex the inner world of a person, the faster and easier the time needed for creative innovation.

Among the external factors influencing adjustment and CSH, cultural distance can be designated as a main one. The person's perception of cultural distance depends on many factors: economic factors, emotional factors and the person's language skills. If the values of one's culture differ from those of another culture and cultural difference is huge, adjustment can be long and painful.

The **circumstances of one's life experience** (related to the internal factors of adjustment and the motivation to adjustment) are the most influential factors. This aspect of motivation is very high among students who are studying abroad. In order to reach their goals they try to adjust as quickly as possible.

The **peculiarities of one's culture** can be crucial to adjustment. For representatives of nationalities who are afraid to "lose face" or for those of the more powerful nations (G8 countries) the adjustment is mostly stressful.

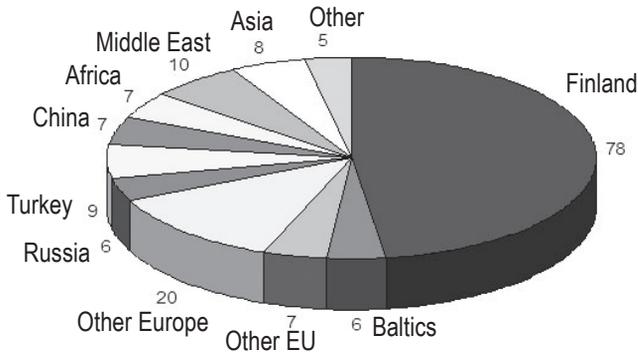
The **social and cultural conditions of the visiting country**, such as the friendliness of locals to foreign students, their willingness to help foreign visitors and socialize with them, are very essential for aiding a healthy adjustment.

CSH is a complex process for students but the results which can be reached (such as new perceptions of the world based on understanding and accepting cultural diversity) are worth the effort it takes to overcome it. The key advantage of effectively managing CSH is the priceless experience and acquired skills students can draw from while living and working in our rapidly changing world with reduced borders where competence in intercultural relations is becoming more important.

The Bologna Accord, with its intention to attract worldwide academic cooperation, has played a role in the increased migration of students from many parts of Europe, Central Asia, Asia, Southeast Asia and the Far East. The enlargement of the European Union has influenced the ethnic diversity of

students at Estonian educational institutions and the educational environment is becoming more and more multicultural (see Fig. 1 below). These changes have a great impact on both the teaching and studying processes.

Figure 1. The number of international students studying in Estonia in 2010



Thus, the aims of education have to reflect the current situation in the educational environment. In light of internationalization increasing cross-cultural competence has to be an integral part of the university's plan for effectively managing internationalization. This demands the training of future university specialists in enhancing cross-cultural interactions and the university must consider implementing procedures to manage the consequences of CSH. The combination of didactic and empirical methods of teaching can be very effective if the teachers are familiarized with studies on building cross-cultural competence.

According to Ting-Toomey (1999, p. 194) without appropriately facilitating the student's adjustment process to studying in a foreign cultural context students are more likely to experience a prolonged period of feeling confusion over values, norms, processes as well as over content, identity, relational and procedural issues. On the other hand, as Ting-Toomey points out, careful attention to the adjustment process of students studying in this culture helps them to have not only a better learning experience but helps them to grow (mature) as individuals as a result of an enriching cultural experience.

Improving the performance of students attending higher education programs in Estonia demands attending to the factors involved in their adjustment to the Estonian cultural context. Estonian institutions of higher education are increasing the effectiveness of their effort to appeal to international students and

their ability to offer an enriching learning experience by carefully planning the internationalization of its programs. This includes taking CSH as an adjustment factor in the learning experience into consideration.

3. Methodology of research

Aim of research: to explore and single out the main components of the culture shock among the first-year foreign students studying at the Tallinn University of Technology.

Research subject: a group of foreign students, studying in the English-language program at the Tallinn University of Technology. The sample size was 61, between the ages of 18 and 45.

Object of research: the peculiarities of CSH in the context of the international program of foreign students of the Tallinn University of Technology.

Research hypothesis: It is supposed that while studying in the international program at the Tallinn University of Technology, CSH has specific features that are experienced by students.

Research objective: Determine the peculiar features and components of the CSH for students studying in Estonia.

Methods of research: The basic method of research for this study is experiment. The basic method used for collecting empirical data is testing. The method used for statistical data handling is quantitative analysis and qualitative analysis is carried out by content analysis. Content analysis is a research technique for objective, systematic, and quantitative description of content. Content analysis is a research tool which is used in cross-cultural researches.

Data collection: Culture shock test

The culture shock (CSH) methodology was developed by Galina Bardier (2002). Empirical research on culture shock was initially developed by Bardier as a method of qualitative research, where the respondents' answers were processed with content-analysis techniques. During a pilot study, a method similar to the Who-am-I? test by Manfred Kuhn and Thomas McPartland (Kyn & Makpartland, 1984) was experimented with for the purpose of further developing the Who-am-I? test. In the beginning, the given instructions allowed the students to freely express themselves. The respondents were asked to describe situations in which

they experienced or faced CSH. Later, however, the instructions become more precise and a definite understanding of CSH was called for. The final version of research methodology was developed on the base of the perception of CSH as a reflection of cultural differences (see Appendix 1).

The following criteria are proposed for selecting the categories of content analysis results of the CSH measurements:

1. Components of the settings and the most common ethnic traits dominant in a particular situation:
 - ‘Cognitive’—connected mostly with presentation, beliefs and understanding;
 - ‘Affective’—connected mostly with feelings, emotions and understanding;
 - ‘Connotative’—connected mostly with behavioral activity.
2. The intensity of personal involvement in a situation:
 - Consciousness of personal involvement in the situation;
 - Unconsciousness of a situation—previous personal experience is used as a reference;
 - Unconsciousness of a situation on the basis of national traditions and collective experience.
3. Sources for the appearance of intolerance in a situation:
 - Active intolerance—a subject of communication himself is the source of intolerance;
 - Reactive intolerance—the object is another person, a communication partner;
 - Situational intolerance—sources which are occasional circumstances which spontaneously and vividly reveal cross-cultural differences.
4. Further development of the situational criteria:
 - ‘Obstacle’—fixation of contradictions in cross-cultural communication and a number of negative ethnic stereotypes, which decelerate the further development of the interactions;
 - ‘Vector’—the changing of the content results in the changing of situation as a whole, the contradictions can either be resolved or, on the contrary, exaggerated;
 - ‘Fan’—the appearance of multi-dimensional situations which include both ethnic stereotypes, the circumstances of their appearance and the personal traits of interacting partners.
5. Positional symmetry/asymmetry of the installation of an object:

- Open intolerance—pressure, aggression, hostility;
 - Hidden intolerance—adjustment, forced submission, abandonment of personal/national identity;
 - Tolerance—acceptance of the other’s identity without damaging one’s own personal identity.
6. Interaction history of the cultures:
- Assimilation experience—affiliation resulting from one culture’s assimilation to another;
 - Exposure experience—discrimination, colonization;
 - Integration experience—overcoming segregation and confrontation.
7. Situation related to a specific field of cultural expression:
- Intolerance in the sphere of worldview—values, world outlook, ethics, aesthetics;
 - Conventional intolerance—personal space, interpersonal distancing, the ways emotions are expressed, common patterns of building relationships, ways of thinking, problem solving, public behavior;
 - “Everyday” intolerance—food, clothes, manners, basic necessities of life.

Data analysis: Culture shock test

For the study of CSH 61 students were questioned and questionnaires from 26 respondents were returned (Table 1). The students were asked to describe situations when they felt culture shock when meeting an unknown culture.

Table 1. Peculiarities of CSH manifestation and criteria of CSH manifestation (n=26), %

Affective	Cognitive	Connotative	Conscious	Unconscious	Traditions	Object	Case	Obstacle	Vector	Fan	Open	Hidden	Tolerance	Assimilation	Integration	Conventional	Everyday life spheres
34	10	20	11	13	42	9	65	32	31	7	5	15	61	9	17	10	20

The largest number of responses was determined by the Attitude Criterion on the affective component of Attitude Criteria—34 per cent of all responses. According to the Level of Personal Involvement Criterion of CSH, 42 per cent of the respondents interpret the situations in which they feel discomfort as a manifestation of traditionalism—as manifestation of traditions operating at an unconscious level.

In terms of Source Criterion the majority of respondents (65% of responses) indicated casual manifestations: for example, natural circumstances and differences in the understanding of a situation were connected with how they experienced the situation. The situation is fixed as an obstacle by the Forecast of the Shock Development Criterion—35 per cent of responses—but there is a trend that in other circumstances the anxiety-producing situations cannot happen (Vector Component); in the case of changing the context of a situation there is no feeling that this situation can happen again—31 per cent of responses.

Under the Disposition Criterion the personal disposition was revealed, yielding 60 per cent of tolerance reactions. As for intolerance (according to the Intolerance Component—13% responses), its manifestation mostly relates to the everyday sphere without touching the deeper levels: those of persuasion, values and attitudes. According to the CSH Experience Criterion—20 per cent of responses—it demonstrates a forecasting development of CSH, so the revealed Integration Component shows more positive cultural experience; consequently, as a strategy for acculturation, one of the most successful strategies possible is the preservation of one's cultural identity along with acceptance of the other culture (integration).

The results of the correlation analysis of the culture shock (CSH) test revealed certain regularities. When in an unfamiliar culture students described the situation in which they faced unfamiliar examples of behavior that made them feel uncomfortable. As a result of researching and analyzing the situations described as uncomfortable by the students, the following data have been revealed and the following conclusions have been made.

4. Results

The results of the content analysis section of the questionnaires from 26 students revealed that the CSH of first-year foreign students possess the following peculiarities: situations which call forth some anxiety and misunderstanding, mainly affective component of adjustment, are mostly situational and unpredictable because they appear in uncertain circumstances, they are fixed but interpreted and explained in terms of cultural traditions. That is why they are characterized by the perception of students who are tolerant. The distinctive feature of foreign and local (Estonian) student perceptions of these uncomfortable situations is correlated with various sources of stress. As it was mentioned above, foreign students consider them as occasional situations and do not fixate on the sources.

Local students can be uncomfortable in these situations and assign the cause of the discomfort to the other party. Although they easily project the cause of their feeling to someone else, at the same time they can acknowledge that they are themselves being intolerant in these situations. The researching of CSH of foreign students has revealed that the manifestation of intolerant behavior is mostly in everyday situations and does not touch spiritual spheres and deeper aspects of personality. The further development of CSH keeps the path of integration directed in a way that is considered more positive.

During the analysis and interpretation of the described situations the components of ethnic settings, used in these situations, have been filtered out. The analysis highlighted that the affective component typically emphasized is associated with feelings, attitudes and anxieties. The situations scrutinized mostly are connected with everyday life situations: in other words, the respondents feel uncomfortable in circumstances related to food, clothes and satisfaction of basic necessities of life. Spiritual intolerance has not been displayed. There is no special stress or uncomfortable feelings in situations of public behavior, personal space, typical models of demonstration of attitudes and interrelations.

During the first year of studies, cross-cultural shock can be seen or expressed at the surface level and does not have complicated forms because it concerns only the student's cognitive and emotional level. Thus, cultural shock at this stage does not take the form of deep stress or emotional disruption. According to Milton J. Bennet's model (1998) this is one of the first stages of the development of the cultural shock syndrome.

In accordance with the hypothesis of the research, CSH has specific features for students studying in the Estonian culture. The specific characteristics of foreign students in contrast to those of the new culture they are interacting in have a combined effect on adaptation. Individuals with cultures similar to Estonia and who often come into contact with locals when they come to study in Estonia were less susceptible to CSH (for example, Finnish students because of nearness, and students of the post-Soviet countries because of their historical background). This hypothesis was proven to be true by this research project.

5. Conclusion

In order for Estonia to continue enjoying the high ranking of international students, university officials must demonstrate increased cultural competence and cultural awareness by effectively managing the adjustment process of international students. This premise is consistent with the data collected by the research team of Tallinn University of Technology. The results of the research have strengthened the research team's conviction that Estonian educational authorities best fulfill the proposed internationalization plan for 2006–2015 by both managing the challenges of the internationalization of university-level education in Estonia as well as researching the particular problems international students have in adjusting to higher education in the Estonian cultural context.

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1. Test for culture shock research: Culture Shock Test (Galina L. Bardier)
Culture shock test
2. All cultures have different ways of looking at reality. By this we mean that each culture has its own criteria to determine its values. There is sometimes the problem of judging another culture according to one's own worldview thus being ethnocentric. Difference, at worst, can mean being wrong and at best can make a person feel uncomfortable. Invariably, individuals have so much trouble adjusting to an unfamiliar culture that we use the term CULTURE SHOCK to describe the phenomenon. To transcend the differences and improve on our cultural interactions, we must find ways to become more culturally competent.
3. PLEASE volunteer three or more examples of your own experiences of

CULTURE SHOCK occasions (in Estonia), when you were surprised or embarrassed to discover that people “don’t do that here” or do things differently in a new setting. The possible topics are: food and clothing preferences, gestures and signs, manners, personal space, divergence of expressions, most prominent types of mind, problem-solving styles, funny life or confusion incidents, basic life necessities, etc.

4. *Answer Sheet*

5. Your name _____ date _____

6. Age _____ sex _____

country _____ (state) _____ Countries visited

before _____

7. Topic 1. (Title) _____

8. Topic 2. (Title) _____

9. Topic 3. (Title) _____

The Construction of National and Ethnic Identity in Online Discussions on Referenda Initiatives in Latvia

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Abstract: *Radical changes such as regaining the independence of the state and changes in ethnic hierarchy strongly influence the discursive construction of ethnic and national identities. In the case of Latvia the crucial issue is still how to form the ‘imagined community’ of a nation and how to include a large number of Russian-speaking inhabitants in previously developed understanding of Latvians as an ethno-cultural nation. The analysis of anonymous discussions in online news portals and political actions with respect to referenda initiatives in 2011 manifests the controversial facets of ethnic and national discourses in Latvia. One of them is the essentially different constructions of the Latvian nation. The Latvian discourse of the ethno-cultural nation does not include the Russian-speaking inhabitants in the body of the Latvian nation. In contrast, the discourse prevalent among Russian-speaking inhabitants constructs them as loyal and belonging to Latvia. Different constructions of the Latvian nation are related with different interpretations of the 20th century history of Latvia.*

Keywords: *discourse analysis, ethnic and national identity, identity construction, Latvia*

1. Introduction

Discursive constructions of national and ethnic identity form a part of ethnic/national discourses in the society. A variety of theories suggest that the process of identity construction is relational and context-bound and involves certain categorization which segments the world, dividing ‘us’ from ‘them’, the in-group from the out-group (Barthes, 1969; Jenkins, 2008a; 2008b). In the context

of the complex ethnic relations between Latvians and Russians in Latvia, the categorization between those who are included and those who are excluded from an in-group raises a number of important issues. Do representatives of the two largest language communities—Latvians and Russians—discursively construct each other as two competing and conflicting groups, or are there other discourses that offer alternatives for discursively constructing the ethnic and national identities?

The focus of the paper is on the social construction of ethnic and national identity, particularly analyzing how Latvians and Russians construct themselves and others when speaking about ethnic issues in Latvia. The data source for this paper are online discussions in the news portal *Delfi* regarding two collections of signatures for initiating referenda (1) on public education only in Latvian and (2) on Russian as the second state language. Both collections of signatures are the most topical events related to ethnic issues in 2011. The textual material for the discourse analysis consists of 1,931 comments posted in response to four news articles on the Latvian and Russian language sites of *Delfi* in 2011. The paper begins with a short theoretical positioning within approaches of social constructionism, and the short description of the context of Latvia, as identity studies are not possible without an insight into a wider context.

2. Theoretical basis: identity as a contextual discursive phenomenon

The research theme already suggests that the author views the phenomenon of identity construction from the perspective of social constructionism. According to this, identity patterns are acquired through the process of internalization in early childhood, but they are not fixed models as we participate in the construction and re-construction of our identity in every interaction (Berger & Luckmann, 1991[1966], p. 194). Social constructionists, opposite to essentialists, view identity as flexible and context-sensitive, and one of the most influential ideas about identity as a construction or process has been developed by Stuart Hall:

In common sense language, identification is constructed on the back of a recognition of some common origin or shared characteristics with another person or group, or with an ideal, and with the natural closure of solidarity and allegiance established on this foundation. In contrast with the 'naturalism' of this definition, the discursive

approach sees identification as a construction, a process never completed – always ‘in process. (Hall, 1996a, p. 2)

Hall has been profoundly influenced by the ideas of Michel Foucault, and his analysis as well as discourse studies in a broader sense are built on the recognition of the discourse’s constitutive force (Foucault, 2004[1972]). At the same time Hall is critical of Foucault’s theory which neglects the limited agency people have in the process of identity articulation (Hall, 1996a). According to Hall, identity is formed as a unique articulation of available discursive components in a particular situation. Representatives of critical discursive psychology draw on the ideas of Michel Foucault and Stuart Hall and develop their own approach—that of discourse analysis. The most important concepts of critical discursive psychology are interpretative repertoires and subject positions which are important contributions to the analysis of identity construction and therefore need to be clarified. Interpretative repertoires are flexible discursive resources that people use in the process of interaction. Each interpretative repertoire comprises a complex historically developed system of categorization, relatively consistent descriptions of historical events, certain images and figures of speech. There are several interpretative repertoires in every society, and people make certain choices between them in the process of interaction (Potter & Wetherell, 1987). In such a way, interpretative repertoires imply dialectical relationships between discourse as a constitutive force and agency of people. The concept of interpretative repertoire is quite similar to the concept of discourse as it is understood in critical discourse analysis. But more precisely it points out the element of agency, and foresees certain flexibility instead of totality.

The concept of subject positions is borrowed from Michel Foucault, and its central idea is that certain language use (discourses or interpretative repertoires) constitute certain subject positions, because language use always involves certain positioning (Potter & Wetherell, 1987; Wetherell, 2001; Edley, 2001). Identity is therefore contextual short-term identification with discursively constituted subject position. As there are several interpretative repertoires available in society so there are also different and even contradicting subject positions. In this interpretation Foucault’s concept of subject positions is supplemented with an element of agency thus allowing the explaining of the multiplicity and inconsistency of identity construction in interaction.

Representatives of critical discursive psychology and critical discourse analysis do agree that not all interpretative repertoires or discourses are equally available in the society and some constructions of social reality may be regarded as dominant, therefore they include in their analysis the concept of ideology.

Within discourse analysis the concept of ideology is not understood as a ‘false consciousness’, but as a historically developed part of discourse, which has been perceived as normality and serves the interests of certain groups (Hall, 1982; Potter & Wetherell, 1987; Fairclough, 1992). Their notion of ideology is strongly influenced by the Gramsci’s theory of hegemony, and Hall has noted that dominant identity discourses may be viewed as hegemonic ideological discourses (Hall, 1996b[1988]).

Considered from the constructionist perspective and drawing on Berger and Luckman (1991), Barthes (1969), Jenkins (2008a; 2008b) and scholars of discourse analysis argue that national identity and ethnic identity are forms of social identity that are based on discursive reproduction of categorization and self-identification during processes of interaction. Accordingly, these phenomena—the national and ethnic identities—are in many ways similar but not the same. On the one hand, both are formed by socially constructed perceptions about common descent and cultural differences. On the other hand, the difference stems from the fact that the concept ‘national identity’ invokes a reference to a state or state-like political formation. For the purposes of this study, a reference to the state can be perceived as the main difference between national and ethnic identity.

In the case of Latvia, constructions of ethnic and national identity are often inseparable, especially, as the study reveals, in case of ethnic and national discursive constructions of Russians living in Latvia. Therefore both forms of identity—ethnic and national—are at the centre of the following analysis.

3. The case of Latvia

During the last twenty years the society of Latvia has witnessed radical structural changes, including the changes of language hierarchy in terms of the official status of the Latvian and the Russian language. Since Latvian was declared the state language, the Russian language in Latvia formally lost the dominant position it had had during the Soviet time. David D. Laitin (1998) characterized these new conditions that had an influence over Russian speakers in Latvia, Estonia, Ukraine, and Kazakhstan as a cataclysm for Russian speakers. At the same time Latvian public discourse was strongly dominated by the discourse of ethno-nationalism (Kruk, 2005, p. 101), which constructed ethnic Latvians as victims of the Soviet regime (Zepa *et al.*, 2006, pp. 79, 86).

A decrease in the proportion of ethnic Latvians in Latvia during the Soviet times and serious threats to the existence of the Latvian language were the central arguments used in ethno-policy in Latvia (Rozenvalds, 2010, pp. 34–35; Zepa *et al.*, 2006, p. 24). The statistics show that the proportion of ethnic Latvians in 1935 was 77 per cent, but by 1989 it had decreased to only 52 per cent of all inhabitants. The language proficiency in 1996 was explicitly disproportional: only 36 per cent of Russian-language speakers evaluated their Latvian language proficiency as good. In turn, 84 per cent of Latvians evaluated their Russian language proficiency as good (BISS, 2008).

Several laws passed in the parliament of Latvia were drafted with the idea to support and strengthen Latvian language [Decision on the status of Latvian language (Supreme Council of Soviet Latvia), 1988; Citizenship Law, 1994; Education Law, 1998; Official Language Law, 1999]. The proceeding of these laws have always met some kind of resistance among Russians, but the most vivid and wide protest actions were organized for the protection of public secondary education in Russian in 2003 and 2004, which may be regarded as the biggest political demonstrations in Latvia since the beginning of the 1990s.

The analysis of the Russian and Latvian language press in Latvia at the time of the mentioned events reveals that discourses used in the Latvian and Russian language newspapers are radically different. This is closely linked to the polarization of political identities, since ethnic interests of political parties dominate over economic and social issues (Zepa *et al.*, 2006, p. 24).

The indicated trend is observable up to the recent events when two signature collections with the aim to launch a nationwide referendum have been started. The first signature collection was initiated by the National Association “All For Latvia!”—“For Fatherland and Freedom/LNNK”, which won eight deputy seats out of 100 in the 2010 parliamentary elections, and fourteen deputy seats in the parliamentary elections in October 2011. The signature collection was aimed to make Latvian the only language of instruction in public schools (The Draft law amended Article 112 of the Constitution by adding the condition that “the state shall provide an opportunity to acquire elementary education and secondary education in the state language free of charge”, as well as a transitional provision stipulating that “from 1 September 2012, education is in the state language from the 1st class in all state and self-government educational institutions”).

According to the procedure of the referenda in Latvia, if at least 10,000 notarized signatures were submitted to the Central Election Commission (CEC) for the draft law, the CEC would be obligated to organize a signature collection. The

appointed time for this signature collection was from May 11 to June 9, 2011. But the number of collected signatures did not reach the necessary level of at least one tenths of eligible voters or 153,232 voters. As only 120,433 persons signed for this issue from May 11 to June 9, 2011, the referendum was not initiated.

The second signature collection was a reaction to the first signature collection and it was initiated by the non-governmental organization “Mother Tongue” and their leaders Vladimir Linderman and Yevgeni Osipov. It aimed to achieve that Russian is regarded as the second state language (The Draft law provided for amendment of Article 4, 18, 21, 101 and 104 of the Constitution by adding the condition about Russian as the second official language). For this purpose, 10,000 notarized signatures were collected in April 2011. The corpus of collected signatures for the Russian language as a second state language was submitted to the CEC only in September 2011. Accordingly, from 1 to 30 November 2011 the CEC organized the collection of signatures. As a result, 187,378 voters or 12.14 per cent of eligible voters signed in support of the Draft law, and the referendum on the Draft law *Amendments to the Constitution of the Republic of Latvia* was held on 18 February 2012 in Latvia.

The referendum’s question was “Do you support the adoption of the Draft Law Amendments to the Constitution of the Republic of Latvia that provides for the Russian language the status of the second official language?” The turnout of the referendum was 71.13 per cent, and 24.88 per cent or 273,347 voters said they were in favor of having Russian as a second state language, but 74.8 per cent or 821,722 voters said they were against having Russian as a second state language (Table 1).

The results of the referendum strongly confirm that the ethnic vote dominated in this referendum. According to the data of the Office of Citizenship and Migration Affairs, there are 71.62 per cent of ethnic Latvians, 19.74 per cent of ethnic Russians and 8.64 per cent of other ethnicities among the citizens of Latvia. Russians in Latvia are concentrated in the capital, Riga, and in the impoverished Latgale region in south-eastern Latvia near the Russian and Belarusian borders. In Latgale, 55.57 per cent voted in favour, but in Riga—36.03 per cent. The small incongruity of voting and ethnic composition in Riga can be explained by the higher mobilization of those who were against and higher turnout in Riga (where the turnout was 77 per cent, in Latgale—60 per cent). Riga’s vote can be partly explained also with the results in polling stations abroad which were added to the results of Riga’s polling stations and where voting against prevailed.

Table 1. Results of the February 18, 2012 referendum and resident population of Latvia by ethnicity at the beginning of 2011, %

	Results of the February 18, 2012 referendum			Ethnic composition in respective territory, 2011	
	Turnout	In favour	Against	Ethnic Latvians	Ethnic Russians
LATVIA	71.13	24.88	74.80	59.5	27.4
Riga	77.14	36.03	63.56	42.5	40.7
Vidzeme	72.97	11.78	87.98	85.3	9.7
Kurzeme	70.99	8.46	91.37	74.2	15.2
Zemgale	68.31	12.23	87.42	68.6	18.3
Latgale	60.05	55.57	44.02	44.1	38.8
Daugavpils (second largest city in Latvia, located in Latgale)	64.41	85.14	14.39	18.0	51.8

It should also be added that the referendum campaign on Russian as a second state language put the ethnic issues on the top of political agenda at the end of 2011 and the beginning of 2012 in Latvia. Therefore, political parties previously dissociated with referenda initiatives became active supporters of one or another position. For instance, initially the collection of signatures for Russian as the second official state language was supported only by the party “For Human Rights in United Latvia” that has represented the interests of Russian-speaking residents for many years, but recently failed to win parliamentary seats at the last elections. But this changed when the leader of “The Harmony Centre” and Mayor of Riga Nils Ushakov announced that he has signed for proposed amendments on November 8, 2011. Afterwards a number of deputies, local government representatives and public officials elected from the party association “Harmony Centre” signed for the proposed Amendments to the Constitution. In the referendum Nils Ushakov along with Vladimir Linderman supported a ‘yes’ vote, while the President and Prime Minister of Latvia called for a ‘no’ vote (*The Economist*, 2012).

Online discussions about these two contradictory signature collections, of which one resulted in a national referendum, are the main data source for the identity discourse analysis in this paper.

4. Methodological considerations and data sources

The focus of this analysis is on discursive representations of ethnic and national identities among the participants of discussions. In the process of analysis, the author is seeking certain patterns in language which would signal the use of certain interpretative repertoires. Besides the approach of critical discursive psychology, used for the analysis of interpretative repertoires, the author also makes use of techniques for analyzing ethnic and national identities that have been developed by the scholars of critical discourse analysis van Dijk and Wodak (Reisigl & Wodak, 2001; van Dijk, 2000; Wodak, 2001; Wodak *et al.*, 1999). Particular attention is paid to referential and predicative strategies—to the types of descriptions used for naming and describing Latvians and Russians in Latvia.

The findings are confronted with previous studies (Kļave, 2010; Zepa *et al.*, 2006), as the similarities and differences might demonstrate the stability or transformation of particular discourses and dominant ideological positions.

The data source of the analysis are four online discussions prompted by the four news articles posted on *Delfi*, one of the most popular online news portal in Latvia, which is available both in Latvian and in Russian—the Latvian *Delfi* and the Russian *Delfi*, respectively (Table 2).

The chosen period for analysis—April 2011—is significant in the context of referenda initiatives on the ethnic issues in Latvia, as two conflicting signature collections on language issues were on the top of mass media at this time.

The analyzed posts are quite expressive and radical in their views in comparison with the interpretative repertoires used in focus group discussions among ordinary inhabitants both in Latvian and in Russian (Šūpule *et al.*, 2004; Zepa *et al.*, 2006). Sociolinguists analyzing computer-mediated communication which characterizes online discussions point out both linguistic and social features of this communication. From the linguistic perspective, this type of communication is a mixture of written and spoken language, but the main social peculiarity of public online discussions is their anonymity. Impersonality and anonymity of the posts leads both to a potential freedom from limiting social control and to an increased expression of hostility and lack of politeness; therefore, public online discussions usually represent the most radical and provocative views in the society (Danet & Herring, 2007; Herring, 1996). At the same time they represent a very appropriate data source for discourse analysis as they are texts that have formed naturally, without any influence from the researcher.

Table 2. Description of the news and posts analyzed

	Title of the news article	Language	News posted (date/time)	End of discussion (date/time)	Number of posts
1.	'There will be a signature collection for the public education only in state language from 11 May to 9 June, 153,232 signatures need to be collected'	LV	11.04.2011 16:56	21.04.2011 12:53	214
2.	'The CEC (the Central Election Commission) has announced a signature collection for the dissolution of Russian schools'	RU	11.04.2011 15:31	12.04.2011 14:20	407
3.	'Non-government organization: there are more than 10,000 signatures collected for the Russian language as a second state language'	LV	19. 04.2011 12:15	20.04.2011 7:26	342
4.	'Linderman, Osipov and Svatkov have collected 10,000 signatures for the second state language'	RU	19. 04.2011 12:53	26.04.2011 23:30	968

According to the approach of critical discursive psychology a researcher's analysis is a different interpretation of social reality; therefore, the issue of reflexivity is of high importance (Potter & Wetherell, 1987). In this context it seems important to point out the author's position with respect to both collections of signatures. The author conceives both signature collections to be the result of the activities of marginal and extreme political groups who aim to gain political supporters at the expense of ethnic mobilization and do not support either referenda initiative.

5. Analysis

Each of the four Internet discussions follows a different inner logic. There are, however, several interpretative repertoires which can be observed in all discussions and the characteristics and illustrative quotations of three most popular repertoires are given in Table 3 (see p.129).

The Latvian ethnonationalist repertoire provides basis for argumentation strategies claiming for the public education only in the state language and being

against Russian as a second state language. Posts provoked by the news on signature collection for the Russian language as a second state language in the Latvian *Delfi* (19 Apr 2011) are the most aggressive and construct the Russian ethnic group in a very negative way.

The possibility to introduce Russian as the second state language is viewed as a real threat and inducement to go and sign for Latvian language as the only language of instruction in public schools.

Papildus dzinulis latviešiem, 19.04.2011 14:10 (Originally in Latvian)
Due to this Russian initiative, Latvians will be more active in voting for education only in state language in Latvia, because this is direct insolence and aggression. How can the Latvian country still tolerate them? Russians have Russia, Latvians—Latvia, Swedes—Sweden, etc. It is not an argument that their grandfathers and grandmothers came here with tanks and afterwards started to impose their rules. The USSR collapsed, and Latvia regained its independence; Latvia is in the EU and the NATO, soon there will be euros. What Russians? What Russian language? Crimes against Latvia have not been forgotten. Every Latvian family has witnessed humiliation and ideology and language imposed on them by the alien nation. Latvia now is free, and although it isn't experiencing the best of times now, at the heart it is Latvian—as it is called Latvia!

The chosen quotation manifests the main argumentation strategies of Latvian ethnonationalist repertoire in an explicit way. It constructs the nation of Latvia in ethnocultural terms, using the slogan “Latvia is for Latvians”, and as an argumentation strategy here the following comparison is used: “Russians have Russia, Latvians—Latvia, Swedes—Sweden, etc.” Russians in Latvia are discursively constructed as occupants, using the expression that their “grandfathers and grandmothers came here with tanks”. The word ‘tanks’ here is used as synecdochically and refers to the Soviet army. The initiative of the signature collection for Russian language as a second state language has been labeled as “direct insolence and aggression”. Argumentation strategies delegitimizing Russian interests in Latvia are based on propositions: “The USSR collapsed, and Latvia regained its independence; Latvia is in the EU and the NATO, soon there will be euros. What Russians? What Russian language?” This way Russians are constructed as belonging to the USSR, while remaining alien to independent Latvia, the EU, and the NATO. The argumentation strategies used involve both a construction of Latvians as victims: “Every Latvian family has witnessed humiliation and ideology and language imposed on them by the alien nation”, and a construction of Russians as a threat.

Table 3. Characteristics of interpretative repertoires identified in analysis and illustrative quotations

	Name of the interpretative repertoire	Referential and predicative strategies used for naming and describing Latvians and Russians in Latvia	Typical constructions in respect of Latvia's historical events: occupation in 1940 and mass mobilization in 1989–1991
1.	The Latvian ethnonationalism: "Our country, we set the rules here; Russians—immigrants of the Soviet era and selfish wanderers"	Russians in Latvia are named as migrants and occupants with negative image (the denominations like the "drinkers", "wanderers", "thieves", "prostitutes", "Russian garbage" as well as "Nazi", "fascists", "carrion" are used in the most radical and aggressive posts)	1940: Russians are associated with the Red Army and the Soviet regime: "Russians are the national minority only in the regions of the Old Believers. In other places they came as cockroaches with the tanks". 1989–1991: Russians are associated with the supporters of Interfront (a pro-Soviet socialist organization which during the years 1989–1991, supported the idea of Soviet Latvia and the USSR).
2.	Integration repertoire: "We live together and there's no way around it"	Mostly neutral denominations like Russians or Russian speakers are used. Russians are characterized as economic migrants	1940: "Russians in Latvia should not be blamed for the occupation: it was the fault of the Soviet system". 1989–1991: "Russian-speakers became a second class, although they were on the same side of the barricades in the 1990s".
3.	The Russian language and rights protection repertoire: "Russians are discriminated in Latvia"	Mostly neutral denominations like Latvians/Russians or Russian speakers are used. Russians in Latvia are constructed as belonging to Latvia: "Latvia is our homeland; Russians in Moscow are entirely different". Latvians are often named as "titulars". The denominations for Latvians like the "Nazi", "fascists", "toads" and "cripples" are used in the most radical and aggressive posts.	1940: The incorporation into the USSR brought industrial prosperity to Latvia; it was not an occupation, but incorporation. 1989–1991: Russians in Latvia supported the independence of Latvia, it is documented in the results of referendum held on March 3, 1991; "Well, Russian speakers, did you vote for the independence of Latvia? Then abide it now".

All in all, according to the manifested interpretative repertoire of Latvian ethnonationalism, Russians in Latvia are constructed as immigrants and

occupants with a negative image. The negative attitude towards Latvia, Latvians and the Latvian language is constructed as an attribute of Russians. Contrary to the negative image of Russians, the positive image of Latvians as a polite and civilized nation has been mirrored. The positive self-presentation and negative presentation of the other is manifested very explicitly within this repertoire.

Integration repertoire: “We live together and there’s no way around it” dominates the argument that it is not possible to speak of “true” ethnic Latvians because of mixed marriages taking place for several generations already. The argument goes that many Latvian families have Russian relatives or family members and therefore Latvians and Russians should not quarrel and should try to live in harmony. The integration repertoire constructs Russians in Latvia as belonging to Latvia and the people of Latvia as long as they can speak Latvian and are loyal to Latvia. The signature collection for the public education only in the state language initiated by the National Association has been criticized and called a political manipulation of extreme nationalists blowing up ethnic cleavages:

Es, 11.04.2011 17:30 (Originally in Latvian)

Our government has missed the opportunity to integrate Russian speakers in the Latvian society already a long time ago. Due to the “donkeys” of our government it was not managed again. Russian speakers became second-rate citizens, although they were on the same side of the barricades in the 1990s. I have never liked radicals, all the same national or no-national. This referendum is aimed at creating a positive image at the expense of ethnic mobilization and it is deepening ethnic cleavages of the two ethnic groups. It is doubtful that one will become more loyal to Latvia, if forced to learn Latvian. ☺ It makes me laugh. The opposite will be achieved. When I think about the representatives of the party, organizing this action, it makes me sick. Old Lācis [deputy in the parliament elected from the National Association] is a good example.

It should be mentioned, however, that this interpretative repertoire was manifested in online discussions less often than the other two repertoires.

The third—the **Russian language and rights protection repertoire**—constructs Russians in Latvia as Latvian Russians, while Latvia has been constructed as their homeland or motherland. They do distinguish themselves from Russians in Russia, and from Russia as a state; at the same time they support the initiative

of Russian as a state language or the idea that Russian should be an official language which could be used to address the authorities. According to this repertoire, Russians are viewed as being discriminated in Latvia:

Латам и компании, 19.04.2011 19:20 (Originally in Russian)
Why are you, like parrots, going on about Russia all the time? We live here, we have all the rights as citizens of our country—Latvia—and we want an official status to our Russian language. That's it!

Подписался --не лоялен?, [‘signed and—not loyal?’] 19.04.2011 18:07 (Originally in Russian)

I am partly Latvian, partly Russian. In total there are very few “pureblood” in Latvia. I SIGNED the appeal. How can somebody there call me disloyal to Latvia or Latvians? I am not loyal to this power, but then a citizen is not obliged to love and honour power if it discriminates his rights. I am loyal to Latvia, but not to Mr. Dombrovskis [the present Prime Minister of Latvia]!!! I am not going to any Russia. I SIMPLY WANT TO LIVE IN A NORMAL DEMOCRATIC STATE, WHERE THE RIGHTS OF ALL INHABITANTS ARE RECOGNIZED.

There is no need for Russian as a state language; it is enough to have it as an official one. But you should not mistreat native Russian inhabitants!

Unlike these posts which use the Latvian ethnonationalism repertoire and construct Russians as a group in negative terms, within the Russian language and rights protection repertoire, Latvians as an ethnic group is usually not constructed in negative terms. Negative expressions are usually targeted at Latvian national politicians rather than Latvians. According to this repertoire the signature collection for public education only in the state language, initiated by the National Association, has been evaluated very negatively as a possible act of discrimination and there has been a long discussion on what should be the Russians’ reaction towards it.

Some authors of the posts suggest that this is an incentive for them to leave the country. The signature collection for the public education only in the state language is often wrongly associated to be a government initiative. Russians are constructed as the discriminated “second class”. Similarly to many others, one of the Russian posts cited below adds an irony that eventually some rich Russian businessman will simply buy Latvia:

Катран, 11.04.2011 16:01 (Originally in Russian)

Super! Government does not understand that Russians will then begin to silently leave, but those who wanted to come here will change their minds. There will be only 5,0000 Latvians left—idiots stay in Latvia and in the end Latvia will be bought by a rich RUSSIAN businessman.

русский человек второго сорта в Латвии (A second-rate Russian in Latvia), 11.04.2011 16:45 (Originally in Russian)

It is high time that all Russians in Latvia understand that they should quickly run away from this failed state.

Among other alternatives proposed to how to react to this possible amendment in the Constitution of the Republic of Latvia are organizing protest actions by the Russians—a riot or Russian coup, or even to declaring a civil war:

Ўцуккенг, 11.04.2011 15:44 (Originally in Russian)

*No need for chicken feed, I suggest we start a civil war.
Let us thrash the titulars [i.e. Latvians].*

lol, 11.04.2011 16:18 (Originally in Russian)

Wait for a revolution, idiots

сторонник марксистко-ленинских идей [supporter of marxist-leninist ideas], 11.04.2011 16:20 (Originally in Russian)

Get up, stand up, the enslaved Russian people of Latvia! Enough of chewing snot!

evlampii, 11.04.2011 17:26 (Originally in Russian)

You, governing creatures, do you want a civil war? Or are you total idiots?

byvshii direktor byvshei shkoli [former director of a former school], 11.04.2011 18:17 (Originally in Russian)

That is enough. If you don't want our children to be like Turks in their own country, Russian speakers, wake up!

In the above quotations the Russians call their own group as ‘Russians’ and ‘Russian speakers’. In the last quotation there is a word ‘Turks’ used as a metaphor for Russians as a discriminated group in Latvia. In the post of ‘сторонник марксистко-ленинских идей’ Russians are regarded as “the

enslaved Russian people of Latvia”. The post of ‘Ймуккенэ’ illustrates the quite popular denomination of Latvians as “titulars” based on the longer expression “titular nation”.

At the same time, other posts are very skeptical about the likelihood of a coup or a riot as there is a lack of strong leaders supporting the idea of a riot among the Russian minority and the security service of Latvia is strong enough to stop it at the very beginning.

In the posts of the news on the second collection of signatures for the Russian language as a state language, a number of posts in the Russian *Delfi* express a satisfaction of *revanche*—most of them perceive it as a response to the initiative of the National Association “All For Latvia!”—“For Fatherland and Freedom/LNNK”.

The interpretive repertoires identified in the online discussions are directly related with the different interpretations of the 20th century history of Latvia. As indicated also by other researchers (for a concise table of differences in the perception of historical events see Broks *et al.*, 2001), in Latvia the events of 1940 and 1989–1991 are the nodal points of the 20th century history.

The analysis of online discussions confirms that different perceptions of the events of 1940 in Latvia provide an argumentative base for the different constructions of Russians in Latvia. Those who do not accept the fact of Latvia’s occupation, and believe that Latvia’s incorporation into the USSR brought industrial prosperity to the country, are very dissatisfied with the ethno-policy implemented in Latvia and view it as a purposeful discrimination of Russians.

In contrary, those who use the interpretive repertoire of the Latvian ethnonationalism and agree that there was occupation in Latvia, construct the Soviet times in very negative terms, and often blame not only the Soviet regime, but also Russians as an ethnic group for the occupation.

The differences in the interpretations of the history and corresponding constructions of Russians in Latvia are connected with the interpretations of more recent events as well. Those who tend to construct Russians in negative terms stress that they were supporters of the Soviet regime in the 1990s. The opposite position constructs Russians as the supporters of independent Latvia.

In general the analysis of discussions confirms that different interpretive repertoires imply distinct systems of categorization and thus construct different social realities. This fact is manifested most vividly by the Latvian ethnonationalist repertoire and the Russian language and rights protection

repertoire. Both mentioned repertoires can be regarded as ideological because they are linked to group interests for power and protect the dominance of a particular ethnic group. They are summoned in a battle for resources, namely the language use and status, which has both a symbolic meaning (Schöpflin, 2000) and a practical one. These repertoires differ in which group ought to be the dominant one and what the ethnic hierarchy in Latvia should be. They offer varying definitions of the Latvian people, while delegitimizing alternative viewpoints. Both of these repertoires employ a discursive strategy of constructing ideologically polarized perceptions about the in-group and the relevant out-group (positive self-presentation and negative presentation of other). Furthermore, intertextual analysis of ideologies, based on comparing manifestations of ideologies in focus groups and online discussions as well as in newspapers (Šūpule *et al.*, 2004; Zepa *et al.*, 2006), reveals that the ideological positions and interpretations of history have not considerably changed during the last years.

6. Conclusions

All in all, the analysis reveals that different repertoires distinctively construct both in-groups and out-groups, and proves the usefulness of critical discursive psychology for the comprehensive understanding of the identity construction in interaction. The analysis of the Russian and Latvian *Delfi* posts on topical ethnic issues in Latvia reveals several salient interpretative repertoires used among participants of online discussions. Although the boundaries of interpretative repertoires are difficult to establish, some “borderlines” may be identified, and the most obvious one is—those who use the interpretative repertoire of the Latvian ethnonationalism, construct Russians living in Latvia as migrants and occupants, and refuse to include them in the ‘imagined community’ of Latvian nation. On the contrary, the “integration” repertoire constructs Russians as economic migrants, not as occupants, but the Russian language and rights protection repertoire constructs Russians as inhabitants or citizens of Latvia, being loyal to Latvia, Latvians and the Latvian language.

These ethnic and national discourses or interpretative repertoires can be regarded as quite stable in Latvia, because their linguistic manifestations in the online discussions on actual ethnic topics include already observed patterns such as the Latvian ethnonationalism and the repertoire of Russian discrimination (Zepa *et al.*, 2006), which forms the basis for discursive conflict in Latvia (Kļave, 2010).

At the same time the author would like to emphasize that the interpretative repertoires identified in the discussions do not exhaust their possible variety. Other interpretative repertoires may be evoked in different contexts, which might have appeared only marginally or not at all in the texts that were analyzed.

This analysis reveals the most radical expressions of interpretative repertoires, since it is based on the analysis of anonymous online comment posts. The indirect form of interaction (in writing) and the complete anonymity of the online discussions are conducive to expressions of radical opinions and discursive strategies of aggressive positive self-presentation and negative presentation of other. On the other hand, events like the signature collections discussed above provoke the radicalization of the society and manifestation of contradictory repertoires—those of the Latvian ethnonationalism repertoire and the Russian language and rights protection repertoire. The explicit and increasing manifestation of contradictory repertoires can be observed not only among participants of online discussions, but also among politicians in Latvia, as during the referendum campaign on Russian language as a second state language in 2012 political parties that were previously dissociated from referenda initiatives became active supporters of either position. In the context of ethnic peace such initiatives as these heavily ethnicized referenda initiatives that were analyzed in this paper might be regarded as provocations and definitely not as instruments for solving ethnic cleavages as they cause ethnic mobilization and radicalization at the same time.

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ACADEMIC LIFE: Professor Ülo Ennuste, DSc – 80

Last but not least, we supplemented the current journal issue a special section to celebrate a significant milestone in the academic life of Estonian scientists—the 80th birthday of Professor DSc Ülo Ennuste—one of the leading economic scientists in Estonia. He has authored and co-authored 15 books and more than 160 research articles of wide acclaim, and his personal contacts on the international arena and cooperation have strongly contributed to the development and popularization of macroeconomics in Estonia. Dr. Ennuste’s current article in BJES enriches the Estonian economic science with a discussion about resources on macroeconomic knowledge in order to facilitate the ‘European Semester’ processes. Its main message is that the quality of the agents’ knowledge structures may play the basic role and importance in reaching effective equilibrium.

Editorial board of BJES

Waiting for the Commission-Strengthened Governance Coordination Leviathans: A Discourse Memo to the Actors in the Macro Game ‘European Semester’¹

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Abstract: *This is an entirely applied paper for additional implementation of extant rich macroeconomics knowledge resources to facilitate the ‘European Semester’ processes—the novelty may be that in this implementation the sensitive problems of deteriorating institutions and destructive activities are not entirely disregarded, and we are explicitly demonstrating that the quality of the agents’ knowledge structures may have the basic role and importance in reaching effective equilibrium projections in this game.*

From the viewpoint of Modern Heterodox General Macroeconomics (Macro) the most powerful economic policy statement by the European Union was made in the ‘Lisbon Strategy 2000’—the economy should be knowledge based. This means that the policy projections of the Union’s and the Member States’ socio-economic institutions and strategies should be designed as knowledge based, meaning that these should be based on modern high-level evolutionary institutional theory, dynamic macro mechanism design theory taking into consideration uncertainties and rare destructive shocks, Bayesian learning, with limited rationality and strategically playing actors, and national knowledge structure idiosyncrasies, etc.

From the Macro view, the latest important governance policy invention from the Commission was the enforcement of the “Six-Pack” Regulations—especially the central package, (The European Parliament and the Council of the European Union, 2011). Regulation “on the prevention and correction of macroeconomic imbalances” introducing the “European Semester” (ES) mechanism for ex

¹ I thank András Inotai, Pekka Ahtiala, Alari Purju and the two anonymous referees of this issue of BJES, whose helpful advice, comments and discussions allowed to significantly improve the analysis.

ante activities in the prevention and correction of macroeconomic imbalances of the Member States in real-, financial- and institutional-economic designs, and strategic policy projections. Last but not least, we add a field of in-depth central coordination enhancing the qualities of national and central knowledge and statistic structures for thither disclosure and transparency (Walker, 2007), and especially for correcting and preventing informational distortions and destructive logical or political skews (Cotton, 2012; Ennuste, 2007a).

Although the Regulation is a narrative it is easy to see that the content may be adequately modelled mathematically as a dynamic informational cooperative game with side-payments for design of equilibrium institutional and strategy policy projections—in the framework played by the actors such as the Commission's professoriate Committees, the EU Parliament, the ECB, the Member States, and others, and complexly coordinated, combined horizontally and vertically, as by consultations and side-payments (material and moral) and by limit-constraints (Ennuste, 1978).

If so, it is most convenient mathematically to rigorously study the necessary and sufficient conditions/postulates for the actors to successively ensure that the game solutions will be implemented (see, e.g., Liu & Luo, 2010; Serrano & Vohra, 2001)—the equilibrium policy projections will be optimally balanced. Most importantly, some of these postulates are in this paper formulated as Memo-points for the Member States as well as for the Central coordinator, and for discourse arguments of these points notes of extracts from corresponding top-level peer-reviewed research papers are presented, including Estonian examples. For a better clarification and to avoid anxieties concerning the 'variable geography' (Pisani-Ferry, Sapir and Wolff, 2012) of the after ESM reform developments in the EU governance complexities, it may be very operational to introduce into the narratives some elements of formalizations (some tentative suggestions in this directions are made in the Annex).

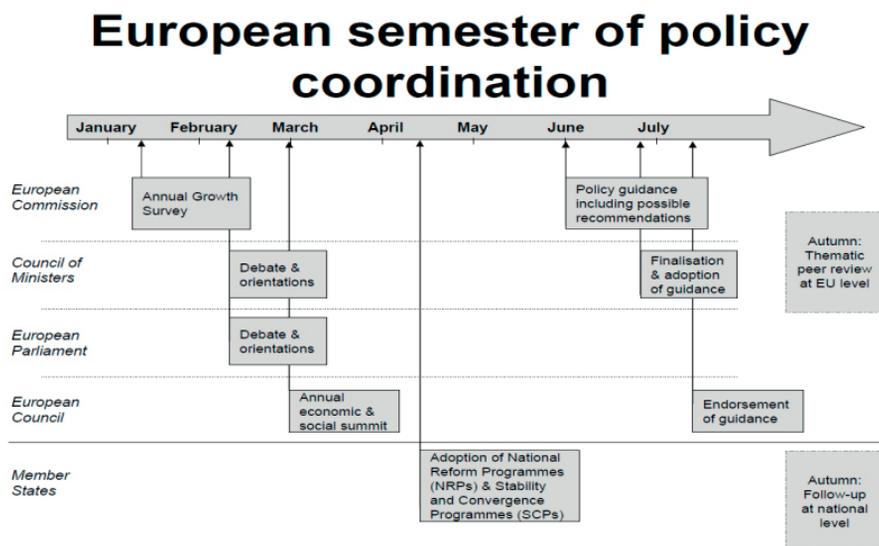
Keywords: *European Semester, macroeconomics, mechanism design theory, Modern Heterodox General Macroeconomics*

Introductory meta-remarks

Coordination theme is the basic socio-economic problem, as Friedman (1962, p. 12) has postulated: “The basic problem of social organization is how to coordinate the economic activities of large numbers of people.”

Coordination theme in the Modern General *Macro* belongs to the domains of institutional/evolutionary economics and mechanism design theories (*NI*)—the former is happily enough more or less a narrative one, while the latter is nowadays rigorously formalized, based on heavyweight mathematics: “Mechanism design theory is a branch of game theory [...] and extends the application of game theory to ask about the consequence of applying different types of rules to a given problem” (Royal Swedish Academy of Sciences, 2007). See also, for example, Ennuste (1978; 2003) on an example of theoretical optimization model of building of national socio-economic institutional and real-economic structure in interactions in a one complex-model—the decomposed solution of this model will derive solution games in the same class presented in ES mechanisms (a complex mechanism combining horizontal and vertical stimulating with side-payments consultation coordination, see Ennuste, 1978; schematically in Fig. 1).

Figure 1. European semester of policy coordination



Source: *European Semester*, 2010.

From the *Macro* perspective, one of the most promising sections in European Semester seems to be

Article 5: In-depth review

1. Taking due account of the discussions within the Council and the Eurogroup referred to in Article 3(5), or in the event of unexpected, significant economic developments that require urgent analysis for the purpose of this Regulation, the Commission shall undertake an in-depth review for each Member State that it considers may be affected by, or may be at risk of being affected by, imbalances. The in-depth review shall build on a detailed analysis of country-specific circumstances, including the different starting positions across Member States; it shall examine a broad range of economic variables and involve the use of analytical tools and qualitative information of country-specific nature. It shall acknowledge the national specificities regarding industrial relations and social dialogue. The Commission shall also give due consideration to any other information which the Member State concerned considers to be relevant and has communicated to the Commission. (Regulation of the European Parliament, 2011)

Naturally, keeping in mind that “a broad range of economic variables” involve social variables like economic inequality, poverty as well as institutions/mechanisms structures, and national knowledge paces (Ennuste, 2008 with many References), etc. and that “country-specific” idiosyncrasies involve an approach broader than that, e.g. politically sensitive variables like ethnic heterogeneity, etc. Here we have to remember that in the small Member States situated nearby big states, the high ethnic heterogeneity may be such a deteriorating phenomenon (Ott & Ennuste, 1996) and that the problem may not be solved endogenously and deserves coordination on the higher political level.

And most importantly, at that we have to keep in mind Rothstein’s anti-devolutionary third argument: “The third argument is that it is unlikely that such mechanisms will be efficiently designed/evolved/adapted endogenously by market agents. Moreover, if such institutions have been created, we should expect market agents to try to destroy them.” (Rothstein, 2009)

This kind of “endogenous impossibility” problems may be very important to consider in the central coordination agendas; for example, specifically for the effective institutional design and correction projections: it may be that some mechanisms are coalition-politically skewed (Cotton, 2011) and to the banking

and magnate lobbying askew—and there may be the case that the opposition has endogenously not enough bargaining power to correct this endogenously (Ennuste, 2009) without central coordination.

In the context of this ‘endogenous’ and outside coordination it seems that we have to introduce here the term ‘semi-endogenous’, see here the interesting extract by Boettke and Fink (2011):

We respond by stressing that institutions structure the incentives underlying individual action, secure private property rights are indispensable for prosperity, institutions have a first-order effect whereas policies only have a second-order effect, successful institutional change comes from within a society, and, given the status quo of developing countries, first-world institutions are likely not to be available to them. (Boettke & Fink, 2011, p. 499)

Of course the article is not trying to advance the understanding that current dominant *Macro* discourse on institutions, economic policies and development should not be taken without any critical examination (see more *N3* below; Chang, 2011).

In the case of Estonia, one of the most urgent in-depth examination examples in the *ES* procedures may be the presently existing anomaly of ‘zero profit tax’. It is probably a politically skewed mechanism and, according to many *Macro* conceptions, dysfunctional in the aspects of sustainability—in favour of the “haves” and probably the product of incompetent short-termism of the law making and lobbying of the magnates (Ennuste, 2009). And it seems that there is shortage of oppositional political bargaining power endogenously to correct that in the foreseeable future without exogenous coordination. Indeed, a section from the Estonian government’s recent projection by 2020 postulates:

17. Continuing the gradual reduction of taxes on labour and profits and to increase taxes on consumption and use of natural resources.

[...] Efforts must be continued to harmonize indirect taxes that have a significant impact on the functioning of the EU internal market and to abolish exceptions in the EU. Direct taxes and tax systems (rates) reflect every country’s specific and unique social and political choices, and thus the principle of freedom of choice of member states must remain in place in this regard. (Estonia 2020, 2011, pp. 29–30; emphasis in the original)

It is easy to see that this section has fuzzy logic as:

- a) the corporate profit tax in Estonia has been for about a dozen years slashed to zero (sic!) and so a gradual reduction of it is an absurdity in the macroeconomic context;
- b) it is unethical to speak about local profit tax reforms neglecting harmonization with the Member States especially in the aspect of competition on capital markets, and incompetently neglecting dysfunctionality problems domestically as well (see more in *N3*).

Deus ex machina. It seems that the *ES* process in the peripheral member countries should first of all limit the implementation of bad policies' mechanisms due to incompetent governance based on low-quality public socio-economic knowledge space. Obviously, some "small" governments of these member countries have also not enough political bargaining power against devolutionary camps for the rational implementation of knowledge-based policies and reforms for sustainable development.

In terms of Estonia, sustainability regeneration *ES* mechanism equilibrium policy does exist in the proper following of the *Macro* concepts proposed in this Memo. Our political administration should focus on trying to apply these efforts constructively.

The European Semester professoriate has an obligation to criticize and improve those policy efforts in the field in institutional designs and as well in intervention strategies, and most importantly not to close eyes in the cases of devolutionary activities.

But if local devolutionary politics is allowed to split the discipline, and communication discourse across that divide continues to break down, the *ES* game actors will forfeit what little administrative coordination power/respect it commands and/or how little respect has been given to the *Macro* concepts and tools especially in the Estonian case to social capital formation and institutional skewness and most of all to the quality of *Macro* competence.

Memo Notes

(A) Macro has progressed towards constructive operational theory (N1)

Especially technically in the field of mathematical mechanisms design (see, e.g., Royal Swedish Academy of Sciences, 2007), and in the field of institutional economics, including political corruption modelling (e.g., Holcombe & Rodet, 2012), and thus also in the classical branches especially considering the limited rationality and Bayesian learning (Royal Swedish Academy of Sciences, 2011), and in the field of uncertainty considerations in the economic policy projections (Phelps, 2006) and North (1990) on institutional change and economic performance, market economic systems concepts (Pryor, 2005), and in general by Phelps (2006) on the macroeconomics' position for a modern economy.

McMillin (2012) writes:

In her article 'Macro has progressed', Kozicki argues that assessing progress in macroeconomics by focusing on the use of DSGE modeling is too narrow a focus, and, accordingly, she considers advances in macroeconomics outside the core DSGE framework. As evidence of progress in macroeconomics, she points to enhanced understanding of financial crises, a broadening in the theoretical and empirical treatment of expectations formation and how expectations are incorporated in macro models, and improvements in our understanding of linkages between the real and financial sectors. (McMillin, 2012, p. 1)

We have to add here to this “narrow Macro” that especially great progress has been made in including financial indicators into large macro-forecasting models that had produced dozens of excellent results in the prediction of the previous global crisis (Bezemer, 2009a).

In the Estonian empirical post-crisis conditions (Ennuste, 2009) and in the framework of the *ES* coordination mechanism the progressed *Macro* concepts and tools may be progressively implicated for the optimization of national economy sustainability probability enhancement—first of all in the enhancement of the quality of national public socio-economic knowledge structure, in the control and regulation of human and real and social capital mechanisms and strategies, and in other fields of public economics—instead of the regrettable presently dominating incompetent use of micro- and meso-economics.

(B) The SE-Estonian equilibrium socio-economic knowledge structures have to be compatible and undistorted (N2)

Macro has many theorems verifying the important implications of the actors' knowledge space credibility levels on the quality of the equilibrium solutions (see, e.g., Ennuste, 2008 and References).

From this aspect, the extant low credibility and slowness of some Member States' public knowledge space should first of all be basically adapted to IT-technology and harmonized with the Eurostat and ECB standards (that should be also improved). This means that the overall statistics are made more transparent and comprehensive, less politically distorted, and more efficient in equilibrium designs and policy projections—for ex-ante prevention of macroeconomic imbalances, and so with the Eurostat.

Unfortunately, at present such significant indicators as Estonia's high national gross external debt, current account and balance of payments, international investment position are not integrated into comprehensive statistical framework. More than that, in administrative statistics there are dominating indicators that in *Macro* sense are not credible, such as PPS currency, especially in comparison to the eurozone countries. In the same sense it is not sufficient to have in the official statistics just one kind of inflation, especially in the Baltic Rim countries (Finland, for example, has introduced two inflation indicators).

In the Estonian case, the national knowledge space is contaminated with politically distorted concept *à la* “we are the best” to hide real strategies of some political camps for the reasons of the political stability like (ironically) “survival in the crisis only of the richest”, etc., and other *Macro*-theoretically absolutely non-sustainable boasting concepts like “we have been the first to come out of the crisis”, etc.—and filled with fuzzy logic plus populist incompetent outdated market concepts based at best on microeconomics. And the predominant understanding among local management seems to be “no capital outflow taxes” although these may be improving welfare in present situation (Kitano, 2011).

And we must not forget in terms of informational distortions the skewness problems in the sense proposed by Cotton (2012), and that skewness angle is easily measured on the complex plain (Ennuste, 2007b).

These regrettable phenomena, alas, also amplified by the Estonian mass media are helping to play down cognition of the real severity of the present socio-economic hyper-crisis situation, and not enabling the making of high-quality

forecasts, and, in turn, significantly magnifying the national socio-economic sustainability risks.

Unfortunately, most of the suggested points stand no chance of easy corrections endogenously. Adopting *ES* coordination policies in these areas would require high competence and quality of political leadership. According to the existing policies, there is a lack of these qualities, and the current Commission staff in Brussels seemingly prefers (according to the existing policies) not to notice these local objective idiosyncratic shortcomings of economically insignificant countries, at least in the bilateral consultation and harmonization processes.

(C) Coordination of institutional changes and designs first (N3)

This *Macro* analytical paradigm is actively promoted by the *Journal of Institutional Economics* and the *Journal of Public Economics*. In a recent publication, Ostrom and Basurto (2011, p. 317) argue: “In order to adequately address the most pressing social and environmental challenges looming ahead, we need to develop analytical tools for analyzing dynamic situations—particularly institutional change.”

The most urgent in-depth institutional problems for the Estonian economy are in the field of rationalization and harmonizations of the tax system and corresponding reforms: in the sense of harmonization of investment competition with the Member States and lowering the risks of domestic capital flight without domestic taxing and avoiding worsening of the Estonian international investment position. And, most importantly, presently there is a lack of coordination between income tax law and national pension law—all these imbalances are increasing risks of deepening the imbalanced economic inequalities, impoverishment and emigration.

(D) Equilibrium economic correction and intervention policy (N4)

The crisis has shown that macroeconomic policy in the Baltic Rim region needs to be better coordinated regionally, especially when it comes to protecting the Baltic area from the “free” movement of “all kinds” of labour, credit, investments, financial obligations, etc., considering the seemingly growing economic differences between the Baltic and Nordic countries in the after-crisis. (By the way, to euphemistically redress these inequalities, the Eurostat is using the imaginary PPS “parity prices”, which are actually local deflators. These PPS

prices are in *Macro* conceptions just blurring the picture and confusing effective coordination and dissemination of grants, at least in sub-region).

As far as fiscal deficiencies are concerned, from the *Macro* angle it appears first and foremost in this game as a symptom: in the Estonian case caused by a highly toxic cocktail from dysfunctional institutions—zero profit tax with complementary misbalanced social taxing, no taxes for capital outflows, plus inflationary indirectly confiscating taxing, with political impossibility for endogenous corrections no national bank's interventions, etc.

Discourse Notes²

(N1) Coordination in the Macro

The coordination theme in modern macroeconomics generally belongs to the domains of evolutionary economics and mechanism design theories – the former is happily enough more or less a narrative one, while the latter is nowadays rigorously formalized, based on heavyweight mathematics, see:

- a) The 2007 Nobel Prize in Economics: “**Mechanism design theory is a branch of game theory³ [...] and extends⁴ (sic!) the application of game theory to ask about the consequence of applying different types of rules to a given problem.**” And see also an example of theoretical optimization model of building of national socio-economic institutional structure.
- b) The 2011 Nobel Prize in Economics considers in the econometric models limited rationality (Sargent & Sims, 2011)

As politicians and lawmakers (the implementers of institutions) as a rule do not know and dislike mathematics and high-level tedious science in general, they try, especially in this very crisis period, to claim that mathematical macroeconomics is to blame as the significant destabilizing factor, not able to forecast important socio-economic events and is no good altogether and whatsoever.

However, this is absolutely not true (Bezemer, 2009a), and is actually slander—first of all, the high-level, such as the Nobel-domain, mathematical macroeconomic theories are in mainstream credible, these contain all the

² A caveat: all extracts of argumentation are strictly separated from credible peer-reviewed public non-commercial publications

³ NB! The generally dynamic Bayesian mathematical game theory – *Author's note*.

⁴ For example, in the field of social behaviour, animal spirit, etc. – *Author's note*.

uncertainties and moral hazards of *animal spirit* in all varieties (limited rationality, strategic manipulative distortion of communication, incompetence, greed, etc.), and these theories should be implemented especially in the times of crisis (Bezemer, 2009b).

If those with political power benefit from corrupt institutions, rulers might not adopt the rule of law so the ruling class can command a larger share of a smaller pie. An empirical analysis reveals that the size of government is larger in those countries that enforce the rule of law. If government expenditures provide some measure of the ability of the ruling class to command resources, this suggests that those with political power could benefit from imposing a fairer and more objective legal structure. Another conjecture is that those in power maintain corrupt governments to pay off their supporters and enhance their ability to remain in power. However, the rule of law is also positively associated with political stability, so better enforcement of the rule of law also enhances the ability of incumbent governments to remain in power. (Holcombe & Rodet, 2012)

*

Several papers that address the issue of progress in macroeconomics are presented in this section, which takes its title from an article entitled "Has Macro Progressed?" submitted to the Journal by Ray Fair. We took the opportunity of the submission of Fair's provocative article to solicit the views of other macroeconomists regarding progress in macroeconomics. Fair's paper along with papers by Peter Howitt, Sharon Kozicki, and Harald Uhlig are presented in alphabetical order in this section. (McMillin, 2012)

*

*The Royal Swedish Academy of Sciences has decided to award The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2007 jointly to **Leonid Hurwicz**, University of Minnesota, MN, USA, **Eric S. Maskin**, Institute for Advanced Study, Princeton, NJ, USA and **Roger B. Myerson**, University of Chicago, IL, USA "for having laid the foundations of mechanism design theory."*

The design of economic institutions

Adam Smith's classical metaphor of the invisible hand refers to how the market, under ideal conditions, ensures an efficient allocation

of scarce resources. But in practice conditions are usually not ideal, for example, competition is not completely free, consumers are not perfectly informed plus privately desirable production and consumption may generate social costs and benefits. Furthermore, many transactions do not take place in open markets but within firms, in bargaining between individuals or interest groups and under a host of other institutional arrangements. How well do such different institutions, or allocation mechanisms, perform? What is the optimal mechanism to reach a certain goal, such as social welfare or private profit? Is government regulation called for, and if so, how is it best designed?

*These questions are difficult, particularly since information about individual preferences and available production technologies is usually dispersed among many actors who may use their private information to further their own interests. Mechanism design theory, initiated by **Leonid Hurwicz** and further developed by **Eric Maskin** and **Roger Myerson**, Has greatly enhanced our understanding of the properties of optimal allocation mechanisms in such situations, accounting for individuals' incentives and private information. The theory allows us to distinguish situations in which markets work well from those in which they do not. It has helped Economists identify efficient trading mechanisms, regulation schemes and voting procedures. Today, mechanism design theory plays a central role in many areas of economics and parts of political science. (Royal Swedish Academy of Sciences, 2007)*

*

The paper uses the paradigms of the New Institutional Economics to quantify a linear optimal choice model as a way of designing perspective institutional clusters for a national economy. This model uses binary integer institutional choice variables and structural parameter values based on subjective probabilities collected from experts by calibration questionnaires.

The optimisation goal may be e.g. a high expected probability of stable national economic performance under socio-economic development credibility constraints, dependent on the realization of prospective significant events. The model may be useful as a complementary tool for the social design of the effective institutional structure,

and especially for evaluation of the socially optimal values of coordinating shadow prices and implementing side-payments in the political institutional design game. We use the Estonian case as an example. The model variables and data calibration table illustrations are provided mainly to demonstrate the broad spectre of issues that may be involved in this analysis. (Ennuste, 2003)

(N2) The quality of national public socio-economic knowledge structures

The narrative meta-synthetic deduction (Gu & Tang, 2005) of rational conceptions for implementing mechanism building of the public social knowledge structure in the environment of the dynamic post-transformation society is extremely complicated.

First of all, all extant definitions of the structure have their drawbacks (Ramazzotti, 2005), and more importantly, private information of the actors in this area is an intangible invisible asset of complex values: moral and material. So are the preferences of the actors.

We have stressed in our discussions the importance to tackle these public social knowledge structures as active dynamic institutions: as the quality of these structure is not having only relationships with general social developments, but also directly, with future developments of the implementing mechanisms under this very study.

Consequently, the studies comprising more or less the whole system may give only very general results. Still, as this study has proved, this kind of wholeness analysis based on the meta-synthetic design (deductive implementation theoretic and inductive empirical-intuitional), might be highly justified, especially in the case of post-transformation situations. In these cases of rapid structural changes in many social areas the rational regulation/coordination of current beliefs, opinions, expectations, and learning structures is extremely important.

The above abstract discussion argued that the adequate socio-economic information structure implementing mechanisms design should have extremely complicated configuration:

- * Complex and parallel coordination networks (e.g., governmental and non-governmental);
- * Complex coordinating instruments (e.g., material and moral);
- * Complex coordinating principles (e.g., incentives and constraints);

- * Moral coordination should contain for actors indicators of credibility in dissemination of messages (non-distortion, non-erroneous and clear and full disclosure), respectfulness in absorption and forwarding others messages, and aggregate indicator of reputation;
- * Complex incentive and restriction mechanisms (e.g., may be based on complex number models);
- * Complex sequentially interacting mechanisms should be preferred, especially in the field of reduction super-uncertainties (coordinating agents' strategies), and also for reducing fundamental uncertainties;

The results of the survey revealed the importance of taking into consideration significant current idiosyncrasies of the societies under the study, e.g.:

- * Types of political systems (e.g., partocratic democracy may be interested in disseminating dominantly populist messages to the public and at irrational closure of national statistics);
- * Linguistic heterogeneities of the population (e.g., part of the newly arrived population may communicatively belong more or less to some other society);
- * Weight of academic community in the society.

An extremely interesting phenomenon revealed by the survey and deductive speculations was that in the current Estonian context, enhancements and extensions of non-governmental soft (based mainly on moral indicators and self-analyses) coordinating networks and institutions was by the bulk of experts, especially among academic people and high-ranking politicians, strongly supported. The noteworthy exceptions in this point have been the opinions of some governmental officials.

In general the study revealed that in the current Estonian context the reputation factors of the actors in the public socio-economic structure building should be more highly appreciated. Importantly, building the track for flexible mechanism changes and adaptation in Estonia in this area should aim toward measures, by adding complementary elements, not obstructing the work of the established credible respective institutions and introducing new uncertainties, and should aim at introducing first of all these policies which are connected with increasing institutional credibility. (Ennuste, 2008)

On capital controls and welfare:

This paper computes welfare levels under different degree of capital controls and compares them with the welfare level under perfect

capital mobility by using the methodology of Schmitt-Grohé and Uribe (2007). We show that perfect capital mobility is not always optimal and that capital controls may enhance an economy's welfare level. There exists an optimal degree of capital-account restriction that achieves a higher level of welfare than that under perfect capital mobility, if the economy has costly financial intermediaries. The results of our analysis imply that as the domestic financial intermediaries are less efficient, the government should impose stricter capital controls in the form of a tax on foreign borrowing. (Kitano, 2011)

(N3) Institutional changes first

Most powerful analytical tools used in the social sciences are well suited for studying static situations. Static and mechanistic analysis, however, is not adequate to understand the changing world in which we live. In order to adequately address the most pressing social and environmental challenges looming ahead, we need to develop analytical tools for analyzing dynamic situations – particularly institutional change. In this paper, we develop an analytical tool to study institutional change, more specifically, the evolution of rules and norms. We believe that in order for such an analytical tool to be useful to develop a general theory of institutional change, it needs to enable the analyst to concisely record the processes of change in multiple specific settings so that lessons from such settings can eventually be integrated into a more general predictive theory of change. (Ostrom & Basurto, 2011)

Our 'Discourse Memo' is theoretically very much inspired by Cotton (2012) and specifically by the following claims considered there: "(1) the rich have better access to politicians than less-wealthy groups, (2) this access advantage makes the rich better off and skews policy in their favor, and (3) contribution limits can reduce the rich group's advantage and result in less-skewed policy [...], which results in more evidence disclosure and better policy." (Cotton, 2012, p. 369)

Let us add here claims that from the modern heterodox macroeconomics position probably (1) "the rich" (tycoons, oligarchs, magnates, CEOs especially of banks, etc., VIPs, dependent think tanks, etc. who are from the macroeconomics' perspective generally "laissez faire" and "small government" parlour) have also better access to, for example, the national public press and formation of national public socio-economic knowledge space, and (2) from the point of political

economics, these access advantages are probably skewing national economic policies and national socio-economic knowledge structures in favour of certain interest groups, and (3) national macroeconomics knowledge structures are most probably skewing towards sub-optimal short-termism and towards a preference of myopic and outdated microeconomics market concepts and objectives in long-term development projections, e.g.: short-term growth v. sustainability, *laissez faire* v. taxes and audition, GDP v. NNI, stimulation v. intervention, forecasting v. projections, horizontal v. hierarchical coordination, competitiveness v. wellbeing, consolidation v. expansion, unemployment v. employment and fair economic equality, populist growth indicators v. economic potential, and so on – towards bad policies first of all from the coordinated economic wellbeing of the Union’s central player’s long-term views with primary priorities like convergence, sustainability, employment, alleviation of poverty, etc.

We develop a game theoretic model of informational lobbying between two interest groups and a politician, in which the politician can require political contributions in exchange for access. The analysis considers three claims: (1) the rich have better access to politicians than less-wealthy groups, (2) this access advantage makes the rich better off and skews policy in their favor, and (3) contribution limits can reduce the rich group advantage and result in less-skewed policy. We show that the rich do have better access, with the politician always offering access to the rich groups and only sometimes offering access to the less-wealthy group. This does not, however, mean that the rich group is better off or that policy is biased in its favor. The politician sets access fees to extract the greatest amount of rent from the political process. When only the rich group has access, its expected benefit from gaining access is fully offset by its payment to the politician. In this case, the less-wealthy interest group who is not targeted by the politician is better off. Contribution limits decrease the politician’s ability to extract rent, which improves the payoffs of rich interests and decreases politician payoffs. Finally, the paper presents a novel benefit of contribution limits: they can encourage the formation of lobby groups or the search for evidence, which results in more evidence disclosure and better policy. (Cotton, 2012)

And on institutional equilibrium also:

Institutions that serve the interests of an elite are often cited as an important reason for poor economic performance. This paper builds a model of institutions that allocate resources and power to maximize

the payoff of an elite, but where any group that exerts sufficient fighting effort can launch a rebellion that destroys the existing institutions. The rebels are then able to establish new institutions as a new elite, which will similarly face threats of rebellion. The paper analyses the economic consequences of the institutions that emerge as the equilibrium of this struggle for power. High levels of economic activity depend on protecting private property from expropriation, but the model predicts this can only be achieved if power is not as concentrated as the elite would like it to be, ex post. Power sharing endogenously enables the elite to act as a government committed to property rights, which would otherwise be time inconsistent. But sharing power entails sharing rents, so in equilibrium power is too concentrated, leading to inefficiently low investment. (Guimarães & Sheedy, 2012)

*

A European Semester should encapsulate the surveillance cycle of budgetary and structural policies.

It would start early in the year with a horizontal review under which the European Council, based on analytical input from the Commission, would identify the main economic challenges facing the EU and the euro area and give strategic guidance on policies. Member States would take conclusions of this horizontal discussion into account when preparing their Stability and Convergence Programmes (SCPs) and National Reform Programmes (NRPs). SCPs and NRPs would be issued simultaneously, allowing the growth and fiscal impact of reforms to be reflected in the budgetary strategy and targets. Member States would also be encouraged, in full respect of national rules and procedures, to involve their national parliaments in this process before submission of the SCPs and NRPs for multilateral surveillance at the EU-level. The Council, based on the Commission's assessment, would subsequently provide its assessment and guidance at a time when important budgetary decisions were still in a preparatory phase at the national level. In this context, the European Parliament should be appropriately engaged. (Estonia 2020, 2011)

Estonian Government projection by 2020 postulates:

17. Continuing the gradual reduction of taxes on labour and profits and to increase taxes on consumption and use of natural resources.

*Greater taxation of wages and profit will limit economic growth more than the equivalent amount of taxation on consumption and use of the environment. For this reason, we must support at every level **a shift in taxation from workforce (direct taxes) to taxation of consumption and resource use (indirect taxes)**. Besides geographic location and reputation of the state, taxation is one of the most important factors that helps draw foreign direct investment to the country. Favourable taxes are the linchpin for positive investment decisions in cases where other prerequisites (basic infrastructure, education, security) are ensured to a degree comparable with other countries. Thus, as one measure to be established, a ceiling will be set on the pension insurance component of the social tax.*

*Efforts must be continued to harmonize indirect **taxes that have a significant impact on the functioning of the EU internal market and to abolish exceptions in the EU**. Direct taxes and tax systems (rates) reflect every country's specific and unique social and political choices, and thus the principle of freedom of choice of member states must remain in place in this regard.*

Estonia must become the 28th tax system to support the uniform consolidated income tax base on condition that it will simplify the functioning of the entrepreneurial environment and that it is possible to maintain the current Estonian corporate income tax principles. Simplicity, transparency, low administrative costs are of key importance for Estonia in maintaining and increasing the competitiveness of the entrepreneurial environment. (Estonia 2020, 2011, pp. 29–30)

It is easy for us to see that by all standards of modern heterodox macroeconomics (synthesis of the evolutionary, institutional, Bayesian and other macro theories, e.g., Keynesian and Friedmanian doctrines, etc.) this section is completely skewed towards the interests of the richer Estonian stakeholders and this especially in the EU long-term context, and based first of all on myopic outdated microeconomic and populist concepts such as: “Continuing the gradual reduction of taxes on [...] profits (sic! – *Author*) and to increase taxes on consumption”⁴—(a) profit tax in Estonia has been annulled to zero (sic!) for about a dozen years already, and is thus an absurdity in the macroeconomic context: unethical and not harmonized in the international competition on capital markets, and dysfunctional domestically as it pushes capital out of domestic economy (Eesti Pank, 2012) and unfairly inflicting increasing labour

taxes and inflation, and (b) increase of taxes on consumption would first of all be hitting most severely the population in-poverty-risk and material deprivation and (c) this tax policy is macroeconomically almost certainly not sustainable as, for example, indirectly it is stimulating outflows of capital and labour out of the country, increasing domestic economic real inequality, etc., and with great probability inflicting sub-optimal long-term development of the national economy.

And the statement “Estonia must become the 28th tax system to support the uniform consolidated income tax base on condition that it will simplify the functioning of the entrepreneurial environment and that it is possible to maintain the current Estonian corporate income tax principles” is not only skewed but also logically fuzzy in the interests of investors and in trying to perpetuate the idea that the less-wealthy should pay for some public expenses connected with the profit-making of the “haves”.

Most importantly, the current populist macroeconomic policy on the basis of distorted low-quality national public knowledge space (dominated by myopic populist liberal microeconomics doctrines such as “flat taxes and small government” and “domestic devaluation”) has, in the recent years, turned Estonia’s economy on a negative divergence trend in the EU-27 comparison (see Fig. 1: Estonian GDP pc even in the decorative PPS currency in sigma convergence has taken a downwards trend). Remarkably, there is a regrettable Figure 1 but, myopically, no word of responsible explanation about this significant dismal trend in this document. Probably a turn to unsustainability has also taken place (recall as unbalanced amounts of capital and labour is flowing out of the domestic economy)—all that regardless of substantial grants from the EU budget. It is likely that the neglect to analyze these most important negative tendencies becomes possible because Estonia’s administrative statistics lacks a clear-cut rubric of ‘Sustainability indicators’.

Projections such as *Estonia 2020*, *Europe 2020*, etc., and clusters of official statistical sustainability indicators must also contain information about macro-financial flows and stocks, human capital macro flows and stocks, FDI flows and stocks, different inflation indicators, relevant tax reforms time lines, poverty indicators, etc.

In this respect, “the process of giving strategic guidance on policies to the Member States when preparing their Stability and Convergence Programmes and National Reform Programmes” should be the central role of the *ES*. It may be claimed that this mechanism has been designed according to modern standards of

the heterodox mainstream macroeconomics (especially Bayesian informational coordination mechanism with side-payments theories). But as such it may be skewed and in conceptual conflict with the national socio-economic managers and administrators interests of most peripheral Member States and the local interests of international banks and monopolies (high inflation, tax paradise, low wages, etc.), and, most importantly, in contradiction with the national public knowledge spaces mainly formatted on outdated liberal microeconomics' tenets.

This information asymmetry phenomenon may hamper or already has impeded the optimal implementation of the European Semester coordinating game mechanisms. And perhaps something has to be urgently done or regulated first of all in this mechanism by the Commission, especially in the field of enhancing the quality of macro-communication mechanisms and improving the quality of national macro statistics (e.g., include sustainability indicators, etc., and publish the comparative GDP growth rates of the member countries (Eurostat, 2012).

The article tries to advance our understanding of institutional economics by critically examining the currently dominant discourse on institutions and economic development. First, I argue that the discourse suffers from a number of theoretical problems—its neglect of the causality running from development to institutions, its inability to see the impossibility of a free market, and its belief that the freest market and the strongest protection of private property rights are best for economic development. Second, I point out that the supposed evidence showing the superiority of 'liberalized' institutions relies too much on cross-section econometric studies, which suffer from defective concepts, flawed measurements and heterogeneous samples. Finally, I argue that the currently dominant discourse on institutions and development has a poor understanding of changes in institutions themselves, which often makes it take unduly optimistic or pessimistic positions about the feasibility of institutional reform. (Chang, 2011, p. 473)

(N4) On socio-economic policy-strategy and institutions' skewness

First, for a recovery from hyper-crisis perhaps Estonia shouldn't all together rush to exit from the variety of significant, direct regulation mechanisms and instruments like fiscal stimulus and monetary relaxation, intervention policies, etc., categorically. Perhaps it is not yet too late to ensure a proper sequencing of these instruments complementary to budget cuts, with the goal of preventing a hyper- unemployment (20%), massive euro loan-bankruptcies of households

and double-dip recession. This, first of all based on domestic recourses (e.g., from the Bank of Estonia, state bonds, etc.).

Second, Estonia should instantly rush to establish “harmonization” with the European Commission regarding the amendment of the extant Maastricht inflation criterion: in present form it is methodologically defective, non-transparent, and with that may cause irretrievable socio-economic and credibility losses for Estonia; and perhaps in the crisis situation, it may be rational for Brussels to move beyond a rigorous adherence to the whole stability and growth pact altogether (see also Sapir, 2009).

Third, a reform of the Estonian tax system is probably instantly necessary: in the sense of harmonization of investment competition with the member countries, for enhancement of Estonian socio-economic sustainability, lowering the risks of domestic capital flight without domestic taxing and avoiding worsening of the Estonian international investment position. And, most importantly, presently there is a lack of coordination between income tax law and national pension law, etc. (Ennuste, 2009)

Annex

A sketch of formalization of the ‘geometry’ of the EU Macroeconomic Governance Hierarchy according to the ESM Reform and Estonia’s position

This sketch is mainly based on Pisani-Ferry, Sapir and Wolff (2012), and partly on Estonia’s position as proposed by Purju (2012).

The euro crisis and subsequent policy responses have challenged the assumptions underpinning the governance of the euro area, and the relationship between the European Union’s euro- and non-euro countries. The euro policy regime has become increasingly complex and difficult to manage, raising the question of the accountability of decision-making to citizens. The complexity also threatens to create frustration for euro-area members who fear that initiatives to strengthen the euro will be hindered, and for non-euro members who fear that they will be de facto deprived of their say in decisions of major relevance to them.

It is easy to see in this situation of the EU after the ESM reform developing variable complex macro-governance hierarchy geometry with many overlappings of the mechanisms and regulations—for the sake of clarity, it may be very operational to introduce in the narratives some elements of formalizations as

on the hierarchical coordination levels as on the Member States' position's structures, simply to classify the complex and multi-dimensional problems more rigorously and transparently and alleviate complexity frustrations.

The General Geographic Model of the EU Macroeconomic Governance Hierarchy (Country Matrix [...] + Coordination Mechanism {...}):

$$R(EU)=EU[(Mec+Mep)+(Mnc+Mnp)]\{LT+ESM\}$$

Where *R* – rebuilt; *M* – set/number of the Member States; *e* – euro countries; *n* – non-euro Countries; *c* – core; *p* – peripheral; *LT* – mechanisms based on the Lisbon Treaty; *ESM* – the European Stability Mechanism in complex ('European Semester' ... and rebuilt regulations and institutions; note the Regulation Network on the Institutional Matrix).

Table 1. The increasingly complex decision-making

Six-Pack item	Regulation/ Directive No.	Six-Pack Regulation	Applies to:	Voting rule
1	1175/2011	Improving budgetary positions and economic policies	EU27 (with minor exceptions which only apply to euro area+ERM2)	1
2	1177/2011	Improving the excessive deficit procedure	EU27, ECB surveillance only applies to euro area+ERM2 countries	N/A
3	2011/85/EU (Directive)	Budgetary frameworks requirements	EU27, the UK does not have to abide by Articles 5 to 7 (concerning numerical fiscal rules)	N/A
4	1176/2011	Macroeconomic imbalances	EU27	2
5	1173/2011	Enforcing euro area budgetary surveillance	Euro area	2
6	1174/2011	Correcting excessive imbalances	Euro area	3
Two-Pack item	Regulation No.	Two-Pack regulation		
1	385/2011	Surveillance for member states with financial stability difficulties	Euro area	3
2	0386/2011	Common provisions for draft budgetary plans and excessive deficit correction	Euro area in general (with minor exceptions for members who are subject to macro-economic adjustment programmes or already subject to an excessive deficit procedure)	3
Agreement				
		Fiscal Compact (TSCG)	EU25 (the UK and the Czech Republic are left out)	4
		European Stability Mechanism (ESM) Treaty	Euro area	5

Voting rules: 1 = QMV, excluding the member state concerned (only euro-area countries vote on euro-area members), Council can reject Commission recommendation by simple majority. 2 = QMV, excluding the member state concerned. 3 = QMV of euro-area countries, excluding the member state concerned. 4 = Reversed QMV (euro-area countries). 5 = QMV or mutual agreement by the Board of Directors and the Board of Governors.

Source: Pisani-Ferry, Sapir & Wolff, 2012

Remarks on the idiosyncrasies' cluster of Estonia's position in the European Semester context in the Mep group (narratives based on (Purju, 2012)), e.g.

$$Cee = (...Xc-...)$$

Where X may mean Estonia's convergence indicator in the *Mep*, $c -$ level not satisfactory, and the minus sign indicating the worsening perspective.

Narratives for finding the most significant indicators

Estonia's GDP growth was 7.6 per cent in 2011 and is expected to be 1.7 per cent in 2012 after a 17.5 per cent decline during 2008–2009. The budget deficit is expected to be 2.6 per cent in 2012. (Purju 2012, p.22)

Estonia's general convergence position regarding the EU countries at the time is detonating—labour and capital is an anomaly flowing out of Estonia, inflation is high, NNI pc is low, gross foreign debt is on the average level compared to the payment facilities, and the tax system is unbalanced, general welfare is declining and real inequality is high and increasing, the ethnic conflict is impeding economic evolution and the country has not enough bargaining to alleviate it, the quality of public national macroeconomic competence is low and the ESM reform is increasing anxiety and populist policies, etc.

Estonia is interested in strengthening the euro area, the common financial market and competitiveness of the EU. Economic and financial policy of the EU should be sustainable and the Member States should fulfil the requirement of the SGP, (Estonia's European Union Policy 2011–2015, 2011). [...] Estonia is looking forward to that the budgetary rule introduced by fiscal compact will support the achievement of EU priorities. (Purju 2012, p.22)

*

Estonia is interested in sustaining its tax system, which is very strongly biased toward indirect taxes, there is a proportional income tax and retained corporate profits are taxed with zero per cent corporate income tax. At the same time, Estonia is interested in harmonisation of rules for value-added tax and excise tax (elimination of exceptions) and some kind of harmonised tax base for corporate income tax, operating on the EU market. (Purju 2012, p.23)

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