Foreword

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I am delighted to have a chance to introduce this peer-reviewed collection of articles, another milestone on the road of academic activities of International University Audentes. This interdisciplinary edition with a comparative nature takes a critical look at the problems arising in the context of being member of the European Union, embracing the contributions from various authors with distinct academic and professional background. The current edition includes not only significant academic research (mostly in the field of business, sociology and to some extent in law), but also essays and commentaries (social science in general and political thought). Somewhat different style and aims of various authors benefit the main goal of this set of presentations: to be exciting reading material to as many readers as possible, including not only representatives of academic world but also practitioners and public at large. Half of the papers were initially presented at the 5th annual international Spring Conference of International University Audentes: "Europe's Role the World and the Future of European Union: enlargement – two years on" (2006). Others present the successful results of our call for papers for this collection among the cooperation partners of the Institute for European Studies and International University Audentes.

Despite of eclecticism, one of the common keywords prevailing here is seeking for “identity”. The search for a coherent playground is the joint expectation of different but co-existing worlds: business, politics, social relations and law. I myself, as a legal scholar, have been analyzing the recent ultimate goal of European Union's legal identity – the process of adoption of the constitutional treaty. It appears that the failure and reluctance to approve the Covenant has been caused mainly by a jumble at the level of Member States who are not sufficiently convinced to explain the status of their own constitutional law in the new situation. The borders for jurisdiction appear to be unclear and highly arguable. It is easy to see that many theorists often try to balance between supranational and national interests depending on their own individual positions and identities.

The theses of the current compilation of articles are, directly or indirectly, related with identity problems. Although the various authors have quite different research angles, they all, directly or indirectly, are trying to identify the desirable elements and perspectives that would form a solid basis for the EU development.

Well-known writer of essays, Paul A. Goble (International University Audentes, Estonia - USA) in his “Is the EU pushing the US away? Reflections on culture, politics and the future of the West” opens the door for discussions. The keynote essay describes the author’s vision on relationship and discussion between US – EU societies and culture from American perspective.

Erik Terk from Estonian Institute for Futures Studies is trying to predict the scenarios for EU development. The author, after taking a retrospective view to the political ideology of EU, analyses possible development patterns in future, assisted by methodologies of David Smith and Andersen Consulting. One of the author's vision on three possible Europe's (see the figure 3 “different institutional developments and their dominants) differentiates “citizens Europe”, “State-like Europe” and “Europe as a Fatherland” depending on who determines the development (States, institutions, citizens).

There is always the question on whether the strong identity of member-state(s) is a precondition for strong identity of EU (or vice versa)? Mait Talts (International University Audentes), in his essay with a philosophical nature, discusses elements of Estonian identity. This issue which is particularly interesting for a relatively young State, has been analyzed by several Estonian sociologists (one of the collections of inter-cultural research was published by Tartu University European College in 2002). Mait Talts starts with the assumption, that the younger generation faces the difficulties to understand the importance of the identity as such. However, the author still thinks that the concept of identity can be used as a tool to understand “who we really are, where we come from, and where we are heading”. One of the questions prescribed is related to the compatibility of the identities of the Member States and the European Union. By author: “Europeanness has to be absorbed into the Estonian identity – or vice versa”. The reader is left to make his or her own conclusions.

The same issue from inter-cultural point of view is treated in the book-review of Siobhan Kattago (Jeremy Rifkin’s well-known “The European Dream”) where the author compares the positions of Rifkin with the considerations of other thinkers (such as Jean Monnet and Robert Kagan). There are several writings on how certain elements of culture and traditions in United States can be adopted by Europeans. Alternatively, the aim of the current review is to elucidate the positive European patterns and models for Americans.

EU is a complex phenomenon. The abstract predictions of EU future would be useless if the existing practices and policies are not taken account. For example, EU fiscal policy is relevant tool to shape EU identity and relations between the EU and the Member States. Mindaugas Dapkus from Vytautas Magnus University (Lithuania), in his paper, is proposing "an alternative criterion for fiscal policy evaluation" i.e Inter-Generational Debt Morality Index. The author's arguments are based on comparative research. Similarly, comparative research is also presented by James O´Neil (International University Audentes). In his intricate paper, the author demonstrates that the American model of capitalism ("Debt Culture") can be well used in analyzing the financial system of one of the most influential EU member states: Germany. The paper of James O'Neil can be called unconventional from the point of view of many contemporary theorists from the field of business and is a good kickoff for further discussions in this disputable area.

Vladislav Volkov from Daugavpils University (Latvia) is giving us an intriguing sociological analysis on "quality of life" in Latvia (as one of the Member States of EU), perceived by Latvians and Russians as two major ethnic groups. It seems that the results of this research (where the main outcomes are presented by several tables, figures, percentages etc) can be well be seen as a part of process of defining the group identity. According to the article, for example, the Russians “are more positive in evaluating their life conditions, but less satisfied with their efforts to achieve their life goals”. However, as Volkov asks – are there mere ethnic differences or ethnic inequality?

Rasa Glinskienė and Birutė Daraškevičiūtė from Kaunas University of Technology, Panevežys Institute (Lithuania) are emphasising the positive side of being in the EU. They find that Member-States “benefit by additional inflow of foreign direct investments (FDI)”. By their research, based on Lithuania´s experience, the increase of FDI is coming not only from other Member States but also from outside the European Union. Authors prove with their paper that FDI as a macroeconomic index generates the growth of gross domestic product and decreases the inflation and unemployment rates.

The edition consists an “institutional mechanism analysis approach” on overview of market-transition in Estonia, written by Professor Ülo Ennuste. The paper includes interesting lexical matrix of market-oriented institutional reform 1997-2006 and its commentaries, explaining the specific features of economic processes Estonia. In conclusion, Ennuste finds that the Estonian market economy transition has a dual character, influenced both by post-Soviet transition (old transition), and the accession to the EU (new transition).

Sándor Meisel from Institute for World Economics of the Hungarian Academy of Sciences suggests that Europe „must redefine itself“. He is calling the EU to achieve „substantial changes“, and foresees „inevitable reforms“. The survey is based on Hungarian experience of EU membership.

The author makes an overview to EU impacts to Hungarian trade, investments, labor market and finds that “a significant part of the fears and worries are baseless or related to occasional mistakes or late internal measures rather than to EU membership”.

Ivar Raig from International University Audentes, taking a somewhat alternative view has still been careful, talking about “some possible” negative aspects of the EU enlargement. According to him, there may take place “an increase of nationalism and social tensions in some member countries, which are not ready for really free movement…” In principle, Ivar Raig believes that the enlargement to East has weakened the capacity of the EU for further development. That makes the author to make protectionist suggestions as “to renegotiate the accession treaty to ask for more transition periods and derogations”. Raig is convinced that the main goal of Estonia is to maintain itself, as much as possible, as an independent and sovereign state.

The author from University of Szczecin, Paweł Ładykowski is convinced that the “new era of democracy” that author relates to the fall of communist regime and joining the EU has been beneficial to the minorities. Ładykowski is giving an example of Kashubians, ethnic minority, inhabitating the Gdansk Pomerania region (former Polish-German borderland).

One of the mightiest determinants of societal identity in contemporary world is television and broadcasting. Maia Sule is a graduate of International University Audentes (at her period of graduation: International University Concordia Audentes) and winner of the Swiss Baltic Net Graduate Award 2006 of Audentes University. Her article “Estonian Television Channels’

Programme and Legal Regulations: One Year after Accession to EU" is a shortened version of her thesis, analysing how Estonia has adjusted its legislation and broadcasting practices to the European directives.

The current set of presentations includes also the views of acting politicians. The member of European Parliament, Siiri Oviir, is describing the positions related to the European Constitutional Treaty. The paper describes situation and the related problems as they were in April 2006. Kristiina Ojuland, the Head of the Commission of Estonian Parliament, describes the EU directed activities of Estonian Parliament, Riigikogu. Both of these papers were presented on 5th Audentes spring conference "Europe's Role the World and the Future of European Union: enlargement – two years on".

Of course, there are hundreds of EU related conferences and an unnumbered amount of papers published every year. Participating recently at the European Communities Studies Association conference in Brussels, outstanding speakers like Romano Prodi and Pat Cox stated that there is too much of populism in the academic world and asked the audience to present the ideas that can be realized in practice. In this light, I feel that the current set of papers is a valuable comparative contribution to the discussion and contains several serious academic views that can be considered not only today but also after several years.

On behalf of the university, I would like to thank all the people who assisted in the preparation of this edition. First, the main editor Professor Ivar Raig who made the selection among many proposed contributions. Heartiest thanks to senior researcher Aksel Kirch and researcher Mait Talts from our

Institute for European Studies. They, patiently doing the preparatory work and communicating with all of the authors, made this publication possible. Sincere thanks to the independent academics and experts from several countries, different universities and research institutions that sent us their critical evaluations on the papers we intended to publish.

As Mait Talts suggests, “the collective identities are under continuing change”, it is worth of mentioning that the publisher of the edition, International University Audentes, being an academic society, goes under the same rule. From this year 2007, the university has the new name, the new rector, renewed strategies and a new home. However, for the academic world, continuity is at least the same important as the capacity to change. Therefore, I wish the cooperation between those who contributed to the edition would be strengthened by their new joint activities.

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SECTION I
LAW AND POLITICS

Is the EU pushing the US away?
Reflections on culture, politics and the future of the West

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A little over a year ago, the leaders of the countries that until recently defined themselves as the West, as the proud product of a civilization that traces its roots to Jerusalem, Athens and Rome, assembled in St. Peters Square for the funeral of John Paul II, the pope who throughout his life sought to call the peoples of these countries back to that tradition and whose statements and actions played such an enormous role in the triumph of the West in the Cold War.

But what made his funeral so striking was not just the memories of the man whom these leaders had assembled to honor but perhaps even more the fact that over the last 15 years, many of them have behaved in ways that not only have highlighted longstanding differences within this tradition but what is more done things that call the meaningful existence of something called the West into question.

One of the deepest of these apparently increasing splits is between the countries now organized as the European Union and the United States, two halves if you will of the West that stood together against the Soviet threat for more than 40 years but that since their victory in that conflict gone their separate ways.

In one sense, these developments, both the earlier alliance and the more recent divisions, should have surprised no one: European countries and the United States have always been very different, and their accord during the Cold War was in many ways more a marriage of convenience between Europe's requirements and America's power than a meeting of minds. But because the European Union as it has emerged over the last several decades is the new actor on the scene, ever more people are asking whether that institution is in fact contributing to the division of the West by pushing the United States away.

That is my subject today. And my basic argument can be simply stated. On the one hand, the end of the Cold War and the rise of the European Union have allowed longstanding differences between the peoples on opposite sides of the Atlantic to re-emerge. And on the other, the EU both by what it has done and even more by what it has said has exacerbated these divisions and currently is invoked by many in the United States to justify both the rise of American unilateralism Europeans dislike so much and the decline in American attention to Europe which only makes the situation worse.

In order to make sense of this, we need to consider three things: the meaning of the West historically, the underlying differences between the culture of

European countries and that of the United States, and the impact of Europe's „civil war" during the first half of the 20th century and of the Cold War during the second on both sides of the Atlantic. Only then will we be in a position first to consider why the EU and the US are each intentionally or not pushing the other away and then by way of a conclusion to suggest some of the ways that the two may overcome their current divisions and reaffirm the continuing importance of the historical tradition of which both are a part.

A Dynamic Tradition

On of the most often remarked upon features of Western culture that sets it apart from almost all others is the fact that it has three roots rather than one. If Islamic civilization can trace its founding back to a single man and a single book and Chinese civilization to an equally limited number of sources, , the West throughout its 2,000-year history looks back to and combines the millenarian visions of Jerusalem, the rationalism of Athens, and the legal order of Rome. And that diversity in origins has contributed not only to the dynamism of the peoples who share in these traditions but also and equally inevitably to divisions within and among them.

There has been a creative tension among these three, with now one and now the other taking the lead but no one of them being in a position to push the other two completely off the table, at least not for very long. That is because all three traditions are in terms of the Western tradition equally legitimate, and consequently, any individual, group or country that exults one of these traditions at the expense of the other will find – indeed, for two millennia, have found – themselves checked by the supporters of the other two.

Indeed, that tension is at the heart of Western civilization as we know it. All of you have heard of the Magna Charta, the 13th century document that opened the way to the establishment of the democratic freedoms we know today. But many of you may not know why it is called „magna" or „great." The reason for that lies in precisely the tensions I am talking about here.

Prior to the Battle at Runnymeade where King John of England was forced by his barons to recognize their rights and accept limits on his own, John's father, Henry II, had been locked in a battle with Thomas Becket, the archbishop of Canterbury, over the respective powers of Church and State in late medieval English. Both Henry and Becket attempted to win this fight by securing the signatures of barons who supported their respective positions on documents that were known as „charters." And thus because the barons were unwittingly taught the value of their signatures, they ultimately were in a position to insist on a recognition of that value by the kind himself.

Examples of the way in which the interplay of religion, rationality, and law have played a role in defining Western societies and driving them forward could be multiplied almost at will, and each of them would be instructive. But here I need to point to another phenomenon, those occasions on which each of these component parts of the West has for better or worse come to dominate all or part of that community and then – and this is equally important for what we are discussing here – been subject to correction by the rise of one or both of the other two.

Because we are talking about three factors, let us consider cases reflecting efforts by the supporters of each to drive the other factors out of public life and indeed out of the Western tradition. Again, there are many examples from which to choose. First, for much of the West's history – indeed for nearly a millennium after the fall of Rome at the end of the classical period -- those who supported the claims of religion over rationality and order were in a position to dominate the other two.

Throughout that period, the Catholic Church set the intellectual agenda for the West, but there were three reasons why those who put religion ahead of anything else were unable to maintain that position in a pure form at any time or unchallenged over the longer haul. First, the Church itself was rooted in Greek rationalism. The most important Church fathers were part of Hellenic civilization and were not immune to the claims and arguments of Athens. Second, the Western Church was grafted both through its own efforts and those of Constantine onto the Roman imperial tradition of a legal order. And third, the Church itself and the Western civilization it oversaw were at all times profoundly affected by those living nearby who were not part of this tradition.

This last point is critical for our discussion today. The West and the Western Church were defined in large measure by what they were not: Initially, they were not part of the luxuriant growth of orientalist cults. Later, they were opposed to the world of Islam. And still later, they viewed themselves as set apart from the world of Eastern Orthodoxy. When the Church and the West were most threatened, both were inclined to define themselves in a unitary fashion, but when these threats receded, they were prepared to allow a flourishing of the three traditions out of which they themselves were formed.

Second, at various points in the history of the West, those who elevated rationality above faith or law took the upper hand. One of the most important of these was the French revolution of 1789, a movement that sought to free the individual „man and citizen” from the constraints imposed by anything other than human reason. That event played a key role in the history of the West, both by breaking the bonds that had held Europe in check in the previous century but also by showing the limits of rationalism when applied independently of all other considerations.

On the one hand, a revolution conceived as the triumph of liberty over everything else rapidly degenerated into one of the worst forms of tyranny ever seen in the West up until that time. And on the other, this very tyranny not only prompted those who valued both faith and law to rise up to rise up and oppose that revolution but to go on to push the claims inherent in each of the latter in ways that over the course of the last 200 years has produced additional triumphs and tragedies on the continent and in the world.

And third, and about this one we can be brief, there have been efforts to make law the dominant factor, using it to drive out both faith and rationality. But such efforts, typically less dramatically than the other two, have quickly failed when those taking part in them have been forced to confront the fact that law not informed by either or indeed both of the other two is not only sterile but fundamentally illegitimate and susceptible of degenerating into another kind of tyranny over the mind and spirit of man.

A Clash Within a Civilization – Not Among Them

The European Union and the United States are both part of the West, but both historically and at any particular time, they reflect not only different sums of that tradition's three component elements but also different evaluations of each other and the surrounding world. And those underlying differences, which I argue are part and parcel of the Western project, are constantly in flux, even if at any particular moment, they appear to both participants and observers as forming an insurmountable wall between the two.

For most of its history, Europe was the West. It was the cockpit of the civilization whose component elements I have just described. As such, many of its leaders are profoundly sceptical about the possibility of finding or imposing any solutions to fundamental human problems. They have seen

what attempts to do that have entailed, and they are thus often reluctant to try. Instead, they are more interested in addressing smaller and more immediate problems, something that contributes to what in the minds of many is a more humane approach but one that in many cases leaves them at risk of being unable to see or respond larger challenges either from within their own tradition or outside.

Now that I live in Estonia, I frequently speak to European audiences about the dangers I see ahead for our Western world. Whenever I do so, Europeans will inevitably ask how much worse things are likely to get. When I deliver the same talk in the United States, the reaction of Americans is very different: They want to know – and it is invariably their first question – how we can overcome them.

That difference is rooted in the very different history of the United States. Among the most important aspects of that reality are the following: First of all, the U.S. is an immigrant society. The defining experience is the decision to leave somewhere else, start over, and create a new life. Second, it is a new society, one explicitly focused on the future rather than obsessed with the past. Third, it is an enormously fortunate country, one protected from others by two huge oceans for most of its history and having a sense of limitless possibilities. Fourth, it is a deeply religious country, one whose freedoms did not develop alongside anti-clericalism but in the view of most Americans as a special sign of God's grace. And third, for all these reasons and others besides, it is a „can do" society, one whose people believe that there is no task they cannot accomplish if they commit themselves to doing so.

As an American, I am convinced that all of these aspects of our national history are something positive, but I am equally aware that each has a downside, especially when the United States interacts with other nations whose traditions are different. The American faith that history is irrelevant and that we can always start over often makes Americans impatient with those whose national experiences have convinced them the past is always and sometimes too much with us. The resources that Americans have at their disposal have allowd the United States to be perhaps the most generous nation in history, but they have sometime contributed to an arrogance and an expectation that others will be grateful. The religious attachments of Americans, something that many contemporary Europeans underestimate and view as a kind of weakness, routinely refresh the American experience, but they too can sometimes contribute to a sense of election that is not justified by the facts. And finally, the American conviction that we can solve problems means not only that we often are willing to address things others hope they can ignore but also that we sometimes rush into things that others, more cautious than ourselves, have prudently avoided.

From my perspective, the common roots of the two parts of the West as well as the very different cultural patterns that the elements of this civilization have given rise do explain more than anything else both why Europeans and Americans are ultimately able to cooperate when they face a challenge but also why – and we see this almost every day in the headlines – each often finds it difficult to understand the other when common threats recede or when only one side thinks that a threat can be countered successfully.

Two Readings of the 20th Century

But much of the current division between the European Union and the United States reflects the different readings of what has taken place in Europe and in the world over the course of the last 100 years.

Put in simplest terms – and those are the ones that typically drive politics – many Europeans have accepted the following narrative. Europe was rent by a civil war from 1914 to 1945, one in which it sacrificed enormously to end the dead hand of the past and the unprecedented evil of Hitlerism. Then it was divided by the Soviet occupation of half of the continent for almost 50 years. And these events left the continent less powerful and prosperous than it would otherwise have been.

Consequently, according to this narrative, the task is to focus on overcoming any divisions in Europe, even if that means a rationalist and lowest-common-denominator approach, and promoting a good life for a continent that no longer faces and will not face again the kind of horrors that its people had to live through during much of the 20th century. Europeans do not want to look for challenges further a field but rather to create a moderate, rationalist civilization. As far as it goes, that narrative is true, but it is not at all alike the one that Americans have concerning the same period.

From the American perspective – again put in the simplest terms that shape much of U.S. thinking – Europe is an aging continent, one that has never been able to confront the problems that its own demons have generated in a timely fashion, preferring instead to engage in denial and appeasement, and one that has failed to understand that it is no longer as important as it once was relative to others. Three times in the 20th century, Americans believe, they had to ride to Europe's rescue, intervening in World War I, World War II, and the Cold War – and had the U.S. not done so, Europe would perhaps not have survived. And now that this conflict is over, the Europeans are not only less grateful for America's role than Americans expect but also insistent on telling the U.S. how to behave even though many of them are no more willing to make a contribution to combating current ills than they were earlier when they were more immediately threatened.

Consequently, in the view of many Americans, Europeans are presumptuous to think that the U.S. will always consult with them and never engage in unilateral actions against terrorism or anything else. And that American attitude, which is now very much on public view in Washington, has had the effect of reinforcing European views about the superiority of their own approach and the inherently problematic, even dangerous nature of the American one.

Europeans counter pose their own rationalism and commitment to law with what they see as the religious, even millenarian views of the Americans. And given that the governments in power in the United States and much of Europe do not conceive of the struggle against terrorism in the same way or having the same importance, it is not surprising that Europeans and Americans not only are sharply criticizing one another but – and this is the more important thing – talking past one another, without paying attention to what they have in common and the ways in which the kaleidoscopic working of the three elements of their common culture are likely and in my view certain to bring them back together again, even though few in either the EU or the US now appear to think so.

Is Division Inevitable or Can the West Come Together Again?

While all of us tend to assume that our time is the most important and that the forces events, and conflicts we are experiencing will define the future for a long time to come, Europeans are somewhat more likely to take that view than Americans are – something that also guarantees that people on either side of the Atlantic will have problems with those on the other. Europeans currently fail to understand that the United States is living through the fourth „Great Awakening," an outburst of religious enthusiasm, and that such events seldom last more than a generation or so before the rationalist and legalist impulses of Western culture resume their role. Consequently, many in EU countries assume that they know what the US will do not only tomorrow but a decade from now. Those who think so are almost certainly wrong, but the assumption they make could lead to actions that would make this a self-fulfilling prophecy.

Moreover, the EU faces challenges that it does not want to acknowledge and certainly cannot yet see a way to address. On the one hand, despite its deeply democratic rhetoric, the EU is an inherently bureaucratic and legalistic organization, one whose radical secularism and unwillingness to engage in popular politics almost certainly will generate countervailing forces among its own people. And on the other, demographic shifts are transforming Europe, forcing many of its own people to turn back to faith and that too is likely to lead to a reaffirmation of the culture of the West.

None of this is going to be easy or quick, and both the EU and the US are likely to continue to do and say things that will annoy, even infuriate the other. But Western civilization is large enough and powerful enough to allow for these divisions and also these rapprochements. What is necessary now – as it has been necessary so often in the past – is for people on both sides of this divide to recognize that fact, to exhibit a certain modesty about themselves and respect for others, and consequently to view what is going on as part of the price we pay for our dynamic civilization rather than a threat to it. If we can do that, then the West may have an even brighter future than it has had in the last several centuries. But if we cannot, then challenges from outside – including Islamism, China and the shifting demography of the world – may in fact become mortal threats to the most successful civilizational project the world has ever known.

On the Way: how and where?
On the development of the EU in the light of realisation of varying scenarios

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This article aims at analysing the development of the EU within the last decade by using a relatively rarely-used method, namely, studying the packages of alternative scenarios composed by different authors, and comparing these to the developments in reality. We thus attempted to derive certain conclusions on the determinants, ties, and critical factors etc. of the system under observation, as well as the limits and opportunities of the system's (the EU's) predictability.

Scenarios compared to reality

Building of alternative scenarios as one of the main instruments of futures studies is meant for use at a high level of uncertainty and takes the form of creating imaginary constructs, which attempt to tie the likely external and internal determinants of the object's development into a logical system, so as to study the different paths of its development.

The process of building and using scenarios does not attempt to reach a sole and favourite hypothesis about further behaviour of the system. It is presumed that the compiled logical construct cannot reveal the determination of the system's behaviour fully, but only its basic traits and that according to the "if-then" principle. In other words, it is attempted to define meaningful combinations of factors of influence and events, and to predict the likely behaviour of the system within the terms of the abovementioned selected combinations.

We proceed from the position that no reliable theory exists for forecasting the integration and further development of the EU as a unique object.[1] In these conditions, the comparison of scenarios derived from different basic logical assumptions to the later actual developments could serve as a step towards such a theory. (Taking in account, of course, that the picture of impact factors of integration could change at various stages of development, and the projections made for the previous stage and their testing need not be of use without correction in such a case).

The probable reason why the "audit" of *ex ante* scenarios has not been used much for the correcting or development of theory is that the scenario method belongs to the set of instruments of policy developers and consultants rather than that of pure theoreticians, and its emphases on plurality and openness contradict the attempts of many theoreticians to create their own original fundamental type of the theory. The other reason is that the authors of the scenario descriptions are not particularly willing to compare the versions of events they have advanced with the events which later actually occurred. They view their professional activity in scenario-writing not as forecasting (where the inaccurate and accurate forecasts could be later singled out) but as an activity for expanding the mental map of the decision-makers (in which

[1] The building of such a theory has been complicated by the absence of empirical materials on integration attempts in scale similar to the EU and in comparable framework conditions. Drawing parallels with the development of various international economic blocs or federal states (e.g. the USA) would be too remote.

case it would be difficult to differentiate between "right" and "wrong" scenarios). By this logic scenarios cannot be considered "right" only because they were realised or "wrong" because they were not.

A new stage on a long road

Sources describing the history and development of the EU have stressed that it was not a "grand design" type of project, where an idea written on paper would later be realised, but an open development, where more suitable and practical forms of integration were sought, and which progresses in a "zigzag" through controversies and crises. However, since the very beginning it has been a highly ambitious undertaking, where economic, social, and political integration have been the goal and where it has been presumed that the integration level of every following stage, whenever possible, should be higher than that of the previous one; in other words, the movement should be towards an increasingly integrated Europe. The relative final state (finalité) has remained sufficiently vague. It would probably be too straightforward to accuse the authors and implementers of the project, whoever they were, of guile or cover-up, of plans of creating a "new United States of America" or other similar conspiracy. The problem is more that the unique construct under development, a multilevel governance system, simply does not fit within the limits of existing treatments of political science, as the words for defining it do not yet exist. For example, the European Commission as to the functions it performs cannot be compared to the traditional government of a nation-state, the European Parliament is not entirely a parliament but largely a co-determination partner in relatively complicated institutional processes, etc.

While the European Union (for simplicity's sake we use the latest term rather than the earlier ones) after the 1954 intermediate crisis had been progressing primarily in the economic dimension of integration (the common market) and (still) largely remained within the framework of a community of states, the Maastricht (1993) and Amsterdam (1997) treaties at the latest made it clear that the "old vessels no longer can hold new wine", that the nature of the new stage of integration should be determined and adequate functioning mechanisms should be developed for its content. Terms like "grand transition" (Jacques Chirac) emerged in the rhetoric, referring to the need for achieving some sort of state of affairs or form which would be new compared with the previous one, while also promising some stability opposed to the constant reforming and changing of the EU: stable EU institutions, stable borders, etc. This logic is seconded by the well-known US sociologist and political scientist A. Etzioni, who describes the EU integration so far as "half-way integration" (admittedly in a book published before Chirac's statement) (Etzioni, 2001, pp 25-31]. This term contains as well the opposites of being on the way and reaching the destination. The previous state as "half-done and incomplete" is opposed (at least potentially) to the following as "complete". It is not entirely clear whether this change of terms, which differs from the previously used "permanently underway" metaphor, only signalled the need for solving the situation, where the post-Maastricht moves in harmonising the economic policies, the transition to common defence and security policy, and the EU expansion no longer fit into the previous institutional framework and the latter therefore needed reforming, or whether it referred to even newer moves towards common policies. In either case it is a fact that the second half of the 1990s initially intensified the debates on common currency and other measures of harmonisation of economic environments, which was followed by a powerful discussion of the EU institutional organisation in the beginning of the next decade. The stage of "silently acting" (the 1990s) was initially replaced in 2000 by the stage of "making noise and acting" – the addresses of important statesmen calling for a discussion of the EU (institutional) future and then the "speaking and acting" stage (the Future Convent of the European Union), which, however, has declined into a vague state of "wait-and-see" after the setback.

It should be pointed out here that the different aspects of integration are interrelated. As A. Etzioni points out: the changed economic organisation of the EU requires a corresponding value-related operating environment (economy does not operate in a vacuum) (Etzioni, 2001, pp 25-31). According to Etzioni, a problem could be posed by the insufficient socio-ethical dialogue in the EU on which policies and society the people want, as well as on the desirability of including new and different members, which increases the heterogeneity in the system.

We selected for the following analysis two packages of scenarios built in the 1990s for the analysis of the EU development possibilities by the British author David Smith (Smith, 1997) and the consulting firm Andersen Consulting (Ellis, 2000). Both packages strongly emphasise economic integration, but both address economy in connection with other aspects of the EU future (social affairs, politics, security, the EU enlargement). One of the reasons for choosing these two packages is the fact that these are among the few where the authors' probability estimations of the various scenario versions are known. (In case of the Andersen Consulting package, the estimate is the personal one of the firm’s director general Vernon J. Ellis, rather than of the compiling team).

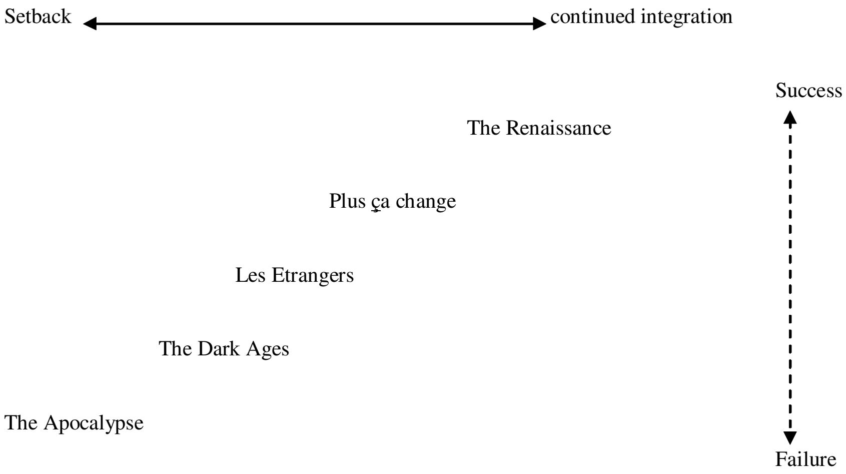
The third set of scenarios to be described is the package of the EU institutional future scenarios (Euroopa Liidu tulevik ja Eesti, 2003), compiled by a consortium of authors (K. Raig, K. Tafel, I. Raig, E. Terk etc.) at the request of the Republic of the Estonian State Chancellery Bureau of EU Integration at the end of 2002, where the scenarios are differentiated as to the different philosophies of institutional development, while in the case of every scenario, from which context it could emerge and which conditions it creates for the implementation of various EU policies (and where it could reach) is described.

One could state that while the Andersen Consulting and D. Smith scenarios mainly attempt to answer the question “Where to?”, the latter package mostly emphasises answers to the question “How?”

Levels of integration success. David Smith’s scenarios

If we should present the scenarios in a two-axis graph, the location of D. Smith’s scenarios would look as follows (Fig. 1):

Figure 1. European development scenarios according to D. Smith.



The **first** and the most optimistic **scenario**, labelled by David Smith as “The Renaissance,” is based on the premise that the development of a working single market in all spheres and overcoming the rigidity of the labour markets would coincide with the economic and political integration of the Central and Eastern European countries (“suppression of protectionist instincts” according to Smith, who emphasises here the high potential of the Visegrad countries) and the positive impact of Russia’s beginning economic growth. A successful transition to the common currency would reduce interest rates, and the euro would become a leading currency of the world. The telecom and transport markets would be liberalised, while increased specialisation would enable the European countries to make use of their specific advantages: Germany’s mechanical engineering, Italy’s luxury goods and design, London’s increasing its prominence as a global financial centre. The growth rate of the European economy would rise to four percent per year. Europe would experience an economic, cultural and political renaissance. The author mentions no specific setbacks in the case of this scenario. The logical assumption is more like: we can do it all without major problems. It is interesting that the author introduces to the ideal construct an additional factor of increased instability and turbulence in East Asia. The rise of that region (especially China) would not contribute to the European economy's move to the leading position, according to the author.

The **second scenario**, named "Plus ça change," also describes continued integration and enlargement, but in terms of only moderate success. Economic growth would be limited to 2.5-2.7 percent per year. One of the reasons would be Europe's tendency to remain in the periphery of the world economy, as Japan and the USA would be the first ones to profit from China's rise. The CEE countries would become more significant for the "old Europe" than in the case of the first scenario. The common currency would spread beyond the circle of its initial users, but with difficulties, since every country adopting the euro would receive concessions for maintaining its independence in other areas as compensation for transition. Any "big bang"-type moves towards a political union would be resolutely repelled. Europe would remain a country of expensive production, where the population is ageing and which would be unable to resolutely implement the directives for the liberalisation of markets, resulting in the delaying of all processes. The UK, Ireland, and some other countries would be able to readjust themselves and overcome the rigidity of the labour markets, but most of the older nations of continental Europe would fail. Europe would be characterised by the terms "sclerotic region" and "declining, but prospering"; it would gradually yield its positions. Nationalism would rise in the streets as well as in national policies.

The **third scenario**, “les Etrangers”, describes a situation where a small group of countries adopting the common currency within the EU could implement closer economic integration, receive extra investments thanks to the stability of the economic environment, and profit from the situation. However, this group would develop into an exclusive club in conflict with the UK as well as the CEE countries, would reinforce its protectionism towards them and toughen criteria to outsiders for joining the EU and/or especially the common currency (the inflation criterion!). The UK would leave the EU, and the German-French axis would dominate the diminished union. Tensions between North and South Italy would increase, and the country would face the threat of falling apart. The CEE countries admitted to the EU would adopt differing positions: some would make all-out efforts to join the “core”, while others would be attracted by Norway’s status.

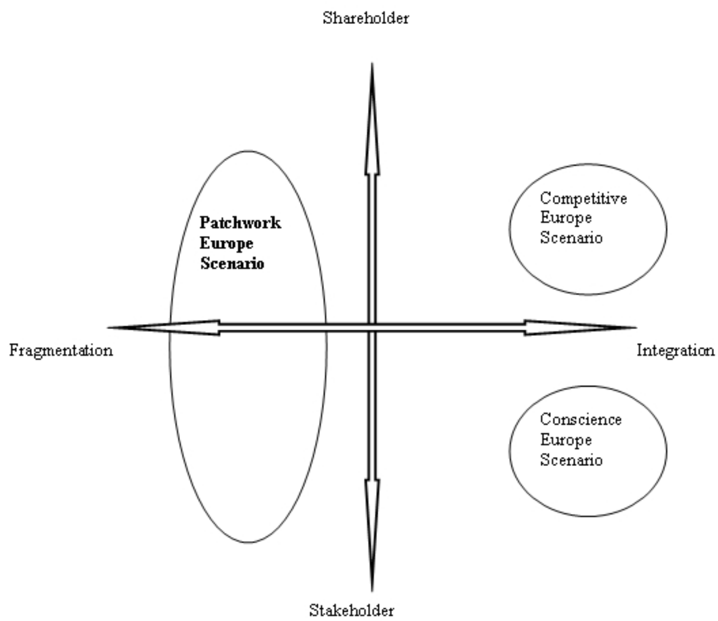
The **fourth** and the **fifth scenarios**, named, respectively, “The Dark Ages” and “The Apocalypse”, are actually crisis scenarios, which differ as to the level of disastrous outcome. In the former case it would mean a gradual economic decline, which would lead to a significant drop in standards of living. In the latter case the propelling force would be outside factors: Europe would find itself under the pressure of an aggressive Middle Eastern and North African Islam (incl. immigration) on the one hand and the increasingly aggressive China on the other. Defence expenditures would increase, the exchange rate of the common currency would drop disastrously, unemployment would skyrocket, etc.

D. Smith also provides the probability estimates of the above scenarios: 10%, 35%, 25%, 20%, and 10%. This means that he considered a moderately successful integration scenario significantly more probable than that of "complete success" and somewhat more probably than the "failure" scenarios.

Which kind of Europe? The Andersen Consulting scenarios

The "playground" of the Andersen Consulting scenarios is depicted in Figure 2.

Figure 2. The Andersen Consulting scenarios Europe 2010



The main basis of differentiation in the set of scenarios is the scenario being either single-mindedly focused on economic growth, competitiveness and profitability, with the social agenda being very modest in comparison, or strongly emphasising social, educational etc. issues. A philosophical basis for these alternatives is either the domination of the Anglo-American culture of shareholders value or an attempt to achieve the welfare of all involved groups, rather than only of capital owners.

A return from the road of integration is interpreted by the authors in the “Patchwork Europe” scenario as a “return to complexity”, the so-called Multispeed Europe, where the different countries’ efforts for promoting Europe’s integration are highly varied and where there exists “a myriad of regulatory and political environments”. This situation obstructs firms’ normal business operations or permits them only in case of highly developed lobbying capability.

The authors observe both threats and opportunities in the “Patchwork Europe” model. For example, in Central and Eastern Europe’s case they range from massive AIDS epidemics to Tallinn’s success as the site of the united Microsoft-Vodafone European main office.

In the case of the “Competitive Europe” scenario, the authors presume the transfer of the centre of power from nation states’ governments and parliaments to the European Commission, which would operate primarily in the role of service provider, concentrating mainly on the development of business environment and nicely controlled by the European Parliament. Giving up social goals and the costly CAP would enable a vigorous enlargement of the EU up to the Turkish and Ukrainian membership becoming a reality (by 2010). The common currency would be adopted by all members and would become the leading currency of the world, although it was admitted that Bulgaria and Romania could face problems meeting the criteria for transition to the euro.

This scenario would result in vigorous economic growth, but accompanied by increasing social conflicts between those who are well educated and info-rich and those who are not. The number of underclass members would increase greatly. However, the authors do not predict significant ethnic or religious conflicts, since the predominant culture would be individual- and business centred and different cultural-religious attitudes would be tolerated.

In the case of the "Conscience Europe", the EU enlargement would take place similarly to the previous scenario, but not as rapidly. (By the way, for some reason the authors predict that the inclusion of new members would weaken the positions of Anglo-American philosophy in the EU rather than strengthen them). The euro would be introduced, but it would become a weak currency due to costly social programmes and concessions made to the new members. The retention of employment would lead to economic protectionism (the so-called Fortress Europe phenomenon). The efforts of maintaining small income differences between various groups of the population, combined with protectionism, would not lead to economic growth. Combined with ageing and pension problems, the sustainability of the system would become questionable.

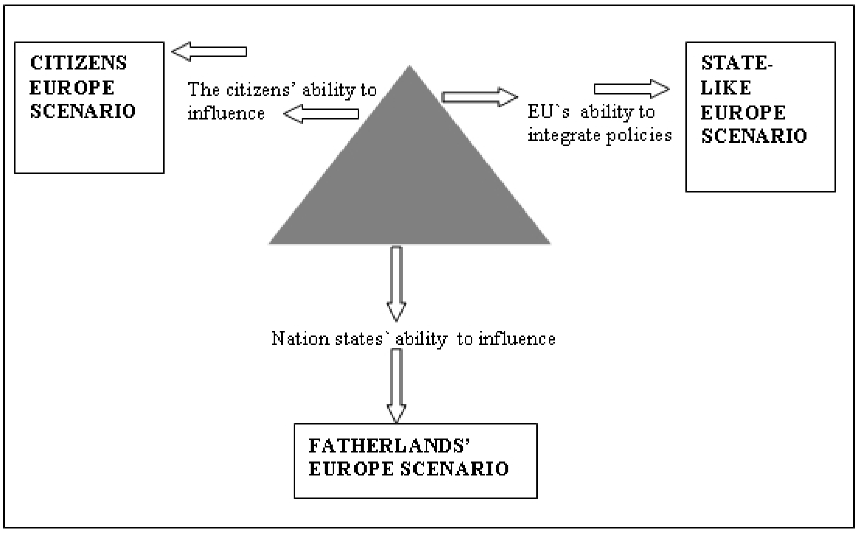
Vernon J. Ellis predicts that the actual future of Europe would lie somewhere between the "Competitive Europe" and "Conscience Europe" scenarios and that finding a working compromise between these two logics would be difficult and time-consuming.

New institutions and the nature of the system. Scenarios of the Estonian research team

While the aforementioned two sets of scenarios were built in a situation where primary attention was paid to the EU's ability to keep up with speeding globalisation and the accompanying measures (single market, common currency), as well as the latter's effect on social policies (mostly in the case of the Andersen Consulting scenarios) where the EU institutions and their relations of power were viewed as a background, the third package viewed in this article was built later, in 2002, in a situation where the institutional future of the EU had come into focus. The main authors of the package of scenarios were K. Raik, E. Terk, I. Raig and K. Tafel.

The main logic of the set of institutional development scenarios (see *Euroopa Liidu tulevik ja Eesti, 2003*) is as depicted in the following figure.

Figure 3. Different institutional developments and their dominants



The scenarios point out three main goals for future development while presuming that success in all three directions would be impossible and some goals would have to be sacrificed for the sake of positive outcome in other directions. These three hard-to-reconcile goals are: a) EU efficiency in the implementation of integrated policies; b) nation-states' ability to influence the developments in the EU; c) citizens' ability to influence the EU directly. Dependent on which goal would prevail, three different scenarios were built: 1. a state-like (federalist) Europe; 2. a Europe of Nation-states (Fatherlands' Europe) – return to greater control over the EU at the member nations' level and a narrower spectrum of common policies; 3. Citizens' Europe or an increase of the citizens' and their organisations' direct influence, at least partly on account of restricting the member countries' control opportunities. Within every scenario, corresponding institutional changes, which would help to realise the ideology, were recommended,

The **first scenario**, a "state-like (federalist) Europe", logically presumes the strengthening of the European Commission's role, primarily on account of the European Council. The latter's functions should be narrowed and its rights to interfere with short-term issues curbed (retaining its role in deciding long-term issues was considered possible). The President of the European Commission would become the President of the EU. The Council's chairmanship system would be abolished.

The **second scenario**, a "Europe of nation-states", would be characterised by a significant curbing of the European Union's centralised functions. The role of the European Commission would be considerably reduced, turning it in effect to the EU chancellery. The central institution would become the

Congress of Europe (and Nations), which would convene regularly, e.g. three times annually. Its members would include representatives of the member nations' legislative and executive branches. The European Parliament would consist of representatives of the member nations' parliaments and the role of the national parliaments would be enhanced compared to that of the European Parliament.

In case of the **third scenario**, "Citizens' Europe", the role of the European Parliament would be enhanced on account of that of the European Council and the Commission would be subordinated to parliamentary control to a greater degree. It would be logical within this scenario that a Congress of European Nations, convening annually, would be established to replace the present COSAC and to carry on the work of the Future Convent. The Congress would join members of the European Parliament and the national parliaments as well as representatives of European citizens' organisations.

The authors considered the first scenario somewhat more probable than the second one (presuming that the latter could be realised only via a serious intermediate crisis), while they disagreed regarding the probability of the third scenario.

The authors characterized, in the publication issued approximately a year after the completion of the initial scenarios, the project being formed in the Future Convent of the European Union as moderately following the "State-like Europe" scenario, i.e. as belonging mainly to that scenario as to its ideology, but containing numerous compromises, being cautious and somewhat contradictory as to its goals (*Euroopa Liidu tulevik ja Eesti 2003,* *p. 47*). It was mainly searching for solutions for boosting the efficiency of the Union's activities (without using the "federalist" term), but minding the necessity for considering the ambitions and desire of control of the member states, especially the large ones. At least rhetorically, the parliaments were considered, but less attention was paid to the ideology of an all-European civic society. Due to these contradictory goals, the draft constitutional treaty created by the Convent turned out to be a rather non-radical compromise (e.g. in comparison with the aforementioned "state-like Europe" scenario). The most significant institutional changes were the curbing of plenipotentiary members of the Commission to 15, the offer of chairman's post for the European Council, and the increasing share of decisions passed with a qualified majority of votes. The need for these changes was partly brought along by the increasing number of EU members after the enlargement.

Ex post analysis and conclusions

Let us now take a look at what was realised of the logic of forecast events and what was not. The following most significant results and events should be singled out:

1. at least moderate success in adopting the common currency and common monetary policy (especially considering the dark prognoses;
2. rather radical "big bang"-type enlargement of the EU (2005 – 10; 2007 – 2);
3. the "shake-and-bake"-type of converting of the Convent's discussion results into the draft of the Constitutional Treaty;
4. difficulties in the EU with the development of the functioning single market (regarding the market of services);

5. increasing hysteria over the retaining of employment (the "Polish plumber"), rising nationalism in the "old" European countries;
6. the failure of the Constitutional Treaty at the French and Dutch referendums.

The latter event could be interpreted as a revenge of nationalism/statism over the elite's integration project, which had triumphed with the EU enlargement in 2005. When analysing the causes of the failures (the French and Dutch referendums), which mistakes were made or not made by the pro-integrationists prior to the referendum, Estonian authors among others have claimed that more extensive propaganda and "consulting with the public" would not have helped anyway (Ilves, 2005; Kivine 2006), and that a major blunder was merely entering to the referendum the constitutional treaty as a document of institutional development, which the common citizen simply would not comprehend (Kivine 2006). While admitting that the content of the treaty is indeed too complicated as a referendum object for the ordinary voter, the question arises of how far can the political elite go in making decisions which cardinally change the life of the people, without asking for the people's views. One should consider the opinion of T.H. Ilves (Ilves 2005) that if the Western European heads of state had consulted with the people prior to the EU enlargement of 2005, the enlargement would most probably never have taken place.

Based on the above, some general conclusions can be made. First, while the short-term fluctuations of the EU development are hard to foresee, **the above scenarios allow us to argue that long-term developments were quite predictable**. The main features of developments and the possibilities of crisis were quite clearly spelled out in the scenarios built by Andersen Consulting and D. Smith approximately ten years ago. According to D. Smith's terminology, the EU is clearly settled on the "Plus ça change" rather than "The Renaissance" path of development. The Andersen Consulting set of scenarios points out the main problem, or at least one of them, which explains why it is that way. The compromise between the basic premises of the "Competitive Europe" and "Conscience Europe" scenarios has certainly not yet been found. These attempts take place in various countries of Europe at different speeds and in different ways. The apparently exaggerated fear of labour from the new EU member countries and the so-called globalisation shock complicate the making of this compromise for the time being.

Secondly, it can be claimed in retrospect that there were no premises at that period for the success of a clearly federalist project of institutional development. It should be confirmed by the failure of a much watered-down version of a federalist project (but sufficiently federalist for the public) in two countries.

Would the situation become more favourable for Europe's further integration as time goes by? It could happen, presuming that the countries of Europe would be able to make progress towards similar solutions in reconciling the "Competitive Europe" and "Conscience Europe" ideologies, presuming increasing understanding that Europe's low integration level would doom it to inevitable decline in the globalising economy, and presuming that the "Citizens' Europe" identity and the citizens' corresponding practical activities would develop. Yet none of these factors need be automatically realised, meaning that the aforementioned setbacks or “black scenarios” cannot be ruled out either.

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The future of the European Constitutional Treaty and Estonia

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The European Union has reached a new stage of development. The half a century old objective to build up welfare societies for the citizens of old West-European states from the ruins of World War II has been achieved. The welfare circle was recently expanded to other states which had shaken off Soviet subjugation.

The traffic went two ways – we ourselves aspired towards Europe which we had until then only seen on "picture postcards" or from Finnish TV. We toiled to ensure our independence and democratic legal order – this has been completed, or at least the introductory part has. The enlargement of the European Union took place and it is continuing.

In 2007 or 2008 Bulgaria and Romania are going to join us. However, while we got rid of some ghosts, others were in place at once. The old states started to fear that they would have to yield a slice of their welfare. The economies of Germany and France have stalled and they thirst for reforms. In fear of losing even more jobs to East- and Middle-European member states the mythical horror figure of the "Polish plumber" was created, the term 'social dumping' came into use.

Everybody is counting money, so do we – how much are we getting and how much could we get. We are going to count the money even more carefully when in 10-15 years time we are going to pay more than receive. At the same time the information we have is scarce, we unfortunately even lack any deeper interest in what the European Union is doing in reality, in substance. Indeed, we read from the press about the regulation of “banana curves”, the standardization of solar radiation and so on and so forth. If the ministers, arriving home from Brussels, keep presenting everything good as their credit and everything bad as the fault of Brussels, then long term results are visible in the case of France and the Netherlands – the European Constitutional Treaty was rejected because the politicians of these states could not be bothered to talk sufficiently to their people, stricken by worries about the future, nor could they justify their decisions.

The constitutional committee of the Estonian Parliament decided to launch the ratification of the European Constitutional Treaty. Our foreign minister justified this with the opinion that this would be a clear foreign policy message about our position. However, while sending the message outward, would our people not feel cast aside like the French and the Dutch did? If this is not the way people think today, then they will certainly do so tomorrow.

The coalition treaty of our present government sets the ratification of the Constitutional Treaty as a target (item 23). Such target setting was appropriate a year ago. But what is the situation today?

I have been asked in the European Parliament what is the explanation to such a way of action – speedy ratification, particularly keeping in mind the decisions from June last year and January this year.

Indeed, after the French and Dutch "no" referendums the Council of Europe decided to take time off for reflection, for more thorough debate about the future of the European Union. State and government leaders adopted a similar decision on 18 June, 2005 at the European Council, promising all due support to the debate that would involve citizens, their associations, social partners, national parliaments and parties. It was also agreed that national debates will be evaluated during the first half of 2006 and the way to proceed shall be decided. During the Austrian presidency the Council of Europe monitors constitutional debates in all member states.

At the initiative of the liberal democrats group (ALDE) the European Parliament approved on 19 January, 2006 a respective report which aimed at using the reflection period as a new start, proposing a new style for a broad-based European debate. A new large scale public discussion over the future of European integration should take place. The dialogue should clarify, enhance and democratise the consensus concerning the Treaty, respond to criticism and find solutions where the expectations have not been met.

For this purpose a special joint forum of the European Parliament and national parliaments shall be established, its first session taking place on 9 May this year, that is before the summer European Council, with the objective to give advice to the Council on how the Union should operate in the future, and to seek ways to overcome the crisis. Three such inter-parliamentary forums have been planned during 2006 and 2007.

Upon approving the report the European Parliament decided that conclusions from the reflection period should be made at the latest during the latter half of year 2007, and at this stage a clear decision should be reached how to proceed with the Constitutional Treaty.

Considering previous developments the European Union and its member states have several options:

Firstly – to abandon the Constitutional Treaty altogether;

Secondly – to try and ratify the existing text as it stands with explanatory work;

Thirdly – to try and ratify the existing text by restructuring it and/or amending it, and/or proposing additional clauses to the countries which have rejected it;

Fourthly – to completely redraft the text.

Probably nobody knows today how exactly everything is going to go. The German Federal Foreign Minister Frank–Walter Steinmeier recently publicly presented the plan to rename the Constitutional Treaty as so-called the European founding treaty.

Germany will also present by the time of her presidency – first 6 months of 2007 – a strategic plan on how the Treaty could be ratified in all Member States by 2009. As said before, there are many options. Which one of them proves to be acceptable, as already mentioned today - nobody knows yet. Consequently, from this perspective our Parliament Riigikogu has no reasonable justification whatsoever for rushing head over heels with the ratification.

But trying, nevertheless, to find justifications for the Estonian Parliament's wish to ratify the European Constitutional Treaty right now and there, let us have a look at the developments in other member states.

14 Member States have ratified the Treaty so far

Before the "no" referendums in France (29 May 2005), and in Holland (1 June, 2005), Austria, Germany, Greece, Hungary, Italy, Lithuania, Slovenia, Slovakia and Spain had ratified it (the last country also by referendum).

Ratification procedure was already pending and the decision was taken a few days or weeks afterwards in Latvia – in the Parliament on 2 June, 2005; in Cyprus – in the Parliament on 30 June, 2005; in Malta – 6 July, 2005; in Luxembourg – 10 July, 2005 by a consultative referendum (which had been declared 3 months earlier); also in Belgium where the law prescribes a particularly lengthy and many-phased procedure, starting from the Senate of the Federal Parliament which took a positive decision already on 28 April, 2005. This was followed by the Chamber and the decisions of regional parliaments. The Flemish Parliament gave its positive final chord on 8 February this year.

For us in Estonia, we who are used to adopting three decisions a day, such a procedure seems like unreasonable dragging out, but going through all these stages ensures that the issue reaches each citizen.

After the decision was taken at different levels to declare an active reflection period the ratification of the Treaty has been suspended in Denmark, the Czech Republic, Finland, Ireland, Poland, Portugal, Sweden and the United Kingdom – altogether 8 countries, out of them 6 old and 2 new member states.

The first development phase of the European Union ended with the last enlargement. Today we have to again explain to the new, oncoming generation why we need the European Union. It is largely a question of communication but also a question of democracy. **The European Union must be integrated into the national state, not the other way round**.

To avoid the alienation of the citizens from this joint project, particularly taking into account the experience of France and Holland, the eight member states which suspended the ratification, replaced the Hamlet-like question "to be or not to be" with a more constructive one - "how to be". By taking time off to reflect their approach mirrors responsibility towards their people and in fact also towards the whole European Union.

I believe that the Estonian Parliament must also bear in mind that trust, differently from talent, is not inborn – trust has to be earned.

The Role of the Riigikogu in EU Legislative Process: 2 Years of Legislative Experience

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Chairman of the European Union Affairs Committeeof the Riigikogu,
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Estonian Parliament, Riigikogu clearly demonstrated and keeps demonstrating its desire to actively participate in the EU legislative process. The legal basis for implementing this desire is provided for in the Riigikogu Rules of Procedure Act amended in March 2004. Pursuant to the amended Rules of Procedure Act, the Government submits to the Riigikogu, in order for the Riigikogu to take a position, draft legislation of the European Union if the scope of that legislation requires, pursuant to the Constitution of the Republic of Estonia, adoption, amendment or repealing of an Act or Resolution of the Riigikogu and draft legislation the passage of which would bring about important economic or social consequences.

I dare say that with the EU accession this has lead to a significant change in the organisation, scope and contents of the work of the Riigikogu.

Positions of the Riigikogu on EU draft legislation are developed by the European Union Affairs Committee on the basis of reasoned opinions of specialised committees. The aim is to involve as many parliamentarians as possible in the debate concerning EU issues in order to prepare for the application of the enforced EU legislation. Of all the specialised committees, the Economic Affairs Committee, but also the Environment Committee and the Finance Committee, have seen the most noticeable increase in their workload due to European Union affairs. Workload of the Finance Committee has increased mainly because of draft legislation relating to financial perspective.

All fifteen members of the European Union Affairs Committee also participate in the work of another specialised committee. This ensures that a discussion initiated in a specialised committee is carried on and continued in the European Union Affairs Committee. However, this also means that in comparison to other members of the Riigikogu, who on average participate in the work of three specialised committee sittings a week, members of the European Union Affairs Committee generally have five committee meetings, including outside plenary working weeks and during summer months.

Over a hundred European Union draft acts and European Commission's consultation documents have been in the proceeding in the Riigikogu since the accession. As a result of negotiations within the European Council or between the European Council and the European Parliament some of these acts appeared repeatedly on the desks of the Members of the Riigikogu. In addition to the aforementioned draft acts the European Union Affairs Committee has discussed about two hundred issues from the agenda of the European Council. Attempts were made to involve as many representatives of corresponding interest groups and associations as possible in discussions around the most important issues.

For example, a new set of EU draft legislation on chemicals (the REACH proposal) has shattered the record, having been discussed 14 times at the

European Union Affairs Committee. Given the significant impact of the legislation on the Estonian chemical industry the European Union Affairs Committee discussed the issue with the representatives of the leading Estonian chemical enterprises at an outside session in Ida-Virumaa.

The motions to amend the EU draft directive on working time and the framework directive on services have repeatedly featured on the European Union Affairs Committee agenda. Amongst other issues the Estonian position on draft legislation concerning the marketing of various genetically modified organisms has been given most consideration. Hence the meeting with the Estonian Genetic Technology Committee whose recommendations with respect to the marketing of genetically modified organisms were considered in the European Union Affairs Committee.

During and due to the Austrian presidency energy issues have frequently been on the agenda in terms of energy security, renewable energy and other aspects. On the initiative of the European Union Affairs Committee a forum was held on 10 March in the White Hall of the Riigikogu with the participation of scientists, representatives of Eesti Energia and various environmental organisations in order to discuss the ways of preserving energy – e.g. by means of rendering buildings more energy-efficient or constructing new combined power stations. It was a perfect timing for the debate initiative since it coincided with a new green paper on energy policy submitted by the European Commission which we had a chance to discuss at the forum.

Let me bring you another example of when the Riigikogu had to amend the legislation in force in relation to the transition to euro. We introduced a completely new element into the Estonian legal practice. Namely, the Riigikogu has now the right to ask for the opinion of the Supreme Court on drafts in the legislative proceeding before their adoption. The introduction of such a change was definitely not our goal. It was more of an obligation since the European Commission and Commissioner Joaquin Almunia established that the Constitution of Estonia hinders the transition to euro insofar as pursuant to its section 111 the Bank of Estonia maintains the exclusive right to issue Estonian currency. In the European Commission's view a problem would arise in transition since the Bank of Estonia would maintain the right to issue euros whereas the European legislation accords this exclusive right to the European Central Bank.

Despite our attempts to explain at all possible levels the existence of the Constitution Amendment Act providing for the primacy of the EU law and, as a consequence, our acceptance of the exclusive right of the European Central Bank to issue euro, we were forced to give up our position at the end of the day. First we amended the Constitutional Review Proceedings Act and the Riigikogu Rules of Procedure Act, thus, granting the Supreme Court the right to provide opinions on draft legislation in the legislative proceeding in the Riigikogu. The draft act requiring an opinion was the Bill on Amendments to the Bank of Estonia Act. The European Union Affairs Committee and the Constitutional Committee prepared the following draft resolution of the Riigikogu: "Does the section 111 of the Constitution of the Republic of Estonia in conjunction with the Constitution of the Republic of

Estonia Amendment Act and the legislation of the European Union allow the following interpretation:

1. The Bank of Estonia, being a full member of the Economic and Monetary Union, maintains the exclusive right to issue Estonian currency;
2. The Bank of Estonia, being a full member of the Economic and Monetary Union, maintains the right to issue the Estonian kroon.

This decision was adopted in the Plenary Hall and consequently forwarded to the Supreme Court who had four months to respond. We have not yet received a response and may not in fact receive it as the Supreme Court is not obligated to take a position. Or, if the response is "unsuitable", we will still be back to square one.

I personally find this example to be one of the greatest "euro-idiocies" we have come across during our 2-year membership.

Sittings of the European Union Affairs Committee are en par with plenary assembly of the Riigikogu as far as European Union affairs are concerned. Unfortunately, however, draft legislation discussed in the European Union Affairs Committee has been ignored by the press who criticises the small workload of the Riigikogu.

But which working pattern could we change if we take advantage of our 2-year experiences in participating in the European Union legislative process? The system originating from the amendments to the Rules of Procedure of the Riigikogu in the field of proceeding European Union affairs has been successfully adopted and is functioning well. I would, at this point, draw your attention to two things.

Firstly, because of the specificity of draft acts or lack of time, specialised committees and the European Union Affairs Committee of the Riigikogu have been less self-assured to supplement the position of the government on a certain draft act. Achievement of such an assuredness would require a more in-depth analysis of the European Union draft legislation. Our plan for the future is to improve the level of discussion in the European Union Affairs Committee by introducing the so-called system of presenters, raporteurs. This means that a presenter would be nominated in the European Union Affairs Committee for every European Union draft act, and that the presenter will then present his or her opinion on the draft act at the sitting of the Committee.

The second problem I would like to draw your attention to is the fact that Estonia's negotiators often have no opinion on the Bill during the first and second meeting of the working group of the Council of the European Union. We have tried to solve this problem by setting up an agreed 4-week period during which the Riigikogu waits for the government to send an explanatory memorandum to a draft act as well as Estonia's positions on the draft legislation or consultation document presented. Observance of this 4-week period has, however, often been neglected. Most of the times Estonia's negotiator takes note of what other members of the work group think and then positions him- or herself accordingly. Therefore there is no remark on Estonia's positions in footnotes of working documents presented on the draft legislation during the reading. In some cases such an approach is justified, but only if entering a parliamentary reservation is considered until after the sitting of the European Union Affairs Committee. In other cases Estonia's interests may not find the best defence in the developing situation.

A positive experience is the participation of ministers at the sittings of our Committee in relation to meetings of the Council of the European Union. Members of the government practically present Estonia's position twice: firstly, to their coalition partners/colleagues at the sitting of the Government of the Republic and, secondly, in the European Union Affairs Committee, which also includes representatives of the opposition as members. I believe that these preparatory activities have given the ministers a possibility to review with a critical eye the positions prepared in their ministries. A special mention should go to the practice according to which a minister participates at the Committee sitting prior to an unofficial Council meeting, which means that also the positions to be presented by him or her at a sitting of the Government of the Republic are prepared, which would otherwise not have been so.

Strong preparatory work of the Riigikogu is obvious in the proceeding of the ratification of the Treaty establishing a Constitution for Europe and activities of the working group of the constitutional analysis of the Treaty establishing a Constitution for Europe formed by the Constitutional Committee. With the view of receiving a clearer understanding of the essence of the Treaty establishing a Constitution for Europe the Riigikogu formed, on 14 December 2004, a working group for the constitutional analysis of the Treaty establishing a Constitution for Europe, who was asked to provide a legally motivated position on whether the Constitution of the Republic of Estonia and the Constitution of the Republic of Estonia Amendment Act allow the

Riigikogu to ratify the Treaty establishing a Constitution for Europe without previously making amendments to the Constitution. The Government of the Republic presented the Treaty establishing a Constitution for Europe to the Riigikogu for ratification on 10 May 2005, considering it to be an international treaty which pursuant to the Constitution may not be subject to referendum.

The constitutional analysis working group noted that protecting the sovereignty and the Estonian language and culture stipulated in the preamble and general provisions of the Constitution should first of all be considered as the most important constitutional fundamental principles when making the amendments to the primary legislation of the EU in the future. The working group states that the representatives of the state of Estonia were present when the Treaty establishing a Constitution for Europe was being elaborated. Some Part of the amendments to the existing Constitution induced by the Treaty establishing a Constitution for Europe increase the competence of the EU at the expense of member states (wider application of qualified majority vote, further competences conferred to the EU), other amendments amplify the meaning of the principle of solidarity and through it the possibilities for protecting the decision-making right of member states (national parliaments' right to a "yellow card", clearly stated right to secede from the EU). Thus the Treaty establishing a Constitution for Europe does not cardinally alter the nature of the EU in the sense of fundamentals stipulated by the Accession Agreement of Estonia.

According to the latest information, the Constitutional Committee decided to bring the Bill on the Ratification of the Treaty establishing a Constitution for Europe to the second reading on the Europe Day, 9 May 2006.

Conclusions

In what way has the role of the Riigikogu evolved since the accession a few years ago?

Firstly, we participate in the EU decision-making process and can, if necessary, exert influence at the EU level through information exchange with colleagues in other parliaments without the mediation of our government.

Our second role is to provide Estonia's positions with a wider political basis. Whereas the decision makers at the sittings of the Government of the Republic are Members of the Government who belong to the coalition, the committees of the Riigikogu also include representatives of the opposition, which in its turn acts as an added incentive for the Members of the Government to prepare their cases even better.

Thirdly, we can participate in making decisions that we will later have to introduce into our legal landscape. The committee that will later transpose the directive thus has the possibility to highlight possible problems and obstacles, and consult with interested parties if necessary.

Fourthly, the involvement of interested parties is the task of the parliament, and still shows high potential for development. I am mainly speaking of our cooperation with interest groups and citizens' associations. Information also flows in the opposite direction, meaning that the MPs provide their electorates with general EU information as well as area-specific information and information directly concerning Estonia.

SECTION II
ECONOMY AND ECONOMIC ISSUES

Dual Market-Transition in Estonia 1987-2006: Institutional Mechanism Analysis Approach

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> "Institutions are not usually created to be socially efficient, are created to serve the interests of those with bargaining power to create new rules."
>
> North, D. 1990
>
> "These considerations lead to the second concept of rational social order: an ecological system, designed by no mind …"
>
> Smith, V. 2005

1. Introduction

Why is it important to revise Estonia's market reform program studies under "institutional mechanism" approach?

According to the plethora of mainstream transition economic studies, Estonia's capitalist market reform process offers an example of a rather rapid and successful return from communist to liberal capitalist economy principles and integration into Western markets (Panagiotou, 2001). Also, Estonia's transformation process includes several specific features that deserve additional attention on the basis of our after-wisdom. Analyses of some of the idiosyncrasies of this process have been still now been neglected and many phenomena are commonly misunderstood (e.g. insufficient knowledgebase, same faulty informed reforming actors, foreign political influences etc) mainly because the mainstream analyses have also neglected in the analysis the latest evolutionary and institutional economics methodological principles of constructivist and ecological rationality (Smith, 2005) and game theoretic methods.

In this context we will try to tackle the Estonian capitalist market reform process in 1998-2006 as a sequentially dual asymmetric meta-constitutional process: first, transition from socialist to a nominal capitalist market economy and, second, the reforms to adopt main elements of the EU countries' credible and harmonious capitalist market models and acquis communautaire (Lavigne, 1999; Andreff, 2004 and Wagener, 2004). The former took place in the secessional (disintegration) downward phase/slope and the latter in the accessional upward phase/slope of the real economy.

By now it is clear that the market oriented transformation processes are long-term and gradual and to a great extent still going on. This "still" probably depends on the initial conditions (Panagiotou, 2001) and takes nowadays the form of economic systems institutional adaptation and harmonization (Andreff, 2004).

And more importantly, in the case of Estonian transition, economics and other social sciences have been mainly and frequently in a subordinate and instrumental role to mask politically motivated ends and ambitions and politically oriented incompetent studies in parallel to many other transition countries (Pickel, 2002). There are by now, from the point of economics, many ill-conceived concepts circulating about economic transition in Estonia as well as in general for many other post-socialist transition countries (Kornai, 1998). We agree with Pickel that "transformation has been above all a political project in which social science can play an instrumental or ancillary role." But we think that in the analysis of this political process institutional political economy may still play a major role in case we approach the reform process as a national project with socially desirable solutions (Ennuste and Rajasalu, 2002) and try to understand the evolutionary structure of the constitutional constructivist systems/mechanisms that design, implement and enforce these reforms (Wagener, 2004). From the ecological approach in our study we exploit amply the Brezis and Verdier (2003) snowball effect theory to show that the Estonian reform processes can be more deeply understood in the tight context of all Soviet Bloc's political and economic collapse.[1]

Analytical framework and methodology to be used

We take that what actually happened was in result an ecological-political evolutionary process aimed at developing a civilized society (Marangos,

[1] Brezis and Verdier (2003) define "snowball effect" as a regional propagation and diffusion mechanism of communist collapse and democratization among Eastern European countries during the years 1989-1991. We are here differentiating two economic snowball effects: first, the secessional from the Soviet economic system to the elementary functioning capitalist market system, and second, the accessional snowball from elementary market system to the EU developed capitalist integrated economic system.

2006). But to understand the reform attempts in this process we have rigorously to study the constructivist behaviour of the evolving reforming agents and their coordination mechanism in this process. Therefore we try to base our narrative as much as possible on the normative Bayesian implementation theory (for latest most conveniently interpreted approaches see e.g. d'Aspremont et al., 2004 and Matsushima, 1993). In this approach the implemented reforms will be considered as equilibrium outcomes of coordinated constitutional mechanism process, and in this sense "designed by no mind". Outcomes that may be properly understood only by analysing the game that was played in the mechanism, game where a small change sometimes may trigger dramatic transitions (Levi, 2005).

The latter approach is in our narrative implicitly extended to cover the constructivist design of economic general compiled reforming mechanisms/systems (Ennuste, 2005). In this mechanism the actors are governmental, political and social groups and economic agents etc as market reform designers, implementors and also coordinators. We postulate strategic behaviour, bounded rationality, incompetence and learning capabilities of the actors. In this approach the initial implementable social choice rule contains as decision variables the alternative complementary reform strategy clusters (Ennuste, 2001 and Wagener, 2004) and endogenous information spaces.

Thus we try to take the area of analysis that Pickel (2002) calls "systemic change by design" and considers as most challenging in the field of transformation theory. The core of our discourse is the comparative study of actually functioning institutional metasystems implementing reforms with the models of socially desirable ones. We may call this theoretical approach the third generation transition theory (Müller and Pickel, 2001 describes the first and second) blended with the New Comparative Economics (Dallago, 2004).

The given model is rich enough to adequately describe complete reforming mechanisms and on the basis of this general mechanism model by comparative studies (including case studies of the core reforms) we may distinguish several types of partial sub-mechanisms. Theoretically, for the implementation of a socially optimal reform process in a general economic situation, an ideal design of reforming system is a necessary condition (complete coordination, rational agents etc.). In the case of special economic situations, incomplete mechanism and limited rationality of actors, it may be possible from the model to deduce and understand the reforming performance of different variations of incomplete reforming systems, especially in the sense of the following questions:

- Why was this reform attempt at that time necessary?
- What kind of reform was realized/implemented?
- How well did the implemented reform perform and what lessons can be learned from it?

And we try also to tackle Fanelli's (2004) three key research questions:

- Why were some countries able to undertake reform while others were not?
- What factors enabled some countries to successfully implement their reform program while the program quickly failed in others?
- Why were some reforms more successful in delivering expected outcomes than others?

We will implicitly estimate the performance of the reform results in our narrative normative/political model from three aspects:

- Effect of reforms: comparison with the hypothetical (counterfactual) status quo basis (no reforms had been implemented but a new situation).
- Effectiveness of reform: relative performance of realized reform is estimated relative to the nationally desirable counterfactual reform results from: 1) ex post "after wise" and 2) retrospective ex ante "before wise" positions.
- Comparative effectiveness: effect of the reform relative to the reform results in other comparable transition countries.
- Comparative strength of the implemented institutional structure (Chong and Gradstein, 2004) to lead to more equal distribution of national income and to avoid subversion of the reform results.

In the estimations of all reform effects we will keep in mind that these effects may be diluted first of all in the secession and disintegration depression effects (Gradstein, 2004) of the Soviet Bloc and, last but not least, in the ascending accession and integration effects connected with joining the EU (Sand-Zantman, 2004).

2. Estonian Institutional Market Reform Process and Revisiting its Idiosyncratic Aspects

This section focuses on Estonia's idiosyncrasies that may have determined why Estonia's post-communist transition and the EU accession reforms have taken some other characteristics than in other Baltic States or EECs. It hypothesizes that the most significant idiosyncratic reform factors may have been: small size and geographical location, re-annexation threat and large Russian-speaking Diaspora, and last but not least, the Estonian image as a "shining star" of transition on the one hand, and on the other, as a still very low income country.

2.1. Idiosyncratic Aspects

Small size and geographical location

Interestingly enough, the broad spectre of mainstream political-economic and econometric models of transition do not directly indicate factors of size and geographical location of the country as significant determinants of the transition processes and it seems the Estonian experience is not going strongly to refute their understanding. Although in the Soviet Empire the small size and compactness of the Estonian economy was by Moscow considered as a good laboratory for soviet stile limited economic experiments on the national scale (Brutus and Ennuste, 1965).

Brezis and Verdier (2003) hypothesize in their snowball effect theory to show that for a communist regime the probability to collapse in a country and open way to market reforms and the principal types of these reforms is a function of effectiveness of the punitive repression sector of the pre-democratic period. In Estonia as a small (population 1.4 million) occupied country in the strategically sensitive geographical location, the Soviet communist repression of the population has been extremely severe considering the relative losses of the population and the economic losses over the last half century (Lauristin and Vihalemm, 1997 and Kukk, 2005). From this we may conclude that the factors of small size and respective small geographical distance from the repressive centre should only have deteriorated the types of initiated reforms and delayed them.

And importantly, the structures and complexities of effective economic market mechanisms and institutions do not depend significantly on the size of the country. It is easy to see that a small country has less resource in the constitutional bodies to build up its capitalist market system and is therefore trying to escape to simplified solutions that may in the end be more effective in the situation of large transitional uncertainties. In this respect gradualism seems for a small country the only way to build up market mechanisms and the discussions about Big Bang reforms and Shock Therapies are not fully understood in these countries.

On the other hand, in the process of independent reforms, economic diversities and bureaucracy in a small country are as a rule smaller than in a big country and this may make economic reforming simpler by not demanding many exceptional institutional arrangements. The latter is mainly logical because a small country is in general economically less heterogeneous (Alesina, 2003).

By now we have already some statistical evidence that may support the hypotheses of a small country being more transition-flexible. E.g., all transition countries had the transition crises, but it seems that smaller countries, even from the relatively backward starting positions like Baltic countries, had by 1992-1997 or so made a transitional convergence with the

Central European transition programs (see e.g. Lavigne, 1999, Table 7.1, 122-125).

Many schools of transition theory emphasize the role of geographical location in the countries' transition behaviour. E.g., in the Estonian transitional econometric gravity models, the direct distance between the countries may be a significant explanatory variable (Paas, 2003; Rajasalu, 2003b). Economic analytical studies such as Hansson (1995) stress also that Estonia's geographical proximity to Finland and Sweden was of pivotal importance in the early transition period and enables rapid re-orientation from the Soviet Union towards western markets.

Diasporas and re-annexation threat

In the analyses of transitional reforms, a significant idiosyncrasy in Estonia, compared with other countries but Latvia, was a significant (ethnic) Russian speaking Diaspora comprising about 1/3 of the total population in 1989, and relatively large Estonian World War II émigré Diasporas in the West.

Russian speaking Diaspora came to Estonia mainly due to the Soviet occupation in about 15-55 previous years, and not by way of natural economic migration and was certainly not of an optimal size of minority (Rapoport and Weiss, 2003)[1]. This group had different cultural and political

[1] For the collection of articles on "the optimal size of minority", see Rapoport and Weiss (2003). They themselves hypothesize that the idea is central in the economic analysis of inter-group cooperation and conflicts. We assume that we may endogenosize this phenomenon as being pertinent to the economic reform issues. In Estonian context one criterion for the definition of optimal size may be based on the Lazear (1999) finding that with the high concentration of immigrants they refuse to learn local language. It is a common

value systems than the ethnic Estonians. This fact may have contributed to the rise in inter-ethnic tensions at the beginning of the transition period and may have influenced the reform processes not in the best way.

Ott and Ennuste (1996) showed that the reforms were more troublesome for Russian-speaking minority (according to 1990 population surveys) than for Estonians and they experienced more anxiety for their position and status as the country began to move toward a market system. And as the probit model results of Ott and Ennuste (1996) show, less Russians than Estonians were in favour of moving toward political independence. The role of Non-Estonians as an inertial force in the capitalist market transition may be concluded also from the study made by Kirch (1997).

Given this difficult task of balancing critical ethnic issues, the market reformers in Estonia had additional constraints in their movements ahead so as not to cause overcritical uncertainties and anxieties to the Russian-speaking immigrants coming from a society that had a long history of imperial ambitions, and which was dominated by authoritarian regimes and central planning. Mainly the staff of the Russian speaking military factories organized already in 1988 the so-called International Labour Movement of the Estonian SSR to stand against Estonian independence movements and market reforms.

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understanding in Estonia that one of the obstacles of the democratization, capitalist market reforming, accession to the EU in Estonia was and will be the problem that bulk of Estonian population is not going to pick up Estonian language and not going to follow Estonian language information channels.

E.g., in 1990, the Estonian Government was engaged not as much with market reforms as with avoiding violent confrontations and conflicts over reforms with local Russians in the north-eastern part of the country. Confrontations were inspired mainly by Gorbatchev's negative stand against Baltic reforms (Lauristin and Vihalemm, 1997, 95). The anti-independence Russian deputies in the Estonian Supreme Council and Soviet military industry lobby in Estonia tried to use the ethnic situation to form by all means (possibly Soviet military forces involved) a new autonomous Soviet Russian Northeast Estonian Republic in the north-eastern part of Estonia. This process culminated in an illegal referendum in Narva on July 16-17, 1993, organized by Russian speaking anti-Estonian population groups. This referendum failed mainly on the ground that the Russian military forces located in Estonia stayed neutral and didn't support with arms their national countrymen.

There have been many other dramatic anti-reform incidents between local Russians and Estonian authorities and "It was a miracle that no violence occurred…" (Lauristin and Vihalemm, 1997, 95) in Estonia unlike Latvia and Lithuania.

It is easy to see that many reforms were passed in a distorted form just to please the local Russians. E.g., any permanent adult resident of Estonia who had worked in Estonia was entitled to receive vouchers for privatization of housing. And since the Russians had in general better communal flats (mainly new urban or former rich Estonian owners'), they were placed in a preferable position (The Law on the privatization of dwellings was adopted in April 1992). The same tendencies could be noticed in the new pension law passed in 1991 (Lauristin and Vihalemm, 1997, 96), etc.

To fully understand the behaviour of different subgroups of this Diaspora, we should not omit the probability of the Russian Federation Security Service's (FSB, former KGB) involvement in engaging elements of Russian-speaking community for anti-market subversions (Slinko et al., 2003) and towards Western movement and later accession to the European Union away from Russian imperial reach of the independent Republic of Estonia. The well documented history of the subversive international activities of the KGB in the Soviet era (e.g. see Andrew and Mitrokhin, 1999) gives us full justification of the approach. But it is too early in this field to make non-probabilistic documented academic statements as far as the documented evidence of secret services will be available for academic research purposes only tens of years later.

The final act of regaining independence was played on the night of August 20, 1991 when the Supreme Soviet voted for the "Resolution on Independent Estonia". It called all countries to recognize Estonia as an independent state. When the Soviet Union collapsed it was in the interest of Russia's President Yeltsin to announce quickly the independence of the Baltic republics (Vihalemm, 1997, 137). And this was an additional blow to the fall of Gorbatchov (Lauristin and Vihalemm, 1997, 98). But in a few years, from August 1991 until the beginning of 1993, the attitude in Yeltsin's Russia towards Estonia changed "from second-best friend to enemy number one" (Vihalemm, 1997, 137). The relationships between the two countries have stayed cool since then. E.g., in 1994, in bilateral trade goods imported from Estonia were subjected to double custom tariffs in the Russian Federation

(Rajasalu, 2003b) and are hidden more or less still so after 1st of May 2004 in the form of various non-tariff restrictions.

It was surely also the political situation in Russia that made the Estonian government seek accession to the EU and implement rapid institutional preparatory market and monetary (Fundamentals of Ownership Reform Act, 1991, introduction of Estonian kroon 1992, etc) reforms and harmonize laws to that end and not wait for spontaneous emergences of market institutions after stabilization-cum-liberalization (Lavigne, 2000) and so avoided the missing institutionalization link (Kolodko, 2000) in the early Washington consensus. The political situation in Russia is still not in favour of good economic partnership: take e.g. the notorious remark made in April 2005 by President Putin "The collapse of the Soviet Union was the "biggest geopolitical catastrophe …".

Though the Estonian World War II émigré Diasporas in the West were quite small compared with most of the transition countries, they have also played a role in Estonian economic reforms. Already during the pre-independence reforms, i.e. in 1988-1991, the governments of that time invited Estonian economic experts and economists from abroad to advise and approbate economic reform plans. There was the so-called Prime Minister's economic friends club working in 1990-1992, which contained Estonian émigrés mainly from Sweden, USA and Canada. From the economic theory aspect we should mention first of all Ardo Hansson who was a so-called independent member of the Currency Reform Committee at the time of the currency reform and in 1993-1998 also member of the Board of the Bank of Estonia. The process of reforms was more or less influenced also by professors Toivo

Miljan (Wilfried Laurier University, Canada), Toomas Palm (Portland University, USA) and Michael (Mihkel) Truu (University of Pretoria, South-Africa).

The “shining star of the Baltics”: Inherited backwardness versus price for the reforms

As Estonia was the only ex-Soviet Republic to be included in the first group of European Union candidate countries and was characterized by the EU since mid-1997 as a ”functioning market economy” (European Commission, 1999), then Estonia became very quickly notorious as a “shining star of the Baltics” (e.g., Panagiotou, 2001). This is, of course, a purely political label-term, but however, in the Estonian transition studies it was and still is almost an imperative to superficially assume that this is really a credible characterization. Although, the mainstream transition studies have indicated that the indicators of Estonia’s transitional leading position among the Baltic countries at least might have been small (e.g. Panagiotou, 2001) and probably within the limits of the statistical error. And most importantly, Estonia could be called in mid-1997 a functioning market economy only in the narrow sense because there was missing, like in other transition countries at that time, the modern welfare system to complement the purely capitalist market mechanisms (Lavigne, 1999, 2000).

Anyway, in the transitional studies the discussions started that: a) Estonia had under the Soviet occupation a relatively prosperous economy (good economic conditions, e.g. no defence expenditures etc.) and the current transition advances are because of the inheritance from the “prosperous” Soviet era, and b) Estonia's current economic backhandedness from capitalist countries primarily originates from the price for the change of the Estonian social and political regime, from regaining independence, from "transitional depression" (Kolodko, 2000), that it is the price for freedom to suffer for reforms etc.

Last but not least, many experts from various Western institutions generously advised and approbated Estonian transitional economic reform plans. But unfortunately, not all of Western advises could have been completely understood in Estonia at that time because of primitive understandings of capitalist market institutions by local reforming actors. And, alas, theoretical studies of transition problems were only in the infancy even in Western countries.

No significant synchronic oscillations of the elements of the reform process with the political pendulum

The introduction of some political flexibility by Gorbatchev's glasnost policies and perestroika in the end of 1980s allowed some opportunities to domestically introduce some sporadic economic reforms mainly under the cover name "experimental reforms". As in all Estonian main political, economic academic and management elite spheres and masses, there existed a long-time common mainstream belief that market system "will improve allocative efficiency and thus the competitiveness of the industries and standard of living in the households." (Kolodko, 2000). But these beliefs did not trigger at that time not yet dramatic political and market transition in Estonia because for fear of prosecutions and the political preference falsification (Levy,2005) was still dominant Thus, the main obstacle and constraint in this major period to market-oriented reforms in Estonia were the Kremlin's dictatorial directives based on the communist ideology, because Estonia was until August 20, 1991 politically de facto integrated into the political system of the Soviet Union. And the main policy target in the market-oriented reforming and timing of reforms in this period may be formulated as: any small market reforms and as soon as they are politically allowed, then it is politically safe and allowed to follow the behaviour of the preceding post-socialist countries and fellow countryman without regard to his own information (Levy, 2005, "herding").

The condition "allowed" had here the critical meaning: all elites new very well to what repressive atrocities Kremlin could resort against Estonia in the case of overstepping constraints imposed by the communist ideology to implement Russian imperial ambitions. These fears forced the Estonian political reformers first of all to wait for credible regional political signals like falling the Berlin Wall etc to start fundamental transition. And, secondly, having in mind the large international political uncertainties to work together in concert in Estonia, whatever were the different understandings in the reforming methods and details.

The reforming process in the period of 1992-1997 may be adequately modelled by the decentralized and mainly underdeveloped democratic system model where the tens of dominating and opposing political actors were in principle homogenous in their objectives regarding rapid capitalist market-oriented reforms, but had different reform models in their agendas. Mainly the lack of competence and incompletely coordinated reforming were the main policy obstacles and these resulted mainly in the introduction of as many basic (first generation transitional reforms; Fanelli, 2004) capitalist market-oriented reforms as possible and some social reforms. This period may be considered to have ended in 1997 when the European Commission claimed that Estonia was a functioning market economy (Agenda 2000). This may also be fixed as the conditional end of the secessional transition period.

As to the structural problems of reform at the beginning of the secessional transition period, the main political parties in Estonia positioned themselves in their pre-election programs homogenously to Western orientated market reform approaches, privatization etc. The political differences here mainly were connected with different models of privatization as "political" versus "economic" (Kein and Tali, 1995). The first approach placed in the fore the restitution of the ownership as it was before WW II, and economic interests of the Estonian citizens, especially the middle class. The second approach considered market reforms mainly as means to create motivated large owners-entrepreneurs for the efficient capitalist market. In this approach, the former communist nomenclature insiders and foreign capitalists had more opportunities to take part in the capitalist market creation.

When the cabinets of opposing political forces started to interchange, it seems that all main political forces kept more or less the same policy line in the main issues of capitalist market creation. We may hypothesize that the cabinets with opposing ideologies, in order to stay credible, had practically not much choice to change the course of market reforms from the mainstream Eastern European transition course. The credibility effects may have been especially forceful in the sense of the secessional snowball effect in the Eastern European countries. The proof of the latter statement may probably be found in the phenomenon that by the start of the accessional transition period, all these countries had more or less similar capitalist market economic institutional structures, notwithstanding the different initial political structures.

During the accessional transition period (starting vigorously in 1998 or so), a more Western-standard general political party system had formed in Estonian. More or less, a political structure had formed where the main economic policy watershed in the pre-election campaigns goes mainly between dominant opposing forces in the agenda of reforming the government budget size and redistribution. The more socially minded centre and centre-left parties were and still are generally propagating bigger governments with higher general government incomes and with more generous social chapters in the budget. The main right-wing parties, vice versa, generally suggest governmental expenditure cuts, to achieve higher competitiveness of the national economy and first of all, to give the priority for the time being to the liberal economic growth. Although nowadays even they have implemented a more socially minded mantra. But it seems again that having achieved in the ruling coalition position, different political forces had again adjusted their approaches to the mainstream standards of the Eastern European Accession Countries, probably as a consequence of the second (accessional) snowball effect. Of course, before the accession referendum 2003 there were some significant political campaigns against the joining from the populist wings of the influential centre party, but without any real consequences. The main economic policy target after the joining 2004 for all Estonian dominant political forces has been the adoption of the acquis. And as Andreff (2004) theorizes, fulfilment of this target may take a good lot of time for all new member countries.

Therefore, we may claim that with great probability the oscillations of the top political pendulum in Estonia had during the transition period no significant direct effect on the process of creating the structure of capitalist market institutional system. And the key normative factor in this process was probably the state of the elements of reforming constitutional system: the political actors had mainly homogenous long-term and fundamental reforming incentives and were in the circumstances of great uncertainties ready to work in concert and compromise in the models of reforms.

2.2. A lexical table-model of the dynamics of characteristics of the Estonian institutional market reform process mechanism

Our concept in this section is that there should be a dynamic Bayesian correspondence equilibrium between the elements of the real market reform process. This real causal empirical correspondence may be ecologically modelled as a dynamic Grangerian regression where the regressors or explanatory variables may be characteristics of the elements of the reforming system (mechanisms, organizations, rules etc.) and the regressands are the reforming results or the implemented economic institutions on the time scale.

But this kind of analyses is not giving much for the understanding of many political-economic whys, how etc. in the reform process. For the last propose we have to micro-model the functioning dynamics of the reforming (constitutional) system (mechanisms and constitutional agents) according to constructivist principles (Smith, 2005). In the simplest way this kind of modelling may be executed in the verbal narrative Table form as below.

For introducing time dimension into the table we composed sub-period columns on the basis of the transition periods given below.

The rows of the table describe the states of the characteristics of the elements of the reform process. We start with the characteristics of the reforming system elements (reforming coordinating centre and reforming agents). Then we describe the elements of determinant environmental variables (e.g. foreign political situation, etc). And then we describe the correspondent reform targets, reform outcomes and effects.

The elements of the table are mainly the keywords of the characteristics of the Estonian real reform process states, but the characterization remarks come from comparisons of these empirical states with imaginary modelling results. The latter belong to the field of ideal socially desirable reform system modelling by the experts with the implementation model described in Introduction.

Periodization

The starting year 1987 of the general fundamental market-oriented capitalist reforms for the socialist countries is commonly accepted by the mainstream transition researchers (see e.g. Lavigne, 1999 and Brezis and Verdier, 2003). However, this starting is followed in Estonia by at least two sub-periods, which include transition to a market economy or the old transition (1987-1997) and EU accession or the new transition (1997-2006). Within the market transition period, two different sub-periods can be distinguished – pre-independence period (1987-1991) and independence period (1991-1997). Within the EU accession period, the harmonization period (1997-2003) and post-accession period (2004-2006) can be treated separately. However, the general reform process in not over yet. The harmonization with the EU still continues and the process will be more or less completed when Estonia becomes a member of the EMU and Estonian kroon is replaced by euro or even later.

On the basis of the above-described periodization are formed the sub-periodical columns in Table below.

Table 1. Lexical matrix of the Estonian 1997-2006 capitalist market-oriented institutional reform mechanism elements: characteristics, dynamics and correspondence

Types of the realized market reform mechanism Characteristics of the elements, states, results and effects.	1987-1992	1992-1997	1997-2004	2004-2006
Coordinating centre (government, parliament etc, characteristics and functions).	Incomplete hierarchical dictating-repressive system with generally nationally undesirable reforming objectives, some informal institutions without sufficient competence.	Incompletely decentralized system with insufficient agenda setting, mainly incompetent but with generally socially desirable reforming targets: ad hoc market reforms to implement nominal liberal capitalist market system.	Under-coordinated bargaining system with compromising (coalition and social) reforming objectives. Insufficient truth-telling mechanisms.	Hierarchical bi-coordination by the EU and Government of Estonia and bi-agenda-setting. Bargaining with compromising (domestic and Union) targets. Insufficient learning.
Reform designing actors (government, ministries, parliament, coalition, opposition, political parties, lobby groups, central bank, international institutions etc) types and characteristics.	Single compact commanding/ constraining government with repressive administrative methods and sporadic spontaneous dissident agents with limited agenda setting possibilities. Local governments' targets controversial, some ad hoc market oriented reforms for macroeconomic stabilization. Low competence on capitalist market institutions.	Representative liberal and similar agents with almost homogenous and associated political targets. Limited competence of the actors in the field of reforming models, especially in the field of privatization. The actors are mainly representatives of the high income groups and in the field of market reforms acted in concert.	Dissonance of coalition and opposition objectives, heterogeneous agents and generally under-coordinating centre. Countermoves to coalition. Centre's targets to implement general credible institutional market structure. The Bank of Estonia is unable to influence inflation.	Heterogeneous objectives, coordinated mainly with side payments and by acquis. Under-coordination of truth-telling (new Member States had to take measures to prevent building up speculative stocks of sugar, Estonia had in this reporting incorrectness).
State of external World.	Unexpected collapse and disintegration of the Soviet Bloc, relaxingly repressive, democratization and capitalist market oriented reforms in Eastern Europe, growing instability (secessional snowball effect, Brezis and Verdier, 2003).	Unstable, constant reannexation threats.	Stabilizing. The accessional snowball effect is Eastern European Countries is prevalent.	Stable. Requirements of the Stability and Growth Pact. Goals of the Lisbon strategy.

Domestic political state.	Relaxing dictator-ship, diminishing repressions against spontaneous market reform agenda setters, growing political and economic instability.	Incompletely democratic, turbulent, but "period de grâce". In the field of market reform constitutional actors were in concert ("herding", Levy, 2005).	Democratic, significant uncertainties, deficient political civic capital, growing political and economic credibility.	Almost democratic, stable. Self-interested political and market activities are not sufficiently coordinated with the community values.
Why market reforms.	To alleviate disintegration, economic system crises (e.g. barter), to enhance secession and economic sovereignty, to orient to market system, to follow propagations of Eastern European transition leaders (snowball effect) for secession.	To implement nominal robust elementary capitalist market institutions, to try to go with other transition leaders.	To implement credible institutional market structure, harmonize market institutions with the EU, and implement social protection institutions as "New transition" (Lavigne, 2000) for the accession to the EU.	Fine-tuning to implement internationally cooperative market structure on the basis of acquis (Andreff, 2004) and to adapt to time consistent adjustments to the changes of the economic environment enforced by the EU authorities
What kind of most significant capitalist market oriented reforms?	Generally rather amorphous and arbitrary ad hoc reforms chosen, no fundamental reforms. Legal restrictions on the formation of joint ventures were abolished, liberalization of trade rules, the Fundamentals of Ownership Act 1991 restored the institution of private ownership.	Generally diversified and non-expensive institutions market economy firs-order institutions. Tens of major reforms each year, many of them incomplete (Ennuste, 2001). Generally "Washington consensus" type first generation reforms.	The EU started the accession negotiations with Estonia, Pension Funds Act passed, new Income Act deducted reinvestments from business income. Generally "Post-Washington consensus" (Müller and Pickel, 2001) type second generation and complementary reforms.	"New transition" where the Government is not free to build institutions according to specifics of the country (Lavigne, 2000) in the EU. Member of the EMU. Buffer reforms for accession.
How well were the market reforms realized compared to hypothetical socially optimal reforms by expert opinions.	Mainly ineffectively. Mainly amorphous ad hoc reforms for small-scale privatization, especially uncoordinated agricultural reforms (Maide, 1995).	Generally inefficiently, except for monetary reforms: procrastinations of privatization, timing and sequencing failures, insufficient central coordination, oversimplified reforms, insufficient social protection etc.	Coordination failures, insufficient redistribution. Almost credible institutional complex market structure implemented.	Mainly failures of the coordination of truth-telling. E.g. the influential Centre Party started to disseminate distorted signals before the EU accession referendum.
How well the reforms were realized and performed compared with other comparable transition countries?	Generally well and sporadically being ahead in mainly spontaneous reforms.	Generally well, in some reforms being ahead, some procrastination. The incompetence of the actors is mainly compensated by learning from Treuhand lessons and Central-European transition	Generally not worse than in other transition countries. Concert phenomenon of different political forces in agreement of reforming. Economic inequality is not lowering.	Generally not worse. No significant accession crises or depression. In 2005 the GDP growth 9.8% and inflation 4,1%. The right to use euro will prolong.

Relative losers economically.	Mainly Russian speaking immigrants, Communist Party nomenclature, farmers and elderly.	Farmers by speedy and fuzzy ownership and privatization laws, retired persons, large young families, intelligentsia.	Farmers, retired persons, large young families, intelligentsia.	Suboptimal high proportion of low wage international subcontracting work.
Relative winners economically.	Mainly management, entrepreneurs, foreign investors.	Management, entrepreneurs, politically active groups, foreign investors, local Russian speaking transit entrepreneurs.	Entrepreneurs, economic and political elites, foreign investors.	High stable income inequality, Gini ≈0.37.

Discussion for understanding Table 1

As already said, the statements and key words in the Table are based on two sources: 1) the comparative ones come from the deductive comparison with the imaginary hypothetical normative design implementation system (described in Introduction), and 2) the empirical keywords and statements come mainly as aggregated conclusions from Section 3, real world analyses supported by many works analyzing the Estonian transition case. The main objective of the analytic table is to comparatively describe the dynamics and correspondence of the states of Estonian market reform conditions, mechanism characteristics, functioning results and effects in a systematic way. In rows we may follow the chronologies of the reform process elements, in columns we see in each sub-period the conditions, explanatory factors etc., and understand probable correspondences between them and the reforming targets, results and effects.

The first two sub-periods of market reforms in the Table, from 1987 to 1997, clearly form a period that may be classified as the secession transition period. The last two sub-periods, from 1997 to 2006, form the accession transition period. In the first transition period, the reforming systems worked more or less for ad hoc reforms to implement a kind of nominal elementary capitalist market economy institutional system. In the accession period, the mechanisms were more or less aimed at a more general agenda, for the implementation of a credible, harmonious and complex market economy institutional cluster, to achieve rapid accession and adaptation to the EU. We agree hereby with Andreff (2004) "that EU enlargement is not a sufficient yardstick by which the end of transition can be fixed, not even in the CEECs.” We mean the end of the accessional transition.

The lexica of the table come mainly from the implementation theoretic literature and from the market transitology. In the former, the most important keywords are connected with the coordination of the design system, in the latter with the market system characteristics. Correspondence and equilibrium between the lexica in the lower rows with the lexica in the higher rows as an important element for understanding the reform processes in the Estonian case may be easily seen.

Summing up, Table hints that in the old transition main Estonian constitutional actors (parliament, government, political elites, business elites and the elites of masses) who were significant players in the transition game implementing market reforms, that these groups had much consensus over the main transition objectives, the close incentives and expectations with long time horizons. Therefore they mainly behaved as one collective even in the new liberal democratic environment. In this phenomenon indeed the path dependence on the Estonian history may have had significant role as Kyriazis and Zoubolakis (2005) have clamed. This may be also the reason way spontaneous reforms and legalized reforms despite of many coordination failures, the forces of inertia were not getting the upper hand, especially inertia of the Non-Estonians (Kirch, 1997 and Ott and Ennuste, 1996). The Russian speaking masses in Estonia were mainly not taking the same optimistic expectations. Here we have to agree with Shlapentokh (2005): “Another important factor is the power and readiness of the particular actor to influence the future of society and its institutions, not to mention their own lives. When people believe that it is impossible to change the future, or the fate of their nation, they become either fatalistic, or tend to violate social norms, resulting in crime, corruption and violence."

As it is easy to see from Table the beginning of the new transition or so was also the explicit start of political manoeuvring and obstruction processes in the field of transition and accession processes. The economic basis for that was relatively growing economic inequality, relative compared to the general economic growth. The opposition to government rapid accession policy on both left and right started to grow. Ordinary people connected the governments' many unpopular market regulations with the regulations from Brussels and this fear was cultivated and heavily exploited by populist politicians. Many national fundamentalists started to fear the new loss of nation's sovereignty. To come out of this and win the referendum on accession the governments had to procrastinate with many harmonization and buffer reforms. These procrastinations afterward had many negative effects. E.g., the governments were later incompetent to sterilize inflationary pressures connected with the governments' income tax policies etc.

In sum Table illustrates in the game theoretic formulations that the capitalist market reforms process came about in Estonia mainly through external shock of the complete breakdown of the soviet socialist chamber in the end of 1980s and this process was vindicated into snowball effect of the Central-European transition. The new Estonian constitutional forces started to gather to break from and distance from the old socialist economic system and rapidly-gradually started to implement new capitalist market system that was the main incentive as the dominating elites as the main masses. In the end of

1990s this transformation changed to the process of convergence with the European Union economic system. In this process the incentives of the reforming actors start to differ notably: some players turn slightly more to right and others more to left. But the inertial forces of the successful beginning of 1990s still have the upper hand and the same game was played as before. The absolute welfare of all groups is increasing in both periods, but in the second period the relative welfare of the masses compared to the elites is decreasing.

Understanding some specific features of Estonia's market reform process on the basis of Bayesian implementation theoretic narrative analysis

First, rational flexibility in Estonian reform policy targeting is to be mentioned from the point of view of the Bayesian equilibrium approach. Early and very small (shallow, narrow, mainly sporadic spontaneous un-institutionalized and economy-driven) proposals and steps towards market economy were taken already at the end of the Estonian SSR within the Soviet Union. These were rational for all actors considering the huge political uncertainties and risks as preliminary steps.

A more ambitious and rather radical economic reform program was put on right after the restoration of independent statehood in 1991, which was return of Estonia to democracy and private property economy. These reforms were in the beginning mainly crises driven and performed in the condition of extremely bounded competence, but in concert rationally orientated to copy institution building in the Central-European transition countries. The most significant from these (sine qua non) there the privatization and monetary reforms.

The equilibrium outcome here was diversifying institutional cluster and simplified and non-expensive mechanisms (e.g. flat income tax).

Later the harmonizing reform process was politically driven and subordinated to the EU accession aspirations that fixed quite a strict framework for further institutional development, although already in the conditions of bigger discrepancies of actors' incentives and smaller uncertainties and incompetence.

Second, still the Estonian reform process included several significant non-traditional approaches in the Central- and Eastern-European transition like implementation of currency board framework and vast restitution of properties that were expropriated after the annexation of Estonia by the Soviet Union in 1940 and 1944.

These choices were good for reforming agents securing international credibility of Estonian new economy. The currency board arrangement insisted on the austerity in government spending and on the requirement that the parliament should not approve budgets with planned deficit and helped stabilize the liberalization of foreign trade as well as current account and financial account transactions, for FDI etc.

The vast restitution or compensation of properties expropriated after the annexation made elaboration of privatization laws rather time-consuming and actual privatization started with some delay but, on the other hand, were important to enhance credibility of national economy. However, privatization was still carried out quite fast and was more comprehensive than usually, including privatization of state-owned infrastructure (telecommunications, railways, national flight company, etc.).

Third, there were some specific timing problems and interactions-complementarities between reforms of different generations. For instance, privatization as the first-order reform was sometimes hindered by under-coordination of incentives of different population groups and slow institution building (as second generation reform) as, for instance, real estate registers, land cadastres etc. were to be established first.

Broader transactions with privatization vouchers had to wait for development of securities market. Some small steps on the way of attracting foreign capital taken already before the restitution of political independence were revised in the process of actual privatization, several additional privileges (tax relieves) were given to foreign capital and later, uniform tax schemes were introduced for all enterprises. Thus, many reforms were carried out simultaneously, many adjustments were later made to co-ordinate and link reforms together in the best possible way. Understandably, the reforming process included quite a lot of "learning by doing" and adapting (correction of laws) by the government, parliament, ministries, political parties and informal social groups.

In the process of harmonization the under-coordination of the truth-telling in the reforming game has to be mentioned and because of that some buffer-reforms were performed improperly (e.g. Estonia had by the time of accession to the EU substantial speculative sugar supplies).

Fourth, the economic decline, especially statistical, in Estonia due to the collapse of the Soviet economy was especially drastic and this fact should not be forgotten in the analysis of reforms or even this decline should not be falsely considered as “the social cost of reforms” or price for a faulty institutional transition design game. Especially considering the objective incompleteness of information and externally and heavily bounded rationality brutally inflicted by soviets to the actors of reform process designers and implementors (Salo, 2005).

Severe real GDP collapse demonstrated the great losses of human and real capital during the occupation. In this sense, the Estonian economy, like other Baltic States, had an extremely unfavourable initial position for a deep seemingly “transitional depression”, but that in reality was mainly as inheritance of the colonial economic system. First of all, during fifty years under the very ineffective Soviet economic system, Estonian economy had suffered huge losses in the sense of missed national income per capita in comparison with e.g. such capitalist market economy like Finland (estimates vary around one million kroon per capita; Salo, 2005)[1]. Second, in the mid-

[1] As a matter of fact, the Soviet Union was literally speaking not a socialist economic system, even in Marxist conception. Probably the most important conceptions already before the transition are those developed by Bahro (1978), Kelly (1985) and Brutus and Ennuste (1965). According to their definition, the Soviet Union was a class society where “A privileged minority maintains a monopoly of administration and management” (Kelly, 1985). Hence the terms “socialist” and “economy” should not be in this context taken literally but only as a kind of convenient label. Or one adequate term may be “centralized command and queue-rationed military economy including black markets” (see also Alexeev and Sabyr, 2004). Consequently, in the context of capitalist market reforms the former Soviet Union

1980s, many Soviet military factories and huge Soviet occupation army units (according to estimates around 100,000 troops; ibid.) with their technical and economic infrastructures were located in Estonia[1]. All this oriented Estonian economy to the soviet-style low production quality and extensive development-oriented economic structure that had to be profoundly restructured in the transition to market economy. In this sense, the Estonian economy of the mid-1990s is not even correctly comparable to the Estonian economy in the mid-1980s, not to speak with Central-European former socialist countries[2].

2.3. Strong versus weak reforms: Comparative remarks on impacts of the Estonian capitalist market reforms on redistribution and sustainability of reforms

Recently Chong and Gradstein (2004) proposed weakness criteria for socio-economic institutional reforms. Weakness can be briefly detected and

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countries, post-Soviet countries, had to start from *tabula rasa* and in this situation, more importantly, had actually no other alternatives than to adopt rapidly simplified neoliberal models.

[1] Thus, it is scientifically absurd to make today e.g. macro-economic comparisons of Estonian economy prior to the transition and based on the meaningless Soviet rationing economy prices and today meaningless military production. Still, this kind of comparisons for Estonian transition analyses have been and still are massively made with amazing superficiality, even sporadically by respectable international organizations (WB, IMF, OECD, etc.) and prominent mainstream economists, although these may be used credibly only for politically oriented manipulations. E.g., among others, Stern (1997) analyzes real GDP growth rates in Eastern Europe, the Baltics and the CIS in 1989-1995 with great "precision".

[2] And, also importantly, in 1995-1997, at least the Baltics were already qualitatively different economic systems: producing civilized production in competitive market economies with equilibrium prices and exchange rates with credible monetary systems etc. Thus we may claim that the secessional transition was completed and a qualitatively new phase of transformation began: accessional transformation to conform capitalist market institutions to the acquis communautaire (Andreff, 2004).

understood on the basis of the resultant relatively exceptional and increasing by time income inequality of population compared to the other comparable countries. Excessive income inequality and its evolution may have the poor influence to the reform processes as this may subvert and destabilize the reforms in the democracies. One approach of the theoretical framework of this double feedback relationship was proposed also by Harms and Zink, 2003. Thus, to fully understand the weakness or strength in the aspect of sustainability of Estonian transitional socio-economic institutional reform processes we have to compare with other countries the factual dynamics of income inequalities and the dynamics of inequalities as the results of reforms.

Some income inequality comparisons

Radical political and economic reforms in Estonia coincided in 1992–1993 with falling of the living standard caused mainly as an after-effect by the collapse of the Soviet industrial system (Kornai, 1998) and partly by inefficient allocations caused by political break-up of the Soviet Bloc as a federative political system (Gradstein, 2004). Thus, in the transition in Estonia, like in other transition countries, the income issues played an important role in the economic stabilization reforms and policies (Lavigne, 1999, 114). The main discussion in these days was about the efficiency versus income dilemma, and this was mainly solved in the tenets of neo-liberal political slogans of the ruling nationalist and reformist coalitions in this period: there is no way to redistribute poverty or in other words, first economic growth and then egalitarian economic policies, but already in the second half of 1990s these discussions focused on the problems on income inequalities and transfers, especially in the election campaigns.

With the help of different decile ratios it is possible to more precisely characterize the spread of income across population rather than using only the difference between top and bottom deciles. Compared for instance with the neighbouring country Finland, incomes by decile ratios differ more in Estonia, but contrary to Finland, the differences have diminished in the periods under discussion.

In international comparisons of income distribution inequality on the basis of decile ratios or Gini coefficients it is not possible to characterize the impact of differences in the absolute value of incomes on inequality. For example, in Finland, the disposable income difference between IX and I decile in 2001 was EUR 16.5 thousand (Statistical Yearbook of Finland, 2003), but in Estonia EUR 2.6 thousand in 2002 (Household Living Niveau, 2003), meaning that this difference in Finland was 6.3 times bigger than in Estonia. Therefore it is important in international comparisons of income distribution to take into consideration also the absolute value of disposable income.

Thus transition to market economy, economic and social reforms in the EU accession period have created conditions in Estonia where the income stratification of the population has not increased; income distribution has been characterized rather by the slight tendency of decreasing inequality in recent years. In these tendencies there may be some influences on the Estonian welfare model being near-by Scandinavian countries' long-term egalitarian welfare societies (Andersen, 2004), that especially after accession.

In sum, we may on the basis of this analysis claim that probably the Estonian economic institutional transition process has thus far had enough strength not to fall into vicious circle of excessive income inequality and positive feedback trap of weak socio-economic institutions.

3. Summary Remarks

Dual transition

The Estonian market economy transition has a dual character: first, the secessional post-Soviet transition and, second, the accessional transition to the EU. These two sub-periods have been called also old and new transition (e.g. Lavigne, 1999) or first and second transition (e.g. Andreff, 2004).

In the context of the capitalist market reform process, the secessional transition started institutionally from tabula rasa in many ways. Firstly, the collapsing Soviet Union, literally speaking, had no complete economic institutional system, but foremost only a repressively implemented production command system oriented preferably to military and low-quality primary consumer goods. This system was centrally and dictatorially coordinated by repressions administrated mainly with rationing and by barter. Institutions such as prices, profits, wages, savings, exchange rates and especially money and assets had in this system a very low economic content and were used mainly for accounting purposes only. Official national production statistics were manipulated by the security offices for propaganda reasons, etc. And secondly, there were at the time not yet available any adequate political-economic academic tenets of the transfer processes from socialist ownership to private, not to speak about normative theories.

At the end of 1980s and mostly at the beginning of 1990s, the Estonian market economic reforms and policies were mainly pragmatically crises-driven and spontaneous. They were targeted first of all at turning around the drastic decline in the macroeconomic situation in the country caused by the collapse of the Soviet Bloc socialist planning economy (Kornai, 1998, Bönker et al., 2002). And second, they were politically targeted at coming out from the economic institutional chaos caused by the collapse and distance from Soviet imperial ambitions. In other words, in this period status quo or not reforming economic system would have involved high probability of prohibitively drastic macroeconomic disasters.

In these circumstances the general trend of the Estonian economic reforms was politically prevalently chosen under the regional "snowball effect" as Western oriented and directed to basically radically liberal private property-based free market economy and integration into Western markets and economic unions. Understandably, this policy was in this critical situation politically supported by the main interest groups (Lauristin and Vihalemm, 1997). It is important to note that there are many politically driven, theoretically erroneous and empirically unfounded claims circulating like the Estonian macroeconomic decline in this period was the "price" for the Estonian market reforms, for independence etc.

As approximately in 1994-5 Estonian GDP started to grow and this growth was mainly led by foreign investments or indirectly by privatization reforms and other reforms that enhanced the credibility of the economy, we may claim that the effect of the reforms has been with high probability positive. In other words, the growth could not have started without reforms.

Accessional economic transition started mainly as politically orientated adjustment, adaptation of and convergence to the advanced economic institutions of the contemporary Western economic unions. The first benchmark here was the EU accession, but depending on the choice of convergence criteria (Andreff 2004).

What have we learned from the last problem in the case of Estonia from the aspect of institutional building in our study? It seems that after joining the EMU expectedly in 2007 or so, the following reforms may be qualified as more or less taking place synchronously with the general EU reform campaigns and not as specific elements of accessional transition.

On the results of the reform process

There is the question how effective have the realized reform processes and the realized economic institutional structures been; could there have been higher growth rates achievable with implementation in these circumstances of hypothetical different clusters of market institutions (Djankov et al., 2003) or with comparisons of reforms in other post-socialist countries.

The answer to the first question definitely is that the Estonian reform processes could have been more effective, as there has been some fuzziness in the ownership reforms in the countryside and staggering in the privatization process of state firms due to the under-coordination of the interests of stakeholders and due to insufficient complementarities and sequentially under-coordinated privatization offices designs. There may have been also procrastinations in the introduction and implementation of social protection reforms on the basis of incompetence in this field in the reforming system and political rivalry in the preparation of the reforms. Privatization was a significant method for attracting foreign direct investments into Estonian economy in the mid-1990s: privatization-related foreign investments accounted for about one-third of the foreign capital inflow.

In the beginning of the reforms, the design and implementation actors had homogenous political objectives and in this situation the under-coordination by the government and insufficient competence of actors was not crucial and the equilibrium outcome-reforms were still sound. But by the development of democracy in the middle of nineties, the strategic behaviour of the opposition and the relative losers became unconstructive for the institutional restructuring. We may claim this was partly due to the lack of truth-telling coordination by the government. The last phenomenon was most disturbing in the case of preparation of reforms for accession (Ennuste and Rajasalu, 2002a,b) and in the beginning of being a member country (speculative sugar supplies, high inflation in 2006-6 preventing Estonia to join without delay the euro-area, e.g.).

On the efficiency of the reforms

Econometric analysis by Rajasalu (2003a) with available international data on the impacts of economic institutional developments (as a results of reform processes) in transition countries on the macroeconomic income indicators suggested that these developments may have had a more important impact on the growth by passing just a certain transition threshold from one institutional system to another. But in the harmonization in the second half of nineties, the institutional structures of the transitional accession countries became too similar to the EU economic policy-making institutional principles (Tabellini, 2003) to make econometric distinctions of the efficiencies of the institutional arrangement in different harmonizing countries possible.

It is important to note that for understanding the efficiency of reform processes of the economic institutional structure in the case of Estonian transition it is not enough to follow the economic growth rates and achieved GDP quantities. Economic institutional structures should first of all contribute to resistance of adverse shocks and enhance credibility of the economy and sustainable development, including institutional developments. So, the efficiency criteria should combine the growth and stability indicators and their sustainability, including reforms. In this respect, Estonian macroeconomic stability indicators have been relatively stable in the accession period. But here again we face the question how much credit for that should be given to the efficiency of the current simple Estonian economic institutional structure and how much to the specific Estonian idiosyncratic phenomena like one of the first EU members in spe among the accession countries etc. Estonia’s average GDP growth in 1998-2003 was 5.2% and inflation 4.3% per annum.

It is still important to understand that the big volumes of economic reform flows could not have been the cause of “transitional economic depression”, as first of all, these reforms were enforced or crises driven to avoid deeper macroeconomic declines. And second, the politically taken radical orientation of the reforms to the West enhanced the credibility of the country and expectations of foreign investors that may have probably instantly compensated for not very significant current costs of building the new economic institutional structure.

On the basis of analyses we may claim that probably the Estonian economic institutional transition process has thus far not been weak and not fallen into some kind of vicious circle (Chong and Gradstein, 2004) of excessive inequality and positive feedback trap of weak institutions. We hope that this conclusion was made not too soon.

On some primary determinants of the transformation

The most significant Estonian idiosyncratic reform conditional factors may have been: re-annexation threat, large Russian-speaking Diaspora, small size and geographical location and political homogeneity domestically.

Many Estonian reform selections and their performances may be explained by idiosyncratic conditions in the country. But as the reform processes are complex, the influences and significance of idiosyncratic factors upon reform programs and their results have also a heterogeneous complex nature. Consequently, the particular idiosyncratic factors have had in different reform programs and their stages different influences and these influences may be discovered and explained only in special reform event studies.

We have to note that by far not all influences of Estonian idiosyncratic reform factors may be explained by more or less credible evidences or documents for the time being, especially the role of anti-independence and reform activities of foreign security services etc.

On failures and lessons

Although positive in general, Estonia's reform experiences are not to be understood and approved without further critical understanding and analysis. It is possible now in our "after-wisdom" to analyze many implemented reforms in their interdependence, to evaluate sequencing of reforms, to compare initial goals and gained results, to evaluate economic and social costs of the reforms, to identify relative gainers and losers and revisit the problem of Estonia's reforming identity as a previous "shining star" (Panagiotou, 2001) in the field of transition.

The empirical analysis leads to the following conclusions. First, the implementation analysis of the changing Estonian economic reforming mechanisms in 1987-2006 has demonstrated many implementation inefficiencies and failures in these structures. There has been chronically incomplete under-coordination with constantly distorted information of the reforming agents and their irrational behaviours and oversimplified understanding of the workings of the advanced capitalist market mechanisms. The deficiency of lack of truth-telling fault correction side payments is still significantly disturbing, especially in the field of integration processes with the EU.

Agricultural and land reforms were carried out by local governments, not by the regulation of central government, which made these reforms extremely under-coordinated and strongly smack of nepotism/nomenclature. On the scale „successful – unsuccessful reforms“ the reforms in agriculture should be regarded as less successful. Agriculture is an example of how deliberately gradual and seemingly humane reforms ultimately turned most painful (Maide, 1995). In real life, just agricultural reform turned most clearly out to happen through shock, where the compensating or „therapy“ component was reduced to the inertia of agricultural production process and picturesque way of life (the decline of money income was compensated here by indispensable “self-supplying”).

With these failures in the Estonian economic reforming system the first step should be to establish coordination mechanisms for more stimulating side payments and limiting constraints to enhance truth-telling and learning as the best strategy for the reforming agents.

Secondly, an intelligent reform strategy is required to eliminate the politically minded manipulations and to give more room to the strengthening of the position of reforming agents in the field of designing more efficient social protection institutions in the realm of budgetary policies. The sustainable economic growth must not be used as an excuse for inaction in this field.

Thirdly, particular attention should be devoted to transforming the Estonian economic reforming system and social environment into proper conditions of a new EU member state to encourage adoption of all new effective reforming resources that open up with the accession and not to stay in the defensive entrenchment positions of nationalistically minded populist politicians. Unfortunately in 2006 failed to fulfil the Maastricht inflation criterion and to apply for joining the euro-area, and in these new conditions, it seems, that Bank of Estonian is unable to sterilize inflationary pressures.

On the political economy of analytical transition implementation models

We have in several sections testified to the rationality of applying a mechanism analytic narrative approach in institutional transitology on the basis of models and methods of modern institutional design implementation. By working out our method we started from imaginary normative socially desirable ex ante dynamic institutional design model (e.g. Ennuste, 2001 and Wagener, 2004). The model was relaxed and decomposed into coordinated implementation game of the centre (implementor) and designing agents. The rules of this game describe the socially desirable mechanisms of reform design and enforcement process that will give as equilibrium outcome socially desirable institutional reforms (institutional clusters). The comparative study of the chronology of the actually realized constitutional mechanisms with the socially ideal mechanisms gives the main clue to understand the process and types of reforms implemented in the real transition process and the lessons to be learned.

E.g., this type of method is the only one known to describe coordination rules for truth telling side payments (Matsushima, 1993). And as our analysis claims, the absence of truth-telling side payments besides of faulty nonlearning actors are contemporarily the most significant faults of the Estonian economic institutional design mechanisms.

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Appendix

Concise Chronologies in the Period 1987-2006: The Transformation of the Estonian Economic Institutions and Domestic and Foreign Environment

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1987	The foreign investment system under the planned state economy was nonexistent. The capital market institutions were nonexistent. The monetary system had neither functional nor structural credibility. Directly centralized economic decision mechanism. Substantial informal barter and shadow market institutions. September, idea about Estonia's economic autonomy (self-accounting Estonia) was put on and several groups were organized to elaborate it.	Private capital ownership illegal. Foreign investments from capitalist countries illegal. Spontaneous national elite groups movements against Moscow's colonial rule and in the field of economy to achieve national control over Estonia's economy (Taagepera 1993).	Urgent need for foreign currency and capital. Private and foreign capital almost nonexistent. Constant shortages. Quality of goods is very low. Heavy shortages of goods. Idea about autonomy stemmed from resistance to construction of environmentally hazardous and economically unviable phosphorite mine and to inflow of non-Estonian population. Huge income inequality between nomenclatura and masses.	Negative attitudes against foreign capital in the USSR government began to change. January, Degree of the Council of Ministers of the USSR allowed the capitalist and developed countries to take part in funding joint ventures, the soviet-side ownership at least 51%. USSR branch ministries didn't consider local interest in their plans. Political repressions diminishing in the USSR. In Poland delocalized Solidarity is gathering wider popular support.	The turning point in the quantity of oil production in the USSR. Economic stagnation in the USSR. In Hungary spontaneous privatization had started.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1988	May 16, the Degree of the Council of Ministers of the Estonian SSR to abolish main restrictions on the formation of joint ventures with capitalist countries. In October the spontaneous mass movement the for independence Popular Front held its founding Congress.	November 16, Declaration of the Sovereignty of the Estonian SSR by the Supreme Council of the Estonian SSR. Inadequate political science knowledge.	Enterprises with participation of foreign capital (joint ventures) were set up. Inadequate local knowledge of capitalist market mechanisms and intuitions.	Some Western Kremlinologists are in the favour the survival of the Soviet Empire	

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1989	November 17, the Law on Enterprises adopted by the Supreme Council of the Estonian SSR. December 11, the Decree of the Council of Ministers of the Estonian SSR to abolish most restrictions on the formation of joint ventures	November 12, Resolution by the Supreme Council of the Estonian SSR declared Resolution of 22 July 1940 on Estonia joining the USSR to be null and void. A parallel legislative body "Estonian Congress" (the shadow parliament of the citizens of the Republic of Estonia) was elected.	Share of Estonians in the population about 61%. GDP at PPS per capita compared to EU-15 in the range one fifth – one third. Spontaneous small private entrepreneurship starting.	The breach of the Berlin Wall. Interethnic and military tension accompanies the build-up of the Estonian independence. Tens of thousands of Russian-speaking high paid military factory workers are organized to oppose independence.	November, the USSR Supreme Soviet adopted a law granting economic autonomy to Baltic republics concerning ownership.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1990	February 24, Estonian Congress was elected (an alternative of the parliament) October, Department of State Property was founded for carrying out mainly small privatization but also other programs of ownership reform. The Law on Privatization of State-Owned Service, Trade and Catering Establishments, December 13. Rapid implementation of the market mechanisms, liberalization of prices and trade contacts. Liberal foreign trade and capital movement.	On March 30, the Parliament passed the resolution that the annexation did not suspend the de jure existence of the Republic of Estonia. Change in regime creates anxiety in Estonian multi-ethnic society. More Estonians than Russians are in favour of market-oriented economic reform. Estonian sabotage against rouble.	Private entrepreneurship starting. About one thousand family operated farms started but the ownership right was not clear, land was the state property. About one-third of the dwellings in private ownership. The total economic loss during 50 years of annexation not less than $ 100 B (author's estimate). Mainly caused by ineffective economic system and loss of human capital.	High interethnic and military tension accompanies the build-up of the Estonian independence. More Russian speaking high paid military factory workers are organized to oppose independence.	The interest of foreign capital in investment in Estonia increases. In Central Europe the substantial privatization started. In Germany the Treuhandanstalt for large-scale privatization transaction established.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1991	In March Estonian Bank started independently quoting the Soviet rouble proceeding from the black market exchange rates. The Law on the Fundamentals of Ownership, June 13. Principal issues, private ownership institution restored. Sanctioned private ownership of land. The enactment of the privatization vouchers. The Law on Foreign Investment, September 10, guarantees ownership rights, repatriation of profits and liberal capital movement rules. The Law on Tax Allowances to Enterprises with Foreign Capital, September 10. The income taxes of the foreign investors are reduced. October, the Land Reform Act was passed. December, the first investment fund (EBIF) established. The spontaneous formation of securities market started. All trade barriers and tariffs have been abolished.	On March 3, an unbinding referendum on the question of independence. Nearly all ethnic Estonians supported independence as well as about 1/3 of the non-Estonians. On August 20, Estonia regained independence. Institutional subversions of the Soviet Union economic regulations. Institutional vacuum in many public fields.	A priority for direct restitution and the use of vouchers, other models of selling were also permitted. No priorities for the insiders. Municipalization of some state assets. The Land Reform Act, October 17. Restitution, directly or by replacement and compensation. Selling for vouchers and money. Selling to foreigners with the permission of the Government. The reorganization of state-owned enterprises started in 1991, leasing formation of share companies.	High military tension accompanies the build-up of the Estonian independence. Kremlin sends in huge additional forces for rapid military operations.	Large-scale privatization in Germany.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1992	The Government Decree, April 6, endorses a list of activities with foreign capital where the license is required (telecommunication, ports, railways, energy and mining). On June 20, the introduction of the Estonian kroon (EEK) pegged to the Deutschmark (DEM1=EEK8) and implementation of the currency board arrangement. June 28, the new Constitution, the institutionalization of private ownership. The Government Decree, July 13, endorses the rules for privatizing and leasing property to foreigners. In September, the Estonian Privatization Enterprise was set up for organizing large-scale privatization (in stile of Treuhandanstalt). More than 35,000 registered organizations.	On June 28, the new Constitution was adopted. The property rights of all persons shall be inviolable (Art.32). September 20, the democratic parliamentary elections. The coalition had no clear policy on privatization methods any more. Tens of political parties with different privatization proposals. Minister without portfolio for coordination of ownership reform was named.	The Agricultural Reform Act, March 11. The Law on the Privatization of Flats, April 16. The intensive sale of small-scale privatization units. At the end of the year, the large-scale privatization program started. During 3 years, GDP decreased more than 35%, caused mostly by the collapse of the former Soviet market. Collapse of the provision of many public goods. The first international tender for privatization of large enterprises announced on November 17. Disruptive changes of the foreign trade towards the West.	During August and September almost all member states of the United Nations recognized Estonia, by September 17 Estonia gained membership.	The total collapse of the former Soviet market where Estonia had more than 90% of its foreign trade. Mass privatization in Czechoslovakia and Poland.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1993	The Law on Securities Market, June 2. The Property Law, June 9. The Law on State Budget, June 16. In one year the revenues and expenditures should be balanced. The Law on Security Markets adopted on July 2. The Estonian Privatization Enterprise, and the Department of State Property were reorganized into Estonian Privatization Agency. The Law on Income Tax, December 8, no further tax allowances for enterprises with foreign capital are to be granted. A flat 26% income tax for both enterprises and individuals was established, 33% payroll tax.	In the 1992 elections, the Pro Patria party won on the basis of campaigning for restitution of ownership. Now this party appears to have modified its position. The land reform problems are discussed but no laws are adopted or amended in the Parliament. May 6, a new Law on Privatization of Flats. The Law of June 17 declares a priority for the use of money in selling state assets. The Estonian Government has signed agreements about mutual protection of investments with many countries. May 13, Estonia became a full member of the Council of Europe.	March 6, the Land Tax Act. Competition has emerged. Prospects for economic growth. In August, the Compensation Fund was established. 50% of privatization proceedings are transferred to this fund. The bonds of the Compensation Fund are sold only for vouchers. The core investor principle is implemented in large-scale privatization. Privatization for money, ignoring the vouchers. Open competition. Payment in instalments for the residents.	Politically conflicting situation with Russia, mainly on the basis of the Estonian Law on Aliens from July 8.	Conflicting situation with Russia makes the size of the market for Estonian firms smaller.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1994	From January 1, the flat 26% income tax for legal and physical persons (also in the case of dividends and capital gains, in principle double taxation avoided). The Government Decree No 291, August 12. Regulation of activities of the investment funds. About 10 investment funds active with total net value of portfolio about EEK 100M. The Government Decree on the Establishment of the Estonian Central Register of Securities. More than twenty commercial banks have been authorized to carry out foreign transactions.	By August, more than 0.2 million restitution applications were submitted. The procedure for selling land to legal persons and foreigners is not entirely regulated. Government makes still final decisions regarding land sales. Privatization of land is tangled.	The Government makes still final decisions regarding land sales. Privatization of land is tangled. GDP at PPS per capita compared to EU-15 is about 30%. The Bank of Estonia is unable to influence inflation.	Estonian Russian treaty about the withdrawal of the Russian troupes. In August the Russian army was out.	July 1, Russia placed double custom tariffs on Estonian agricultural produce and foodstuffs.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1995	January 1, Investment Fund Act became effective (adopted on August 12, 1994). February 15, the Commercial Code. Many forms of business organizations enacted and regulated. The minimum capital requirements for the private limited company EEK 40,000 and public (stock) limited company EEK 400,000. Publicly offered shares of privatization traded at the securities market, emergence of secondary market. November 22, the Amendments to the Law on Income Tax, prevents double taxation for investment funds. Over 83 000 registered enterprises, of these 23858 active.	March, the parliamentary elections, directions in privatization exactly the same. In April, the new Parliament voted down the bill to stop privatization. The post of the minister without portfolio for the coordination of ownership reform was dissolved. The minister without portfolio for the coordination of the affairs with the EU is nominated. The ruling governmental coalition is heterogeneous and therefore increasing meta-economic risks. PM Vähi steps down, October.	From January 1, the reduced tax rate 10% for physical persons on interests. Difference between the lending rate and deposit rate about 10 points that is about two times more than in Finland. This is the indication of still large country-risks of Estonia compared to Finland. On the account of foreigners 1/5 of the securities. By the end of the year, the small-scale privatization was almost completed. Estonian Hansapank's (commercial bank) shares listed in the Helsinki Stock Exchange.	June 12, the Association Agreement with the EU signed. December, the Parliamentary elections in Russia. November 24, Estonia applied for the EU membership. White Paper. Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union (presented by the Commission) COM(95) 163 final.	January 1, free trade agreement with the EU came into force. International cross-border equity flows into emerging markets are rapidly declining.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1996	By the beginning of the year, there are in the preparation: Law on Exchanges, Law on Investment Funds, Amendments to the Law on Securities Market, Law on Public Offering of Shares, Law on Depositories, Law on Promissory Notes, etc. May 31, the Tallinn Stock Exchange started its operations. More than 60 000 registered enterprises, of these 24609 active. More than 2/3 of enterprises' assets are privately owned.	The presidential elections this year are increasing meta-economic risks. The new ruling coalition is also heterogeneous. Discussions in the Parliament about the introduction of the trade tariffs.	January, the Bank of Estonia launches the TALIBOR and TALIBID rates (Tallinn interbank offered rate and bid rate). By the end of the year, large enterprises have been almost completely privatized. Estonia is regarded as a functioning market economy and the first period of transition (marketisation and privatization) is regarded as almost completed.	The presidential election in Russia (before elections the incumbent presidents may be more inclined to start small wars). The elected Russian President is waiting for heart surgery (this is increasing political uncertainties).	Prospects of the growth of the Russian economy. Russia's economic country-risk rating about 90%. The expectation that the cross-border equity flows into emerging markets jump up again.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1997	April 15, the Deposit Guarantee Fund Act passed. The Law of Trade tariffs for agricultural and food products adopted but not implemented. December, the Council of the EU decides to start the accession negotiations with Estonia at the beginning of 1998.	The adoption of the acquis was included among political priorities. PM Tiit Vähi from the Coalition Party steps down, 25th February. The new PM is Mart Siimann, Coalition Party, opposed by the National conservative parties.	The problems of the Estonian economic competitiveness in the EU market are widely discussed. August, warnings that the Estonian economy is in danger of overheating, based on the expectations of the GDP increase over 10% for 1997. Consecutive Tallinn stock market crashes, October. Highest market capitalization value was on August 29 almost EEK 27 B and TALSE index 493 points.	Agenda 2000 - Commission Opinion on Estonia's Application for Membership of the European Union, 15th July. Estonia rejects Russian security guarantees as not necessary in the continued westward orientation, October.	Asian crisis, withdrawal of capital from emerging markets.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1998	March 11, the Competition act passed. March, the Commission of the EU institutionalizes the accession negotiations with Estonia. June 10, the Pension Funds Act passed. May and July, Ühispank and Tallinna Bank merger, and also two leading banks Hansapank and Eesti Hoiupank merger. December 31, Bank of Estonia fixed exchange rate EUR 1= EEK 15.6466 that was equivalent of fixed rate DEM 1= EEK 8	Political manoeuvrings of pre-election year. Foreign Minister Ilves joins the Farmers Party. October, United Opposition in showdown over the budget draft could sink government. December 8, Riigikogu liberalized the citizenship law.	Agricultural producers who exported to Russia have been hardest hit by Russian crisis. September, Swedbank increases its stake in Hansabank to20%.	July, EU presidency transfers from UK to Austria and is not hurting Estonian EU bid.	Russian economic crisis. August 31, the value of the rouble dropped 30%. Latvia joins WTO. Food exports to Russia fell dramatically.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
1999	January 1, the central banks of the EU countries began quoting the Estonian kroon. 27 January, Riigikogu passed the Anti-corruption Act. 9 February, Riigikogu passed the revised Credit Institutions Act in line with the corresponding EU legislation.	The Moderates, Pro Patria Union and the Reform Party had 53 of the 101 seats in Parliament in the March 7 elections and formed the coalition government. The parliament with 53 votes nominated on March 22 Mart Laar for the post of PM. Constant obstructions in the parliament at the procedures of the revision of the budget.	February 9, the sale of Eesti Telecom shares by the State concluded, the State share dropped to 27%. Market capitalization value of the Tallinn Stock Exchange about EEK 18 B on February 16, TELECOM about EEK 9 B. According to the Statistical Office, Estonia's GDP takes a 5.8% plunge for the first quarter. Recession in economic activity.	January, EU presidency transfers to Germany and this may hurt the speed of the Eastern enlargement of EU. February, Russian MPs influence Finland and Sweden to exclude Estonia from EU membership negotiations.	The current account deficit remains high. Estonian tariffs and tariff related measures need to be improved. Exports to Russia and Russian transit traffic fell.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
2000	New Income Tax Act enters into force on 1 January. Passed on 15 December, from business income reinvestments are deducted. June 14, Riigikogu passed Trade Unions Act. Employers Union agrees to Trade Union proposal to increase monthly minimum wage from 1,400 to 1,600 kroons.	Modernization of the public administration has been limited. Functioning of the judiciary needs to be reinforced. Difficulties with enforcement of industrial and intellectual property rights, pension and public administration laws.	Average monthly gross wages Q1: 4,501 kroons. Gini index Q1 is equal to 0.38, this is relatively high. Q2 Temporary depression withdrawing. In the area of regional economic policy, progress has been limited. Share of Estonians in the population about 68%.	On November 8, the EU Commission stated in its Enlargement Strategy Paper together with candidate countries' individual progress reports: "Estonia … should be able to cope with competitive pressures … within the Union in the near term …".	The current account deficit remains high. Estonian tariffs and tariff related measures need to be improved. Exports to Russia and Russian transit traffic fell.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
2001	The government fixed first time average size of personalized 2001 social tax for annual recalculation of the first pillar pensions. May 9, Riigikogu passed Financial Inspection Act that concentrated supervisory activities of banks, insurance companies and securities markets. June13, Adoption of Unemployment Insurance Act that instituted the Unemployment Insurance Fund. September 26, Riigikogu passed the Contractual and Non-contractual Relations Act that replaced many former separate legal acts.	September, Arnold Rüütel was elected President of Estonia.	September, Draft of the Funded Pensions Act to introduce second (pre-funded) pillar of the pension system. November 1, Estonian Privatization Agency was closed, remaining few privatizations transferred to Ministry of Finance. Abnormally high income inequality compared to European standards. Suboptimal supply of public goods.		April, Estonian Government adopted basic principles for preparation for and implementation of the European Structural Funds and Cohesion Fund Support, action plan for implementation of support in 2001-2001.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
2002	March, Government ceased the sale of Estonian power plants to NRG as it wasn't able to make instalments in time. Power Plants remained in state ownership.	January, Prime Minster Mart Laar resigned, new government was formed by Siim Kallas.	Economic growth strong but driven mainly by domestic demand, export growth weak, current account deficit.	November, NATO invited Estonia to start accession negotiations.	European Union concluded accession negotiations with Estonia and other candidate countries.
2003	September 14 referendum approved the accession to the European Union.	March, parliamentary election, right-wing government.	Low industrial innovation and high international subcontracting. Infl. 1.3%.		
2004	April the Speculative Stocks Act passed. May 1 the accession to the European Union. Fine tuning and harmonization of the market institutions.	Share of Estonians in the population about 68%.	Extractive behaviour of political and economic elites. GDP at PPS per capita compared to EU-15 is about 40%. Large current-account deficit.	April 1 accession to NATO.	Before the enlargement of May 2004, as with previous enlargements, new Member States had to take buffer reforms to prevent operators building up speculative stocks of sugar.

Year	Economic Institutions	Prime Explanatory Phenomena			
		Domestic		Foreign	
		Political	Socio-Economic	Political	Economic
2005	May 18 Russia and Estonia sign the border treaty. Russia started to procrastinate with ratification.	April, new centre-right coalition and Cabinet. "transition from socialism to capitalism is very difficult." Gorbachev: Sunday Times, June 5, 2005.	Estonia had irregularities in preventing building up speculative stocks of sugar in the EU. Economic inequality of population relatively high.	"The collapse of the Soviet Union was the biggest geopolitical catastrophe …", President Putin.	
2006	Expectedly accession to the European Monetary Union not earlier 2008 or so.	Tax policy is mainly focused on reduction of income taxes and raising commodity taxes.	Inflation over 4% and over Maastricht criterion, and 1% over deposits interest rates.		Better credit conditions for Estonia in the EU and worse export conditions to Russia.

The experience of EU membership – two years after accession

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This paper gives in its first part a short overview and an assessment of the main characteristic features of the eastern enlargement of the European Union that took place on 1 May 2004 and incorporated into the community ten new member states. On the basis of these features that distinguish the recent eastern enlargement from all the previous ones, some conclusions are formulated concerning the potential effects and consequences on the "new" European Union of 25 countries.

The second part contains a brief evaluation of the expectations and fears expressed on the eve of the accession and in the first months and years of membership. These are contrasted with the developments and facts Hungary experienced during the relatively short period after the accession in a few selected areas of the economy.

1. Main features of eastern enlargement of the European Union and their impact[1]

1.1 Unlike earlier phases, the eastern enlargement concerns more than just Europe. The United Kingdom, Denmark, and Ireland (1973), Greece (1981), and later on Spain and Portugal (1986) acceded to the European Community

[1] This part of the paper draw extensively on Inotai (2003a) and Inotai (2003b)

in a divided Europe. Their accession was actually targeted at shaping Western Europe, and at a successful extension of the protective net of integration to the rather unstable southern European democracies in order to increase the weight and the influence of the Community on the continent. A simultaneous aim was to put constant pressure on the other group, COMECON, which had already been struggling with increasing problems. In fact even Finland, Austria, and Sweden were integrated in this spirit, to close the process started back in 1974 in the same cast of mind (with the introduction of a free trade zone for industrial products), even if the institutional framework of enlargement (i.e. the legally valid membership) was set up several years after the Berlin wall was pulled down.

The fundamental question of the eastern enlargement is by far not merely Europe's internal affair. It concerns Europe's future maneuvering room, weight, and influence in a drastically changing world. One concern is whether the continent's global political involvement can be increased once it is compelled to turn its attention to and use the majority of its resources not for the mitigation of Europe's internal tensions and securing a kind of apparent stability, but to devote most of the unifying continent's energies for the global representation and enforcement of its interests. Another issue at stake is the reinforcement of Europe's earlier significant position in the global economy and world trade in the new surroundings of an emerging information and knowledge society. Last but not least, the question arises whether Europe's characteristically odd role of the period behind us – namely, insignificant political influence in really substantial issues clearly manifest even in handling conflicts within Europe, coupled with an economic power of considerable account – is sustainable in the future. It is highly probable that in the first two decades of the 21st century this gap will not be closed. Unless Europe strengthens its weight in global politics and broadens its room for maneuvering, its economic role will erode. The strategic significance of the eastern enlargement actually unravels in this context.

1.2 Europe must redefine itself. Undoubtedly, pressure to do this is due in part to the global development and its impact on our continent (as well as on others). But actually much more is at stake. To be more precise: in order to successfully meet global challenges, both integration policies (primarily common agricultural policy, the institutional system, the decision-making mechanism, and the common budget) and the member states that have above-the-average influence on such policies (in the first place, Germany and France, but also other countries) must undergo substantial changes. Enlargement will but press for reforms, and it might result in a critical mass indispensable for triggering overall reforms. It must be stressed, however, that such reforms would be inevitable even if enlargement were not to take place. Actually, some of them should have been implemented in the decade behind us. But in practice the majority of necessary reforms have been lingering, loopholes have been found, and halfway measures have been taken, mainly as an interim handling of previously accumulated problems and not in conscious preparation for future challenges. No one disputes the need for overall reforms, but there are major disagreements between the member states with respect to their practical implementation, and even more, their timing. Whether the consequences of enlargement can bridge gaps or generate further conflicts of interest and thus paralyse institutions is as yet unforeseeable.

1.3 Each of the previous enlargement processes had been preceded by a period of the deepening of integration. In other words, the achieved qualitative changes (called deepening) encouraged further countries to apply for membership as nobody wanted to miss the chance offered in this process. But this correlation also works the other way round: consciously or unconsciously, candidates had to live up to increasingly higher standards in order to integrate because the Union also wished to safeguard its essential achievements in a growing community, while being afraid that some of the members might "loosen" or dilute the earlier achieved level of integration. At the time of the accession of the United Kingdom, Ireland, and Denmark a common trade policy was already being shaped (1969-1974). Spain and Portugal joined the Union only after the plan for a single internal market had taken effect (1985-1992). Finally, Austria, Finland, and Sweden acceded two years after the time schedule of the Economic and Monetary Union was accepted in the Maastricht Treaty (1993-1999). A peculiar feature of the eastern enlargement is that no spectacular deepening process with a clear time scheme or road map is linked with the current widening process. Naturally, numerous things took place in relation to this particular enlargement process: just think of the introduction of the single currency, the appreciation of the quality of co-operation in the fields of justice and home affairs, or the institutional reforms required as a precondition to enlargement. But all of them formed parts of earlier programs scheduled previous to this period, or minimum and ad hoc agreements were achieved with the explicit goal of removing any possible difficulties from the way to eastern enlargement.

It became increasingly clear that the "Big Bang" enlargement should be followed by a "Big Bang" deepening if Europe wants to solve the problems arising from enlargement and meet global challenges in a single large strategic package. This would consist of the following pivotal constituents: a fast reform of the common agricultural policy (not to be dragged on until 2013), discussions on possibilities of further modernisation of spending priorities and revenues of the common budget, a substantial extension of the majority decision-making system, the qualitative development of the common foreign and security policy, and the realisation of a migration policy of genuinely European dimensions. Naturally, these should be complemented by an accelerated accomplishment of the so-called Lisbon Agenda.

1.4 In the decision concerning the eastern enlargement of the European Union, political considerations were given greater emphasis than at any time during earlier enlargements. This fact can be traced back to the lack of an overall strategy, on the one hand, and the EU's deficient preparation to the eastern enlargement, on the other hand. This raises no problem in itself; what is more, it is definitely fortunate, because, in contrast to numerous opinions, the European Union is not merely an economic community, but a political actor as well. For this reason, political interests and considerations can be identified in every decision, especially in the enlargement scheme so important from the point of view of the EU's future. Political considerations played their part in each earlier enlargement. When Greece, Spain, and Portugal joined the Union, politics was the primary concern, as the main reasons for their admission included the intention to strengthen democracy and – as it is an indispensable instrument – providing legal, economic, and financial support to economic modernisation. It stands to reason that politics was of a minor account when Finland, Sweden, and Austria were admitted, as they were more developed and net contributors to the EU budget. Nevertheless, that round of enlargement cannot at all be termed as "free of politics."

The problem with the eastern enlargement is not that it is the result of an epoch-making political decision, unique in the history of the European Union, though it would have been expedient to make this decision much earlier and implement a scenario of successive accession of smaller groups. The real and serious conflict is between a politically motivated decision and its economic, institutional, and financial consequences and costs. Naturally, a similar tension was also generated during the Mediterranean enlargement. But in that case, the Union undertook all the economic and financial consequences of its political decision. The reason for this was that from the very first moment both regional and structural funds had been replenished, thus the new member states had access to sizeable development resources. In the case of the eastern enlargement, such an equilibrium could have been set only if accession were to have been performed in small groups. Efforts for balancing the political priorities of large-group accession and the budgetary consequences of enlargement have failed. This was, of course, clearly reflected already in the seven-year budgetary perspectives accepted in May 1999 in Berlin and continuing until 2006. But at that time enlargement envisaged the accession of but five CEEC's and Cyprus in the list of countries to be admitted not earlier than 2002. However, in Copenhagen in December 2002, it became clear that the Union's financial scope is even narrower than earlier assumed.

Thus, there is a fundamental disequilibrium between the large-group enlargement, motivated primarily by political considerations, and the Union's financial preparedness for the consequences of enlargement and its possibilities. As we saw, discussions on the financial perspective of 2007-2013 tried to address this issue. The outcome is the well-known compromise.

1.5 During the earlier enlargements, the Union admitted no more than three countries in one group, but in 2004 ten new member states joined simultaneously. Moreover, the economic performance of these new countries with few exceptions falls not only behind the EU average, but even behind the economic performance of the least developed old member states, as measured in the GDP. In some cases differences are striking. On the other hand, a scrutiny of the circumstances of the Greek, Spanish, and Portuguese accession reveals that at the time of their joining the Community, they were not closer to the EU average than, say, Slovenia, the Czech Republic, or Hungary are at this moment.

What is more, in several respects the economies and societies of the countries that joined the EU in May 2004 suggest a much faster development, adaptability, and innovation than the economies and societies of some of the old members. The genuine problem does not lie in the statistically measured and often deceptively quantifiable "lag." The differences between the economic performances of the individual new member countries are far more significant.

In comparison to one another these ten countries are extremely divergent. What is more, this is not necessarily in correlation with the level of economic development, measured in GDP terms. Social and institutional preparedness is only partially linked with the level of economic development. Of course, the two may not be detached for a long period and in a large measure, but they have quite a sweep of their own. (E.g. at a relatively low per capita GDP value, Estonia is considerably more adaptable to the EU than some of the other new member states, which have significantly higher per capita GDP indicators.) Disparities between different levels of adaptability are relatively fairly reflected in the indicators of the structural transformation and international competitiveness of an economy. However, these differences were reduced in the 2001 and 2002 annual country reports of the Commission. Most probably the reason was not merely the decrease of differences in some cases (while an increase or definite deepening was seen in others), rather the need to provide grounds for the political decision of admitting parallel ten countries, which could not have been provided if sizeable differences had been found among the performances of the individual countries. As a result, the above-mentioned differences will appear subsequent to accession, probably within a relatively short time. This way the enlarged European Union will have to face problems related to this increased heterogeneity that could have probably been avoided in the case of a multi-stage enlargement carried out in small groups. In the current situation, however, efforts must be made for preventing these tensions and for reducing likely conflicts. This is the collective responsibility of old and new member states because basically the success of enlargement depends on it.

1.6 Another characteristic feature of the eastern enlargement of the European Union is that it creates new geopolitical realities in the continent; in other words, it redraws the geopolitical map of Europe. Previous enlargements of the Union extended the borders of the Community towards the continent's natural and geographical frontiers. That was the case when the United Kingdom and Ireland joined the EU and also when the Iberian countries and the two Scandinavian states, Sweden and Finland, became members. There were only three exceptions: Denmark, Greece, and Austria. As a result of the eastern enlargement, the borders of the EU remain far from the continent's geographical borders. There are European countries also on the other side of the eastern frontiers of the newly acceded member states with which some of them have well-established traditional economic and cultural relations. This is relevant mainly for the Baltic States, Poland, Slovakia, and Hungary.

This feature has at least two consequences. One of them concerns the extension of existing and the creation of new networks of infrastructure and communication in such a manner that these should not end at the borders of the eastern EU members. To the contrary, they should establish well functioning physical and logistical links with the neighbouring regions and countries. Much more attention must be paid and more financial resources should be envisaged in the future to the elaboration of common region-wide cross-border projects. This latter once again emphasises the necessity of rethinking the priorities of the cohesion actions and certainly their financing.

The other consequence of the continent's modified realities and geographical rearrangement in an economic, historical, and cultural sense is the growing necessity of reshaping and sometimes extending the so called neighbourhood policy of the European Union. Just as southern European member states play an important role in building relations and carrying on a dialogue with the countries of Northern Africa along the southern shores of the Mediterranean, it is expected that in an enlarged EU, the experiences, proposals, and concepts of co-operation with Eastern Europe (especially Russia and Ukraine) will similarly gain a hearing. Cyprus, on the other hand, may be given a major role in the Middle Eastern area of the Mediterranean Sea.

1.7 Finally, the eastern enlargement of the European Union modified to a great extent the balance of small and large countries inside the EU, as well as the balance between member states contributors to the community budget and recipient countries.

The first change, namely increase of the number and the proportion of small and medium sized members from the point of view of their population, already had repercussions on the debates in the process of elaboration of the Treaty on the European Constitution. This could be observed especially concerning the voting rules in the case where a qualified majority is needed.

The increased number of countries that are and will be in a net beneficiary position during the coming years and in the period of the next financial perspectives in the field of the community budget operations, had also a certain impact during the past debates and on compromises about the new financial framework for 2007-2013, and will have such an impact on further discussions.

2. Hungary's first experience with membership in the EU

May 1st of 2004 has been and will remain a historical date both for the European Union, for the ten acceding countries, and for the future of the continent as well. Similarly to other countries, Hungary also duly celebrated this occasion. However, and it may sound paradoxical, the night of April 30 to May 1 did not change the life of any Hungarian citizen. Nothing more than "just" a new chronology started with membership in the EU. This historical date was preceded by a long road of preparing for membership that can be traced back decades and that got an institutional framework after 1991 by the signing of the Europe Agreement. At the same time, the process of integration did not stop with accession. At least three important areas of integration-related activities have to be considered in this context: (a) further adjustment in all areas where previously made commitments could not be (fully) met, (b) integration into existing EU policies and institutions where the pre-accession status did not allow full accommodation and participation (e.g. Common Agricultural Policy, structural funds, full-fledged membership with voting rights in all institutions, (c) an active role in the shaping of the future of community policies.

2.1 The most common expectations and fears

In the years and months before accession, a large number of arguments were created and disseminated concerning benefits and losses. Most of them, on both sides, have proved mistaken, at least considering the first few months of membership.

Expectations focused on EU financial transfers that could improve the living standard of most citizens in a short time, create a flourishing economy in depressed regions, offer new and lucrative job opportunities, and help the losers of systemic transformation. In fact, the financial resources coming from the EU budget will be substantially higher between 2004 and 2006 than in the pre-accession framework (and even more significantly higher after 2007). Their distribution in time is uneven and, even more, the perception of the healthy impacts on the economy and on personal income (living standard) needs, as in every other net beneficiary country, some time. Therefore, a "perception gap" can develop between expectations and reality just in the first and critical years of membership. Problems emerging from such a situation can successfully be faced by a two-way strategy. First, communicate a realistic assessment of the early impacts of membership to the society, and, at the same time, establish all legal, institutional, economic, and other conditions for absorbing available resources in the shortest time and at the highest efficiency possible.

Also, most of the fears proved unjustified. More importantly, if negative developments occurred, they were mostly due to other factors, mainly linked to previous economic policy mistakes and not directly connected with accession.

Inflation has accelerated in the first half year of 2004 from 5 to about 7 per cent, but mainly as a result of the reduced state budget support to energy, heating, and local transportation, as well as a poor agricultural output in 2003 and a large budget deficit in the last years. Accession itself had an ambiguous impact on price levels. Price rises could be observed in three areas linked to EU membership: higher value-added tax for certain products and services (from 0 to 5 or from 7 to 15 per cent), adjustment to the sugar policy of the EU (higher sugar prices), and higher excise duties on tobacco products.

On the other side, membership had a price-reducing impact due to the lower common external tariff (excepting for a very few cases), keener competition on the enlarged internal market, and, indirectly, the appreciation and overvalued status of the Hungarian currency. The year 2005 demonstrated, certainly to a large extent due to an improved monetary policy, an improvement of the inflation rate, which fell to 3.5 per cent.

No change happened on the labour market. Hungary remained the new member country with the lowest level of official unemployment (about 6 per cent in 2004 and about 7 per cent in 2005) and, unfortunately, also with the lowest level of economic activity of the active population. Most structural changes took place in the pre-accession period where trade and capital flows had been (almost) fully liberalised. In the coming months and years, labour market changes will overwhelmingly depend on government policies, as in how to handle the budget deficit, how to support the investment activity of small and medium-sized companies, and, primarily, how to make public administration more effective and competitive. No doubt that these steps are closely linked to membership in the EU, but they are not “dictated” by Brussels but should contribute to creating a successful Hungary within a changing European Union.

One of the most widespread fears was – and in some circles still is – that financially weak and domestic-market-oriented small firms will not be able to face increasing competition in the large internal market. This question is very complex, since the category of “small companies” includes highly efficient global firms, EU-oriented enterprises, rapidly expanding undertakings, and also very weak or just muddling-through companies. On the one hand, it is true that membership enhances competitive pressure due to the accession to the internal market, the full liberalisation of agricultural trade, and the rapid increase of service activities. On the other hand, membership offers a large market of 450 million consumers instead of a limited domestic one with 10 million potential buyers. Most probably the Hungarian company sector, as that of all other new and future member countries, has been entering a second stage of transformation, in which capital concentration is urgently needed in order to become more competitive. One million small (and mostly one-person) companies, one-third of which exist practically on paper only, can hardly be maintained. However, the expected merger and acquisition wave, that may reach larger foreign companies working in Hungary as well, is not a direct consequence of EU membership but a logical stage of successful modernisation and a precondition of building competitive capacities in the enlarged/enlarging European Union.

Due to the relatively short period, the impact of accession on regional development cannot yet be measured. Most probably, however, previous assumptions will remain correct. According to them, all regions will experience a take-off effect, but, in the first years, the development gap may widen or at least not start to close between the richer and poorer regions, due to their different absorption capacity.

Finally, no problem was noticed concerning national sovereignty. Evidently, excepting some extremist views from the right and the left alike, it has not been a major political issue in Hungary during the pre-accession period. Policy areas that previously belonged to national competence have been smoothly handed over to Brussels (e.g. trade policy or agricultural issues) and harmonisation with community policies continued according to the obligations taken on in the accession documents. In the two post-accession years, Brussels' "intervention" into Hungarian politics and economy did not become more manifest for the average citizen. Neither has the general (and mostly positive) attitude of the people changed towards the EU in this short period. This is, to a large extent, due to the adequate level of preparation of the country, the cautious approach of Brussels in the first years of membership, and the rather specific (sector-related) and partial character of the experience gathered after the accession (Inotai, 2004).

2.2 Selected short-term impacts

The relatively short period of membership of Hungary in the European Union does not allow drawing a detailed picture of the overall economic impacts. Nevertheless, this section makes an attempt to formulate some assumptions and show some changes or constrains that can be associated with membership.

Trade

As a result of previous trade liberalisation and free trade established with the EU as of 2001 (excepting a small share of agricultural products), the trade-creating effects of economic integration have been mostly used (Meisel 2004). The positive impact can be clearly seen both in the dynamic increase of bilateral trade flows and in the share of Hungary on the EU market as well as the EU's share in total Hungarian trade. The latter reached 75 per cent of Hungarian exports and about 60 per cent of Hungarian imports before accession. In consequence of the accession, trade with the new member countries has been added to these figures. As a consequence, in the trade aspect, Hungary became one of the most EU-oriented countries of the EU-25, with an intra-EU share of 83 per cent in exports and about 65 to 70 per cent in imports.

Due to global developments and structural factors (e.g. oil imports from non-EU sources), this high level of EU-orientation can hardly be increased in the future. Nevertheless, it does not mean that bilateral trade will not experience further rapid growth based on the high growth rate of the Hungarian economy, dynamic investment activities (partly supported by EU transfers), and rapidly increasing personal income of a large part of the society. One of the driving forces of this development will be the service sector, due to the advantages offered on the internal market. Another positive impact derives from the already manifest activity of small- and medium-sized Western European firms, as a result of membership and institutional and legal security. Most importantly, however, we expect a substantial increase of trade flows among the new member countries that, as a result of membership, have lost their protectionist trade instruments. According to calculations, the abolition of non-tariff barriers alone could increase trade among the new member countries by 20 per cent a year in the next period.

Integration in the internal market

One of the basic fears of the Hungarian policy-makers and business leaders just before accession was that several companies may be denounced at the Court in Luxembourg due to market-disturbing activities or because of receiving subsidies and state aid not in conformity with the competition rules of the internal market. Up to now, such fears have proven to be exaggerated. This is due to the adjustment made in the last years and months before membership, the serious monitoring process carried out by the Commission in the months before membership, and, probably, also to the (unwritten) "grace period" applied to new members in the early stage of membership.

Evidently, there is an "implementation deficit" in most new member countries in the harmonisation of the complete legislation of the internal market. However, it is rapidly declining, while this deficit is surprisingly stubborn in some "old" member countries despite the fact that the internal market legislation should have been put into force already by the end of 1992. As one of the most recent Commission reports indicates, the new member countries are in some areas even better than most of the old ones. For instance, the rules taken to liberalise the energy market are fully EU-conforming in five countries, including Hungary, Lithuania, and Slovenia, but lagging far behind in e.g. France.

Investments

Hungary has attracted foreign direct investments in the amount of about 40 billion Euros in the last 15 years, both as a result of market-conforming privatisation, green-field investments, and, increasingly, reinvestment of profits made in Hungary. EU membership is expected to have a multiple impact on investment behaviour. First: in some sectors investment needs have already been covered in the last years and companies became fully integrated both into the domestic and international (European) markets and the global subsidiary network of multinational firms. Second, membership is expected to generate a second wave of international (and domestic) investments based on the new legal and institutional framework offered by full-fledged membership and the geographic and economic advantages of Hungary becoming a regional hub for a number of production and service activities. Third: at the same time, EU membership may change the comparative advantages of the country, both as a result of higher costs (e.g. wages) and of fulfilling demanding EU standards (technical and environmental ones and those related to consumer protection). As a result, a more pronounced two-way flow of capital can be predicted, leading to the upgrading of activities in Hungary, both concerning the technology content of production (and services) and the value added produced in the country. Moreover, some Hungarian firms have already become active in the Central and Southeast European region and allocated almost 6 billion Euros to projects outside the country. So-called regional multinational firms (also present in other accession countries) and selected specialised small- and medium-sized companies are likely to turn to regional markets as the EU keeps on enlarging (Havlik et al. 2005).

As a general rule, however, it has to be underlined that it is EU membership that may be the main attracting factor for foreign direct investments. Predictable and future-oriented economic strategy based on the best use of comparative advantages and on the abolition of still existing barriers (e.g. physical infrastructure, human resources, public administration, etc.) is the key to success. EU membership can certainly be helpful. Nevertheless, according to the experience of other countries (see Austria and Sweden); it has neither the charge nor the capacity to replace or iron out the consequences of flawed domestic economic policy decisions.

Business sector

In the last years, the enterprise sector made clear progress on the way to understanding the EU and adjusting to the new conditions. This changing behaviour is particularly well reflected in the rapidly growing number of applications for EU resources. Still, the business sector remained divided after accession. While 62 per cent of Hungarian companies say they have sufficient information about the EU, 18 per cent of firms working only in the domestic market still think they do not need such information because they would not like to export their products or services. This, however, is a big mistake, since firms from other member countries, old and new alike, now have free access to the Hungarian domestic market and can easily become competitors of such Hungarian firms. Otherwise, Hungarian companies' expectations and fears are close to the average of the new member countries. According to data of 2004, 57 per cent are optimistic concerning the impact of EU membership (59 per cent is the average of ten countries), and 24 per cent are pessimistic. Fears are strongest in such sectors as the construction industry, real estate, and business-related services. Some firms expect higher unemployment and increasing flexibility of highly skilled labour, including looking for more rewarding job opportunities in other member countries. Twelve per cent of firms deal with serious financial problems.

Without neglecting the above-mentioned problems, one has to stress that, on average, the microstructure (and competitiveness) of Hungarian firms seems to be healthy, at least in comparison with the rest of Central and Eastern Europe (Fóti 2005).

Integration in the Common Agricultural Policy

It could be expected that agriculture, as a special community policy area, would be in the limelight in the first period after accession (Kiss 2004). In fact, several issues were raised in the first months of membership connected both to the rules of the CAP and to the special, mostly weather-related, conditions in Hungarian agriculture. A short-term general conclusion can be drawn that, as a full member of the Union, a country has greater bargaining power when trying to gain the understanding and support of the Commission (and partly also those of some member states), as compared to its candidate or negotiating status.

The convergence program

As a new member country, Hungary was obliged to present its first convergence program, as proof of being committed to the key rules of the economic and monetary union. It is well known that accession to the EU and to the EMU must have a time gap of at least 2 years, since each member country has to prove its maturity to cope with the EMU criteria within the ERM-2 framework for a period of at least two years. Some new members announced their decision to enter this framework in 2005 (Estonia, Lithuania, Latvia, and Slovenia), with the aim of becoming members of the Euro-zone by about 2007 or 2008. Brussels does not require any fixed year for EMU membership, however, it wants to have a credible convergence schedule containing not only the basic statistical figures that have to be achieved at the given moment but also the policy instruments governing and controlling this process.

Hungary has not entered the ERM-2. The inflation rate in 2005 was higher than the reference level, but it is showing a tendency toward decreasing. The long-term interest rate remains high although moving closer to the prescribed reference rate. Government debt grew from 57.1 percent of GDP in 2004 to 58.4 percent in 2005 and can be considered high. Hungary has a major problem with the government deficit. According to the latest Eurostat data published a few days ago, the government deficit of Hungary (6.1 percent of GDP) is the highest in the European Union. The coming short half-year period will show if the newly elected government is able to present a credible updated convergence programme aimed at reducing the high deficit and at entering the Euro-zone in 2010.

Labour market

In the months preceding enlargement, most EU-15 countries openly expressed fears of massive migration from the new to the old member countries. Hungary has never belonged to those countries with considerable migration potential (unfortunately, flexibility of workforce is very modest even within the country and without any language barrier). The accession treaty has limited the number of potential migrants (workers), not only by the well-known pattern of 2+3+2 years, but also by restrictions in the free movement of services, certainly a more interesting issue for Hungarian businessmen who want to set up new ventures or offer trans-border services in the EU-15 countries. In the future, enhanced migration cannot be ruled out in selected sectors (health care, including both doctors and nurses), but there is no reason for massive migration. In turn, in the first years of membership, requests from other EU citizens to work and settle in Hungary has experienced a rapid increase, mostly in business-related activities, but also in the case of individuals seeking job opportunities (Fóti 2006).

Shaping EU policies

Successful membership in the EU is by far not only a matter of satisfactory accommodation and adjustment to the acquis communautaire and the establishment of adequate institutions. To a large part, success depends on how a member country can fit itself into the everyday operational framework and the decision-making process of the Union.

The accession of Hungary offers a number of excellent opportunities in this respect. In 2005 the EU and the member countries had to take decisions on such vital issues as the common budget starting in 2007 as well as on the process of further enlargement (mainly the issue of Turkey). The elaboration of new rules of immigration policy remains an important task. In the medium run, reforming of the entire integration is on the agenda. This process includes rethinking of traditional policies (as the common agricultural policy), dealing with new challenges generated by relatively new community policies (mainly the economic and monetary union), and also developing future areas of community actions (common foreign and security policy, justice and home affairs, the achievement of the objectives contained in the Lisbon agenda, etc.). As a new member, Hungary was confronted immediately with some of these challenges, while others are expected to come in the near future.

Conclusions

Most politicians and experts and probably also the majority of society agree that the first years following accession, but at least the period between 2004 and 2006, are crucial from the viewpoint of successful membership in the longer term. Some of the pressures and opportunities may be identified, and their effects may be predicted and even measured. Other factors will become obvious in progress. A significant part of the fears and worries are baseless or related to occasional mistakes or late internal measures rather than to EU membership. However, there are two areas where serious problems may arise, indeed. One is the internal budgetary constraint that can be predicted until 2006, which makes it almost impossible to avoid the comprehensive reform of the structure of expenditures, including the transformation of the

Hungarian dominant systems of the national social redistribution. The other area is the level of consciousness of the society, passivity, the blaming of Brussels, and in particular the immediate degrading of any problem related or unrelated to accession to the level of domestic or party politics. It is obvious that a passive and artificially divided society cannot take advantage of membership or has to pay an extra price for it, and the convergence process thus takes more time than would be necessary otherwise.

In order to avoid the above situation, the following is required during the first years of membership. (a) The available EU resources should be utilised as fast and efficiently as possible, (b) some spectacular projects serving economic development should be launched, and (c) Hungary should get actively and successfully involved in the formation of community policies whether concerning global reforms towards competitiveness or the development of new policy areas of integration.

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Some negative aspects of the EU enlargement and their impact for Estonia

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1. Some theoretical positions about negative impacts of the European Union's Eastwards enlargement

Beside numerous positive impacts of the EU eastward enlargement, analysts should not forget some of the negative impacts. As other authors of this publication have already stated, the impact of the EU eastward enlargement on West European countries consists primarily of the opening of markets. This will bring cheap products and services from Eastern to Western Europe and redistribute a portion of income in favor of the new member countries. The opening of markets increases the effectiveness of direct investments and stimulates economic growth effects in the whole of Europe. (R. Baldwin, 1994). But this might also increase nationalism and social tensions in some member countries which are not ready for really free movement of goods, services, people, and capital.

In some Eastern European countries a major part of the economy is based mostly on subcontracts with Western European companies. Western firms have invested heavily into the Eastern part of the EU and have also introduced new technologies. Consequently, western firms have made new member countries very much dependent on foreign direct investments. But an increase in the price of labor and a rise in taxes in the new member countries may result in a diminishing of foreign direct investments and moving them into non EU European and Asian emerging markets.

The opening of most of the West European labour and services markets to East Europe from May 2006 also introduced quite a large area of social problems and tensions among EU member states.

EU structural funds have clearly been oriented to promote greater economic and social coherence. Coherence is generally intended to mean bringing the average income levels (GDP per person) closer together. But a long history of using these funds has shown that only a few countries, like Ireland, are able to use the monies of structural funds efficiently. Some other countries have very often wasted common money, or made only very little progress in using this money. Since the EU new budget period started in 2007 the money which has so far been used mainly to fund projects in Greece, Portugal, and Spain will be reallocated in large part to the new EU member countries and territories; there is no guarantee that this money will be used better than it was by the old member countries as new member countries want to use this money mainly for solving their social problems and not so much for real structural policy, which will make economies of these countries more competitive and knowledge based.

Still the biggest part of the EU budget is spent on agricultural producers for implementing the common agricultural policy (CAP). Eastwards enlargement will increase the EU foodstuff over-supply, raise the expense of the agricultural policy, and force the EU to reform the CAP. The still huge expenses for agricultural policy on the EU and national levels suppress the increase of EU economic competitiveness. The CAP would result in extensive financial transfers to all farmers from the taxpayers in the EU old member states, as they are the biggest contributors to the EU budget, and from consumers in the new member states, as prices for agricultural products will increase first of all in the new member countries.

The cost of the EU eastwards enlargement will primarily be paid by the old member states. It would be logical if these costs were distributed more or less equally among all the old member states. Unfortunately, this is not possible. Most probably the burden of eastwards enlargement will fall mainly on the shoulders of the poorer old members, as they will lose a large portion of structural funds money. Rich countries have moved to cut their contribution to the EU budget, which is now limited to 1.045 % of the EU GDP.

As some large EU countries are still keen to keep the present CAP, it cannot, therefore, be excluded that a coalition of these countries could block CAP reforms in the near future and even after 2013. This might mean the end to further EU enlargement. Some old member countries did this already through non-ratification of the EU Constitutional Treaty. There was need to reform the CAP before the EU eastward enlargement.

Furthermore, enlargement of the European Monetary Union will be a big risk for the stability pact and for the Euro, especially if new poor members are quick to join the Euro zone. A number of prominent economists, including Nobel Prize winner Milton Friedman, have predicted the collapse of the monetary union without a political union and the lack of powers to sanction countries failing to improve economic performance.

In conclusion, large and ambitious eastward enlargement happened, but it has weakened the capacity of the EU for further enlargement and for raising the competitiveness of the EU economy.

2. Two years on in Estonia. Some negative impacts of the EU accession

EU accession was harmful for Estonia's liberal trade policy. Estonia was obliged to establish common customs duties and quotas for such previously relatively cheap goods as sugar, metals, cereals, motor vehicles, and cotton. As a result, goods imported from third countries (Russia, Ukraine, USA, Japan, China, India, Korea, etc.) increased. But nobody ever even estimated that a nearly triple increase in prices for sugar would be followed also with a sugar penalty for Estonian producers and traders for so called extra storage resources.

Estonian free trade agreements with Ukraine and some other countries were terminated. As the Europe Agreement was already advantageous to the EU, the accession agreement never said any word about compensation for Estonia's present day less favourite trade conditions. Actually Estonia joined the economic zone with less trade and other economic freedoms than Estonia had before, but nobody ever even asked for compensation of these losses.

According to the economic freedom indices, calculated by Fraser Institute and Heritage Foundation, Estonia still belongs to top ten list, apparently the highest that Estonia has received in respect to indicators reflecting various aspect of its economic development. But both of them have indicated some decrease of economic freedoms during first years of EU membership.

Due to the harmonization of the tax policy in the EU, Estonia was forced to increase some prices for consumer goods. The requirement to end VAT tax exemptions and tax reductions increased prices for newspapers and other publications, heating services, and tickets for cultural events. Further tax increases are expected for tobacco, heat, and fuels.

The rapid convergence of economic development and the high growth rates may be considered as wholly positive, but the rapid convergence of price and tax levels, however, may result in aggravating social problems. The first signs of these problems are already present. Catching up with Europe has put first of all men under the pressure, they experience high level of stress. Many of them are not able to handle the challenge and as result drop out: into hospitals, prison, alcoholism, drug addiction etc. For example the life expectancy at birth for men in Estonia is only 65, 8 years, the lowest figure among all EU member countries. Currently HIV-positive individuals make up 1,3% of Estonia's adult population, which is even by far highest figure among EU countries (Heidmets, 2007).

Estonia was obligated to ensure free movement of capital and the opening up of real estate markets to all member states from the date of accession. This produced enormous growth in real estate markets, followed by an increase in prices. According to some calculations, nearly one quarter of Estonia's GDP growth originated in this artificial growth, which is not sustainable even in the near perspective? As a result, a significant part of Estonia's real estate, houses, flats, and land, especially in Tallinn and the island of Saaremaa, is owned by foreigners or is under their control. As the prices of land and other real estate in Estonia are still many times lower than in neighbouring Finland

and Sweden, this situation is favourable for financial speculations. The rapid increase of prices for real estate will keep even families with an average income in Estonia away from real estate markets as they have problems in getting loans. More than that, a big portion of poor people is forced to sell their real estate properties for everyday living expenses. According to the Eurostat survey, at risk of poverty rate (18 %) in Estonia is one of the highest in the EU.

Unfortunately no one has analyzed whether the EU half closed labour and services market is damaging or, on the contrary, profitable for Estonia, taking into account Estonia's demographic and labour market situations.

Already more than 15 thousand Estonian citizens are officially living in Finland. A total of 1,692 Estonian citizens got working permits during the first 8 months after the EU accession. The number of the Estonian workforce in the United Kingdom is already at over 4 thousand, and in Ireland nearly 3 thousand. These people are mostly highly skilled construction and transport workers and medical personnel. They left Estonia mostly with the aim to earn a higher salary abroad. As a result, in Estonia there is a large shortage of construction workers and bus drivers, and medical staff is overextended.

Estonia's accession to the European Monetary Union requires, on the one hand, that Estonian prices be comparable to EU average prices. But rising to the EU average level of prices also presumes a growth in income in at least the same tempo. Price convergence would need a certain level of income convergence, but the state has no financial means to ensure this for low paid and unemployed people. Entering the EMU presumes, in turn, low inflation and stability of prices. Price and income convergence, and accession to the EMU, are intrinsically contradictory aims and therefore difficult to carry out.

Estonia's EU accession treaty cannot guarantee continuation of the Estonia's high level of economic freedoms and liberal tax policy. The inevitable consequence of the obligatory implementation of the EU bureaucratic economic policy has already increased the number of civil servants in Estonia. The number of civil servants needed to manage agriculture has nearly doubled. Full implementation of the EU agricultural, environmental and some other expensive policies will decrease the competitiveness of the Estonian economy.

To protect successful economic policy Estonia should ask to renegotiate the accession treaty and ask for more transition periods and derogations, which would preserve for Estonia, in some fields, a greater economic freedom or compensation for less favourable economic conditions in the European Union.

Long transition periods are needed especially in taxation, agricultural, and environmental policy, in order to maintain attractiveness for foreign investors. The subsequent principle for economic policy might be that harmonization is carried out to the extent that is minimally required.

Estonia abolished the corporate income tax for reinvested profit in 2000. As a result, foreign direct investments grew rapidly. Nearly half of these investments originated from reinvested profit during the last years. According to the accession agreement, Estonia must abolish such a corporate income tax system before 2009. Estonian political parties and civil servants will most likely have serious problems with defending low corporate and personal income taxes in the EU. Only a very few EU member countries support the idea of tax competition inside the EU and share the logic that low corporate, excise, and other taxes are needed to attract foreign capital and keep economic growth rates high.

3. Further EU enlargement and possible negative impacts for Estonia.

Different governmental sources estimate that the EU accession aid to Estonia, mainly from the EU Structural Funds and Cohesion Fund, may last tens of years at a rate as large as a maximum 4% of Estonia's GDP, initially up to 6 billion croons annually. But one should not forget that EU enlargement continuously involves a big group of poorer countries, first of all Bulgaria, Romania, and Turkey, so the average level of GDP will drop drastically already in 2007, and Estonia may fall outside the support fund category more quickly, already by 2014.

Estonia' present model of economic development is closer to the liberal free market model of capitalism than to the European social-democratic model of the welfare state. Today we see rising economic nationalism and a fight between these two basic models. If Europe is not able to move towards a more liberal model of market economy, then Estonia will lose its comparative advance, and economic growth will soon decrease. Implementing of all EU over-regulated economic policies with more than 24 thousand regulations, directives, and court decisions means giving up a part of Estonia's present economic achievements, and one of the most competitive new economies in Europe will fall apart.

4. Conclusions

The first two years of membership in the EU generally bolstered Estonia's political and economic development, bringing new opportunities and new threats. The biggest opportunity is to become richer than now through foreign direct investments and getting resources from the EU structural funds. But the biggest threat is to lose Estonia's liberal economic environment and became a boring, relatively poor EU country.

As Estonia's accession to the EU is in many aspects unique, international cooperation of politicians and social scientists might bring very interesting results not only for Estonia but also for the whole of Europe in terms of finding new models for building modern societies, more effective ways of integration of Central and East European countries into the Western World, and increasing competitiveness of European economies.

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The Kaliningrad region before and after the EU enlargement[1]

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1. Introduction

The rapid economic transition of the Baltic States and Poland along with their recent EU memberships raises the question, has the Kaliningrad region[2] benefited from the EU coming to its borders or has the region suffered from the EU enlargement? In this short report, the author aims at answering the question, what is the socio-economic impact of the EU's latest enlargement upon the Kaliningrad region?

The study focuses on analysing change in the region's foreign trade and foreign investment, due to the fact that the region's external economic relations are likely to experience changes earlier than the rest of the economy. Here, one should keep in mind that major changes in economic behaviour do not occur overnight, and hence, one is only able to analyse the immediate impact of the Union's expansion on Kaliningrad. One should not forget that

[1] This article is based on the report prepared for the Russian-European Centre for Economic Policy (RECEP). The author gratefully acknowledges the contribution of the interviews, discussions and meetings, which took place during the expert period. The author wishes to thank all the persons involved in the research process. Special thanks go to Marina Cherkovets (RECEP), Sergey Prihodko (Institute for the Economy in Transition), Christer Pursiainen (RECEP), and Vitaly Zhdanov (the Administration of the Kaliningrad region). The views expressed in the article do not necessarily represent those of the RECEP, its funding organisation or opinions of those persons, who were interviewed, discussed or met.

[2] In the report, the terms 'the Kaliningrad region' and 'Kaliningrad' are used interchangeably.

some immediate reactions to the enlargement are probably only temporary ones. Furthermore, it is extremely important to keep in mind that just a year has passed since the enlargement occurred, and therefore, all the necessary statistical data is not available yet.

Before one is able to deal with the two aforementioned research objectives, one should have a look at the economic potential of the Kaliningrad region prior to the EU expansion. An overview of the region's economic potential is necessary to comprehend the true impact of the EU enlargement.

2. An overview of the Kaliningrad region's economy

2.1.The economic potential of the Kaliningrad region prior to the EU enlargement

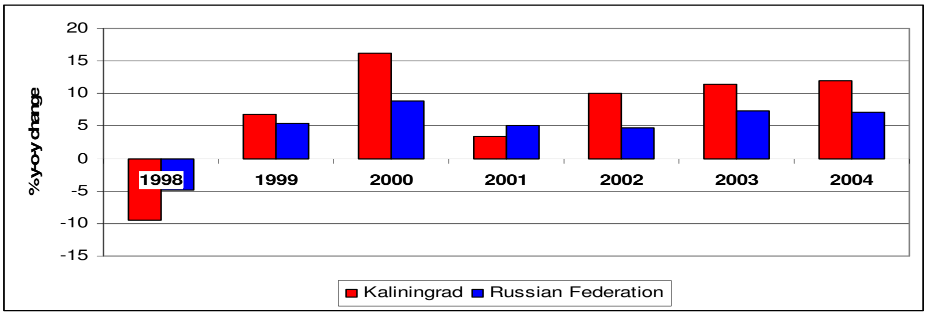
Russia's economic slowdown in the 1990s had major consequences for Kaliningrad. By 1999, the region's industrial production fell by over 60 per cent compared with 1990, as old production and trade relations were eroded. Since then the Kaliningrad region has rapidly started to recover.

During the past three years, the Kaliningrad region has grown considerably faster than the Russian Federation as a whole. Annual GDP growth rates in Kaliningrad have exceeded 10 per cent during the period 2001-04, whereas economic growth in Russia has remained between 4-7 per cent. If the Kaliningrad region manages to maintain such a high growth rate, the region is able to meet the ambitious goal of doubling its economic size in 10 years [1] Should the growth of the 2001-04 continue, Kaliningrad is already able to

[1] Note: an annual growth rate of 7.2% is required to double the GDP in 10 years.

double its regional GDP by the end of this decade. However, in order to maintain such a high growth rate, the regional companies need more energy, since energy bottlenecks are already currently slowing down the economic growth (see Table 1)[1].

Table 1. Annual GDP change in Kaliningrad and Russia, % y-o-y



**Source: Pan-European Institute (2002-2005a)*

Despite Kaliningrad's impressive growth, some statistics produced by the Russian statistical service (Rosstat) suggest that the living standard in Kaliningrad is lower than in Russia on average. For instance, Kaliningrad's average monetary income in June 2005 was RUR 6571 (EUR 187), approximately 85 per cent of the Russian average. The passenger car intensity and meat consumption per person, however, give an opposing picture of the region's living standard. When using these material wellbeing indicators, Kaliningrad outperforms many Russian regions. Furthermore, the

[1] The planned North European Gas Pipeline may aid the energy shortage of Kaliningrad. The planned capacity of the two-string pipeline is 55 bn cubic metres per year, and the first 27.5 bn cubic metre string is to be commissioned in 2010. The over 1200 km long pipe will cost approximately USD 4 billion. Offshoots might be built to link the pipeline with Kaliningrad. The timetable of the plan seems ambitious, though not unrealistic. Even prior to the accomplishment of the planned pipe, the growing energy needs of the Kaliningrad companies must be met in one way or another. Here one should stress that the energy producing units of Kaliningrad should not export energy if it results in energy shortages in the region.

author's own observations in various Russian regions lead him to think that the Rosstat data is not fully able to describe the true picture of wellbeing in Kaliningrad, probably due to a large chunk of unrecorded economy, and therefore, the real living standard in Kaliningrad is most likely higher than in Russia on average (Liuhto et al. 2004 and 2005).

Kaliningrad ranks as the 37th among 89 Russian regions[1] in terms of its investment potential. The region's infrastructure, its transport infrastructure in particular, is highly developed by Russian standards. For example, Kaliningrad has Russia's only ice-free ports on the Baltic Sea shore. In addition, the Pan-European Transport Corridors 1A and 9D go through the region. Therefore, it is not surprising that Kaliningrad ranks 3rd after St. Petersburg and Moscow in terms of its infrastructure potential. On the other hand, the region's labour, financial, production, innovation, and consumption potentials are somewhat lower than the Russian average (see Table 2).

Table 2. The investment potential of Kaliningrad among Russia's 89 regions

Investment potential 2003-2004	37
Change from previous year (a deterioration of 2 positions)	-2
Infrastructure potential	3
Institutional potential	29
Natural resource potential	40
Labour potential	52
Financial potential	52
Production potential	53
Innovation potential	54
Consumption potential	58
Investment risk 2003-2004	22

**Source: Expert 2004*

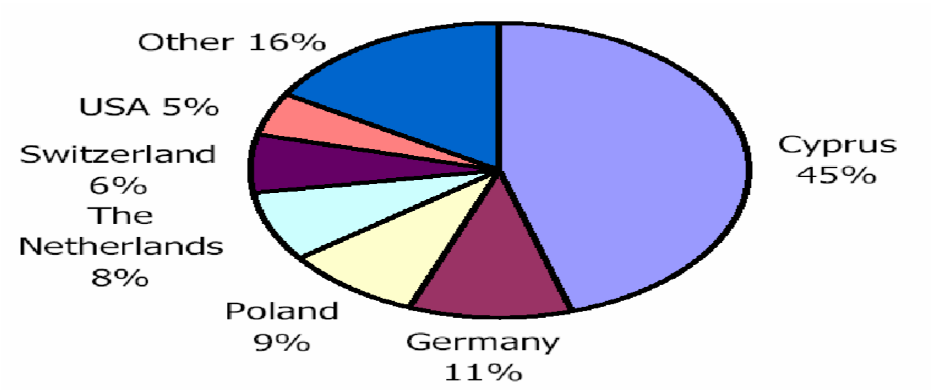
[1] The number of the regions in Russia has been reduced since this ranking was conducted.

Relatively low investment potential is one of the reasons why the amount of foreign investment in Kaliningrad is relatively modest. The region accounts for not more than 0.2 per cent of the foreign investment stock of the Russian Federation. The aforementioned stake is even lower that Kaliningrad's share in the Russian GDP, 0.4 per cent. This indicator suggests that Kaliningrad does not perform as well as the country as a whole in attracting foreign investment. This implies that Kaliningrad has not succeeded in putting to full use its geographical proximity to the EU or the SEZ to attract foreign investments there.

Kaliningrad's accumulative foreign investment inflow amounted to nearly USD 300 million by the end of 2003. In 2003, Cyprus, with a 45-per cent share, was the largest investor in the region, indicating that the major part of 'foreign' investment originates from Russia. If one excludes 'Cyp-Rus' investment from the foreign investment stock, the major foreign investors come from Germany, Poland and the Netherlands. The active presence of Cyprus, Germany and the Netherlands in Kaliningrad is not a surprise, since they are also among the leading investors in the Russian Federation as a whole (Pelto et al. 2004).

Similarly, Poland's presence in Kaliningrad is anything but unexpected due to her geographical proximity. Lithuania's absence from the list of the main investors in Kaliningrad indicates that Lithuanian firms have concentrated more on less-capital intensive business operations, mainly on trade and services, rather than on industrial production, as the number of Lithuanian firms in Kaliningrad is noteworthy. Here, one has to remember that companies based in the neighbouring countries may utilise the opportunities of the target region without investing there, which may also explain the modest investments of Lithuanian firms in Kaliningrad (see Table 3).

Table 3. Foreign investment inflow to Kaliningrad in 2003 by country



**Source: Pan-European Institute 2005a*

Here, one should not forget that Lithuania and Poland are not major capital-exporting countries. Their combined outward foreign direct investment stock is less than USD 2 billion, i.e. Lithuanian firms have invested abroad only USD 0.1 billion and their Polish counterparts USD 1.8 billion. The outward investments of Lithuania and Poland are clearly smaller than those of the Nordic countries. Denmark, Finland and Sweden have invested USD 77 billion abroad, USD 69 billion and USD 189 billion respectively. Russia’s own investments abroad amount to over USD 50 billion (UNCTAD 2004; Vahtra & Liuhto 2004).

Kaliningrad’s foreign trade has developed extremely positively. In 1992, Kaliningrad’s foreign trade amounted to not more than USD 0.14 billion. In 2003, their turnover has become nearly 20 times larger. In 2003, the region’s imports were valued at USD 2.1 billion and the exports USD 0.6 billion. The sales of Kaliningrad to the Russian mainland amounted to USD 1.1 billion. Then, Kaliningrad's sales to the Russian mainland were over a half, compared with the region's imports. The aforementioned ratio stresses the great importance of the SEZ in boosting Kaliningrad's sales to the Russian mainland[1]. The region's import structure and the list of the main importers confirm the above conclusion (see Table 4).

Table 4. The largest importers of the Kaliningrad region in 2003[2]

Rank	Company	Field of operation	Share of region's total imports
1.	Telebalt	Electronics	5.9%
2.	Avtotor	Automobiles	5.2%
3.	Promexportimport	Household appliances	2.6%
4.	Interfood	Foodstuffs	2.4%
5.	Lukoil-Kaliningradmorneft	Oil business	2.3%
6.	Agerratum	Foodstuffs	1.7%
7.	Stella Plus	Electronics	1.4%
8.	Sodruzhestvo Kargo	Material for fodder	1.3%
9.	Podonit Plus	Black metallurgy	1.1%
10.	Produkty Pitanya	Foodstuffs	1.0%
Total of 10 major importers			**24.9%**

**Source: Liuhto et al. 2005*

Kaliningrad plays an important role in the Russian Federation's foreign trade, especially in the country's imports. The region accounts for 4 per cent of the country's total imports, though the population of the region covers only less than 1 per cent of the federation's population and less than a half percentage of the country's GDP.

[1] One of the peculiarities of the Kaliningrad SEZ is the imposition of regional import quotas. Beginning in 1998, about 35 categories of goods are subjected to import quotas (Vinokurov 2004a).

[2] Lukoil is at the moment Russia's largest oil producer. In August 2005, it produced 1.76 million barrels per day. The volume of Lukoil-Kaliningradmorneft's oil production constitutes 0.7-0.75 million tonnes per year. Most of its production is exported.

It is natural that the foreign trade intensity of a small economy, especially when it is geographically located apart from the mainland, becomes high[1]. However, Kaliningrad's current SEZ, based on customs privileges, is a more important factor than its exclave[2] position or small economic size in explaining the region's high import intensity[3]. The aforementioned argument can easily be explained by comparing the region's proportion of the Russian Federation's total imports and exports.

The region accounts for 4.0 per cent of the Russian Federation's imports, whilst merely 0.4 per cent of the country's exports. Such a high import share cannot only be explained by the exclave position or the small size of the regional market. Correspondingly, the region's export share corresponds to its GDP share, suggesting that Kaliningrad is not a particularly export intensive region. The low export intensity refers to the relatively weak competitiveness of Kaliningrad-based goods abroad. Here, one should not forget that improving the external competitiveness of goods via the SEZ is a much more demanding task than that of improving their internal competitiveness, i.e. the competitiveness of Kaliningrad-produced goods inside Russia (see Table 5).

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[1] The ratio of Kaliningrad's foreign trade over its GDP was 160% already in 2003 (Usanov et al. 2005).
[2] Kaliningrad is a semi-enclave of the EU as it is not fully surrounded by the Union because Kaliningrad has access to the Baltic Sea.
[3] The non-CIS imports per person are clearly higher in Kaliningrad than in any other Russian region (Liuhto et al. 2004).

Table 5. The Kaliningrad region in the Russian economy

	Kaliningrad's share of the Russian total
Basic facts	
Area	0.1%
Population	0.6%
Economy	
Gross domestic product	0.4%
Industrial production	0.5%
Retail trade	0.5%
Enterprise population	0.9%
External economic relations	
Exports	0.4%
Imports	4.0%
Foreign investment	0.2%
Number of companies with a status of "a firm with foreign capital"	2.0%

**Source: Rosstat 2004*

2.2. Kaliningrad in international comparison

Kaliningrad's economic recovery seems less glorious when compared to Poland or particularly to the Baltic States, which belonged to the same country less than 15 years ago. The table below shows that the GDP per capita in Kaliningrad is less than a half of that in Latvia, which has the lowest living standard amongst the Baltic States.

Kaliningrad succeeds better with its external economic relations. Its exports per capita are already two thirds of that of the Latvians, and its imports per capita are higher than in Latvia and Poland. When analysing Kaliningrad's high import intensity, one should naturally remember that a great part of the region's imports are finally targeted to the Russian mainland, which distorts the aforementioned comparison.

The weak performance of the Kaliningrad region becomes more obvious, when analysing the region's attractiveness in the eyes of foreign investors. The FDI stock per capita in Latvia, Lithuania, and Poland is 5 times that of Kaliningrad. The gap between Estonia and Kaliningrad is even wider – 20 times (see Table 6)[1].

Table 6. A comparison of the Kaliningrad economy with its neighbourhood in 2004 (at current prices)

	Kaliningrad	Poland	Estonia	Latvia	Lithuania
GDP (€ billion)	1.9	195.2	9.0	11.0	17.9
Exports (€ billion)	0.9	60.0	4.7	3.2	7.5
Imports (€ billion)	2.5	71.6	6.7	5.6	9.9
FDI stock 2003 (€ billion)	0.2	42.6	5.3	2.7	4.1
Population (million)	0.945	38.174	1.351	2.319	3.446
GDP per capita (€)	2011	5113	6662	4743	5194
Exports per capita (€)	952	1572	3479	1380	2176
Imports per capita (€)	2646	1876	4959	2415	2873
FDI stock per capita 2003 (€)	212	1116	3923	1164	1190

**Sources: UNCTAD 2004; Eurostat 2005; Statistics Lithuania 2005; Pan-European Institute 2005b*

The gap between the Kaliningrad region and its neighbours becomes narrower when Kaliningrad is compared with the Lithuanian or Polish regions bordering it. This is mainly due to the fact these Lithuanian and Polish regions do not generally perform as well as other regions in these countries. GDP per capita in Warminsko-mazurskie and Podlaskie, the Polish regions bordering Kaliningrad, is 'only' double that of Kaliningrad.

[1] The FDI figure for Kaliningrad contains all foreign investments, including foreign loans and portfolio investments, in the Kaliningrad region. In addition, one has to remember that a great part of the 'foreign' investments are Russian by origin. This naturally distorts the comparison of Kaliningrad with its neighbouring countries, as it exaggerates Kaliningrad's FDI attractiveness.

Correspondingly, the Lithuanian regions bordering Kaliningrad – Klaipeda, Marijampole and Taurage – have a GDP per capita 25-150 per cent higher than in Kaliningrad.

Though Kaliningrad's GDP per capita is lower than in the surrounding regions, the official employment situation in Kaliningrad is better. The unemployment rate in Kaliningrad is only 6.2 per cent, measured by the ILO standards, whereas the unemployment rate of Warminsko-mazurskie and Podlaskie is clearly over 15 per cent. Lithuania's regions bordering Kaliningrad have lower unemployment rates, 6.9-12.7 per cent, than Poland's eastern parts. Kaliningrad's narrow labour potential, together with these relatively high unemployment rates in the surrounding regions, has created a rather interesting phenomenon, i.e. a labour movement from Lithuania and Poland to Kaliningrad. Kaliningrad companies, particularly those in electronics and other advanced fields, search for qualified experts abroad (see Table 7).

Table 7. A comparison of wellbeing in Kaliningrad and its surrounding regions

	Kaliningrad	Warminsko -mazurskie (Poland)	Podlaskie (Poland)	Klaipeda (Lithuania)	Marijampole (Lithuania)	Taurage (Lithuania)
GDP / capita (€)	2011 (2004)	3871 (2002)	3992 (2002)	5039 (2003)	3186 (2003)	2520 (2003)
Unemployment	6.2% (2004)	19.7% (2004)	16.4% (2004)	12.7% (2004)	6.9% (2004)	8.9% (2004)

Such a wide gap between Kaliningrad and its bordering regions underlines the fact that the economic activities across the border are below their potential due to the barriers hampering cross-border business activities from taking place. To put it differently, Kaliningrad would definitely benefit from lowering the economic border between Kaliningrad and its surrounding areas.

To sum up, when comparing Kaliningrad with its neighbours, one should take into account methodological differences in producing statistics between the EU and Russia, the large size of the unrecorded economy in Kaliningrad and the exchange rate issues, which prevent one from producing a precise comparison. The author's own experience in travelling in Kaliningrad and its bordering regions in Lithuania and Poland suggests that the real living standard gap is perhaps not as wide as the statistics may indicate.

3. The external economic relations of Kaliningrad after the EU enlargement

In 2004, the trade between the EU and Russia increased substantially. Particularly the EU15 managed to increase its trade turnover with Russia by approximately USD 25.3 billion. The new members' trade growth was more modest, some USD 5.5 billion. The trade growth can mainly be explained by the high prices of natural resources and increasing consumption in Russia, which has kept Russia's imports going up since 1999. In 1999, Russian imports amounted to only USD 40 billion, whereas 5 years later they were almost 2.5 times higher. During 1999-2004, the country's exports have jumped from USD 75 billion to close to USD 185 billion. The volume growth in the EU-Russian trade and the structural change in trade have been much less impressive.

Even today fuel and metals cover over three quarters of Russia's exports. Machinery and equipment represent less than 5 per cent of the total exports.

Correspondingly, consumer goods continue to dominate Russia's imports. Machinery and equipment already account for over 40 per cent of the total imports. Unfortunately, much of the machinery is not investment goods but consumer products, such as passenger cars and cellular phones. In fact, in the first quarter of 2005, the fastest growth was registered in car imports; the number of foreign cars imported into Russia jumped by almost 70 per cent.

In addition to an increase in the prices of natural resources, the enlargement per se has also had a direct impact on EU-Russian trade. The EU's share of Russian foreign trade jumped by more than 10 percentage points, as a result of their 10 new members. Last year, the EU covered approximately half of the country's foreign trade (see Table 8).

Russia is the fifth largest trading partner for the Union, with a share of 7.6 per cent of the Union's imports and 4.4 per cent of exports (Karaganov 2005). The enlargement did not cause a strategic change in the geographical division of the EU's foreign trade, since the foreign trade of the 10 new members with Russia is rather modest. Poland with her 3-per cent share in Russian foreign trade is clearly the main partner among the new members. In this context, it is necessary to mention that the share of the EU15 in Russia's foreign trade has remained unchanged after EU enlargement, but the share of the new members has diminished from 13.2 per cent to 11.7 per cent. All in all, despite the strong growth in EU-Russian foreign trade, one should not argue that an immediate strategic shift would have taken place in the trade between the EU and Russia.

Table 8. Russia's foreign trade before and after the EU's enlargement in 2004

	Share before enlargement (% - 1-4/2004)	Share after enlargement (% - 5-12/2004)	Change in trade (USD mn - 2003/2004)
Austria	0,9	0,7	213
Belgium	1,1	1,2	980
Cyprus	**2,8**	**2,0**	**1198**
Czech Republic	**1,3**	**1,2**	**461**
Denmark	0,4	0,5	406
Estonia	**0,7**	**0,7**	**181**
Finland	3,6	3,0	1984
France	2,9	2,9	1659
Germany	9,3	9,3	5342
Greece	0,6	0,5	339
Hungary	**1,6**	**1,5**	**543**
Ireland	0,6	0,3	-261
Italy	5,7	6,0	4354
Latvia	**0,7**	**0,6**	**325**
Lithuania	**1,4**	**1,3**	**800**
Luxemburg	0,0	0,1	99
Malta	**0,1**	**0,0**	**43**
Netherlands	6,6	6,4	6691
Poland	**3,3**	**3,1**	**1675**
Portugal	0,2	0,3	582
Slovakia	**1,0**	**1,1**	**229**
Slovenia	**0,3**	**0,2**	**58**
Spain	0,8	1,1	551
Sweden	1,2	1,3	1033
United Kingdom	2,8	3,1	1342
EU15	36,7	36,7	25315
EU25	(49,9)	48,4	30827
CIS	17,9	18,5	13471
China (excl. Taiwan)	6,5	5,7	3283
Japan	2,9	2,9	3059
USA	3,2	4,0	2605
TOTAL	100	100	66120

**Source: Customs Russia 2005*

The foreign trade of the Kaliningrad region developed very positively last year. Kaliningrad's foreign trade turnover reached in 2004, nearly USD 4.5 billion, a growth of over 60 per cent compared to 2003. The first half of this year shows that the strong growth continues. During the first six months of 2005, the foreign trade turnover of Kaliningrad has increased by nearly 60 per cent. Particularly, Kaliningrad's exports have skyrocketed. In 2004, they doubled and extremely fast growth seems to continue. Imports are growing at a lower pace. In the first half of 2005, they increased by some 35 per cent (see Table 9).

Table 9. The trade flows of the Kaliningrad region, USD million

	2000	2001	2002	2003	2004	1H/2005
Exports of goods (A)	475	455	471	574	1264	884
Imports of goods (B)	875	1047	1610	2142	3198	1710
Sales of Kaliningrad goods to the Russian mainland (C)	424	619	759	1118	1802	1048
Ratio A/C	1.12	0.74	0.62	0.51	0.70	0.84
Ratio B/A	1.84	2.30	3.42	3.73	2.53	1.93
Ratio C/B	0.48	0.59	0.47	0.52	0.56	0.61

**Sources: Pan-European Institute 2005a, Kaliningrad Statistics 2005*

The high peak in exports is not directly linked with the EU enlargement. The growth in exports in 2004 was mainly due to the large increase in the export of oil and oil products (by 2.8 times) and machinery (by 2.2 times). This was chiefly due to companies from other regions in Russia channelling their exports through Kaliningrad so that they were registered as Kaliningrad's exports. The proportion of Kaliningrad's own firms in the value of exports was approximately 50 per cent. One should keep in mind that energy and machinery account for over 60 per cent of the region's exports .[1]

The use of the Kaliningrad region in minimising export taxes and duties casts some shadow over the new SEZ, as it suggests that the artificial exploitation of tax breaks may continue, if the SEZ is not controlled carefully. On the

[1] A further study on the development of Kaliningrad's machinery exports should be carried out, since it might reveal, how some Kaliningrad-based companies have succeeded in upgrading their exports, while the Russian exports as a whole suffers from the overwhelming dependency on the exports of natural resources. Kaliningrad's success could be copied also elsewhere in Russia.

other hand, the impressive growth in machinery exports is a very encouraging fact, as Kaliningrad may show the rest of the Russian Federation a way how to decrease the natural resource dependency in exports.

In 2004, Kaliningrad's imports increased by USD 1 billion, a growth of nearly 50 per cent. Such a tremendous jump is not a novelty in the Kaliningrad region, since the annual growth of imports has remained between 20 and 54 per cent during the whole decade. The EU enlargement has not changed the structure of the region's imports. In 2004, materials linked with machine building and foodstuffs accounted for two thirds of the region's total imports. The structure was practically the same a year earlier.

Last year, Kaliningrad's sales to the Russian mainland reached the record high, USD 1.8 billion, being almost over 60 per cent higher than a year earlier. The sales to the mainland are very concentrated. Three products – TV's, meat and fish products – account for 40 per cent of these sales. It is important to notice that sales to the mainland have increased faster than imports to the region. Therefore, the ratio between the mainland sales and the region's imports reached a record high in the first half of 2005. The aforementioned ratio illustrates the 'old' SEZ is not only a transit region to the Russian mainland, but an increasing amount of value adding takes place in the region.

One should also notice that the region's imports were double the exports in the first half of 2005. In 2003, imports exceeded exports by almost four times. In other words, Kaliningrad's external trade has become more export-oriented. In addition, one should notice that the exports have rapidly caught up with that of sales to the Russian mainland. The ratio between their real exports and 'the mainland exports' is over 80 per cent. This is a great achievement, since in 2003 this ratio was barely over 50 per cent. Though the 'old' SEZ has contributed positively to the increase in the region's exports (e.g. subcontracting with foreign firms in electronics), the SEZ is not the major explanatory variable for increasing exports but rather the increase in energy prices.

Kaliningrad's foreign trade is understandably more orientated to the EU than that of the Russian Federation. Clearly over two thirds of Kaliningrad's foreign trade is conducted with the EU, whereas the EU covers a half of the foreign trade of whole Russia. The geography of Kaliningrad's foreign trade has not significantly changed when one compares the years 2003 and 2004. The leading troika have kept their places, i.e. Germany, Poland and Lithuania were still the region's main trading partners in 2004. Together they formed 37 per cent of the region's foreign trade. A year earlier, their combined stake was three percentage points higher. Last year, France became Kaliningrad's fourth largest trading partner, as its trade with Kaliningrad increased by an impressive 500 per cent. Kaliningrad's trade with the Netherlands, the region's 5th largest trade partner, almost tripled, probably due to high oil prices. Despite the EU enlargement, the Kaliningrad region's foreign trade with Belarus jumped from USD 120 million to nearly 150 million, making Belarus the 6th largest trade partner for Kaliningrad. Sweden's trade with Kaliningrad collapsed in 2004 when compared to 2003, from USD 140 million to USD 60 million respectively. The collapse has probably nothing to do with the enlargement per se. The trade value of the 8th largest trade partner (nearly USD 50 mn), Denmark, remained practically unchanged in 2004, compared to a year earlier.

Non-legal foreign trade activity across the Kaliningrad border, i.e. shuttle trading, was vivid prior to the enlargement. Vinokurov (2004a, 15) wrote prior to the enlargement as follows: “since Polish and Lithuanian borders have become external borders of the Union, stricter customs regimes will most probably cause lower volumes of black and grey trade on the borders. Certainly, as long as heavy price imbalances exist, this kind of border trade (cigarettes, vodka, spirit, gasoline) will not vanish entirely, but their volume must shrink considerably. In the long run this may be judged to be a positive phenomenon, but in the short and medium term, it will create enormous difficulties for an estimated 20,000 to 40,000 families in the region that currently make a living on shuttle trading. This would create an extremely serious structural problem at the regional level because a disproportionate part of these families live in smaller border towns where other employment possibilities are severely limited.”

Even if no statistics on shuttle trading exist, it seems obvious that the shuttle trading has decreased after the enlargement due to new regulations and stricter control at the borders[1]. However, it is difficult to believe that the socio-economic impact of decreasing shuttle trading would have been as dramatic as has been indicated by Vinokurov, since the estimation that 20,000 to 40,000 families, i.e. 50,000 to 100,000 Kaliningrad citizens, would

[1] In mid-September, Itar-Tass (2005) reported that as of the beginning of the year, Kaliningrad frontier-guards have confiscated more than 200,000 packets of cigarettes to the total sum of two million roubles. The main part of them was to be smuggled into neighbouring Lithuania.

have been dependent on shuttle trading prior to the enlargement is indisputably too high. The aforementioned estimate would have meant that 5-10 per cent of the Kaliningrad population would have been involved in this non-legal trading. If this would have been the case, the unemployment rates of Kaliningrad would have skyrocketed after the enlargement. This has not happened, quite on the contrary, Kaliningrad's unemployment rate at the end of 2003 was 9.1 per cent, whereas a year later it was 6.2 per cent measured by the ILO standards.

Foreign investments in Kaliningrad increased over 90 per cent in 2002, by nearly 20 per cent in 2003, but only 10 per cent in 2004. The 2004 development indicates clearly that the EU enlargement has not started a foreign investment boom in Kaliningrad. The explanation for such a 'low' growth rate in 2004 is not the saturation of the Kaliningrad market, as foreign investments in the region are still extremely modest. The total foreign investment stock in the end of 2004 was less than USD 350 million.

During the year 2004, the Kaliningrad region was able to attract foreign investment of just some USD 60 million. In the first half of 2005, foreign investment inflow has been notably low, only USD 18 million. The slow growth of foreign investments in 2004 and in 2005 is due to the fact that some foreign companies, mainly the 'Cyp-Rus' ones, wait for the new SEZ law to be adopted. The adoption of the new SEZ will probably cause a temporary foreign investment boom in Kaliningrad, as it releases those investments which have been postponed (see Table 10).

Table 10. Annual foreign investment inflow into Kaliningrad, in USD million

	1994-99	2000	2001	2002	2003	2004	1H/2005
Total foreign investment of which	**114**	**19.1**	**24.6**	**47.7**	**56.2**	**61.9**	**18.3**
Direct investment	n.d.	6.6	3.2	5.9	14.0	22.4	8.2
Portfolio investment	n.d.	-	-	-	-	4.9	1.3
Other investments - trade credits and loans	n.d.	12.5	21.3	41.8	42.2	34.6	8.7

**Sources: Pan-European Institute 2005a, Kaliningrad Statistics 2005*

In January-September 2004, some 40 per cent of the foreign investment in Kaliningrad ended up in trade, nearly 20 per cent in communications, over 30 per cent in the paper industry, fuel industry and foodstuffs[1]. Presumably, the foreign investment structure and its geographical composition have not changed considerably due to the EU enlargement. The main change in the geographical division might be the lower share from Cyprus in the foreign investment statistics of 2004, since many of the Cypriot firms have postponed their investments as they await new SEZ legislation to take place. One must bear in mind that the majority of the Cypriot investment in Kaliningrad is Russian in origin. For these ‘Cyp-Rus’ investors, the enlargement has not been as an important motive to invest in Kaliningrad as the SEZ.

Due to a small amount of foreign investments, one cannot argue that foreign investments are the main driving force in Kaliningrad’s economic development, but an important addition to the overall investment activity. The share of all foreign investments from the total investments into the fixed

[1] Kaliningrad’s foreign investment division by sector is not dramatically different from that of the whole country. Trade accounted for 32%, industry (incl. fuel industry) 50%, and transport & communication 5% of Russia’s all foreign investments gained in 2004 (Finpro 2005).

capital in the region was nearly 10 per cent in 2004. It is highly likely that the foreign investment inflow would grow and the role of foreign firms would become much more important in the regional development, when the implementation of the Common European Space begins.

Even if the EU enlargement has not resulted in major change in foreign investment flows into the Kaliningrad region, it has officially made the EU the main foreign investor in the Kaliningrad region due to the fact that Cyprus joined the Union.

Besides investments from the countries belonging into the EU, one should not forget the China phenomenon may be taking place in the Baltic Sea region. In other words, it is highly likely that Chinese companies will become more interested in investing in Russia and particularly in a new Kaliningrad SEZ. Those Chinese firms, whose business idea requires proximity to the European market, but nevertheless, which wish to maintain low cost levels, may find Kaliningrad an attractive investment place. Several company managers in Kaliningrad interviewed for this research expressed that the interest of Chinese companies has significantly grown towards the Kaliningrad region during the past 12 months.

Attracting more foreign investments into the region requires a more active investment promotion of the Kaliningrad region, since the possibilities provided by the Kaliningrad region are not familiar to the majority of foreign investors. Therefore, the activities of the Kaliningrad Regional Development Agency should be further supported or a separate unit, the Kaliningrad

Investment Promotion ('KalinInPro') should be established sooner rather than later[1].

Despite the high importance of a foreign investment promotion agency for the Kaliningrad region, one has to keep in mind that larger foreign corporations may find Kaliningrad's labour potential too narrow to make major investments there. At this juncture, one should not forget the fact that in some industrial fields, foreign corporations have already encountered difficulties in finding a qualified labour force in the Baltic States[2]. As Kaliningrad possesses an even smaller labour reserve than her Baltic neighbours, any labour bottlenecks will be reached surprisingly quickly. The narrow labour potential of the region would also create extra pressures to raise salaries at a faster tempo in Kaliningrad than in mainland Russia. Here, one should remember that the unemployment rate of Kaliningrad is already low at the moment, i.e. their unemployed persons do not create an extra labour reserve for industrial companies. In addition, one should keep in mind that the ageing of population and low birth rate negatively affect the future labour reserves of Kaliningrad. Therefore, it can be argued that the Kaliningrad region is able to accommodate only a limited number of major industrial producers.

In this context, one should bear in mind that the Kaliningrad companies, naturally, may use the labour force of close-by countries, such as Lithuania,

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[1] In mid-June 2005, the Foreign Investor Association of the Kaliningrad region was founded. This association may have a positive impact on aiding new foreign companies to adapt to the regional business culture.

[2] The Estonian Investment Agency stopped trying to attract manufacturers years ago, favouring service-based investors instead (Sherwood 2005).

Poland, Belarus and Ukraine. Even more distant alternatives can be considered. In fact, some of the Kaliningrad companies already at the moment use inexpensive and work-concentrated workers from China. However, their total number is presumably rather modest.

In order to produce a more detailed picture about change in the economic behaviour of Kaliningrad firms after the latest EU enlargement, one should conduct an empirical study among the companies in the region. Special emphasis should be placed on analysing changes in investment behaviour, and in particular, one should analyse whether new investments are linked with the mainland's growing potential or with their expansion aims abroad.

Even if the author does not have statistics on the Kaliningrad companies' investments abroad, one may proffer an educated guess that the investment flows from Kaliningrad abroad are rather modest, as the capital accumulation in the region is not particularly notable[1]. As a whole, one cannot completely exclude the possibility that some outflows of the Russian capital also take place via Kaliningrad. The EU enlargement per se has very little to do with these outflows, though a great part of these flows have traditionally ended up in Cyprus, now belonging to the EU (Vahtra & Liuhto, 2004).

Tourism is an important source of receiving foreign revenues in many neighbouring countries. The number of foreign tourists visiting Kaliningrad was just 70,000 in 2004, whereas the tourist flow into Estonia, with a comparable population size, is substantially higher. Approximately 960,000

[1] Forbes (2005a, 2005b) has named 27 billionaires in Russia. None of them lived in Kaliningrad. In fact, none of Russia's 100 richest persons was a citizen of Kaliningrad.

foreign visitors were accommodated in the hotels of Tallinn alone. If one adds to the aforementioned figure one-day tourists from Finland, the total amount of tourists in Estonia can be measured in millions. Therefore, tourism and the shopping related to it contribute a significant stake for the Estonian GDP. This is not the case in today's Kaliningrad.

The development of tourism in Kaliningrad indicates that the number of Russian visitors has doubled in the period 1997-2004. During the same period, the amount of foreign tourists has increased from 50,000 to today's 70,000. On the basis of their tourism development, one cannot argue that foreign tourism, or even domestic tourism, would have significantly suffered from the EU enlargement. On the other hand, one cannot argue that the Kaliningrad region has managed to fully exploit the possibilities provided by its unique nature, history and geographical position.

Various issues slow down the building of the tourism industry in the region, such as undeveloped international transport connections, the small number of Western-standard hotels and visa requirements between the EU and Russia. Kaliningrad in particular would benefit from the visa-free zone between the EU and Russia[1]. As the building of the visa-free zone belongs to the road

[1] According to Vinokurov (2004b, 1 and 11), "it is feasible for Russia to introduce visa-free regime for the EU citizens in Kaliningrad Region. On the EU side, visa regime for Kaliningrad may be kept intact, if multi-entry Schengen visas with longer validity will be made available to the residents of Kaliningrad and visa procedures will be eased up. … Opening Kaliningrad for Europeans, even if originally a unilateral move, would greatly facilitate doing business in Kaliningrad. It would provide tourism and hospitability business with numerous advantages, on the other hand, and provide investors with powerful incentives to come to the KO [Kaliningrad Oblast i.e. Kaliningrad region], on the other hand." Here one should note that only about a quarter of Kaliningrad residents had the external passport in 2004.

maps between the EU and Russia, their rapid implementation would support regional development in Kaliningrad (see Table 11).

Table 11. Tourism and border crossings in the Kaliningrad region

	1997	1998	1999	2000	2001	2002	2003	2004
Tourism (thousands)								
Foreign tourists	53	65	65	59	60	63	67	71
Russian visitors	112	117	144	164	182	212	224	240
Border crossings (millions) (entry plus exit)								
Persons	n.d.	n.d.	8.6	8.9	9.0	9.1	7.9	7.0
Vehicles	n.d.	n.d.	2.9	3.1	3.1	3.1	3.3	2.9

**Source: Kaliningrad Statistics 2005*

Though one should not explain the positive development in Kaliningrad's external economic relations by the enlargement per se, one can easily conclude that enlargement has not brought those negative consequences to Kaliningrad's economy which some researchers proposed prior to enlargement, i.e. Kaliningrad has not been economically trapped within the EU.

4. Summary

1) The majority of the economic indicators suggest that the EU enlargement of 2004 has not caused a negative impact on the economy of the Kaliningrad region. Though the region's foreign trade has developed extremely positively after the enlargement, one should not argue that the enlargement per se has caused the positive development. The main explanation for growing imports in 2004 is the increase in sales to the Russian mainland (the transit effect towards the Russian mainland). Correspondingly, the main explanation for growing exports is the increase in oil and machinery exports, which is, to a

large extent, due to companies from other Russian regions channelling their exports through the Kaliningrad province (the transit effect from the Russian mainland). It is important to note that no dramatic change has occurred in terms of Kaliningrad's foreign trade structure or its geographical scope, though the EU's share has increased significantly, particularly due to the EU membership of Lithuania and Poland.

Despite no precise statistics existing, one may assume that the shuttle trading has considerably decreased between the Kaliningrad region and its surrounding countries after the EU enlargement. Even if the decrease in the shuttle trading has had a negative socio-economic impact on hundreds of families (not on tens of thousands of families) living in Kaliningrad, one should not forget that the abolishment of grey and black cross-border activities is beneficial to the regional budget. Furthermore, the abolishment of non-legal foreign trade activities between Kaliningrad and its neighbours supports legal competition in Kaliningrad, i.e. it supports market reform in the region, which is needed to build up the sustainable competitiveness of firms.

2) The enlargement's immediate effect to the foreign investment inflow to Kaliningrad is modest. In 2004, the foreign investment inflow to Kaliningrad grew 'only' by 10 per cent. The growth rate of 2004 is lower than in 2002 and 2003. After the adoption of the new SEZ law, it is probable that the foreign investment inflow to Kaliningrad will pick up, as some existing foreign-owned companies release their investments, which they have postponed throughout the past 18 months. This naturally does not mean that the enlargement would be the major explanatory variable for increasing

foreign investment inflow to Kaliningrad but rather the adoption of the new SEZ. The EU became the major investor in Kaliningrad due to the EU membership of Cyprus. In reality, the investments from the aforementioned country could be re-spelt as Cyp-Rus, since the overwhelming part of the capital arriving from there is Russian in origin. One could not observe any strategic shift in foreign investment inflow or its industrial division, which could be exclusively explained by the enlargement. Also the country division of Kaliningrad's foreign investment stock has not changed significantly, since the inflow of foreign investment in 2004 was not more than USD 60 million. In the first half of 2005, less than USD 20 million has floated as foreign investment into the Kaliningrad region, indicating that the foreign investment inflow in 2005 will be lower than a year earlier.

It is beneficial to bear in mind that the development of the investment climate in Kaliningrad and in Russia as a whole is a more important factor affecting foreign investment flows than the enlargement per se. Secondly, one should not forget that the role of the foreign investments in the overall investment activity of the region will become more important in the future. The enlargement and the intensifying relations between the EU and Russia, for instance via the Common Economic Space[1], will most probably increase the movement of factors of production to and from Kaliningrad.

Thirdly, **the Kaliningrad administration should be more active in attracting foreign investments into the region, for instance by**

[1] Vinokurov (2004c; 2004d) deals in his articles with the concept of the Common Economic Space in great detail.

establishing a special unit – 'the Kaliningrad Investment Promotion' – to carry out this task.

Summa summarum, the immediate economic impact of the EU enlargement on Kaliningrad is relatively modest, though still a positive one. The Kaliningrad region will play a special role in the future development of EU-Russian relations. It has been said that St. Petersburg is Russia's window towards Europe. Similarly, one may conclude that Kaliningrad is Europe's window toward Russia. Open windows are needed for creating a true partnership between Russia and the EU.

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Debt Culture comes to Germany

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Introduction

The term Debt Culture was used to characterize these processes, which are universal in the sense that they express tendencies common to all capitalist economies that constitute the global economy. An alternative understanding is that these processes constitute the so-called American model of capitalism and that they are becoming increasingly characteristic of other countries' economies. Steinherr writes, "…this model is destined to dominate global finance" (Steinherr 1998, p. 36). In recent years, and especially in 2005, the spreading of these tendencies to Germany has become evident; this paper seeks to address these developments in terms of the classical point of view set forth in O'Neil (O'Neil 2005).

The premise established in O'Neil (O'Neil 2005) - that a proclivity exists to prefer investment in financial assets rather than real productive assets (what the classical economists called productive labor or productive capital) - has increasingly manifested itself in the developments since the recession of 2000-01 as profits have soared at an accelerated rate yet employment growth has been sluggish, or even non-existent, and real investment (in plant, equipment, machinery) has grown at a "low rate" (The Economist 2003, 2005a, 2005c) (Roberts 2005) (BEA 2005). If the profits are not being generated from a process of an expansion of production - in which case real wages could show an upward movement - then they must be arising from a transfer of value from labor to capital and even within capital itself (via the use of derivatives). Since real wages continue to stagnate and even decline then the latter value transfer explains the surge in profits – a large component of which are financial in nature (EPI 2005). A surge in the neo-mercantile behavior of the state and the private sector within the sphere of circulation of goods and financial assets has been responsible for such a transfer of value. During the Golden Age of capitalism (late 1940s –1973) the functioning of the "market" was able to expand production and raise average real wages but in the more recent period of Globalization (since 1980) weakness in the expansion of production (except in China) has necessitated state intervention and the development of derivative instruments to override what the market is increasingly incapable of doing by itself. As Martin Wolf writes "…the normal link between productivity and real earnings is broken." (Wolf, 2006c). Derivatives (forwards, futures, options and swaps) allow companies to realize value - "make a profit" - without having to produce it ("…the options market is a "zero-sum game", (Kolb 2000, p. 312) "…one side's gain is the other side's loss" (Levy 1998, p391); thus, investment in financial assets can seem to be a substitute for investment in real assets; the consumption of real assets ("tangible") by productive labor is actually the source of value creation. When what seems to be is mistaken for what is, the consequence is the spread of Debt Culture.

1. Debt Culture Comes to Germany

In O'Neil (2005) it was argued that Modern Economics (and thus policy makers) is (are) increasingly incapable of understanding the process of globalization because it only analyzes appearances as represented by market activity in the sphere of circulation of goods and financial assets ("supply and demand"); whereas the essence of economic activity is based in the production of goods (use values, objects of utility or wealth) by productive labor. Money and financial assets (equities, bonds and derivatives or securities), which are exchanged in the sphere of circulation, are only legal claims upon the value (and wealth) produced by such labor. This basic principle - that science deals with the essence or inner nature of processes – was first upheld, and systematized, by Adam Smith: labor is the source of the wealth of nations. David Ricardo defended the principle - via his distinction between value and riches (wealth); Karl Marx upheld the principle as well via his notion of commodity fetishism. Under the original form of Mercantilism gold was money, which had to be produced, and its value was a consequence of the labor time required to produce it. Under contemporary neo-Mercantilism, because money is not gold that can circulate goods, this connection between the value of money (including financial assets held in money form) and production is not apparent. The apparent connection was severed by the collapse of the Bretton Woods international monetary system between the years 1968 and 1973; however, the essential connection between the value of money and production remains. Thus modern economists – and even their radical critics – all suffer from the extreme delusion that a portfolio of financial assets constitutes wealth and that an increase in the "market value" of these portfolios is tantamount to wealth accumulation. Smith's Wealth of Nations was a portfolio theory critiquing the first incarnation of Mercantilism for its adherence to this delusion that wealth is money. The accumulation of monetary forms of financial assets cannot outpace the accumulation of productive capital since these are only the forms of appearance of the value created via the expansion of productive capital. Since appearances in nature can be deceiving – nature likes to hide - financial crises are required to resolve this contradiction between essence (production of concrete objects of utility or consumer and producer goods) and appearance (the prices of equity, bonds and derivatives) via destruction of spurious "wealth". Thus, in the "long-term equities may disappoint" as Martin Wolf of the Financial Times has written; real stock market performance, in March 2006, was at the level of 1998. Now, in mid-June 2006, after four or five weeks of destruction of fictitious monetary wealth, equity markets are even further below those levels of March 2006 (Wolf 2006a). Hans Redeker predicts equity markets will continue this downward trajectory for the rest of 2006 (Redeker 2006). According to Michael Browne a bear equity market has arrived that, within itself, contains no catalyst for it reversal (Browne 2006).

Capital in the form of money ("cash") is only potential capital. A return to such money capital can only arise if it is transformed into the elements of productive capital (buildings, equipment, raw materials and labor). Money capital must be invested into production of goods and services (objects of utility) and those goods must be sold in order that a return to such an investment can arise. In the past banks played the pivotal role in facilitating this transformation of money capital into productive capital. The German economic model was known for its close monitoring of this vital connection between money and productive capital (Shonfield 1974). The American model of capitalism claims that such a close connection - via a bank based system - between provision of money capital to firms for use as productive capital is inefficient since it does not lead to maximization of shareholder value (Copeland, Koller, Murrin 2000) (Steinherr 1998, p. 21). O'Neil (2005) showed that the essence of such shareholders value or Equity Culture (Economist 2001) is Debt Culture and that the basis of such a Debt Culture arises from the proclivity to invest in financial assets. This proclivity has burgeoned in recent years and is best characterized by the decrease in German bank lending to the private sector (The Economist 2003) and the transformation of Deutsche Bank into "a giant hedge fund" (The Economist 2004b). Such a transformation exemplifies the proclivity: instead of Deutsche Bank performing the traditional role of transforming money capital into productive capital - a process which transformed Germany into the world's leading exporter - it has sought to achieve a high return on equity "…by trading on its own account - by becoming a hedge fund" (The Economist 2004b). Hedge funds use debt capital to trade financial assets in order to realize financial profits, which constitute a transfer of value from some other market agent who has speculated incorrectly. The realization of financial profits from trading financial assets comes from the losses of the other agents. Thus, the trading of these financial assets arises within the sphere of circulation and does not produce any new value. Therefore, money invested as capital in these activities by hedge funds and banks constitutes capital invested in circulation of financial assets - not capital invested as productive capital. As it was argued in O'Neil (O'Neil 2005), such a proclivity arises from the insufficient return to productive capital. The tendency for profitability on productive capital to fall was the principal focus of the classical economists referred to above.

From the point of view of Modern Economics there can be too much investment in equity capital - and hence too little debt in the capital structure because "...most companies dislike issuing equity" - as well as too much investment in productive capital and both lower the rate of return to equity and therefore diminishes shareholder value (The Economist, 2001). This is evident in the depiction of German economic development by the Economist. The low return on productive capital (understood by the Economist only as the non-human element) is said to arise from the nature of the German banking system which provides money capital to firms too cheaply - due to government guarantees - in order "to support investment not maximize returns" (The Economist 2003a). This led to too much investment in productive capital up until 2000-01 and low returns. As banks came under pressure from shareholders to raise their return to equity (e.g., Deutsche Bank as above), the costs of capital rose with a consequent decline in real investment as a percentage of GDP (The Economist 2003a).

Thus a decrease in one component of productive capital – real investment - is associated with a rise in the monetary value of the claim on that investment ("shareholder value") as a consequence of the severing of the characteristic close relation between money and productive capital in the German economic system. Via transforming the German financial system "…capital-market reform will lead to a more efficient use of capital, and higher rates of return…more money will be invested abroad…Indeed, if labor costs can be squeezed by reforms, firms can adjust without having to cut investment as much…" (The Economist 2003a). According to the Economist, the decline in investment can be offset - in order to increase GDP - via further transformation of the German financial system to make it as “sophisticated” as that in the United States. The world’s principal economic imbalances - the US twin deficits on domestic government finances and external current account - are attributed to excess savings on the part of Europeans and Asians, which results in insufficient domestic demand and insufficient demand for US exports (Wolf 2006b). Germany must adopt “…a more sophisticated financial system…” to allow them to “…borrow money more easily…” to induce consumer financial innovation so as to increase consumption demand to offset declining real investment (The Economist 2005c).

The suppliers of such financial innovation will then be suppliers of interest bearing capital, or consumer oriented debt capital, i.e., one of the components of what this author calls Debt Culture (O’Neil 2005). One of the tendencies of what has been called the proclivity is for investors to prefer investing in these debt forms in order to gain a higher yield, the search for which induces a rise in the price of financial assets, even while investment in real assets declines (and thus the expansion of production as well). In this decline wages and employment stagnate while capital looks for higher returns outside Germany. These characteristic factors of the US model - outsourcing, downsizing, rising levels of inequality and indebtedness - are increasingly apparent in Germany. They express what was called “duality” whereby lower profitability on productive capital leads to a search for higher yields in financial assets creating bubbles in their prices expressed in money (O’Neil 2005). Policy makers and economists mistake this rising money value as “shareholder value” and design policy to enhance it - the consequence are these unfortunate characteristics mentioned above. The policy makers/ economists mistake expansion of individual consumption for expansion of productive consumption (productive capital): whereas, actually, individual consumption depends on expansion of production. If, as in Modern Economics, an increase in production is seen to require an increase in individual consumption, then the consequence is Debt Culture. Thus, according to this logic, to help correct global economic imbalances Germany must expand consumer debt culture to provide a further inducement for international financial capital inflows into Germany. Such inflows will be investments into circulation of financial assets rather than productive assets and will serve to increase domestic demand without expanding production. Debt allows individuals or countries to consume before having to produce. This is actually the root of America’s external current account deficit rather than high savings in Germany and Asia. The advocates of the US model for Germany want to see German “dependence” on exports undermined via expansion of German consumer debt culture in order to correct the US current account deficit. Thus what is US profligacy, as constituted by the US current account deficit, is to be corrected - utilizing such logic - via Germany itself engaging in profligate behavior via expanding its own consumer Debt Culture. Wolf cites Larry Summers employing the same logic (Wolf 2006b). Thus as savings rates decline all over the developed world - reflecting slower expansion of productive capital (along with correspondingly lower real wage income) - policymakers and investors mistake this for insufficient individual consumption demand and as a consequence Debt Culture expands. Insufficient demand is a consequence, not a cause, of insufficient accumulation of productive capital.

Just as Debt Culture arises from incorrect premises at the macro level, the same is true at the corporate or micro level when considering firm behavior regarding the meaning of shareholder value. We have seen that it tends to be understood as being detached from real productive activity. This is reflected in the theory of value of Modern Finance Theory which first argued that the value of a firm (of its financial assets) arises from investment in real assets only (i.e., real investment by firms or investment in productive capital) (Modigliani/ Miller, 1958); in contradistinction to this, it was later argued that firm value can also depend upon "side effects" of financing (capital structure, dividend policy and financial investment in derivatives) (Brealey and Myers, 2000). Thus financial innovation (especially creation of derivatives) becomes a means of creating shareholder value and this is perceived to be independent of the amount of labor employed by the firm (Copeland, Koller, Murrin, 2000). The detachment of shareholder value from productive activity in Germany is evident when the Economist speaks of "… the painful transition that Germany is making…to the starker mechanisms of…shareholder value…" within an environment of "…persistent economic malaise". In such an environment "…wages have been forced down…" as jobs have been cut "…despite rising profits…" and threats "… by companies…to relocate abroad" (The Economist 2005a). Record profits are being realized "…by cutting wage bills and reducing investment, especially in Germany…" (The Economist 2005a). Thus, profits are increasing not via expansion of production but via value transfers from labor to capital (as stated in the Introduction). Consequently, just as at the macro level there appears to be too much investment, so too at the micro, corporate level there seems to be too much investment in industries that "…do not have sufficient attractive investment opportunities" (Copeland, Koller, Murrin 2000) (The Economist 2006b).

Just as the process of globalization was characterized as requiring corporate restructuring to alleviate a similarly perceived problem in the US in the 1980s, so today in Germany the leveraged buyout (LBO) model arises to deal with such a perceptual investment problem. It appears that in Germany and the rest of the world there has been too much investment in real assets with insufficient returns (The Economist 2005c). The advocates of the US model say this has arisen due to poor corporate decision making arising from a lack of a market for corporate control. Only by opening Germany to international competition to induce "…a process of renewal…" can fossilized management practices be superseded. The old German model "…has clearly become uncompetitive…" and a process of "bidding for Germany" has begun whereby "…international investors remain the prime moving force in Germany's drooping economy" (The Economist 2005a). Once again financial activity can be seen to accelerate while real productive activity retrogresses. Yet the value of the former depends upon the latter – such a contradiction can only be resolved via the destruction of spurious shareholder value in financial crises. Thus we are witness to such destruction in equity markets, over the last four or five weeks – early May to mid-June 2006 – as risk averse investors express their debt proclivity via substituting bonds for stocks (Toogood 2006). As a consequence nominal long-term interest rates have resumed the downward trajectory – in spite of inflationary fears (Shing 2006) – that has been the principal empirical characteristic of financial markets in the period of Globalization (early 1980s -2006), i.e., a long-term bond market bubble.

If developments in the US over the last 20 years portend similar consequences for Germany, then the arrival of the LBO model in Germany is ominous. This is true because "…their methods are often unsentimental…costs and staff can be slashed, equity is turned into high-yield debt, and a positive return is sought sooner rather than later…" (The Economist 2005a). Such a positive return can only arise from "…substituting equity with debt forcing much of the free cash flow out of the enterprise and back in to the capital markets…" (Copeland, Murrin and Koller 2000, p. 6). In this manner the return to equity capital is thought to increase via decreasing its quantity via transforming it into interest-bearing capital. Thus at the corporate level the same is true as at the macro level: the spread of the US model is accompanied by expansion of debt. The increase in yield on financial assets (equity and bonds issued to finance the LBOs) is associated with a decrease in real productive activity. Again this expresses the duality of rising financial asset prices and stagnant or falling real wage income even as labor productivity increases.

Instead of looking at the differences between the financial systems as explaining the relative economic development of the US and Germany, it may be more beneficial to understand the processes as arising as a consequence of the similarities between the countries. The principal similarity being that they both are capitalist economies that are subject to the same proclivity to prefer financial investment in forms of debt capital to real investment in productive assets which expand employment and wage income (the means by which goods produced can be purchased without debt expansion). The difference in the financial systems between the US and Germany is only a formal difference; whereas, Steinherr considers it to be an essential difference (Steinherr 1998, pp. 21-22). In contradistinction to Steinherr, the aforementioned indispensable similarity is that both suffer from "unattractive" returns to investment in productive capital whose consequence is a "search for yield" in financial assets. Such a search is purely speculative and has given rise to equity market bubbles in Germany and Japan – which have now been pricked - and an international bond market bubble, resulting in low interest rates, which presents a paradox to economists. The low interest rates result in further search for yields in financial assets, which further increase prices and depress yields.

The increase of "liquidity" due to a low cost of capital arising from a bank-based financial system is not just a consequence of the nature of the financial system - whether it is bank based or not - but is a consequence of what this author calls the proclivity to invest in financial assets. Steinherr considers maintenance of liquidity to be "…the sine qua non of the American Model..." and yet also its "Achilles' heel", "…the Achilles' heel of the American model of finance is its reliance on highly liquid money and capital markets"; it's the "key requirement" for "successful" derivatives trading (Steinherr 1998, pp. 53-55). Actually, it's an endogenous consequence of low profitability on productive capital (this is elaborated below). Since the recession of 2001 the US financial system and international corporations have been most responsible for the surge in global liquidity in recent years (The Economist 2005b). The high level of risk aversion which manifests itself as such a proclivity is further contributing to a detachment of money capital from productive capital as more and more capital seeks investment in the form of lending via interest bearing capital or seeks investment in the sphere of circulation of goods/financial assets. The magnitude of the proclivity for investment in this form of capital is so large that a more than plentiful supply of debt capital can be raised by companies pursuing the LBO route: "the size, speed and success…" of such debt raising generation "…gives a sense of the sea-change taking place in Europe's capital markets…" as hedge funds "…have emerged in search of the yields that lending in highly leveraged transactions can command" (The Economist 2006a). Consistent with financial innovation in the US, "…a fancy array of debt instruments" is being supplied to the European market demonstrating that "…there are pots of money to be lent to the right borrower…" (The Economist 2006a).

Thus, even as German banks, corporate culture and the German financial system have been transformed to resemble the US system, excess liquidity continues to arise, not from the nature of the financial system, but from proclivity of private investors to invest in debt forms of capital.

2. The Origins of the Proclivity in Theory and Practice

Debt Culture means mistaking the accumulation of the claims on productive capital – securities or equity capital, bond capital and derivatives - for the accumulation of productive capital itself. It mistakes appearance for essence. Thus the use of the word debt does not necessarily mean that each of these forms is debt in the sense that they are interest-bearing. Only bond capital is interest-bearing since it is a form of lending. They are all forms of debt in the sense that they are claims on the value, and hence the wealth, produced by productive capital. Just like paper fiat money is a debt claim to ownership of the goods produced by productive capital (Marx 1973, pp. 210-11). While money has a value because it can be transformed into commodity capital (goods) – this is its purchasing power – the securities only have a price because they are only claims on the commodity capital (consumer and producer goods) produced by labor. Alternatively, the securities are claims upon net operating income (NOI), which must be produced by the firm's operations. As monetary forms – they are not money themselves - they must first be transformed into money prior to being converted into the commodity capital (wealth) produced by labor. There is no distinction between price and value in neoclassical theory; hence, it is always confounding the two. The confusion is expressed in corporate valuation via the equation V= S + B, where V is considered to be the value of the real assets (non-human components of productive capital), S is the value of equity capital and B is the value of bond or debt capital. The problem is that only the right hand side of this equation is observable in the market (equity and bond prices). The real assets are not in the market; they are components of productive capital, which is in the sphere of productive consumption. These goods only derive their "value" from contact with the human component of productive capital; when factories are shut down their value (as well as their use value) is destroyed because they cannot be consumed by human labor. When objects of utility or use values are in the spheres of production or consumption they have neither a price nor a value. Only goods in the market have a price or value. The value of the firm, therefore, can only be expressed in units of money but the left hand side of the equation does not appear as a monetary magnitude. The terms S and B - as claims on NOI - are not equal to the total investment of the firm because this equals investment in real assets and in people who are the source of the value which appears as NOI. Hence, V is only one component of total investment with the human component only being recognized as a cost rather than a source of value. Thus, this expression for firm value cannot really be an equation because the qualitative units of measurement must be the same for an equation to exist. This explains why "…nobody really knows how to value shares…Analysts do not have a clue…companies are equally ignorant…If anybody had any idea…stock market bubbles would never arise" (The Economist 2001). Their "value" is purely imaginary: they are the tools of the workers. Tools are the part of human nature that distinguishes us from animals, they are a part of our bodies, and as such they can no more have a price or value than can our arms, hands or legs. In what follows the term value of real assets will continue to be used, as well as the word value to refer to the price of securities, but these observations should be kept in mind in order to understand why such confusion exists in economics and finance. The confusion arises from seeing all current market behavior as being dependent upon expectations of quantitative increase or decrease of future "variables": such an expectation is merely the unconscious expression of the imaginary value of these necessary human tools. Neoclassical theory only recognizes quantitative change of an assumed given, qualitative content. However, change is both quantitative and qualitative (Hegel 1833); moreover, a profound qualitative difference exists between the two concrete periods of capitalist development: the Golden Age and Globalization.

The origin of the proclivity arises from a two-sided process arising at the end of the Golden Age in the late 1960s and early 1970s: on the one hand, from the side of transformations in the accumulation of productive capital, and on the other hand, from the side of transformations in the accumulation of money capital (and the understanding of these two sides by their theoreticians and practitioners). The totality of this process is the severing of the relative harmony, connection or attachment that existed between the two forms of capital during the Golden Age. This attachment gave rise to the appearance that financial investment was tantamount to productive investment. Thus, in this period we witness the birth of the Modigliani-Miller theorems and the perception that the value of the firm (of the real assets) is equivalent to the value of its financial assets – and that this is only determined via its investment policy or capital budgeting decisions to purchase and put into use real assets in the sphere of productive consumption (Modigliani and Miller, 1958 and 1961). This is the period of the buy-and-hold strategy of investment – based on long-term fundamentals - so that it was a reasonable perception to believe that the price of the firm's equity was determined by, and reflected, the investments in real assets undertaken by the firm. In this period of the Golden Age financial bubbles were a rare phenomenon reflecting the relative unity between the accumulation of money capital and productive capital. This is in marked contrast to the contemporary period of Globalization where the frequency of such bubbles approaches that of the nineteenth century (Tvede 2006) – and this owes itself to the detachment of the accumulation of money capital from productive capital as well the dominance of the markets by a neo-mercantile trading mentality instead of a buy-and-hold long-term fundamental investment strategy (Toogood 2006). In contradistinction to the

Golden Age, during the contemporary period of Globalization it is no longer a reasonable perception – it is actually a misconception – to believe that the price of the firm's equity reflects the real investments of the firm. We first consider the process from the side of productive capital and the reflection of this process in the minds of economists/practitioners.

2 A. The Proclivity from the Perspective of Productive Capital

The origins of contemporary Globalization as it emerged out of the decline of the Golden Age are associated with the dissolution of the Bretton Woods system of fixed exchange rates between 1968 and 1973. The tendency for profitability on productive capital to fall reasserted itself in this period and eventually gave rise to the severe recession of 1974-75. The same period witnessed transformations in neoclassical value theory as well as giving rise to alternative ways of understanding the nature of value – these alternative forms of thought returned to the classical ideas of the founders of economic science. This text maintains that it is necessary to understand the former as a prerequisite for developing the latter.

The collapse of Bretton Woods was framework within which the practical activity of capitalist enterprise had to contend in order to protect itself from declining profitability. This dissolution was not exogenous to this practical activity, as Steinherr contends, but was a necessary consequence of the activity itself (Steinherr 1998, p. 36). This framework expressed itself as a significant increase in the instability of goods prices, exchange rates and interest rates.

Accompanying these transformations were pivotal transformations in the available means by which money capital could be accumulated. These means were facilitated by the theoretical transformations in neoclassical value theory known as Option Pricing Theory (Brealey and Myers 2000, p. 601). This theory enabled the development of derivative financial instruments, which themselves allowed capitalist enterprise to cope with the burgeoning price instability.

As it was alluded to previously, in the early 1970s it was recognized that, within Modern Finance Theory, problems existed in the fundamental theory of corporate finance as represented by the Modigliani-Miller theorems (Arditti 1973). These problems were associated with the notion of the cost of capital and were an analogue to the Cambridge Critique of Capital theory in neoclassical economics (ONeil 2005). The problems concerned themselves with the appropriate cost of capital to utilize in firm valuation (i.e., to value the non-human component of productive capital or real assets). The confusion also arose due to equivocation on the part of Modigliani and Miller, because in 1958 and 1961 these authors were firm in their conviction that only the real investment by the firm determines its value; but in 1963 they backed away from this conviction due to the existence of a State subsidy to debt accumulation (the interest tax shield) which they misperceived as value creation. Thereby giving rise to a fundamental misconception of Debt Culture: that debt (capital structure or financial leverage) creates value. This was one of the first manifestations of contemporary neo-mercantilism.

Stewart Myers (Myers 1974, p. 1) attempted to clarify the confusion finding that the "…capital budgeting rules …proposed by Modigliani-Miller…are not generally correct…" and therefore offered an alternative rule to value new real investment by the firm to account for presumed interactions between firm financing and investment decisions. The validity of Modigliani-Miller was thought to be justifiable only in a perfect market – as if anything perfect could exist except in a Platonic thought process. Yet this is where all of Modern Financial Theory begins their analysis: assuming that something exists – a perfect market - that cannot possibly exist. This gave rise to the notion that something besides real investment in productive capital (real assets) is responsible for the "value of the firm". Specifically, the financing activities of the firm itself were perceived to be creators of value (dividend policy, capital structure and financial innovation via creation of derivative securities, i.e., those activities which the original Modigliani-Miller perception rejected). Myers subsequently employed neoclassical logic to deduce that the growth opportunities arising from real investment "…can be regarded as a call option on a real asset…All of this paper's interesting results stem from the idea of regarding real assets as options whose ultimate value depends on future discretionary investment by the firm" (Myers 1977, p. 171). The capitalist enterprise – the principal expression of productive capital – was then regarded as comprised of two components: 1) the assets in place and (2) an "intangible" option constituting a growth opportunity. As it turns out, the valuation of these two components is mutually contradictory within the formal logic of Modern Finance Theory. As Brealey and Myers recognize in their textbook (2) can't be valued via the traditional discounted cash flow technique utilized to value (1) (Brealey and Myers 2000, p. 601). In other words, the Option Pricing Theory can only value the option component but this is inconsistent with traditional discounted cash flow: thus there is an irreconcilable contradiction within the formal logic of neoclassical financial theory.

Thus, real investment – the expansion of productive capital which creates employment, profit (net operating income that provides interest to service debt), and purchasing power to buy the produced goods (so as to avoid debt creation to increase demand) - is only considered to be an option: it can be "exercised" or not depending upon whether or not the option has "value". Real assets disappear only to reappear as an option: a financial asset, a derivative claim on the value produced by the real assets (when consumed by labor) which no longer appear. If they do not appear then they cannot produce the value upon which the derivative is a claim. Such is the formal logic of neoclassical theory whose practical consequence is the risk-averse proclivity to mistake accumulation of such claims for the accumulation of real wealth in the form of productive capital.

Playing along with the logic we may ask: what determines the value of the option when the Option Pricing Theory is applied to the firm? Not coincidentally it turns out that when the owners of the firm (owners of the real assets) – the shareholders - create debt they are also, "effectively", not owning the firm because the lenders of money capital to the firm – the bondholders - have created a call option that allows the owners to buy back the real assets which they "effectively" do not own (Brealey and Myers 2000, p. 585). Not only this, but the bondholders have also created a put option which allows the shareholders to put the real assets to the bondholders. If this put option has value for the effective non-owners of the firm then in this case the effective non-owners become real non-owners and the bondholders, who never wanted to be owners to begin with – this is why they are lending money capital - are "forced" to be the owners of the firm (Kolb 2000, p. 512). If the call option has value then the effective non-owners exercise the option to own the real assets that they never actually ceased to own in the first place. The bondholders are then not forced to own the real assets that they never wanted to own in the first place. All of this financial innovation takes place without any payments between the counter parties: "owning a corporate bond is …equivalent to owning the firm's assets but giving a call option on these…to the shareholders" (emphasis on – but - in original, emphasis on - giving - by O'Neil; Brealey and Myers 2000, p. 694). Presumably the payments are only effective payments otherwise it violates rationality (if options have value than why are they given away by the bondholders?); as well as the law of the exchange of equivalents. Such is the twisted logic that underlies the American model of debt creation.

Both Brealey and Myers and Kolb argue that this view of the firm provides an incentive for the owners, i.e., the real owners (or their lackeys, the financial managers) - not the effective owners - to increase business risk via selecting riskier capital budgeting projects. As if the firm's managers determine business risk, this is actually independent of their individual decisions as it arises consequentially from the activity of all the firms in the economy as a whole – it is a corollary of the falling rate of profit on productive capital. Firms with higher business risk typically carry less financial leverage (Levy 1998, p. 603). Actually, the incentive is to increase financial risk via debt creation because this is the prerequisite to receive the call option from the bondholders. Without debt creation there would be no call or put options "sold" by the bondholders; thus, an unlevered firm cannot be valued via Option Pricing Theory. As business risk increases, due to lower profitability on productive capital, the probability that the call will be exercised increases, the value of the call will then increase and if it is in the money it will be exercised. Upon exercising such an option the shareholders will receive another call option only if they create more debt. Hence, debt creation is a prerequisite to any probability that the call will be in the money. As the call option is perceived as being equal to the value of equity capital, it follows that the increase in the value of equity capital depends on debt creation via further bond emission. Hence, as Pinches says Option Pricing Theory explains the interaction between the value of equity capital and the value of debt capital (Pinches 1996, p.418). But this is only the neoclassical expression of what O'Neil (O'Neil 2005) has called Debt Culture: the increase of all forms of debt (corporate, State, consumer), puts at bay the tendency for the rate of profit to fall on productive capital via enabling increased demand for goods and securities in general and equity capital in particular. The term duality was used to express how the advanced level of labor productivity creates deflationary forces that can only be offset via expansion of debt in a futile attempt to prevent goods and securities prices from falling. The expansion of liquidity is both a cause and a consequence of this affliction of contemporary capitalism. The difference between American or European or Asian financial systems is merely a formal difference that expresses this essential affliction. The proclivity is merely the manifestation of the process by "investors".

The equation for the value of the firm, the value of its assets (i.e., real assets) becomes: V= VC + (X – VP). Thus S becomes VC and B becomes (X – VP): equity capital is transformed into a call option (VC) and bond capital is transformed into two components, one part (X) is "risk-free" and the other is a put option. Again, as if there could be any kind of activity that could be risk-free under capitalism. This is another foundation of neoclassical financial theory that is false. The State debt generated by the US government is considered risk-free. Actually it is highly risky because it must be serviced by higher taxes on the downsized productive laborers in the USA because taxes have been cut for those most able to pay. Also, it is dependent upon highly risky money capital inflows into the USA to service the balance of payments deficit induced by the profligate American Debt Culture. Only the nominal return is risk-free if we can assume the inflows to finance the profligacy will continue. This equation is derived from put-call parity; a no-arbitrage pricing relationship arising from trading options in the sphere of circulation of financial assets; whereas value is created in the sphere of production. The equation is deduced from the balance sheet of the firm: an accounting statement. Thus, it only deals with accounting gains and losses not economic profit that must be produced via productive capital expansion. This summarizes the neo-Mercantile nature of contemporary capitalism. Recall that the original form of Mercantilism thought that profit arose in the sphere of circulation or exchange via buying commodity capital (goods) low and selling high. The only difference within today's Neo-Mercantilism is that Option Pricing Theory has facilitated the creation of a myriad of different forms of financial assets (derivatives) whereby mercantile profit can be realized, not just by buying low and selling high, but also by selling high and buying low (so-called short selling). In this process no value is produced, it is merely transferred between the agents of the derivative contracts – with the suppliers of the contracts extracting their cut for the services rendered.

Within this theoretical transformation in neoclassical value theory – which is the foundation for the practical ongoing process of globalization – not only have real assets disappeared but the options to invest, i.e., the financial derivatives, have become "real". Real options, if they have value, allow abandoning a previously implemented real investment. Likewise, the ownership of productive assets has become optional "…making ownership a standardized tradable commodity" (Steinherr 1998, p.21). The convoluted reasoning constituting the application of option pricing to corporate securities implies that ownership of productive assets is in limbo until exercise time arrives. During this time the shareholders are encumbered because they are effectively non-owners of the productive assets, only if the call option has value at the exercise date can the shareholders "…regain unencumbered ownership of the company's assets" (Brealey and Myers 2000, p. 695). If the put option has value then the shareholders can shift the burden of owning the productive assets to the bondholders. Consequently, the shareholders will be "…forcing the firm upon the bondholders" (Kolb 2000, p. 512). This disturbing type of language reveals the extreme risk aversion associated with productive capital and is another expression of the proclivity; it is indicative of the extreme decay in the thought processes of modern economists in comparison to the classical economists. The put option is seen as a right to default – the right to violate a legal contract – considered to be granted by limited liability. This demonstrates how the legal understanding of limited liability has changed since its initial conception in the youthful period of capitalism (17th century). Limited liability was designed to protect the productive capitalists from the depredations of usurious interest rates charged by interest-bearing capital (Steinherr 1998, p.14) (Marx 2000, Vol. III, chap. 36). In contemporary globalization this has been turned upside down as financial deregulation has unwittingly and paradoxically resulted in the subordination of productive capital to interest-bearing capital. This is implicit in the Capital Asset Pricing Model, which sees the cost of equity as including a mark-up (the risk premium) over and above the risk-free rate (a form of debt); this is a theoretical inversion of the practical activity that deducts interest from the net operating income produced by productive capital. Thus, in practice, debt is subordinate to equity – to see it otherwise is just one more expression of Debt Culture.

The side effects theoretical literature gave rise to "Treasury rethink" regarding capitalist enterprise (the fundamental unit of productive capital). Value arose not only from real asset creation via acceptance of positive net present value projects (real investment) but also from the use of derivatives for hedging and "for profits" (speculation) (Pinches 1996, chap. 15). The notion exists that hedging and speculation are opposites and that the former decreases firm risk while the latter increases firm risk. Thus, the decreasing profitability on productive capital, which appears as increased risk at the firm level, allegedly can be offset (hedged) via investing additional money capital (potential productive capital) into a derivative "asset" to form a hedged portfolio that is less risky than the natural, exposed position arising from operations (productive capital). Consequently, an option exists to invest money capital – whose opportunity cost is a lower productive investment that is not factored into the option pricing equation – in a financial asset in order to hedge the higher risk of productive assets. However, this is just another form of the Proclivity because it may turn out that it would have been better for the risk averse agent, suffering from the affliction of the Proclivity, not to have swallowed this advice offered by the seller of the derivative: because the fear that the market would move against the afflicted agent may not come true after all! In which case the confused agent had speculated incorrectly - by having hedged - and the money capital invested in the derivative is transferred to the counter party to the derivative contract who speculated correctly. Consequently hedging is just a form of speculation and the two are not opposites but different manifestations of the Proclivity. There is an opportunity cost, in that this is potential capital not transformed into productive capital slowing the pace of accumulation of the latter. The skepticism in Modern Finance Theory, regarding "whether or not derivatives create value", expresses the anti-scientific nature of such financial engineering.

2 B. The Proclivity from the Perspective of Money Capital

There are three aspects that contributed to the development of the Proclivity regarding the accumulation of money capital. All three arose as a consequence of the lower rate of return on productive capital that precipitated the dissolution of the Golden Age. They are: 1) an increase in the supply of money capital seeking profitable investment alternatives, which was associated with; 2) the wide variety of new instruments that were available -

into which this supply could be channeled due to the financial innovation enabled by Option Pricing Theory; 3) the process by which banks became disintermediaries (they have gotten out of the business of making loans to firms – as the Economist has portrayed it), in contradistinction to their traditional role of providing money capital to firms to invest into productive capital. This (3) occurred because of increased competition arising from the development of the bond markets. All of these were different aspects of the same process of financial deregulation, which differentiates the Golden Age period from the period of Globalization.

Aspect three will be the main point of focus because this is what characterizes the detachment, discussed above, of the relative accumulation of the two forms of capital. It is also most relevant to recent developments in Germany where Deutsche Bank traditionally had "…an outstandingly strong position in large-scale industry…a businessman expects his banker to have an intimate knowledge of all phases of his business …". The banks themselves had "…technical departments whose job it was to make a judgement on clients' requests for loans on the basis of their scientific and technical merit…" it was "…the pride of German bankers" to assure themselves that the money capital they advanced would be invested in value creating enterprise (Shonfield 1974, p. 254). This depicts the meaning of the expression close monitoring between money and productive capital used above. As Steinherr says, US banks were not that much different in this respect than their German counterparts because "…the banking sector's commercial and industrial loans remained the main industrial financing vehicle. It was not until the late 1960s that disintermediation from the banking sector on the asset side was beginning to make itself felt" (Steinherr 1998, p. 69). Again, there was an attachment and relative unity between the two forms of capital (commercial and industrial loans finance commodity and productive capital, respectively); at least until the late 1960s when the severing between the two began to arise: disintermediation is a fancy word to describe this unsavory process.

Compare the close traditional unity to the description of the relationship today. Lending to productive capital is seen as too risky because "…the world's leading banks decided some years ago that lending is a mug's game…they began to get rid of their loans, repackaging them and selling them off as securities…over the past 30 months one big bank, Deutsche Bank, has reduced the loans on its books by over 40%…". The reason is due to the fact that "…loans produce on average only half the 15% return on equity that banks and their shareholders demand these days" (The Economist 2003b). German "…banks are pulling out of corporate lending, which offers paltry returns. They are also treating industrial stakes more like other investments." (The Economist 2000). Thus, real capital – industrial stakes – disappear only to reappear as securities – other investments - and loans to productive capital have an insufficient return to satisfy shareholder expectations; banks therefore must involve themselves in trading financial assets, including derivatives, to enhance their return to equity. To do so they may even have to advance their own capital thereby increasing their risk. This is the Proclivity from the side of money capital. As the Economist describes the situation, those who purchase the loans via securitization are having the higher business risk associated with the lower return to productive capital transferred to themselves. To compensate they seek insurance in the credit derivatives market, which has burgeoned in the last 10-15 years (The Economist 2003b). All of this risk shifting behavior is an expression of the Proclivity and confirms the classical notion of a falling rate of profit on productive capital. Risk objectively arises from this source independent of the subjective expectations of investors; expectations reflect, or are determined by, this objective risk. George Soros is right when he talks of reflexive expectations; however, he also sees it subjectively due to the influence of the Austrian school upon his thought process. Thus, this rate of profit, just like the imaginary value of real assets of the firm, is unobservable: they can only be inferred via conceptual analysis of concrete social development. The difference is that the rate of profit is not imaginary but rather the regulating law of capitalist development.

Securitization – selling insufficiently profitable loans previously made to productive capital – reveals the desperation to find yield via increasing demand for new forms of financial assets created via financial innovation; this is not difficult since "…in a climate of falling interest rates, investors who were once happy investing in low-risk treasury bonds were tempted to look for a higher yield, accepting that this meant a higher risk of default" (The Economist 2003b). The banks themselves must use the credit derivatives markets, revealing the highly speculative nature of the positions they are engaging in. Moreover, "now, almost all big banks invest their own capital in hedge funds" (The Economist 2004a). The detachment of German banking (money capital) from its traditional monitoring with respect to productive capital is verified because "…Josef Ackermann, the chief executive of Deutsche Bank and his ten-man group executive committee have taken Deutsche in precisely the opposite direction. Since 1996, they have been transforming it from a giant institution serving German commerce to a global money machine with no particular national loyalty" (The Economist 2004b). Thus, the transformations that have arisen on the side of money capital accumulation, in the period of Globalization, have "…produced a shift from a buy-and-hold to an active arbitrage-and-trading-driven approach to portfolio management…financial claims, ownership rights and contingent obligations are increasingly taking the form of liquid securities" (Steinherr 1998, pp. 37-41); real productive asset accumulation disappears behind the mirage of a neo-mercantile, speculative trading frenzy on paper claims written on downsized productive capital. The market for corporate control means creating arbitrage positions on real assets, transforming them into real options that have abandonment value, then putting them to the stakeholders who are left holding the bag. This is what the LBO model did to the American Dream of the stakeholders; the last five years demonstrate that this dream has been transformed into an American nightmare: the social consequences unfolding in the United States are there to see for all with the courage to open their eyes and squint through their rose-colored glasses.

3. The Theoretical Implications of the Proclivity

The premise is that the foregoing explains the decrease in real investment documented by the Economist throughout the entire world – except in China (The Economist, 2005); moreover, it explains the extreme risk-aversion implied by the so-called equity risk premium puzzle of neoclassical economics. Brealey and Myers admit that the struggle over debt policy is a "game" and a "warped strategy" entailing "…costs…to the economy as a whole…" but they neither specify nor examine these costs. (Brealey and Myers 2000, p. 516). One such cost is the wave of downsizing that has afflicted the USA for the last twenty-five years and which has transformed it into a net debtor. As already mentioned, the implications for its spread to Germany portend similar increases in social inequality as experienced in the US in these recent twenty-five years. A brief examination of these takes place in the next section. Essentially, productive capital has been substituted out of investors' portfolios and the myriad monetary forms of securities have taken its place; even though, technically, productive capital never existed in neoclassical portfolio theory to begin with. The irrationality of pricing appearing in today's financial markets has puzzled many analysts; things appear to be abnormal and are not concordant with their neoclassical mindset (CNBC Europe is useful to watch in this regard; see also, Wolf, 2006a and the Safehaven website). The above implies that the accumulation of money capital outstrips that of productive capital due to irrational exuberance and the contradiction can only be rectified via destruction of the fictitious, irrationally priced, monetary expressions of equity capital or shareholder value. This correction is ongoing as this is written suggesting that an alternative, rational explanation must exist that can explain this irrationality. The theory of the firm as shown above is inherently contradictory. An increase in risk decreases the value of assets in place but increases the value of the growth option. But since this latter has been transformed into a real option, value can be created via exercising it and downsizing the assets in place. This is the theoretical basis for corporate practice in the period of

Globalization. As if growth can be separate from real productive assets (assets in place) and the people who consume them and in so doing produce value. To maintain such a warped strategy reflects the depleted cognition pervasive in contemporary post-modern society.

The alternative rational portfolio theory, based on the rational Enlightenment thought out of which economic science emerged, is that the total capital (TC) of society equals the sum of money capital (MC) and productive capital (PC) [which includes commodity capital or goods (in the market and inventories)]: TC = MC + PC. Both sides are measured in units of money; however, whereas MC is an observable market magnitude, PC is not – PC can only be expressed in units of imaginary accounting money. Thus PC can be manipulated via creative accounting. The proclivity means that PC is substituted out of portfolios so that, 1 = MC/TC + PC/TC, and as globalization proceeds the proportion MC/TC increases relative to PC/TC. The skepticism over who owns the real assets of the firm – the bet upon whether the option should or should not be exercised – eliminates the distinction between equity and bond capital. Potential money capital changes form into a derivative with the consequence that a part of TC detaches (divests) from PC and invests itself into the myriad forms of MC (financial assets) and appears in the financial markets as excess liquidity (an excess supply of money capital) that lowers interest rates. Just as the classical economists suspected, these low rates reflect a low rate of profit on PC. Hence, as the fictitious shareholder value has been wiped out since early May, long-term interest rates have resumed their downward trajectory characteristic of the period of Globalization, the yield curve inverts reflecting resistance to US central banks attempts to raise rates and the real return to bond capital continues to erode as real interest rates decline with rising inflation (Wolf 2005b, cites Larry Summers' perplexity over a low real return to bond capital). The growth of the credit derivatives market reflects the lower real return to bonds and therefore their increasing risk; moreover, contrary to neoclassical theory, because risk is objective, not subjective, the higher bond risk appears as low real realized returns instead of higher returns due to higher risk. This is because they are serviced via deductions from net operating income produced by the downsized productive capital. The practical proof, that the value siphoned out of productive capital via neo-mercantile trading activity arises from human labor activity, is the irrational exuberance expressed, in the last 15-20 years, over the flight of money capital into China; and its subsequent migration out of China - in the form of the wealth of commodity capital – and onto the shelves of Walmart. The surplus labor of workers in China then reappears as the purchase of US Treasury securities (as a financial asset), which underwrites the American Debt Culture. This enormous amount of potential money capital is then being consumed unproductively to finance US government profligacy. This epitomizes the analogous nature of contemporary neo-Mercantilism to its original incarnation that was so eloquently critiqued in the Wealth of Nations (Smith 1776).

4. The Social Implications in Germany

The acceleration of neo-mercantile activity in Germany over the last 5-6 years expresses the reversal of the German Miracle characterizing the Golden

Age period; just like in all European countries and the USA the gains made during this period - in average living conditions for the average person who must work for wages/salaries - are being reversed because market advance is no longer conducive to transforming higher levels of productivity into real purchasing power to clear the commodity (goods) markets. Wolman and Colamosca subtitle their book on this subject the Betrayal of Work (Wolman and Colamosca 1997). Therefore, the State must intervene to facilitate market advance via the redistribution of a relatively smaller amount of value produced by downsized productive capital. In the US this has taken the form of "cutting government fat" under Ronald Reagan, Bill Clinton and the Bushes, while in Germany it is expressed as "cutting the welfare State " and increasing "labor market flexibility" and appears as the Hartz laws and Gerhard Schröder's Agenda 2010 and will be further pursued by Angela Merkel's Grand Coalition; it takes the social out of the "social market economy" of the Golden Age. "Behind this trend is a new generation of managers who understand that firms belong to shareholders, not bosses or 'society'" (the Economist 2000). The implication that firms exist separate from society illustrates the undemocratic hostility exemplifying the attitude of the proponents of the US model. The most productive workers in the world – that is why they are (were) paid the highest – are seen as an excessive cost, so that these legal measures (the Hartz laws) must be implemented (because the market can not do it by itself) to facilitate the creation of shareholder value. The world-class engineering industries, which led to the high productivity of these workers, are considered to be problematic – the Economist entitles a recent piece as, "The Problem with Solid Engineering"; moreover, the export surplus is seen as "damaging" and "self-defeating".

Germany is seen to require the expansion of consumer goods industries and therefore also expansion of consumer debt providers availing themselves of the excess liquidity swamping the financial markets (the Economist 2006b).

Dietmar Henning discusses a report that has "…found that the gap between rich and poor in Germany has grown considerably and will continue to do so". The report, written by Dr. Claus Schäfer ("Life is Good for the Wealthy"), shows that "the overall share of wages as a proportion of income of all types has fallen constantly since 2000". This is associated with increased burdens of taxation upon the lowest social groups and rising financial profits due to the rising DAX. This latter, however, will be tempered by the recent market downturn. Just like in the USA, tax cuts for upper income groups has not led to "…creation of new jobs, but 'a continuous increase in payments to shareholders' as well as the 'rising acquisition of financial assets and increasing executive board salaries'…" The study also finds that 'the classical rule that companies with rising profits invest more and create new jobs no longer functions'…". Furthermore, "…the level of state debt in comparison to GDP has risen from 41 to 66 percent…" (Henning 2005). In 2000, the newspaper Die Welt accurately expressed concern over the process of disintermediation by German banks: 'The merger mania in the German banking sector is not a sign of burgeoning strength—it is a symptom of weakness' (Richter 2000). The Frankfurter Rundschau concisely describes the arbitrage and abandonment of existing real assets when it writes '…Everyone is buying up, merging, in order not to be taken over, stripped to the bone and swallowed up by someone even more powerful' (Henning 2005). Peter Schwarz writes that - confirming the Judas nature of neo-mercantile State intervention – "there is a direct connection between the general social decline at work in Germany and the boom in share and stock quotations…" induced by the diffusion of hedge funds "…according to a study by the audit firm Ernst & Young, financial investors bought up 133 German enterprises during 2005, investing about 30 billion" (Schwarz 2006). Henning writes that, prior to the elections in the fall of 2005, a study "…commissioned by the SPD-Green Party government and…conducted by several economics research institutes…" concluded that the Hartz "reforms" failed to meet their goals of reducing unemployment (Henning 2006). Hence, the detachment of money and productive capital is evident when Schwarz cites the jubilation of Manager Magazine when it comments that 'Share values have disengaged themselves from the economic state of a country with nearly 5 million unemployed, 1.4 trillion euros in national debt and experiencing one of the deepest depressions of the post-war period' (Schwarz 2006). Thus, the same inimical social tendencies discussed by O'Neil (O'Neil 2005) accompany the spread of Debt Culture to Germany.

5. The Place of the Proclivity in the History of Economic Thought

In addition to the above classical economists that have inspired this text the name of Keynes must be added. When Keynes writes, "the destruction of the inducement to invest by an excessive liquidity-preference was the outstanding evil, the prime impediment to the growth of wealth, in the ancient and medieval worlds" (Keynes 1936, chap. 23), we must add the contemporary capitalist world as well. Although there is not total agreement with this statement (it incorrectly implies that capitalism has always existed), it closely approximates the implication of the Proclivity as above: the euthanasia of productive capital (which expressed itself in theory as the euthanasia of the economics of Keynes) (O'Neil 2005). In this chapter Keynes, in referring to classical economics, understood that the interest rate must be governed "…by the yield on productive capital"; however, his interpretation of the classical school differs from the present one. Nonetheless, it was Keynes' work that led to the rebirth of classical political economy in the 1970s, providing the fertile ground where the seeds were planted for the development of this text. Keynes brought Piero Sraffa to Cambridge, encouraged Maurice Dobb and Sraffa to edit Ricardo's works and in so doing contributed to the devastating criticism of neoclassical theory consummated in the Cambridge Controversies. Keynes' contribution to this text – and therefore to classical political economy - arise from: 1) the understanding that a conflict of interest exists between the providers of money capital to the firm and that deflation of commodity prices creates an increase in the relative value of debt capital that thereby increases its relative supply - what is called duality in O'Neil (O'Neil 2005) and in this text; 2) his practical activity in attempting to device an international monetary system that did not subordinate the expansion of productive capital to the maintenance of the value of the national currencies. The euthanasia of his life's efforts by the economics profession has facilitated the intensification of the detachment of money and productive capital - expressing itself in the Proclivity.

Conclusion

Steinherr argues that financial systems are "…determined mainly by political factors, such as the role of the State and of markets…" especially "…where democratic principles…and property rights have remained unchallenged…as societies become increasingly democratic and market-oriented, the bank-based financial system will give way to the market-based system" (Steinherr 1998, pp. 22-23). However, the limbo regarding the ownership of productive assets is certainly an endogenous challenge to property rights. Curiously, we have seen that he used the expression Achilles' heel to imply the necessity for exogenous liquidity provision by the Central bank; yet the Proclivity constitutes an endogenous Achilles' heel in an environment whereby democratic rights have been curtailed in the eight years since his book was written. Moreover, this challenge to democratic rights has been implemented from the top down via the neo-Mercantile practice required by both contemporary States and markets. The imposition of these policies, which were rejected by electorates both in Europe and the United States, required the behind-the-scenes manoeuvres that characterized the electoral processes in the USA in 2000/2004 and Germany in 2005. Such manoeuvres are the real Achilles' heel of contemporary, post-modern society.

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A Possible Change of EU States‘ Fiscal Policy in Conditions of World Economy Globalization: Debt Redemption Aspect

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Introduction

Globalization stimulates the integration of economies of particular states, whereas both phenomena together induce a changing competition character in both micro and macro levels. In global competition, countries’ integration is a means to resist private economic-financial groups or large states in the world market. Integration changes competition, going from the duopoly competition based on political ideology between the military-economic blocks (commanded by the USA and the former USSR) to the more intense economic competition form - to the oligopolistic competition between the regional unions[1]. Environmental alternation induces to revise the economy’s operational rules. One of the domains to be changed is national fiscal policy.

Under the conditions of globalization in the long term, one has to expect worldwide fiscal policies’ convergence. The direction of convergence will be determined by the countries that have developed the most efficient industrial mechanisms matched up to the fiscal culture, and that are able to control their States’ budgets the best. The analysis of this complex issue and a solution to it are the core of this article.

[1] Already now the development process of the economic union of the EU states, North America (USA-Canada- Mexico), Asia, and South America is in progress.

To evaluate the efficiency of national fiscal policy, two main indexes are applied: public debt and budget deficit. Budget deficit (BD) is the discrepancy between governmental spending and income of the financial years when spending exceeds income. Public debt (PD) is accumulated consolidated public debts emerging from the borrowed and unrepaid funds dedicated to finance the former budgets. The importance of these indexes is seen in their standing among the four EU most significant criteria in evaluation of the economic status of the EU states. Many evaluations of government fiscal policy are based upon comparative analysis of the relative and absolute PD and BD values. In the case of the evaluation of relative indexes of fiscal policy, the relative dynamic comparison of the particular states' indexes or their collation with a specific criterion of the optimal strong fiscal policy is possible. The PD and BD criteria are related to the particular values of these indexes. According to the Stability and Growth Pact, the consolidated public budget deficit level and public debt are, respectively, up to 3% and 60% of annual GDP. Fiscal policy indexes and criteria applied in the EU are criticized due to various reasons (Amaghi 2002; Mackiewicz 2004; Kopits, Symansky 1998):

1. These criteria's selection within the EU turned out to be a political solution with a target to control the weakest states' fiscal policy. This became obvious when the large EU members (Germany and France) stopped executing the intruded principles of a "correct" economic policy. To avoid penalties, they took the lead to soften the conditions in pursuance of the fiscal policy criteria.
2. The EU fiscal policy evaluation criteria suggested are accepted as universal, that is, applicable for all countries, but actually that is not so. For example, even if there is a higher debt level than provided this

> does not mean that debt will not be paid as everything depends on many factors such as the rates of economic growth, debt administrative costs, etc. The latter, in their turn, are dependent on the countries' development level. It should be acknowledged that Stability and Growth Pact purports to apply a particular fiscal policy evaluation to each state in consideration of its economic status; that is, the state's' efforts to improve are appreciated even if they do not meet basic criteria. Such flexibility, based upon the qualitative evaluation, in the author's point of view, gives overmuch freedom for political manipulations.

The contradictions of fiscal policy evaluation and drawbacks of fiscal policy indexes open scientific issue that must be solved. The alternative evaluation index of the fiscal policy and PD level must be suggested, and the evaluation of the EU states' fiscal policy must be done in this way. So, the object of this research is fiscal policy evaluation. The goals of the article are as follows: to suggest alternative fiscal policy evaluation criteria; on the basis of these criteria to evaluate the budget (fiscal) policy of the EU States in the context of the great global economies; to define a means enabling the EU to improve its position in the global market. One of the possible exploration directions is the evaluation of an actual fiscal policy (especially public debt) situation, predicting problematical points and highlighting advantages. For fiscal policy evaluation the method of comparative analysis is used, comparing the present EU fiscal policy with regards to its main competitors (the USA and Japan).

The first chapters the author explains the role of debt redemption period in the fiscal policy evaluation and proposes a fiscal policy evaluation index - intergenerational debt morality index. In the next chapter the fiscal policy status of the EU countries and its main competitors, the USA and Japan, is evaluated. Inferences about possible EU fiscal policy change and influence in forming the fiscal policy traditions are drawn in the last chapter.

The importance of the debt redemption period in the fiscal policy

The necessity of the new motivated fiscal policy evaluation index emerged after the contradictions in evaluating debt control in micro and macro aspects had been noticed. The essential contradiction that practically eliminates any possibility to suggest optimal or efficient debt level evaluation criterion is related to the public debt redemption period. In micro economic or management levels, debt redemption is related to the physical ability of a particular individual to pay debt interests and, finally, the debt itself. Here debt redemption is linked with the individual's responsibility during his active period of life. With their structure and logic in macroeconomics, debt control indexes conform to the indexes of micro levels, but their particular level cannot be concretized due to the "infinite life expectancy" of a state as an everlasting economic subject: contrary to private business, where inability to pay debts under the contract terms leads to bankruptcy, the actual insolvency of the state is rather a moral[1] than a real menace. Having no restriction for the debt redemption period, the only warranty to repay the debt of a current period turns to be the moral- ethical liabilities of the state. Public debt redemption period indeterminacy (infinity) has been substantiated due to the PD and BD benefits brought to future generations that will have to pay

[1] Even if a state cannot become bankrupt for not paying its debt, it will, nevertheless, not avoid complaints by domestic and foreign creditors. Complaints can take the form of public riots or the economic-financial isolation of a state. Thus, non-compliance of financial liabilities is followed by moral reprobation and indirect economic outcomes.

the debts of the current generation (governments). The benefit will be gained from borrowed funds: Properly invested, they will lead to the growing living standards of future generations (Rioja, Glomm 2003; Rankin, Roffia 2002). The debt redemption period indeterminacy is under criticism because it does not stimulate governments to more efficient usage of the public budget; this leads to debt and, accordingly, tax growth. The "goods," such as increased environmental pollution and drained natural resources left for the future generations, make it doubtful whether the benefit is so significant that it can justify the tax burden of future generations.

So, the not defined *PD redemption period* (*time horizon*) *is the only weakness in further development of the economic idea in terms of public debt control.* That's why on the basis of the debt redemption period definition, this article suggests an alternative fiscal policy evaluation index and criterion. The *debt redemption period* based fiscal policy index is proposed because it can combine all the factors having influence over the debt control and its redemption, and also including those formerly used (current public debt level and budget deficit).

In this article, fiscal policy is evaluated by proposing the *Inter-Generational Debt Morality index*, using the ideas of Generational Accounting (GA) methodology. The founders of this methodology suggest solving the issue of debt redemption time horizon delimitation (Bonin, Patxot 2004; CBO study 1995). In the GA methodology, forthcoming income and spending of the state are compared, and possible tax level variation ensuring full public debt redemption in a particular time is calculated; the theoretical assumption of debt redemption period infinity is excluded, and the time horizons for seventy-five, ten and three years are proposed. In this way the policies of the long, average, and short run term are evaluated. But, however, the GA idea's protagonists do not substantiate why those periods were chosen for the policy evaluation. That is the reason the author of this article decided to clarify the selection of the debt redemption period criteria to the evaluation of national budget policies.

Inter-Generational Debt Morality index

In the proposed public debt evaluation index, the current generation's (current government) responsibility for the future ones is highlighted. The author states that each generation must be responsible for itself and must not create new problems for future ones. That is why the concept of *Generation* is relevant and must help to determine governmental liabilities in its existence period.

According to the author, the concept *generation* can be determined as a group of mature people of a certain age which: 1) is legally and morally responsible for itself; 2) is able to take care of itself and of its dependants. From a sociological point of view, the timescale-age of a generation can be recognized as the age of an average person physically and morally ready to start an independent life. For statistical purposes the age of a generation can be identified, for example, as the average age of newly married couples, or the average age of women giving birth. On the author's supposition in the modern world, this period has to include the time necessary for obtaining basic and higher education and professional skills, and also the finances to start an independent life. This is a theoretical approach to the individual's independency and generation. According to the author, this timescale-age must be 25 years, that is 18 years dedicated to obtaining a basic education, plus 4 years for gaining a higher education, plus 3 years to becoming fixed in professional, business, and personal life. The age of 25 years is conditional. The author will apply it in further calculations as a minimal evaluation unit in estimating national budget policies.

The proposed integrated index of fiscal policy is defined as *Inter-Generational Debt Morality Inde*x (i_{DM}). Its idea is that every government assumes responsibility to provide, *within the funds available*, the country's residents with better economic welfare, at the same time undertaking to repay debts over the *defined time period*. The Inter-Generational Debt Morality index allows presenting, in the author's opinion, significant debt redemption characteristic in a more convenient form. The debt redemption duration, expressed trough the Inter-Generational Debt Morality index, is determined by the current debt level, debt service costs, the country's revenue growth rates, as the source of funds for debt redemption. It directly represents the key idea – to evaluate the debt redemption period (time "depth") considering its impact on future generations (formula 1):

$$i_{DM} = \frac{t_{Debt}}{t_{Gener}} \qquad (1)$$

Here t_{Debt}*- actual public debt redemption period;* t_{Gener}*- definition of one generation in terms of years (here 25 years).*

The author suggests following efficiency levels of government fiscal policy (that are related to the government's capability to repay its debts); they are expressed through Inter-Generational Debt Morality index and presented in table 1:

1. The fiscal policy responsibility level of 25 years (of one generation). Assuming that state control and fiscal policy decisions are realized by middle-aged persons (supposed to be 50 years old) the state's responsibility must be borne via those persons active period of life. Accordingly, the public debt redemption period of one generation gives the guarantee that the current government and the representatives of other economic-political institutions must bear at least moral responsibility for the efficiency of their decisions taken without transferring the responsibility to future generations. In terms of management, the ones taking decisions have to feel responsibility for the consequences of the decision. I treat this level of responsibility as the responsibility of individual politicians and it is related to the average age of politicians and I name it the "Moral fiscal policy" (table 1).
2. The fiscal policy responsibility level of 50 years (two generations). This level is based upon the attitude that indirect responsibility for the politicians' solutions is borne by the citizens of the country because they elected politicians to represent their interests. Within the average life expectancy of the inhabitants, the first conditional generation of 25 years at present indirectly taking part in politics has to bear the moral responsibility for the politicians' economic solutions that are seen in the fiscal policy indexes. Thus, the first generation during its lifetime has to pay debts and the time to repay the rest of the debts will be 50 years (or within two generations' time horizon). The availability of the public debt redemption period of 50 years to evaluate the fiscal policy morality can be substantiated by the already discovered duration of the long-term business cycle of Kondratjev. Its average time-span reaches 40 to 60 years, or an average of about 50 years. This criterion of the 50 years' debt redemption period of the

moral fiscal policy also incorporates the EU qualitative attitude about the necessity to balance the budget in the course of a business cycle. The proposed debt redemption level of 50 years reflects the responsibility limits for a mature society (first generation), and I name this level "Sustainable fiscal policy" (table 1).

Table 1. Inter-Generational Debt Morality index levels for fiscal policy evaluation

Debt repay term in years	0- 25years	up to 50 years	up to 75years	over 75 years
Conditional number of generations 1 generation= 25 years)	..................<1	.....................<2	....................<3	3<....................
Inter-Generational Debt Morality index i_{DM}=t/25	..................<1	.....................<2	.....................<3	3<....................
Qualitative description of inter-generational morality	Moral fiscal policy	Sustainable fiscal policy	Risky fiscal policy	Amoral fiscal policy

3. The fiscal policy responsibility level of 75 years (three generations). Another level of responsibility is related to the presently available attitudes toward the state's secrets. On the basis of understanding political responsibility and concern about the state's stability, the society must not learn the particular information for a while. In many states the marginal time to keep their (government) secrets is 75 years. In the author's opinion, lengthy restrictions on political information do not guarantee sufficient control of politicians and allow them to avoid responsibility for, in some cases, infamous, egotistic, and antisocial decisions. However, "the period of political rest from responsibility" could be applied by using it only as a marginal criterion of "a fair and morally accepted fiscal policy". However, I treat this as "risky fiscal policy", and exceeding this level of Inter-Generational Debt Morality index could be called "amoral fiscal policy". Outside this debt redemption duration level, no one person involved in the debt management decision process could take any real responsibility (because of all direct and indirect decision makers "disappearing").

Research assumptions and results

The purpose of this article is not to suggest a new method for public debt forecast, but to propose an alternative criterion for fiscal policy evaluation and to present its application. Therefore, in estimates of debt redemption period, this linear debt variation model will be applied (formula 2):

$$D_t = D_0 + D_0 \cdot i \cdot t - T_0 \cdot g \cdot t$$ (formula 2) or when D_t=0,

$$t = \frac{D_0}{T_o \cdot g - D_0 \cdot i}$$ (formula 3)

Here D- total government debt, % of GDP; i- long-term interest rates, %; t- debt redemption period in years; T_0- government revenue, % of GDP; g- GDP growth rate, %.

Upon application of the proposed criterion, we will make an evaluation of the fiscal policies of the EU countries, the USA, and Japan. Estimates used data (Eurostat, Economy and Finance) from the EU Department of Statistics, and missing information was supplemented with OECD data (OECD Factbook 2006). Data used for the estimates as well as their results are presented in table 2 (in Appendix). Some assumptions and constraint were made in calculations:

- In the estimates, a total public debt, but not a net debt, is evaluated – i.e., not the difference between public debt and its assets. The assumption is based on the author's attitude, that public debt should be covered with the help of current economic mechanism, i.e., without any qualitative modification. The reduction of public debt on the scale of public assets in the economic sense would mean an alteration of its current qualitative state, and this raises some doubts about the stability of other economy representing indexes, i.e., economy growth rates, interest, and others. Therefore, it is assumed that a state will cover its debts by effective economic management, rather than changing the rules of the game for future generations; i.e., it will be considered that the taxing system for debt redemption will not be altered, and taxes will remain stable.

- The scientific attempt to present the new fiscal policy's evaluation index is made there. However, as most states worldwide practice, according to the author's calculations, an "amoral fiscal policy," the author of this article decided firstly to arrange states according their ability to redeem public debt. For this the effect of interest payments on debt was reduced using the coefficient 0.25. So, the real situation of Japan, the USA, and even the EU is even worse, because the ability to redeem the debt is overvalued.
- We state that throughout the entire debt redemption period (in the long run) budgets of states will be balanced. This assumption is long-term-oriented, i.e., 25-75 years, during which we will apply the qualitative debt control criterion of the EU, i.e., and deficit offsetting (balanced budget) during the business cycle. In other words, it will be assumed that current public total debt will be reduced using only money received from a country's economic growth.
- In these estimates of public debt redemption period, we will refer to assumptions about global convergent movement of budget policies, during which all economic rates (here g and i) in conditions of global competition will continuously become equal. For this:
    - I simulated the Debt Morality Index change considering two economy growth assumptions: in the first I supposed that economy growth rates of the states until public debt redemption will amount to the average of two values: average of economy growth rates of the last 10 years (1996-2005) and a criterion of 3 percent growth rates, which was raised by the EU as a long-term objective. This estimate is applied to all

states, without exception, supposing that during debt redemption they will reach the long-term average statistical economy growth rate. In the alternative estimate option (the second assumption) of public debt redemption evaluation, it is supposed that throughout the entire term of debt reduction the growth of the economy will be 3% (i.e., the EU growth objective has been already reached).

- o Long-term interest rates (Annual average of 10-year government bond yields) will be used for estimates of states' public debt service costs. Data of long-term interest rates are calculated as weighted average values of 2001-2005; they are adjusted supposing that in the long-term these average interest rates of the state will approach the average weighted interest rate of the analysed whole. The states' GDP relative shares of 2005 serve as weight coefficients.

Using the inter-generational debt morality index, the budget policies of the USA, Japan, and the EU are assessed as amoral in respect to future generations. The situation of Japan is most complicated. Estimates (negative index) show that Japan will never manage to repay debts if its economy growth rates do not increase and if it does not initiate serious budget reforms. The current situation of the European Union is better than that of its economic competitors: debt morality index is close to the level of 3 generations, while the USA would repay its debts only in 16 generations. Regardless that the public debts and GDP ratio are close to the EU level, the USA, if it does not change its current economic policy and geopolitical behavior, has less opportunity to improve its situation:

- Its long-term interest is higher than that of the EU. Due to very active military and economic domination in the world and rising resistance, confidence in the USA economy may decrease, and the only way to return investment would be to increase the interest rate level even more. Thus, debt service will become more expensive, and the growing interest may result in the slowing down of investment and production as well as USA revenue decrease.

- To carry forward debt repayment, taxes should be significantly increased, and that is always opposed. Compared to the current EU revenue level, the USA tax should increase at least 2 times. In an economic sense, this means a change of the taxing system and the entire economic policy.
- USA growth rates remain higher than those of the EU, and exceed 3%; and this means that assurance of even higher economic growth will be even more complicated (table 2, in Appendix).
- USA possibilities to finance its debts with the help of debt monetarisation have decreased, and will decrease in the future, since the force of the Euro in worldwide monetary competition will grow up. Disregard of such changes would just increase incredulity in the USA Dollar and in its economy, while EU possibilities to take advantage of worldwide monetarisation increase.

Propositions for EU fiscal policy modifications

Formation of an oligopolistic market of economic unions makes the factor of costs very significant: for the state it is a more effective way to use resources. The state's fiscal policy is an important part of such an efficiency ensuring system. *The EU should use its relatively better situation of fiscal policy for economic worldwide concurrence to attract foreign investments toward the EU and to enlarge its influence at the geopolitical level.* To reach this:

- It is necessary to tighten up evaluation of fiscal policy and strengthen responsibility: opposition of bigger and more developed states, i.e.

France, Germany, and Italy, not only discourages other states-members from observing stated rules, but also threatens EU vitality itself. It is a source of perpetual disputes.

- The situation of public debt control of new EU members in respect of suggested debt criterion is favorable at the moment; however, undue optimism may encourage politicians to pursue careless fiscal policy and to make risky decisions. For example, in 2005 economic growth in Lithuania was 7%, but the government does not even try to form an adjusted (not even to speak of a surplus) budget; one needs to keep in mind that, together with economic growth, which results in revenue growth, significant EU financing is obtained; so, EU recommendations to form a cyclically adjusted budget are not followed. In such a way debts are gradually rising, the redemption of which would become complicated in case of growth rates slowing down (Lithuanian Inter-Generational Debt index exceeds 1, if growth rates slow down to 3%) (table 2). Therefore the succession of fiscal policy should be ensured; this must induce different political parties to pursue only economically based policy, avoiding the application of populist and thus destabilizing means.
- It is necessary to use the experience of states' effectively managing their budget. So, the northern states' standard is not only as "welfare" economy cases with strong settlement of social problems, but also as states responsibly managing their budgets. Namely Sweden, Finland, and Denmark are among the states assuring public debt redemption in a period of 2 generations (table 2, in Appendix).
- In order to make fiscal policy more attractive to the world's investments, it is necessary to highlight the idea of "moral" fiscal policy, and to reveal its benefit to business in the long-term. At this point the application of Inter-Generational Debt Morality index would help in propagation of a morally responsible government image.
- The EU must plan means and conditions to improve debt through special funds. Thus, the states with better positions in terms of debt

redemption (the new EU States included) could help the weaker ones to solve their fiscal problems.

Summary

In this paper the alternative index of fiscal policy evaluation is proposed; the fiscal policies of the EU, the USA, and Japan are also evaluated; and proposals for EU fiscal policy development are made.

- Proposed Public Debt Evaluation index, i.e. Public Debt Morality index is related to a human's active life expectancy. According to the author, the public debt should be redeemed over a period assuring the responsibility of the current generation, which makes decisions regarding the fiscal policy pursued, by it; only in such a case at least minimum moral controlling pressure on the government making economic policy decisions may be ensured. There are three evaluation levels of fiscal policy morality which relate fiscal policy efficiency of the current generation to its ability to cover the public debt: debt redemption periods of 1, 2, and 3 generations. The fairest generationally responsible fiscal policy is that the public debt morality index does not exceed 1, i.e., public debt should be redeemed within the average lifetime of politically active persons. Marginal debt redemption criterion, i.e., debt redemption level of 3 generations, pertains to potential human lifetime (a 100 years), and to the currently applicable political period of national secret preservation (may amount to 75 years). Thus the marginal level of political responsibility is linked with the fiscal policy responsibility level.
- Upon the USA's, Japan's, and the EU's public debt evaluation, it was determined that the EU's Inter-Generational Debt Morality index is closest to the debt redemption level of 3 generations. Among EU member states, only Latvia, Lithuania, Estonia, Luxemburg, and Slovenia were attributed the most responsible fiscal policy pursuing

group of states. Of the old member states, the Nordic countries and Ireland are distinguished as the best, the experience of which should be applied in EU fiscal policy improvement. The EU is proposed herein to availe itself of the current favorable fiscal policy situation, applying it as macroeconomic marketing means for attraction of foreign investments to the EU. The proposed criterion for fiscal policy evaluation will not ensure its efficacy if there is no political willingness.

- The author proposes to improve weaker (in terms of debt redemption) states' debt through special EU funds. Of course this needs formulating exact rules of debt redemption. States with better debt redemption positions (the new EU countries included) could help the lower performing states (the old ones) to solve their fiscal problems.

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Table 2. Evaluation of Fiscal policy according to the Inter-Generational Debt Morality index (iDM)

State	*% of GDP*		*%*		***Evaluation of EU Fiscal policy using historical data of growth rates (1)***			***Evaluation of EU Fiscal policy with 3% of objective growth rates (2)***		
	General government debt	***Total general government revenue***	***Long-term interest rates***	***Real GDP growth rate***	***Debt redemption period in years***	i_{DM}	***Qualitative definition***	***Debt redemption period in years***	i_{DM}	***Qualitative definition***
Japan	**164,00**	**26,09**	**2,72**	**2,56**	**-365,65**	**-14,63**	**amoral**	**-493,36**	**-19,73**	**amoral**
United States	**63,40**	**27,66**	**4,38**	**3,08**	**400,90**	**16,04**	**amoral**	**400,90**	**16,04**	**amoral**
UE 25	**63,64**	**45,07**	**4,27**	**2,65**	**123,05**	**4,92**	**amoral**	**94,60**	**3,78**	**amoral**
Austria	64,30	49,70	4,21	2,60	**104,35**	**4,17**	**amoral**	**78,90**	**3,16**	**amoral**
Belgium	95,70	49,84	4,22	2,54	**373,50**	**14,94**	**amoral**	**197,12**	**7,88**	**amoral**
Cyprus	72,00	37,28	4,93	3,24	**225,77**	**9,03**	**amoral**	**311,28**	**12,45**	**amoral**
Czech Republic*	36,80	40,04	3,77	3,33	*37,37*	*1,49*	*sustainable*	*43,06*	*1,72*	*sustainable*
Denmark	43,20	55,78	4,25	2,58	*44,19*	*1,77*	*sustainable*	*35,56*	*1,42*	*sustainable*
Estonia*	5,50	38,02	4,02	4,74	3,15	0,13	moral	5,07	0,20	moral
Finland	45,10	54,04	4,19	3,24	*35,36*	*1,41*	*sustainable*	*39,27*	*1,57*	*sustainable*
France	65,10	49,78	4,18	2,62	**104,24**	**4,17**	**amoral**	**80,00**	**3,20**	**amoral**
Germany	66,40	44,60	4,14	2,18	**232,45**	**9,30**	**amoral**	**101,94**	**4,08**	**amoral**
Greece	109,30	44,82	4,29	3,47	**284,62**	**11,38**	**amoral**	**630,46**	**25,22**	**amoral**
Hungary	57,40	44,04	5,70	3,56	**76,51**	**3,06**	**amoral**	**113,97**	**4,56**	**amoral**
Ireland	29,80	34,34	4,19	4,06	*27,54*	*1,10*	*sustainable*	*41,49*	*1,66*	*sustainable*
Italy	106,50	45,66	4,26	2,14	**-666,73**	**-26,67**	**amoral**	**452,76**	**18,11**	**amoral**
Latvia	14,70	34,02	4,13	4,95	9,60	0,38	moral	16,92	0,68	moral
Lithuania	19,60	33,02	4,45	4,46	15,62	0,62	moral	*25,37*	*1,01*	*sustainable*
Luxembourg*	6,60	45,08	3,72	4,05	3,75	0,15	moral	5,11	0,20	moral
Malta	75,90	39,38	4,64	2,39	**1221,06**	**48,84**	**amoral**	**252,24**	**10,09**	**amoral**
Netherlands	53,10	45,04	4,18	2,63	**84,27**	**3,37**	**amoral**	***66,64***	***2,67***	***risky***
Poland	43,60	40,20	5,63	3,59	***52,53***	***2,10***	***risky***	***73,54***	***2,94***	***risky***
Portugal	59,40	41,54	4,23	2,68	**122,79**	***4,91***	**amoral**	**96,00**	**3,84**	**amoral**
Slovakia	42,50	38,84	4,88	3,64	*47,48*	*1,90*	*sustainable*	***65,73***	***2,63***	***risky***
Slovenia	29,80	45,00	3,61	3,45	23,25	0,93	moral	*27,56*	*1,10*	*sustainable*
Spain	46,90	38,30	4,20	3,31	***60,51***	***2,42***	***risky***	***71,45***	***2,86***	***risky***
Sweden	51,10	58,94	4,32	2,87	*44,94*	*1,80*	*sustainable*	*42,00*	*1,68*	*sustainable*
United Kingdom	41,50	40,76	4,42	2,89	***57,70***	***2,31***	***risky***	***54,31***	***2,17***	***risky***

** Long-term interest values of Czech Republic, Estonia, and Luxemburg is long-term interest average of 2005.*

Source: European Central Bank http://www.ecb.int/stats/money/long/html/index.en.html

Taxation relations and tax culture perspective in the context of integration and globalisation

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Introduction

The state tax system is not only the main source of state budget income in every country, supporting administration of public functions, but also a factor, stipulating the state business environment and investment rise, wherefore economic growth increases. Thus, tax systems become a measure of competition and governments of EU old and new member states should pay more attention to development of taxation relations under integration and globalisation conditions. The stronger the economies of EU member states are, the more competitive is this organization in the world. Taxation relations, involving a broad spectrum of appearances - from each separate taxpayer, his objective and subjective perception of tax burden, different relationship between labour, capital, and consumption taxation till the difficult state taxation policy - is essential for state life as an investment stimulating measure supporting also econoic growth. Thus, it is constructive to analyse this phenomenon in a broader point of view in the context of European integration and globalisation.

Problem of this research. After European Union extension on May 1st 2004 and 10 new member-states' entering this organization, supporting free movement of capital and persons increased competition in the taxation field.

In a way taxation plays a much more important role in the state competitiveness rate than earlier, thus we defined it as an important problem of the EU and the rest of the world. Besides, indirect taxes harmonization's overwhelming taxation base and tariffs, hot discussions on harmonization of direct profit tax base calculating, increase of taxable income and both development of business conditions becomes more important as competition condition, thus it is an actual scientific and practical problem and it is valuable to analyse this phenomenon in a broader point of view. Besides, not all countries have the possibility to decrease a heavy tax burden; however, in seeking advantages in competition; all of them could develop their tax systems according to tax culture aspects. The latter concept has been known in the world for about 80 years; still its scientific and practical perception is not so developed in Lithuania and in other new EU member states. F.Meisels first mentioned this concept more than eighty years ago, later it was analysed by J.A.Schumpeter, A.Pausch, M.Camdessus, V.Tanzi, J.Martines-Vazquez, R.Berger, H.M.Hartmann, U.Hübner, B.Nerre, and others. Therefore, we think perception of taxation relations not only as obligation but also in a broader point of view will be valuable for its development under difficult integration and globalisation conditions.

Object of the research – taxation relations and tax culture in the context of European integration and globalisation.

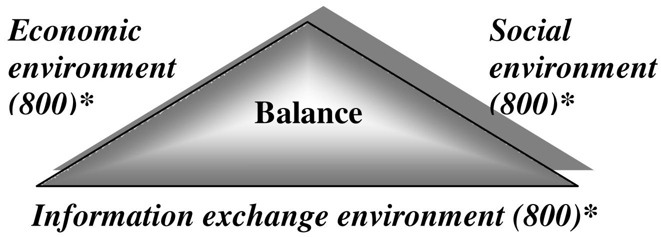
Purpose of the research – analyse taxation relations in a broad point of view in the context of European integration and globalisation.

Methods used: systematic analysis of scientific literature, analysis of comparison, analysis of generalization, statistical data analysis, correlation regression analysis.

EU member states according to statistical indexes in the context of integration and globalisation

Two years after the European Union extension on May 1st 2004 and 10 new member states' entering this organization, it is purposeful to evaluate social and economic changes in these countries and compare them with analogical changes in other countries. The economic development of the new EU countries increased compared to other developing countries; stil, they lag behind developed countries. This also is proven by the Wealth of Nations Triangle Index calculated by Money Matters Institute from 1996 and evaluating 70 developing states according to economic (development of national economy, its internationalisation and business environment), social (stability and development, health and welfare and natural environment) and information exchange (information aptitude, its infrastructure and distribution) conditions (Figure 1). Each angle contains 21 variables and each of them is given equal weight, based on a desire for simplicity, transparency, and balance among the three angles. The higher is the total Wealth of Nations Triangle Index, the faster is state economic development.

Figure 1. Methodology of the Wealth of Nations Triangle Index calculation (designed by authors according to Money Matters Institute)



**The best possible score for each triangle is 800. The best possible overall score is 2400.*

According to the World Paper (2005), EU extension was a great impulse to economic and social welfare development to East and Central European states; nevertheless, data for index calculation were taken when the 10 new recent EU member states were still waiting for participation in this organization. It is maintained that this anticipation contributed to the increase of the index. The Wealth of Nations Triangle Index in 2004, with both compounding indexes and state position change compared with 2003, is presented in Table 1. There the Asian "tigers" - South Korea and Taiwan - and the three Baltic States – Estonia, Latvia, and Lithuania – persist in the top 10.

Table 1. The 2004 Wealth of Nations Triangle Index* (World Paper, 2005)

No.	Country	Rank change compare to 2003	Total	Economic environment	Social environment	Information exchange
Developing countries						
1	Slovenia	+1	1878	556	706	617
2	Israel	+2	1861	534	700	628
3	South Korea	-2	1856	598	648	610
4	Czech Rep.	-1	1855	595	687	573
5	Taiwan	+1	1816	572	674	571
6	Estonia	+1	1814	616	617	581
7	Hungary	-2	1790	531	711	548
8	Slovak Rep.	0	1751	565	681	504
9	Lithuania	+2	1718	545	709	463
10	Latvia	+2	1705	526	661	517
12	Poland	-3	1634	475	691	469
27	China	+7	1438	586	518	334
30	Belarus	+6	1406	465	615	325
31	Russia	+7	1404	485	537	382
35	Ukraine	+7	1378	449	601	328
70	Kenya	-1	967	417	391	160
	Average score for developing countries		1407	471	349	587
Developed countries						
	Singapore		1915	674	642	599
	Spain		1952	625	781	546
	Japan		1975	649	711	615
	Netherlands		2111	678	772	661
	USA		2143	630	738	776
	Average score for developed countries		2019	651	729	639

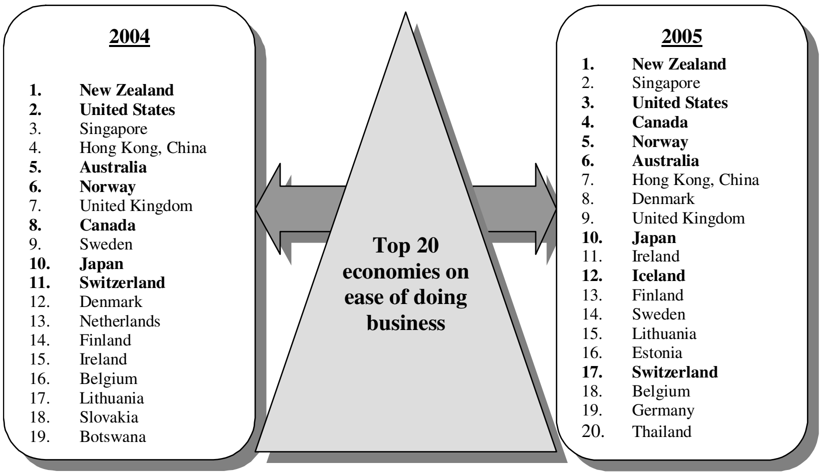
** For each variable, raw data is converted into an Index score from 0 to 100, with 0 representing the worst performance against all other nations and 100 the best performance. Index scores are combined for each angle and then totalled.*

According to economic conditions, Estonia takes the first place, while according to total index it is in the sixth. Latvia and Lithuania moved 2 stages up comparing the Wealth of Nations Triangle Index of 2004 with that of

2003. It is interesting that China, according to total index level is in the 27^{th} place, since according to economic conditions it is 9n the 6^{th}. The total index of this state is low, since social conditions are lower than economic ones. The reverse result occurs in East and Central-European countries where the index of social conditions is much higher than the economic; meaning there is higher social than economic stability.

Change of business conditions in a state is not less important, since it creates work places and gross domestic product in a state. Investment rise, depending on business conditions in a state, relates to faster economic development – improvement of the ease of doing business is associated with up to 2 percentage points greater annual economic growth (Doing business in 2005). The World Bank and International Finance Corporation present annually, from 2004 on, a report of the Top 20 or Top 30 economies in ease of doing business. First, business conditions were evaluated according to 5 indicators: starting a business, hiring and firing workers, enforcing contracts, getting credit, and closing a business. Later, there were updates on another set of indicators: registering property and protecting investors. The Top 20 economies in ease of doing business in 2004 and 2005 are presented in Figure 2. But this comparison is not really equivalent since there were three new indicators introduced: dealing with licenses, trading across borders, and paying taxes. Therefore, taxation relations play an increasing role for states' competitiveness under integration and globalisation conditions (about half of the states undertook taxation burden decreasing reforms along with facilitating tax administration procedures). The Top 3 countries remained almost unchanged (Figure. 2) – New Zealand is at the top of economies in ease of doing business, Singapore is a runner-up, the United States is third. Three Asian countries – Hong Kong (China), Japan, and Thailand - are among the Top 20. Two Baltic States – Estonia and Lithuania – are also among the Top 20. It is interesting that the Nordic countries moderating the highest business taxes are in the Top 20. Besides, more than half of the countries on this list are not EU countries.

Figure 2. Top 20 economies on ease of doing business in 2004 and 2005 (Doing business in 2005, Doing business in 2006)



The significance of taxation is also noticeable from the indexes' calculation; for instance, as the taxation environment indicator is included into the business environment index, it is therefore purposeful to analyse the generalized tax burden rate, its change and impact on GDP growth, and the size of the shadow economy in a broader context of integration and globalisation.

Tax burden change in EU and other countries during 1995 - 2004

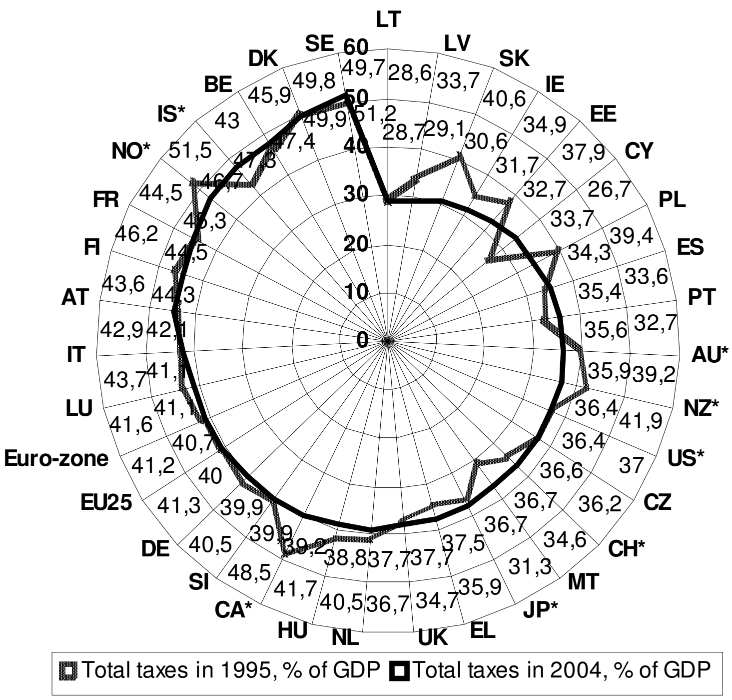
Developing the EU market (EU entering the new member states, which level of development and traditions in separate fields differ from EU old states), where it is easier to migrate both for enterprises and citizens, taxation marketing, involving tax collecting ways and amounts, among EU states becomes much more important. Some new EU member states, for instance Slovakia, have already unified tariffs of three taxes – profit, VAT, and income – others are still seeking for that or preparing to decrease tariffs (Lithuania, Latvia, Estonia, and Poland). The general comparable tax level in the state is presented by the tax burden rate. Therefore, there is a tax burden rate change during the years 1995-2004 of the EU25 and 8 other countries (not EU member states) from the Top 20 economies in ease of doing business (boldface countries in Figure 2) presented in Figure3 (the external circle values show total taxes [% of GDP] in 1995 and the internal circle values – total taxes [% of GDP] in 2004).

As we notice from the tax burden map, this rate decreased in almost half of the countries comparing 2004 with 1995, but there are three countries where the tax burden increased more than 3%: Malta, Cyprus, and Iceland; the tax burden of the other EU25 and Euro-zonecountries decreased 0.5% each. During 2004 the highest tax burden rate was in Sweden (51.2%), the lowest – in Lithuania (28.7%). It is interesting that the tax burden rate in the EU (between the highest and the lowest tax burden rates) differs almost doubly; in addition, the new EU member states and 6 out of 8 economies at the top in ease of doing business (not including the Nordic countries, as Norway and Iceland) have a lower tax burden than the Euro-zone and EU25 average rate.

It is noticeable that EU competition in the taxation field increased for the 10 new member states upon entering this union on May 1, 2004.

Thus, integration and globalisation play an important role in tax burden change, which affects business environment and competitiveness in most countries. However, the position of countries on the list of Top 20 economies in ease of doing business shows that this in not the only indicator the affecting business environment changes in a state. Therefore, for a broader point of view, it is purposeful to analyse tax burden relationship with other macroeconomic indicators (GDP growth, shadow economy) under integration and globalisation conditions.

Figure 3. Total taxes (as a % of GDP) in EU countries and other countries from Top 20 economies in 1995 and 2004 (Eurostat, www.oecd.org)



**General government total outlays, % of nominal GDP, www.oecd.org*

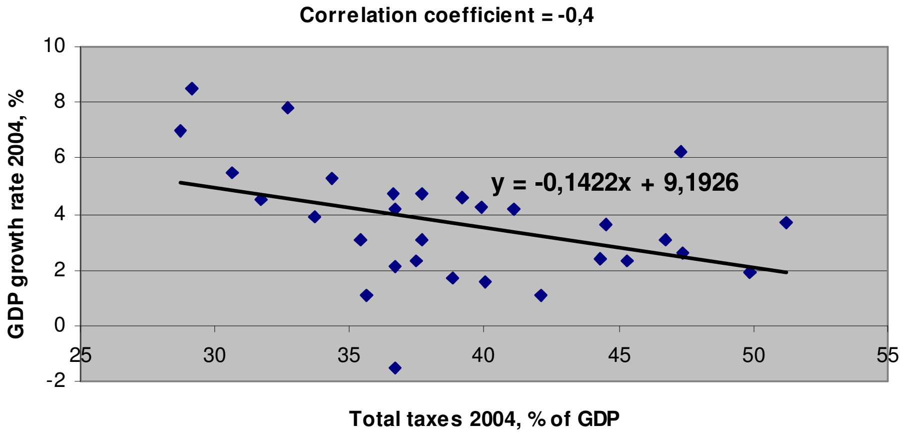
EU25: the Czech Republic (CZ), Estonia (EE), Cyprus (CY), Latvia (LV), Lithuania (LT), Hungary (HU), Malta (MT), Poland (PL), Slovenia (SI), Slovakia (SK), Denmark (DK), Sweden (SE) and the United Kingdom (UK) and Euro-zone: Belgium (BE), Germany (DE), Greece (EL), Spain (ES), France (FR), Ireland (IE), Italy (IT), Luxembourg (LU), the Netherlands (NL), Austria (AT), Portugal (PT) and Finland (FI).

Other countries from Top 20 economies: Iceland (IS), Norway (NO), Canada (CA), Japan (JP), United States (US), Switzerland (CH), New Zealand (NZ), Australia (AU).

Tax burden, economic growth and shadow economy relationship

Correlation regression analysis of tax burden and GDP growth in 2004 and correlation coefficient (-0.4) show there is not a very strong negative relationship between these indicators (Figure 4). Besides, the example of the Nordic states (Norway, Denmark, Sweden, Finland, and Iceland) shows that high tax rates may not have a negative impact on successful business development.

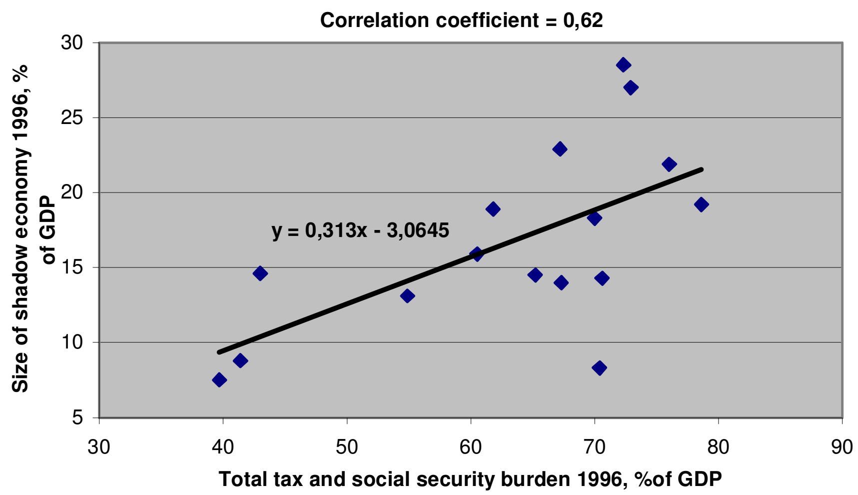
Figure 4. Total taxes (as a % of GDP) versus GDP growth rate, 2004 (Eurostat, www.oecd.org)



It is interesting, nevertheless, that though the Nordic countries have among the highest tax tariffs – the tax burden in Finland, Norway and Iceland is, respectively, 44.5%, 46.7% and 47.3% of GDP, Denmark – about 50%, Sweden – 51.2% in 2004, they all are among the Top 20 economies in ease of doing business; besides, the size of unregistered business is only about 8% in these countries (Doing business in 2006). The reason for that is the quality and sufficiency of public services, which are financed from business taxes. But this is more an exception than a rule.

Administration of state public functions requires means, most of which are collected from taxation income. Existing shadow economies create shadow product, from which taxes are not calculated and paid. Thus, state income from taxes decreases and thus decreases the income of every citizen, expressed in public services, which are administrated by the state. The importance of tax burden as a main factor of the shadow economy was recognized by F.Schneider (1994b, 2000) and S.Johnson, D.Kaufmann and P.Zoido-Lobaton (1998a, 1998b) (F.Schneider and R.Klinglmair (2004) exclude the impact of administration intensity and public services on the shadow economy). However, tax burden may be either the reason for the shadow economy or the result of it. Taxes affect labour supply in a shadow economy, and the higher the difference between total and net income, the higher is the desire and need to minimize this difference and move to shadow business. The state, seeking to collect the amount of planned financial means for administration of its functions, can increase tax tariffs, also increasing the tax burden, which thus increases the size of the shadow economy.

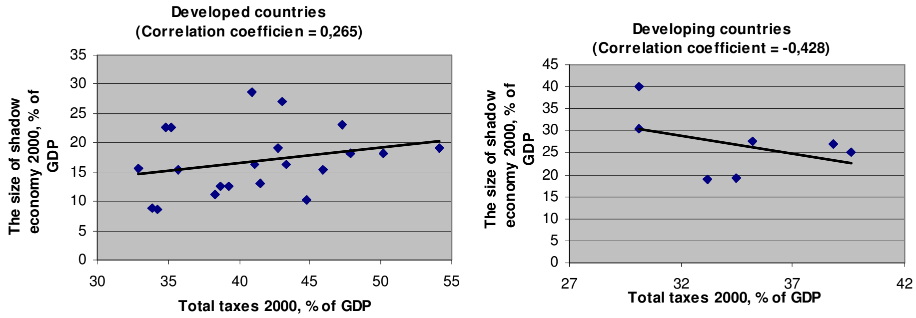
Figure 5. Size of shadow economy 1996 (as a % of GDP) versus total tax and social security burden 1996, (Schneider, 2000b)



Research on the relationship between tax burden and shadow economy in 16 OECD countries was done by F.Schneider (2000b) in 1996, and a broader analogical research in 109 countries of the world was done by F.Schneider and R.Klinglmair (2004) in 2000. Evaluating the relationship between tax burden and shadow economy one notices that increasing social insurance and direct tax burden, along with total tax and social insurance burden, increases the level of the shadow economy (Figure 5). The highest level of tax burden and shadow economy among 16 OECD countries in 1996 was in Greece, Italy, Belgium and Sweden (tax burden rate was, respectively, 72.3; 72.9; 76.0 and 78.6 %), the lowest in Switzerland and USA (tax burden rate was, respectively, 39.7% and 4.4%, and the size of shadow economy was respectively 7.5 and 8.8%). Besides, a correlation coefficient of 0.62 shows strong positive statistical relationship between tax burden and the size of the shadow economy, thus state governments increasing the general tax burden and not initiating changes in taxation relations, risk an increase in the size of the shadow economy and worsen relations with taxpayers.

Regression analysis done by F.Schneider and R.Klinglmair (2004) in 2000 shows a statistically significant negative relationship (-0.052) between shadow economy and economic growth in developing countries and statistically significant positive correlation relationship (0.077) between shadow economy and economic growth in industrialized countries. When the size of the shadow economy increases 1% from GDP, official level of economic growth decreases 4.9%. Analysis of tax burden and shadow economy in 21 industrialized countries (when tax burden increases, the size of the shadow economy also increases, correlation coefficient = 0.265) and 7 developing countries (when tax burden increases, the size of shadow economy decreases, correlation coefficient = -0.428) in 2000 present similar results (Figure. 6).

Figure 6. Size of shadow economy versus total taxes 2000, % of GDP (calculated by authors according to data from Schneider, Klinglmair, 2004; Eurostat; www.oecd.org)

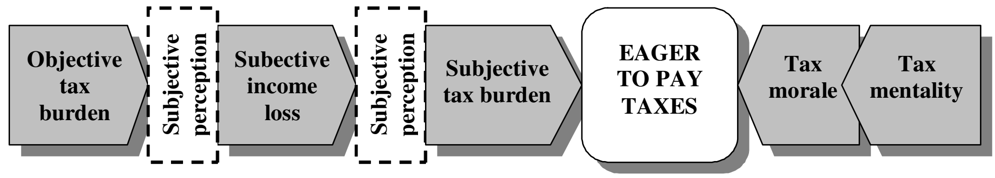


Marginal tax burden also has an impact on the size of the shadow economy. According to R.J.Cebula's (1997) calculations, increase of marginal income tax tariff by 1% (ceteris paribus) increases the size of the shadow economy 1,4%. And the decrease of tax burden does not always give a positive result or it is shown only in the long-term. For instance, research in Austria done by Schneider (1994a, 1998b) shows decrease of direct tax burden did not affect the size of the shadow economy. The reason for that might be only a decrease of the tax tariff while other tax culture indicators affecting changes of taxation relations remained unchanged.

The other reasons for the shadow economy and the role of the tax burden are presented by S.Johnson, D.Kaufmann, and P.Zoido-Lobaton (1998b). They conclude that there is a negative correlation between the size of the shadow economy and tax tariffs, and not high tax tariffs themselves, but application of an ineffective and discriminatory tax system in a state, as we can see later, irregardless of the tax culture, increases the level of the shadow economy. But they found a positive correlation between the size of the shadow economy and profit tax burden. In this report, the shadow economy is affected by many factors (taxation relations in a state, tax administration procedures, level of corruption, bureaucracy, etc.), not only by the tax burden itself. This is proved also by the example of the Nordic countries, showing that taxation relations in a broad point of view, including permanent interaction of taxation institutions with taxpayers, social services and permanent help, providing information for taxpayers, are also significant.

Not only economic but also psychological indicators have an impact on taxation relations and perception of tax burden (Schmölders, 1980). Eagerness to pay taxes is affected by such psychological indicators as tax morale, tax mentality and perception of tax burden (Figure 7). Different authors' concepts of tax morale and tax mentality differ; however, the popular opinion (Tretter, 1974; Holtgrewe, 1954; Schmölders, K.Schnelle, 1978) is that tax morale is a part of tax mentality. Evaluating further how this subjective income loss affects his personal income sufficiency determines the subjective income burden, which can be higher or lower than the rate calculated by the statistical department. Thus, the social system of the country, relations between institutions and its citizens, information spread and sufficiency and other economic and psychological indicators affect citizens' eagerness to pay taxes.

Figure 7. Indicators, having an impact on eager to pay taxes (designed by authors according to Schmölders, 1980)



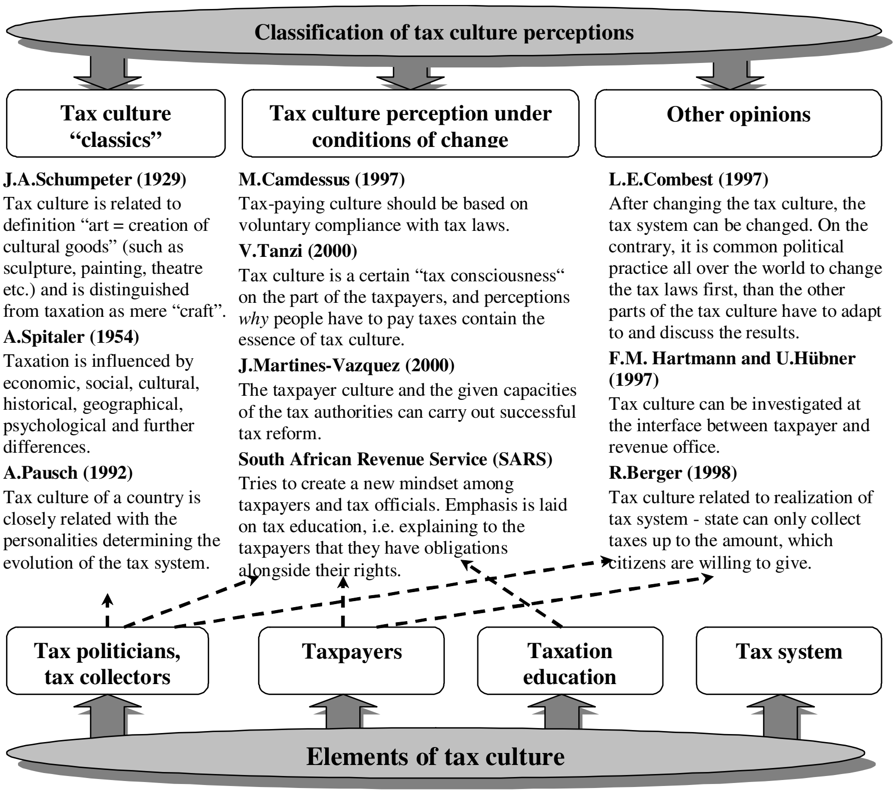
Therefore, a high tax burden in some countries under integration and globalisation conditions shows not only higher obligations for business and citizens, but also a more developed system of social services and diversity of other state functions. Unclear tendencies between economic growth or tax burden and the shadow economy show more attention should be paid not only to tax burden as a separate indicator, but also to the quality of state services, which are financed from taxable means, their sufficiency, stability of taxation policy, information spread, the and development of relations between the tax institution and other public institutions and its citizens. The result could be creation of a tax system based on tax culture aspects.

Tax culture perspective in the context of European integration and globalisation

The perception of tax culture is a new and very little analysed phenomenon in Lithuania and other new EU member states; however, recently there have been more Lithuanian scientists (K.Levišauskaite˙ and others) discussing this topic. The perception of tax culture in the Lithuanian scientific and practical field is very small; therefore, we think it is necessary to present the genesis of tax culture perception for a broader view of this phenomenon.

F.Meisels first used the concept of tax culture in 1926. Further, J.A.Schumpeter, A.Pausch, A.Spitaler, M.Camdessus, V.Tanzi, J.Martines-Vazquez, R.Berger, H.M.Hartman, U.Hübner, B.Nerre and others developed the perception of tax culture. B.Nerre (2001) presents the following classification of perceptions of tax culture: tax culture classics, tax culture perception under conditions of change, and other opinions. The comparison analysis of these perceptions in foreign scientific literature according to elements of tax culture is presented in Figure 8.

Figure 8. Comparison analysis of perception of tax culture (designed by authors according to Schumpeter, 1929; Spitaler, 1954; Nerre, 2001; Tanzi, 2000)

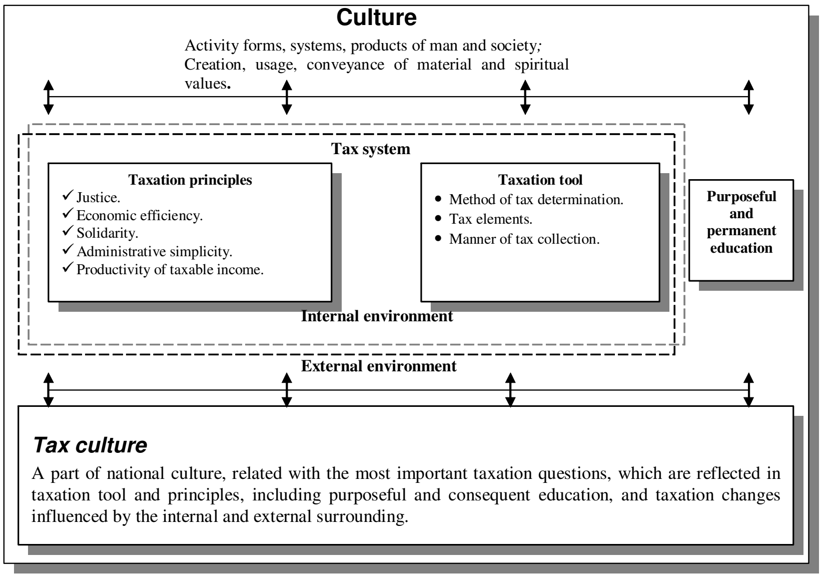


Summarizing, one can say that the “classical” understandings of a country’s “tax culture” (J.A.Schumpeter, A.Spitaler, A.Pauch,) are almost entirely restricted to the creators of the tax system. The others, as M.Camdesus, V.Tanzi, and J.Martines-Vazquez, conclude that taxpayers should accept such a situation in any case, and their consciousness should be increased.

German scientist B.Nerre (2001) declares that the synthesis of the two terms “tax” and “culture” succeeds via evolutionary process: history is the linking or embedding variable. He discloses, to our mind, the summarizing definition of tax culture: a country-specific tax culture is the entirety of all relevant formal and informal institutions connected with the national tax system and its practical execution; these are historically embedded within the country’s culture, including the dependencies and ties caused by their ongoing interaction.

Most authors apply only separate elements for understanding of tax culture; even the conception of B.Nerre does not involve all excluded elements. To our mind, tax culture as a part of national culture is related to the most important taxation questions, which are reflected in taxation tool and principles, including purposeful and consequent education, taxation changes, influenced by internal and external environment.

Figure 9. The place of tax culture in the national state culture



As a part of national culture, tax culture is related to taxation principles, reflected in the taxation tool and also in taxation principles (Figure 9). We also think perception of tax culture is significant, and concepts of "tax" and "culture" can be combined. Both taxpayers and administrators interfere with taxes, thus following the appropriate tax culture and ethical norms; we can improve our interrelations and decrease pressure.

As was proved, tax burden as one of the most approximate indicators of tax culture, showing general comparable tax levels in the state, depends not only on business activity, and on other economic, social and information exchange indicators, but also on the shadow economy. Tax burden is affected by difficult European integration and globalisation processes today and also affects these processes itself. Therefore, in order that the tax system be accepted and recognized by more taxpayers in any country, it should be based on tax culture aspects.

Conclusions

Summarizing previous ideas, we can present these conclusions:

- The economic growth of the EU 10 new member states increased due to the factor of their entrance.
- Both the KPMG International chief and research on tax burden during 1995 – 2004 show that the tax burden in the world decreased (tax burden rate decreased in almost half of the analysed countries comparing 2004 with 1995, but there are only three countries where the tax burden increased more than 3% - Malta, Cyprus and Iceland; the tax burden of EU25 and Euro-zone countries decreased 0.5% each). Globalisation and integration has an impact on that – decreasing restrictions of free capital and citizens' movement and increasing the competition between countries, which include indicators of tax marketing.
- In discussing state economic growth, the size of the shadow economy, and investment attraction, the tax burden is not a crucial indicator. This we can see from the example of the Nordic countries (Norway, Denmark, Sweden, Finland, and Iceland) which, having one of the highest tax burden rates, are in the Top 20 economies in ease of doing business. Besides, reverse results among tax burden, economic growth, and the shadow economy in industrialized and developing countries in 2000 (when tax burden increases, the size of the shadow economy increases in industrialized countries, and decreases in developing countries) show there are no clear tendencies among the relationships of these rates.
- Tax burden, as one of the most approximate indicators of tax culture, showing general comparable tax levels in the state, depends not only

on business activity, other economic, social, and information exchange indicators, but on the shadow economy also. Tax burden is affected by difficult European integration and globalisation processes today and also affects these processes itself. Therefore, in order that the tax system be accepted and recognized by more taxpayers in any country, it should be based on tax culture aspects.

- And as we note from the research, not only economic but also psychological indicators have an impact on eagerness to pay taxes; therefore, not only the objective, but also the subjective perception of tax burden, perception of tax morale, and tax mentality are essential. Every government should talk about taxation relations from a broad point of view and about tax systems involving tax culture aspects. More than 80 years of analysis of this topic in foreign scientific literature (F. Meisels, J. A. Schumpeter, A. Pausch, M. Camdessus, V. Tanzi, J. Martines-Vazquez, R. Berger, H. M. Hartmann, U. Hübner, B. Nerre and others) shows that tax culture deserves more attention in any country.

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Economic Integration and Foreign Direct Investment

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I. Introduction

Since the beginning of the Euro-integration process, Central and Eastern European countries have received a huge amount of foreign direct investments (FDI) from Europe and the United States. Poland, Hungary, The Czech Republic, and Slovakia concentrate nearly 60% of cumulated FDI inflows towards transition countries for the period 1989-2001, which represent more than 88 billions of dollars (ERBD 2002). Over the past few years, Lithuania has attracted more and more foreign investors and has become a competitive centre for product sourcing in the Baltic region. One of the reasons is a high-skilled, low cost alternative to production in the West, along with a stable and strong production springboard to the huge markets to the East.

On the 1st of May, 2004, Lithuania officially joined the European Union, at which time the new process of European Integration started. The process of integration usually causes changes of all macroeconomic indexes. As a transition economy, Lithuania provides an interesting case for study. During the last 50 years, intensive industrialization has given birth to enterprises specializing in electronics, chemicals, machine tools, metal processing, wood products, construction materials, and food processing. The light industry sector includes the production of textiles, ready-to wear clothing, furniture, and household appliances. After 1990, all these sectors, along with the banking system, have attracted substantial investment. Large-scale privatization of many of the larger formerly state-owned enterprises and infrastructures create continued investment and modernization possibilities.

In section II we present some theoretical elements to explain the effect of economic integration on FDI. In the following section, we explain our methodology and describe the data. The results of analysis are presented in section IV. In the last section, we conclude.

II. A Theoretical Analysis

In the large perspective, the process of economic integration is usually accompanied by a reduction in tariff- and non-tariff barriers, the adoption of a common external tariff on imports from the rest of the world, free movement of capital and labour, and harmonization of taxation and regulations. Economic integration thus implies a reduction in transactions costs, for goods and factors (Vengrauskas, Perminienė 2002). The impact of this process on FDI depends on the motive of FDI, but also on the origin and destination of foreign investments (intra- or extra-regional). First, one can consider foreign investments as an alternative to exports for a firm intending to supply a foreign market (horizontal approach of FDI where firms produce the same good or service in various countries). In this case, the reduction in transaction costs following the set up of an economic union could imply a decrease in intra-regional FDI. Conversely, for vertical FDI, integration agreements can lead to an increase in FDI (Blomström and Kokko 1997). These direct effects can be completed by indirect forces when the process of integration does not involve a free trade area exclusively, but allows the removal of non-tariff barriers, capital flows liberalization, free mobility of workers, etc. In this case, economic integration could lead to reinforce a firms' competitiveness in the host market, and increase revenues and the size of the market, which could, in turn, contribute in fine to favour "market-seeking" FDI. The problem is quite different when considering extra-regional FDI. In this case, there is no ambiguity since, whatever the form that FDI takes, horizontal or vertical, economic integration tends to increase investments from non-member countries. This can result from indirect effects related to the set up of an economic union, as a reinforcement of the level of protection, or doubts about the level of future protection (Blomström and Kokko 1997). But, firms from non-member countries will also be induced to invest in a member country to get lower tariffs within the area. In the case of horizontal FDI, a foreign producer will "jump" the common external tariff to have access to a larger market, while in the case of vertical FDI, foreign firms will locate the different stages of production in various member countries at a lower cost. It is important to notice that this additional FDI can be distributed unevenly in the economic union to concentrate on geographical areas that have the most important locational advantages (Kvainauskaitė 2003). This implies that additional FDI flows generated by new memberships do not necessarily locate in the new members.

III. Data and Methodology

After a long period of isolation, Lithuania's opening to Foreign Direct Investment in 1990 allows the influence of Foreign Direct Investment on macroeconomic indexes to be studied more clearly. Increasing Foreign Direct Investment generates the foundation of new firms and reorganization of old ones, stimulates the privatization process, and brings new modern technologies. These factors lead to the growth of gross domestic product (GDP) as well as the decrease of inflation and unemployment rates. This estimation is computed on the sample of Lithuania for the time period 1996 – 2004 by the method of correlation.

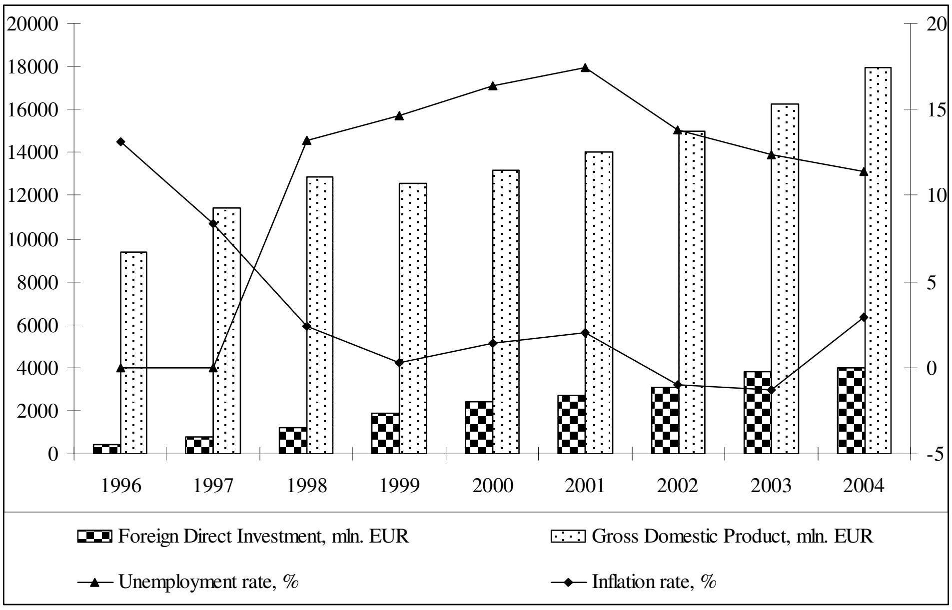
The analysis is based on the data from the annual enterprise survey conducted by the Lithuanian Statistical Office (Lithuanian Department of Statistics) and presented in Table 1.

Table 1 Macroeconomic indexes in Lithuania (1996-2004)

	Foreign Direct Investment, in millions of EUR	Gross Domestic Product, in millions of EUR	Unemployment rate, %	Inflation rate, %
1996	407.21	9,351.77	No data	13.10
1997	811.29	11,404.57	No data	8.40
1998	1,205.53	12,852.58	13.20	2.40
1999	1,882.87	12,557.75	14.60	0.30
2000	2,389.98	13,185.21	16.40	1.40
2001	2,704.26	14,011.44	17.40	2.00
2002	3,087,91	14,956.82	13.80	-1.00
2003	3,818.29	16,270.59	1.40	-1.30
2004	3,967.62	17,926.81	11.40	2.90

Focusing on a transition economy, such as Lithuania, seems very suitable for comparative analysis because of the dynamic of macroeconomic indexes. These dynamic changes during the period 1994 – 2004 are presented in Figure 1.

Figure 1 Macroeconomic indexes in Lithuania (1996-2004)



In terms of sectored distribution of FDI, 40% of FDI stock in 1996 was in manufacturing. After large inflows into telecommunications and the financial sector, this figure decreased to 32% in 2004. When the number of projects is taken into account, in 1996, 20% were in manufacturing, as compared to 21% in 2004. Within manufacturing, food products, beverages, and tobacco attracted the largest share of investment (12% of total FDI stock), followed by textiles and leather products (4%), and refined petroleum and chemicals (4%). Electrical machinery and optical instruments as well as wood products also received significant foreign investments. As for service sectors, wholesale and retail trade accounted for a quarter of FDI stock in 2004, telecommunications for 18% and financial intermediation for 14%.

The comparative analysis in this paper is provided by the method of correlation among Foreign Direct Investment, Gross Domestic Product, and Inflation and Unemployment rates.

The correlation analysis tool measures the relationship between two data sets that are scaled to be independent of the unit of measurement. The population correlation calculation returns the covariance of two data sets divided by the product of their standard deviations based on the following formulas (Čekanavičius, Murauskas 2001). Equation (1) presents formula of correlation coefficient $r_{X,Y}$:

$$r_{X,Y} = \frac{\operatorname{cov}(X,Y)}{\sigma_X \times \sigma_Y} \tag{1}$$

Here X and Y are two data sets, for example, Foreign Direct Investment and Gross Domestic Product.

Equations (2) and (3) present formulas of dispersions.

$$\sigma_X^2 = \frac{1}{n}\sum\left(X_i - \mu_X\right)^2 \tag{2}$$

$$\sigma_Y^2 = \frac{1}{n}\sum\left(Y_i - \mu_Y\right)^2 \tag{3}$$

You can use the correlation analysis tool to determine whether two ranges of data move together – that is, whether large values of one set are associated with large values of the other (positive correlation), whether small values of one set are associated with large values of the other (negative correlation), or whether values in both sets are unrelated (correlation near zero).

IV. Estimated Results

Joining the European Union, countries benefit by additional inflow of foreign direct investments from European Union members and other countries. The data show that the same process happens in Lithuania. During the period 1994 – 2004, the growth of Foreign Direct Investment in Lithuania is 874%: from 407 million EUR in 1994 to 3.967 million EUR in 2004.

The correlation analysis was made among Foreign Direct Investment and other macroeconomic indexes: Gross Domestic Product, Unemployment rate and Inflation rate. The correlation analysis results are presented in Table 2.

Table 2. Correlation analysis results

	Gross Domestic Product	Unemployment rate	Inflation rate
Foreign Direct Investment	0.9568292	-0.4060249	-0.7442379

The relationship between Foreign Direct Investment and Gross Domestic Product is very strong: the correlation coefficient is 0.9568292. One of factors that influence the growth of Gross Domestic Product is the growth of Foreign Direct Investment.

Foreign Direct Investment growth impact in the unemployment rate's decreasing in the country is significant: the correlation coefficient between Foreign Direct Investment and Unemployment rate is -0.4060249.

Inflation rate decrease is also influenced by the growth of Foreign Direct Investment: correlation coefficient -0.7442379.

Foreign Direct Investment is a very important macroeconomic index. It has significant influence on the macro level of Lithuania's economy.

V. Conclusions

Many countries, including developing and transition economies, compete against one another in attracting foreign investors by offering ever more generous incentive packages and justifying the actions with the productivity gains that are expected to accrue to domestic producers from knowledge externalities generated by foreign affiliates. Lithuania benefits by additional inflow of foreign direct investments from European Union members and other countries during the European integration process.

Increasing foreign direct investment generates the growth of gross domestic product, and the decrease of inflation and unemployment rates.

The attraction of foreign direct investment is not a self-contained aim; it is only a way to support the growth of the economy.

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SECTION III

SOCIAL SCIENCES AND MEDIA

European Identity: A study using the method of Identity Structure Analysis in Estonia in 2003-2005

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Societal integration as a tool for a new dimension in the collective identity in Estonia

The Estonian population can be described as relatively diverse by several indicators: by ethnic background (Estonians, Russians, Finns, etc.), by language use (mainly Estonian or Russian), and by income differences. Starting from 2000, the Gini coefficient has increased somewhat, reaching the level of 37,4 in 2003 (in 2000-36,2), according to EU-SILC study in 2003 (Statistical Yearbook - 2006: 131). Social, political, and cultural divergences have made the society more fragmented. As such this could be viewed as setting new circumstances for the development of democracy, contributing to new challenges for the social integration of society requiring new orientations. The process of social integration can perhaps be analysed in terms of redefining a conception of a common national identity of the Estonian people that includes Estonians and ethnic minorities.

However, the Estonian population cannot be assumed to be a carrier of a single new ethnic and national identity. Disparities might arise when those social factors and mechanisms that should assist the processes of cultural integration (in terms of the formation of a multi-cultural society) and national integration (in terms of Estonian citizenship) towards overall societal integration are undermined by other factors.

In the sociological literature, societal integration is predominantly considered to be the best developmental model for the well-being of societies in central and eastern European countries (and in Estonia) as suggested, for example, in the general conceptions by Münch (1998) and Beck/Grande (2004), and in the special analysis for Estonia by Löfgren and Herd (2000) and Lauristin and others (2004).

We conceive successful integration to be a process of societal co-operation aimed at forging a new community of people that shares a super-ordinate, qualitatively distinctive orientation. For Estonian society it is important in this context to distinguish integration from assimilation and segregation of ethnic minorities since, on the one hand, it is important for the Russian minority to maintain its original cultural heritage, and, on the other hand, it is important that minorities be able to prosper in their dual cultural circumstances. While it is one thing to express support for the idea of integration, it is quite another matter to ensure its realisation.

The differentiation between many levels and segments of integration means that the process of forming new, well-functioning structures in society is much more complicated than a restricted understanding of integration that focuses only on the two different language groups: Estonians and Russians. It is possible to define the current situation in Estonia as the realisation of the first stage of the societal integration process – namely, the acknowledgment of common social problems instead of specific inter-ethnic problems, and the enhancement of tolerance between the Estonians and the Russian-speaking population. Estonia may be regarded as entering into the next stage of the societal integration process, which should entail the efficient cooperation between Estonians and non-Estonian ethnic groups in the context of the European Union. This study reports evidence of the European dimension of identity in the Estonian urban population and the extent to which this represents societal integration in Estonia.

Identity structure analysis in the EU Referendum process

It is doubtful whether there is a 'European' identity as there are many varieties of what people may think as being European across the nations of Europe and across the different ethnic minorities within European nations. For these researches it is necessary to know to what degree the Estonian people are going to identify themselves with Europe and how important they deem Europe to be, or do the Estonian people expect greater variation in the expression of "Estonian identity".

The European past contains complex paradigms, which complexity could itself be presented as a common European cultural background. Western ideas of personal values, liberalism, the rule of (written) law, principles of human rights and equality are good examples. Having in mind these more or less largely shared ideas and paradigms, one can define the historical and cultural closeness to Europe as the affinities of people sharing common experiences of European history, even when this has involved antagonistic relationships and war. European integration is first and foremost the formation of political institutions with their normative and political identity, along with the formation of a common market.

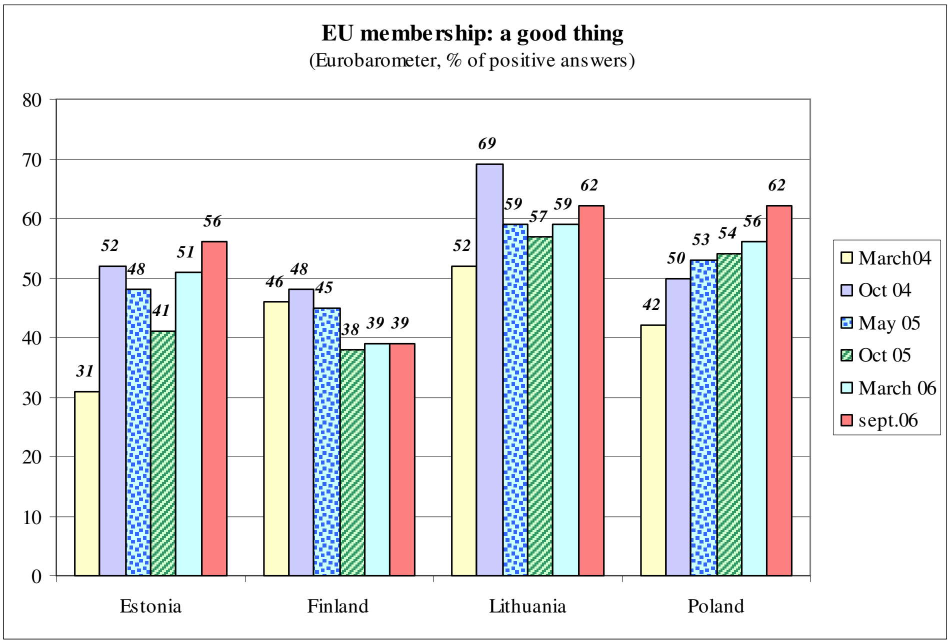
Cultural communication and education could in their turn promote identification with, and the unification of, European political space, as expressed by Michel Foucher (Foucher, 1998/2000). Communication can encourage the consolidation of the collective dimension, while leaving the national communication space at large untouched. National culture and history would provide the justification for a common sense of 'Europeanness', while at the same time, leaving the question of political space open.

When Estonian society faced the EU-referendum in September 2003, the share of those who voted in favour of the European Union was 66.8 per cent, while the percentage of those who voted against membership was 33.2. The overall participation rate in Estonia was 64.1 % (Estonian National Electoral Committee, 2003). During the debate that took place in the first year after Estonia joined the EU, the majority of citizens realised that EU membership provided new possibilities for defining the country's position on Europe's political and cultural map. As we see from results of Estonian media-researcher Aune Past: "there was a statistically significant difference among two groups – those satisfied with the changes in Estonian life and those unsatisfied. Those who were satisfied with the general changes in Estonia perceived the European Union as attractive, safe and fast-moving. The safety dimension was the most important factor in defining and deciding those who voted in favour of, and who voted against, EU membership. Safety was a more important factor for ethnic Estonians than for ethnic Russians" (Past, 2005: 136).

Although geographically being indisputably a part of Europe, Estonia's position there has not always been conclusively defined. Today, ideas about identifying with Estonia's welfare nation neighbours (referring to similarities with the Nordic countries) are spreading. One of these tendencies is that Estonian regional identity within the European Union could become similar to that of the Nordic countries (Finland and others). On the other hand, Estonian identity has some specific features which allude to the possibility of belonging to the group of Baltic countries (Estonia, Latvia, Lithuania). Furthermore, according to some popular formulations of certain politicians, Estonia tends to be more similar to Ireland and the United Kingdom.

Ethnic or national identity is about the feeling of being a member of a political or cultural community as summarized by Martin Kohli (Kohli 2000: 122), and positive answers to the question whether the "EU is a good thing" were good indicators of the feelings in favour of the European Union. Eurobarometer Studies data showed a clear willingness with regard to the EU in Estonia. Eurobarometer Studies 62 and 63 reported that the proportion of Estonian people who answered that "EU is a good thing" had grown, as it had in Estonia's neighbouring countries of Lithuania, and Poland. In March 2004 this was 31%, in October-November 2004 it was 52%, but it decreased in October-November 2005 to 41%, in March 2006 it increased to 51% and in September 2006 – to 56% (according Eurobarometer Studies 61-66; Fig. 1).

Fig. 1. EU Eurobarometer Study "EU is a good thing"

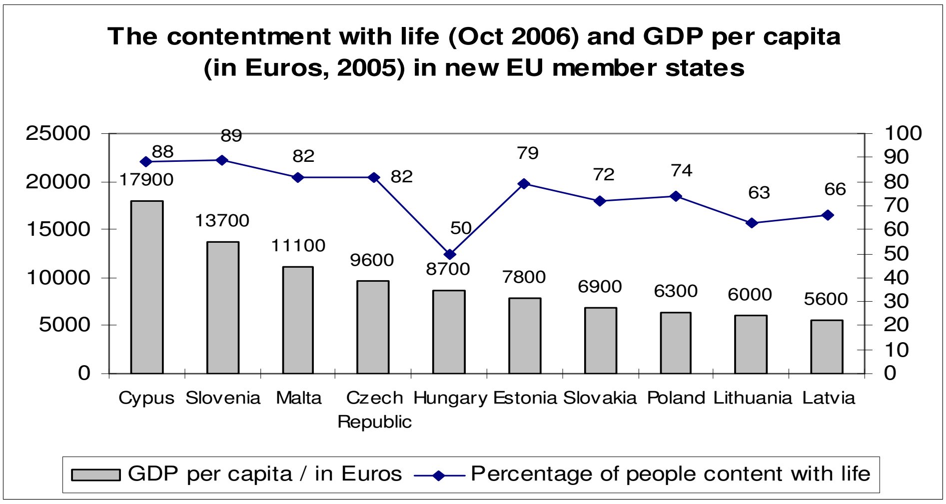


** Eurobarometer Studies 61, 62, 63, 64, 65 and 66.*

We understand common European identity as a shared sameness of people belonging to the same group, with a common narrative and broadly matching attitudes, beliefs, and values. The formation of a new European dimension of identity in Estonia – related to the process of accession to the European Union - as an incorporation of a new dimension in collective identity, started at the beginning of the '90s (Kirch and Kirch 2001: 130). But may we say that due to Estonia's EU membership, a European dimension is becoming part of Estonians' self-perception?

European enlargement has influenced the self-definition of the Estonian people. Transition will give them the opportunity to re-define “Europeanness” from the viewpoint of new European identity components incorporated into Estonian identity. This process is most clearly observable in the accession countries. It is possible to define the current economical situation in Estonia as the realisation of the first stage of the social life integration with European Union. According to the data of 2003, Estonia’s indicators of economic growth and contentment with life were among the lowest compared to the other new accession countries. However, during the last couple of years, Estonia’s position has improved significantly and the country’s GDP per capita already exceeds Poland and Slovakia. During the last three years contentment with life in Estonia has grown significantly: when in the autumn of 2003, 53% of inhabitants were content with their life (CCEB2003.4 Autumn 2003), the follow-up survey conducted in the autumn of 2006, within the framework of Eurobarometer 66.1 as you see in Figure 2, gave the result that this number had already grown to 79%.

Fig. 2 Estonia’s total GDP per capita and contentment with life in 2005*



**data from Eurostat news release: 63/2006-18 May 2006 and EB66.1 - Estonia (Sept-Oct. 2006), p.6*

European identity is a notion that is rooted in the EU applicant countries' social discourses. Facing the EU-accession according to a first study in 2000 (Kirch, Rull, Tuisk, 2001) significant agents such as Euro-optimists and Euro-sceptics, rather than the Estonian government, Estonian cultural elite, or business circle, were predominant entities in the expression of identity in our target groups. The question is whether these entities remained "significant others" in 2003 and 2005.

The authors used the Identity Structure Analysis (ISA) conceptual framework to investigate these issues. The method was developed by Peter Weinreich in order to study the structure of personal and collective identity changes (Weinreich, 1989; Weinreich & Saunderson, 2003). The data were gathered in the following Estonian cities: Tallinn, Tartu, Viljandi, and Narva (N=174 persons), before the accession of Estonia to the European Union in April-

June 2003. Further data were gathered during the referendums on the European Union Constitutional Treaty in European states and the contract establishing the Estonian-Russian Border Treaty in May and September 2005. The data were gathered in two universities of Tallinn.

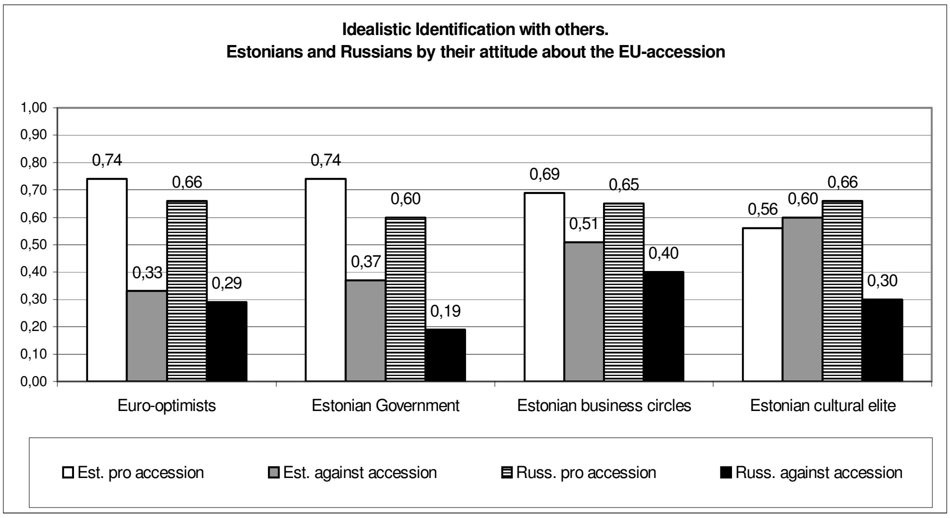
The 2003 study's identity instrument consisted of 10 bipolar constructs and 12 entities (in 2005 – of 10 bipolar constructs, one of constructs (about drugs) was eliminated and a new construct (about border issues) was created during the Estonian-Russian Border Treaty discussion period – see Appendix 1) The constructs reflected personal attitudes towards different economic strategies, the free movement of people, the role of EU-legislation in comparison with national legislation, minority rights protection, etc. The individual psychological level of societal processes reflects some of the social tensions and conflicts that sometimes get anchored to EU-accession issues. Respondents were able to construe themselves (their self-images) in different contexts, and appraise significant others and groups in terms of the characteristics expressed by way of each particular bipolar construct, one at a time, on a 9-point scale. The eleven entities included "Me as I would like to be" (ideal self), "Me as I am now" (current self 1), "Me in 2003, the year of the EU-referendum" (past self), "Person whom I honour and admire" (admired person), and "Person whom I don't like at all" (disliked person) as mandatory entities required by the ISA method. "Me when representing Estonia at EU negotiations in Brussels" (current self 2), allowed respondents to appraise themselves in imagination as agents directly involved in EU matters. Further entities included - "Estonia's business circles," "Estonia's cultural elite," "Euro-optimists in Estonia," "Estonian government," and

"Euro-sceptics in Estonia". These represented both significant others as well as agents of Estonian society.

The indices idealistic identification and ego-involvement were computed using the Identity Exploration (IDEX) computer software. The definition of idealistic identification is as follows: the degree of similarity between the qualities one attributes to the other and those one would like to possess as part of one's ideal self-image. The idealistic identification index has a parameter range between 0 and 1. Magnitudes are considered high when above 0.70 and low when below 0.50.

In 2003, entities or significant others towards whom the Estonian "yes to EU" group (N = 73) aspire are: "Estonian Government" and "Estonian business circles" as well as "Euro-optimists" (Figure. 3). The Russian pro-accession group (N = 28) aspire towards the entities "Estonian business circles," and "Estonian cultural elite" (having one of the highest values) and also "Euro-optimists". These findings also show that the Estonian accession supporters seem to be hesitant to identify in an aspirational manner with the cultural elite, as concern about preservation of Estonian culture and language after accession had been mostly expressed by intellectuals and people engaged in the sphere of culture. At the same time, the Russian pro-accession respondents' index magnitude is 0.66, showing that their identification with the Estonian cultural elite is stronger than that of Russians "against the EU," and even higher than among Estonians themselves. The latter finding is probably based on these Russians' broader perception that culture is not subject to change when a nation joins the EU.

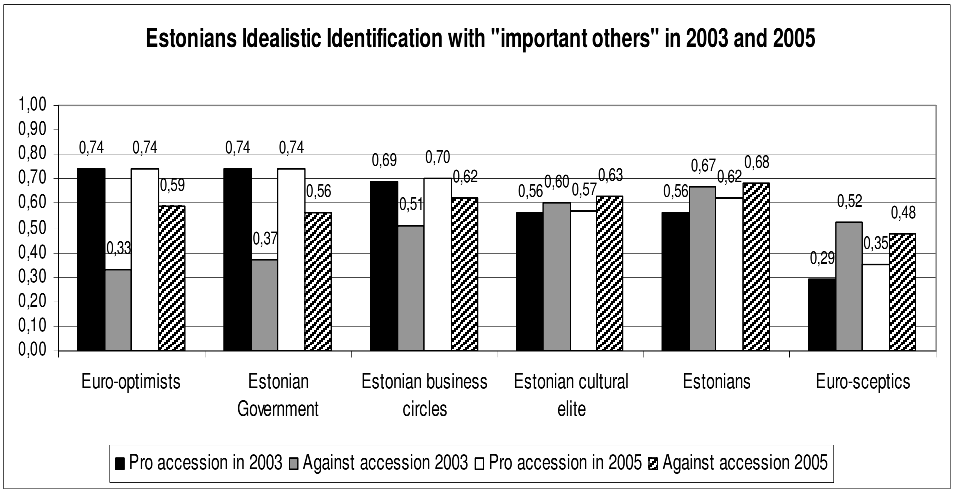
Fig. 3. Idealistic identification with significant others by Estonians and Russians in 2003 (before EU-referendum)



For Estonia's anti-accession Russians (N= 14), therefore, the EU is more of a political project than it is for anti-accession Estonians (N= 44). It is interesting to notice those Russians who were against Estonia's accession to the EU do not express their idealistic identification toward Estonian Government highly. It is amazing coincidence that the Government and its activities are idealised as lowly as with disliked person as respective index values are clearly low – only 0.19 and 0.21. Here we have underline that those of Estonians who were against the accession are to some degree patriots of Estonia as they idealise Estonian Government significantly higher (index value 0.37). Also disliked person has been "evaluated" higher (0.28) compared to Russian respondents (0.21). The Russians' lower idealistic identification with the Estonian government can be explained by the fact that it represents an authority associated with strict demands concerning the Estonian language, law and citizenship policy (although during the last decade several of these requirements in respective legal acts have been loosened).

Comparison of study results from years 2003 and 2005 broadly refer to the growing positive trend of identification with EU dimensions – people see among positive "important others" people and institutions related to EU (Fig.4).

Fig. 4. Estonians idealistic identification with others in 2003 and 2005

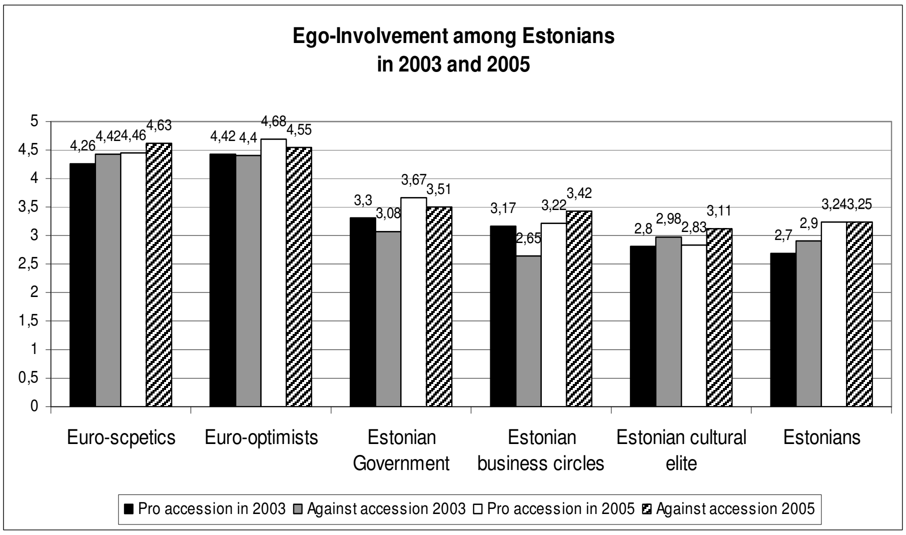


Concerning the results from the latest study we can say that people who in general support Estonia's belonging to the EU identify themselves largely with the Estonian Government, more than with local business circles or with the cultural elite. All people, whatever their views on Estonia's place in the EU integration process, were strongly identified with people 'representing Estonia at EU negotiations in Brussels'. Even people against the accession identify now more with Estonian Government and cultural elite. These findings suggest that, instead of direct identification with European optimists or pessimists, respondents in their aspirations identify more with the state institutions and significant social groups (“the Government”, business circles, the cultural elite) that are real actors in EU integration process. Magnitudes of the index increased for both groups – those who are pro- and to a greater degree those who are against integration – indicating that acceptance of EU ideas increased during this short period between two studies, especially noticeable for those “against”.

Ego-involvement – shows how important is some entity to the respondent. Ego-involvement index makes it possible to estimate the relative impact of others in the development of one’s own identity. The index has a parameter range between 0 and 5, and the magnitudes are considered high when above 4 and low when below 2. After the EU referendum a slight increase with Euro-sceptics was visible among young people and also with Euro-optimists, which suggest a slightly greater involvement with Europe-based issues in general (Change is demonstrated in Figure 5).

According to assessments of ego-involvement in 2005, respondents’ attitudes towards EU are most exercised by debate between European-sceptics and European-optimists. Respondents’ high ego-involvement with Euro-optimists and Euro-sceptics demonstrates the significance of a democratic political environment and openness in Estonia as both of these entities represent alternative perspectives. This balanced situation should benefit the orientation of today’s changing society.

Fig. 5. Ego-Involvement among Estonians in 2003-2005



ISA offers a means of quantitatively representing informal ideologies, in terms of the structural pressure on constructs. Structural pressure refers to the consistency with which a particular construct is used in the appraisal of self and others. This consistency derives from the compatibility of the construct's evaluative connotations with one's overall evaluation of the entities to which it is attributed (Weinreich & Saunderson, 2003).

High structural pressure on a construct means that, during appraisal of self and others, cognitions about, and evaluations of, them are compatible. That is, the construct is used consistently to evaluate self and others, thus representing a core value for the individual/group in question. Other constructs may form secondary, inconsistent or unevaluative dimensions of identity, depending on the degree of structural pressure with which they are applied to self and others – inconsistent dimensions being centres of incompatible cognitions and evaluations. An examination of the core constructs for those who are for EU-Accession (Table 1) and those who are against/uncertain about the accession (Table 2) reveals salient differences in informal ideology between the two groups.

Table 1. Pro-EU: Structural pressure on constructs by respondents' attitude about EU-Accession in May and Sept 2005

In May 2005 , for EU-Accession, n=19			In Sept 2005, for EU-Accession n=21		
No	Construct	Structural Pressure	No	Construct	Structural Pressure
6	In the EU protection of human rights is guaranteed well enough	72.70***	6	In the EU protection of human rights is guaranteed well enough	60.73**
5	Free movement of employees between the member states gives better job opportunities for people	71.89***	5	Free movement of employees between the member states gives better job opportunities for people	52.54**
4	The EU is capable of guaranteeing, peace, stable development and security	69.35**	4	The EU is capable of guaranteeing, peace, stable development and security	58.59*
10	Border treaty with Russia should be signed, this grants sovereignty and security	68.98**	10	Border treaty with Russia should be signed, this grants sovereignty and security	43.08
3	The EU retains the capability to develop and reform	63.15**	3	The EU retains the capability to develop and reform	62.39**
7	EU membership promotes and encourages the development of Estonian language and culture	56.96*	7	EU membership promotes and encourages the development of Estonian language and culture	44.77

*Note: Structural pressure is scaled from -100 to 100. ‘Core’ evaluative dimensions are ***70–79; **60–69; *50–59. .*

As expected from their attitudes different values are considered as important for these two groups we have under investigation. For EU optimists the constructs 3, 4, 5 and 6 play a large role by expressing their belief in "overall features" of the EU. At the same time construct 10 (Estonia’s border treaty with Russia) seems to express a very important role for both groups (in May 2005), although we can easily see that for each group the border treaty with Russia has the opposite significance. For EU-optimists the treaty as such is seen to grant sovereignty (Table 1) while for EU-sceptics it is perceived to lead to Estonia's losing sovereignty (Table 2). But by September 2005 the Border Treaty has lost its importance, the value having dropped more dramatically among pro-accession group of the respondents (from 68.9 to 43.1).

For the optimists the anticipation of ‘free movement of employees between the member states’ (construct 5) can be taken as a 'core' construct, while for the sceptics the opposed notion is anticipated, that is, ‘several problems arise in Estonia due to free movement of labour force’, for which structural pressure has increased from 50.5 to 75.4.

Those EU-sceptics who perecive difficulties with the labour market have become more convinced about this, and more of the opinion that international competition is not in their favour (SP: 50.51, 75.37). By contrast, those EU-optimists who support a free labour market, become less certain about its merits (SP: 71.89, 52.54). Changes of the structural pressure values also reflect that personal issues (concerning ‘self’, such as ‘me in the labour market’) emerge with greater importance, while larger political issues such as border agreements remain somewhere on the far horizon. Also the increase among EU-sceptics of structural pressure on the EU as supranational body retarding local decision-making (Table 2: construct 9, from 53.8 to 67.2) is a sign of disappointment about processes that have taken place from May to Sept.in 2005.

Table 2. Anti-EU: Structural pressure on constructs by respondents' attitude about EU-Accession in May and Sept 2005 (Against or Uncertain about EU-Accession)

May 2005, n=16			Sept 2005, n=26		
No	Construct	Structural Pressure	No	Construct	Structural Pressure
3	The EU is under way to becoming a bureaucratic organization, unable to reform oneself	57.32*	3	The EU is under way to becoming a bureaucratic organization, unable to reform oneself	58.00*
10	The Estonia-Russia border treaty should not be undersigned, this is going weaken Estonia's sovereignty	56.81*	10	The Estonia-Russia border treaty should not be undersigned, this is going weaken Estonia's sovereignty	47.72
9	The EU is a supranational formation that to a certain degree restricts decision-making and independence of the states themselves	53.78*	9	The EU is a supranational formation that to a certain degree restricts decision-making and independence of the states themselves	67.20**
2	New member states cause extensive changes in EU policies (for example in agriculture)	51.91*	2	New member states cause extensive changes in EU policies (foe example in agriculture)	45.86
5	Several problems arise in Estonia due to free movement of labour force	50.51*	5	Several problems arise in Estonia due to free movement of labour force	75.37***
6	Protection of minority rights in the EU becomes turned into an empty cliché	44.76	6	Protection of minority rights in the EU becomes turned into an empty cliché	55.61*
8	Most important are the aims of the EU as a supranational body	40.02	8	Most important are the aims of the EU as a supranational body	52.52*

*Note: Structural pressure is scaled from -100 to 100. 'Core' evaluative dimensions are ***70–79; **60–69; *50–59.*

The findings of the research over time indicate that the earlier centrality of the pro-EU participants' belief that 'free movement of employees between the member states gives better job opportunities for people' becomes less certain (SP: 71.89, 52.54), while the opposed belief of the anti-EU respondents, that ‘several problems arise in Estonia due to free movement of labour force’ becomes held with greater conviction (SP: 50.51, 75.37). According to our analysis, high structural pressure on a construct of free movement of employees between the member states means that it is used consistently to evaluate self and others.

We can conclude, that by the end of 2004, the Estonian society has reached the phase, where increasing international communication, economic and cultural ties have initiated the shift towards the creation of new “borderless” identity (Kirch, Kirch, 2006: 181). But new opportunities can create only minimum ground for the reception of the new set of European values. Today there are rather tendencies towards identification with Estonian well-fare neighbours, i.e., referring to similarities with Nordic countries.

Conclusion

We understand European identity as a social construct – the shared characteristics of people belonging to the same group, with a common narrative and broadly matching cultural attitudes, beliefs and values. The formation of the new European identity in Estonia – related to the process of accession to the European Union - as an incorporation of a new dimension in a collective identity, started at the beginning of the 1990-ies.

European enlargement has influenced the self-definition of Estonian people. Transition will give the opportunity to re-define “Europeanness” from the viewpoint of new European identity components incorporated into Estonian identity. Although being indisputably a part of Europe, Estonia's position there has not been always conclusively defined.

Efficient cooperation between Estonians and other nations in the context of the European Union could be more productive in the framework of common scope of international institutions, in the broader European context. The status of European citizenship should help form a valued national identity for Estonian and Russians and other ethnic minority groups, very likely influenced by European values.

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Appendix 1 Questionnaire of the study (2005)

Each page of the questionnaire had one of the 10 bipolar constructs in the top. The entities on the left side expressed facets of respondent's world-picture. He/she had to cross one position for each entity of the scale (see the example below).

1L		1R
Me as I am now	– – – – 0 – – X –	
Estonia's business circles	– – X – 0 – – – –	
Person who I honour and admire	– – – – 0 – X – –	
Me in 2003 (year of EU-referendum)	– – – – 0 X – – –	
Estonia's cultural elite	– –X– – 0 – – – –	
Euro-optimists in Estonia	– – X – 0 – – – –	
Me as I would like to be	– – – – 0 – – X –	
Estonia's Government	– – – – 0 – – X –	
Me when representing the state in Brussels	– – – X 0 – – – –	
Euro-sceptics in Estonia	– – – – 0 – – – X	
Person who I don't like at all	– – – X 0 – – – –	

The constructs. The following constructs were used at the top of each page while list of the entities remained unchanged throughout the instrument.

1L EU laws are liberal enough in regulating market economy	1R EU laws are too tough for liberal economy
2L New member states cause extensive changes in EU policies (especially in agriculture)	2R New member states adapt existing system, and EU policies do not change very much as a consequence
3L The EU is under way to becoming a bureaucratic organization, unable to reform oneself	3R The EU remains ability to develop and reform
4L The EU is capable of guaranteeing peace, stable development, and security	4R The EU is not able to cope with conflicts and guarantee security in every member state
5L Free movement of employees between the member states gives better job opportunities for people	5R Several problems arise in Estonia due to free movement of labour force
6L In the EU protection of human rights is guaranteed well enough	6R Protection of minority rights in the EU becomes turned into an empty cliché
7L EU-accession endangers the development of Estonian language and culture	7R EU membership promotes and encourages the development of Estonian language and culture
8L Most important are the liberties and welfare of EU citizens	8R Most important are the aims of the EU as a supranational body
9L The EU is a supranational formation that in a certain degree restricts decision-making and independence of the states themselves	9R The EU is a supranational formation that to a certain degree restricts decision-making and independence of the states themselves
10L The Estonia-Russia border treaty should not be undersigned, this is going weaken Estonia's sovereignty	10 R Border treaty with Russia should be signed, this grants sovereignty and security

Estonia: the next round of the search for identity

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Many people in Estonia tend to believe that since 1988 so many changes have taken place that today it is problematic to speak about anything 'common' or uniting for Estonian society. Estonia's 'identity' as an autonomous political, social, or cultural entity seems to have become a hopelessly empty concept.

The younger generation especially believes that there is almost nothing (except the common language) that unites all ethnic Estonians today, not to speak of the whole population of present day Estonia. Presumably what features are attributed to Estonians or by Estonians to themselves, to their country, to the social environment where they have settled, and how they view their past and imagine the future themselves is no longer essential. This is caused, on the one hand, by the enormous capacity and pace of social changes (to which hardly anybody pays attention anymore) and, on the other hand, by the growing dimness of comparative, identification or contra-identification contexts. Herewith I am trying to show that although serious problems in determining Estonian identity do exist, it is still not an "empty"

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or even “dead” concept and helps us, in fact, understand who we really are, where we come from, and where we are heading.

Prof. Peeter Torop claims that Estonia lacks an adequate language in which to talk about identity, and Estonia has to initiate an ‘inner conversation’ with itself (Torop 2002). According to Prof. Marju Lauristin, there is nowadays an obvious lack of young innovative thinkers as the modernist writer Friedebert Tuglas or the leader of the neologistic movement Johannes Aavik were at the beginning of the last century. The present day opinion-leaders are not able to capture all issues related to identity in a situation where the turnover of all kind of ideas is so massive that it is hard to reveal their real value (Lauristin 2000). These are quite harsh statements, but first we should overcome the negativistic attitude toward using the very concept of collective identity. Collective identities not only influence but also form a base of our personal self-identification. Absolute individualism is a fiction in any culture, although Estonians who often overestimate the significance of individualism tend to think about it in the opposite way. When speaking about collective identity, I am proceeding from the presumption that any collective identity is a mental construct, a fictional or imaginable human affiliation (see Anderson 1983), but still a construct that cannot be created in a totally arbitrary way. It is evident that collective identities are created ‘asymmetrically’, first at all by the Great Men, not as much by the common people, although the “common spirit”, “*Zeitgeist*”, and other similar hardly conclusive, but doubtlessly existing phenomena, referred to first by the German philosopher Johan Herder, play a role in this process and cannot be ignored even by these same Great Men. Collective identities are based on common myths of history, culture, and other similar collective visions and are developed in "dialectics" of comparison, identification, and opposition together with other collective identities.

It should be evident that collective identities are also under continuous change. Peter Weinreich from the University of Ulster has defined identity as a mental continuity changing with time between generations (Weinreich 1989, p. 50-73). At the same time it seems that understandings about identity among generations have become quite diverse. From one side globalisation has involved enormous pressure for cultural equalisation, but at the same time there have emerged new possibilities for differentiation of self-identification at the local and individual levels. Capitalist risk society and individualisation of risks (see Beck 1986) offers diversity of identification possibilities that lead at the end to the formation of a so-called ‘multiple identity’ (Giddens 1991). Multiple identity and ever-easier exchangeability of identities are certainly factors that help one to adapt to unstable circumstances of the social environment and are thus functions of liberty. In modern society an individual is interpreted as totally ‘free’ only in the case that he/she refuses to let ‘outside’ factors determine himself/herself (Väljataga 2000). At the same time it is clear that merely using the concepts of multiple identity or building so-called ‘identity hierarchies’ does not contain sufficient explanation of all problematic issues related to the use of the concept 'identity'.

Here the question arises of how the identities on different levels (personal, both outwardly the manifested and ‘internal’ or more intimate one; the identities of the level of social group, social stratum, or sub-culture; ethnic, national and trans-national, regional, or global identities) relate to each other. There is also the question of how the different aspects of personal and collective identities such as gender, ethnicity, religion, cultural, professional, intellectual, or spiritual aspects are related. Are different identities or abovementioned different identity aspects always 'harmlessly' compatible, or is there an evident possibility of the emergence of tensions between the above-mentioned levels that could lead through identity conflicts to the formation of new identities? How do these different identities influence each other? Are the identities in fact freely 'convertible'? What limits or directs their developments in time? And - after all – has not the theory of individualism and risk society been created merely in order to justify the real injustices of Western society?

Estonians are individualists by nature and the splintering of interests in a capitalist environment is unavoidable. Social structures do not offer the assurances they used to offer, and today those very same structures are rather often seen as harassing to individual freedom. As individualism contains in itself immanent rebellion against any kind of unification (including common values, common interests, and common feelings about something), therefore any kind of enforceable unity has been anathema for Estonians; but rather often this might be just a pose. This is also a reason 'traditional' nationalism has been losing its one-time popularity, although for some part of society nationalism may become a specific 'spiritual refuge' such as religious movements have been offering through ages. We have to agree with Jaan Kaplinski, who claims that nationalism in Estonia is undergoing a metamorphosis into a religious issue (Kaplinski 1999). Proceeding from this thought we have to admit that according to the traditions of Western democracy nationalism is going to recede to a personal affiliation level of each individual. A great and all-embracing feeling of unity cannot be expected from Estonians anymore. It could be imaginable only in case of war or if some other kind of undesirable outside factor emerges. We cannot forget that Estonian history throughout the 19th and 20th centuries was related to the formation and development of national identity with an ethnic background. During this period nationalism was a regulating hegemony (Jansen 2003, pp. 15–30) that captured and merged other identities into it, and this role has started to change only since the last decade of the 20th century. It has been largely understood and expressed that during the Soviet rule this cultural identity used to be the main consolidating factor, taking over in some degree the attributes of political identity (the emergence of which was suppressed by the regime). In this way the song festivals and other cultural events together with well-known intellectuals' speeches held there, became politics though often enough the speakers themselves did not have these very meanings in mind.

Although during the Soviet era Estonian-ness was suppressed, being an Estonian was self-evident and it was not handled as a problematic issue. The essential accent herein was a clear-cut antithesis – "we" - the Estonians and "they" – the Russians, but there was also no need to speak about 'two' or more 'Estonias', the metaphor invented by Estonian sociologists to describe the 'split' nature of Estonian society after socio-economic reforms (Sotsiaalteadlaste avalik pöördumine 2001). "They" were never "another Estonia", but something totally "different" or "alien" (as a final outcome the conception on aliens was formed on the basis of the notion of “they”). But we have also forgotten that quite a few nationalistic Estonians sincerely believed at the end of 1980s and the beginning of 1990s that when the Republic of Estonia comes, “they” will leave our country with no greater problems. Local communist party leadership made up of ethnic Estonians operated during the Soviet rule, but nobody really cared about their exact positioning. The important issue was that the structure of Estonian nationality was seemingly ‘whole’; we had a non-official elite represented by the cultural elite, and contradictions between this ‘informal’ elite and the common people in the generally egalitarian Soviet society did not exist in practice. The only dividing line in Soviet society was between (the communist) party members and non-members and attitudes about this membership in the “dialectics” of adaptation and passive resistance of this time were ambivalent. The average citizen tried to live his “small life” as if there were no Soviet structures – but being careful, of course, about what to say and do in public. During the Soviet rule Estonian culture became a separate institution, and not only was the cultural elite engaged with it, but so also were other members of society who were not affiliated with culture as such.

During the Soviet period Estonia’s (as of a cultural-ethnic entity’s and non-political subject’s) identity was something stable, certain, and more clearly determined. Estonia was for Estonians themselves, and for other Soviet citizens, first of all the “Soviet West”, a specific region in the “real-socialist” Soviet Union. This region was opposed at least in a cultural sense to the rest of the Soviet Union and resembled more Central- and Eastern European socialist countries of that time. Western intellectuals (Kundera 1984) shared this conception of a "kidnapped West”, although for the common citizens of the West Estonia did not exist anymore.

In any case “negative” identity construction dominated (i.e. understanding who we **do not** want to be), and identity formation and its need for recreation were not under serious consideration. Moreover, according to public understanding, there was no need for continuous “positive” identity creation (the distinguishing of Estonia from the rest of the Soviet Union was self-evident, and the basis for identity was considered the simple recreation of culture). It is even possible to claim that the Soviet period conserved for a longer period earlier cultural models; post-war generations were brought up in the spirit of the pre-war “silent age”, under the guidelines of their grandparents who still had memories of the period of the rule of authoritarian President Konstantin Päts by remembering it as an old, good ‘clique-time’, only warning their progeny not to speak about it openly. At this time a myth about President Päts’ period was formed, and thereby the restoration of independence was for a quite many Estonians explicated as the “comeback of Estonia”, which was paralleled with the openly manifested narrative of the “return to the West”.

Herewith Estonia tried at one and the same time to return to the West (in a geopolitical sense) and by citizenship and restitution policies in a large degree also to the Past. As we know very well, neither of these processes was totally problem-free. The construction of the “East” (and even in traditional sense of Eastern and Central Europe) as a comparative, identification, and distinction context had become a problematic issue. As other East Europeans, also Estonians did not like to compare themselves to their fellow suffers and did not seek for ways of identification (or even paradoxically contra-identification) with them. Today's obvious *drang nach Westen* of East and Central European countries has virtually the same connotation for all the states, but relates them all only into one comparative context (the West), while the implications of mutual comparison have been almost meticulously excluded. Fortunately there exists a Russia that has never been an aim for us East-Europeans to come close to. Therefore the "negative" identification works well everywhere in Eastern Europe even today. We have always known better about who we **do not want** to be. When opposition to everything Russian-like was popular during the Soviet period, then now, when the mostly English-speaking 'global' culture is attacking, we have no immunity against it, even if we compare it to such a selective ambivalence as Estonians had during and after the national awakening age towards the German culture.

Accession to the European Union gave Estonia the clear opportunity to form its "positive" identity. After the second half of the 19th century, Europe has been the handiest basis for identification (although some thinkers, like Jaan Kaplinski, have opposed this idea consistently). At the same time Estonia has been on the periphery of Europe, and rather evident is the danger that such a peripheral identity can strengthen during European Union membership (Kirch 2002, pp. 87-101). Today it is quite common that Estonian-ness has been seen as a certain kind of mental inertia. It just happenstance that we, Estonians, live on this piece of land next to the Baltic Sea, speak a bizarre 'Basque-like' language that is hard for others to learn, and as we are settled here, we try to do the things which are expected from us because of that. For instance, we develop an Estonian national culture, although the forms and needs of this development are understood in different ways by different people and generations. For the younger generation the development of national culture is no longer a value as such, at least it is not perceived as a moral obligation. But also the weakening of national feelings is not clear and unambiguous, as it might be for a small nation with a fragile cultural veneer when taking into account the pace of the attacking global culture. Some kind of similar, but long lasting cultural situation could have taken place also in case Estonia had not turned into a new economic-political formation in the beginning of 1990s. Nationalism as a relatively young ideology (compared to religious identification) should change to a certain degree, but which way and into which direction is so far unclear. At any rate, Andres Langemets finds that at the beginning of the new century nationalism manifests itself almost entirely through convergence into the global culture (Langemets 2000). The highest "national pride" has been attributed to those ventures which are successful on a global scale and thus exclude every implication to the very notion of 'national'. Raili Nugin, who has analysed Estonian self-images in media texts, concludes that for the year 2001, culture had become a 'runaway from reality', at least, it has been no more the kind of nationwide endeavour it used to be during the Soviet rule (Nugin 2003, pp. 162-173). At the same time the European Union is not merely like an outer shell of a certain stage of the inevitable process of globalisation, but a subject that forms in a clearly fixed background system for identification in a larger scale.

The question of the degree of coinciding of the politically constructed European Union and the historically formed European culture (in Samuel

Huntington's sense 'civilisation') has been on the agenda since the European Community started to take on the role of spokesperson for all of Europe. Huntington’s views (Huntington 1996) have, due to their speculative nature, gained a great deal of criticism in the West, but in Estonia his ideas have been accepted without specific question just because they place us “on the right side” of the civilisation barricade. However, less attention has been paid to the fact that Huntington’s statements can be also considered an attempt to define all Western culture by opposing it to Eastern culture (or civilisation); similar “negativistic” identification can be detected in the aspirations of contemporary Europe by opposing itself to America. But does the European Union have any specific cultural identity of his own, or have developments been based only on the logic of economic processes that have primarily brought about all the EU policies? Does the political and institutional structure of the European Union impose on European culture its own solutions, which can suppress the natural development of culture? Has this not already taken place? Is Estonia's belonging to the European cultural space not self-evident, or should we here continuously support and reproduce institutionally “Estonian Europe-ness” or “European Estonia-ness”? The debate that took place in Estonia before the country’s entry into the union was interesting also in the fact that, although in an embryonic form, it brought up quite a few new and interesting identity models or at least attempts to create or restore something to that effect. Quite promising were the “positive” identity discourses created by the popular Eurosceptics movement. These discourses could have become popular alternatives to the model of “Estonia as a decent and tedious member-state of the European Union” proposed by Toomas Hendrik Ilves. I have tried to analyse the background of Estonian popular Euroscepticism and subconscious pro-Europe discourses according to French Philosopher Jean-Francois Lyotard's theory of beginning ('myth') and end ('purpose') (Talts 2004, pp.118-128).

While in the pro-EU discourse could have been seen "positive" future utopias, the popular Euroscepticism contained a strong tendency to a return. Therefore, the nostalgia of President Päts' period restitution ideology reflected in the slogan "Estonia comes back!" was not missing in the anti-EU movement together with the resurrection of interwar Europe's autocratic ideals ("Estonia manages alone!" – used during the elections in the 1990s). These acted in simple black and white opposition to the official pro-European discourse's alleged global-capitalism obeying and Estonian national interests' betraying that, unfortunately, despite their good intentions, influenced the discussion in a negative way.

A similar change of paradigm was seen in Estonia in the first part of the last century, after Noor-Eesti's small 'Cultural Revolution' (Annus 2000, pp.88-95). That was the period when the European ideal within the Estonian identity was determined, the influence of which lasted through all the 20th century (Langemets 2000). The return to one's 'own culture', or, rather, to the attempts to search for the roots of Estonia's 'own culture' emerged again only in the end of 1930s and was interrupted by the events related to Soviet occupation. But significant herein is the fact that also at this time there was talk about the weakness of Estonian national feelings, the specific national inferiority complex, and the aspirations towards assimilation as obvious threats to Estonian identity.

What kind of future could be foreseen for identity constructions in Estonia? The share of cultural and ethnic factors as primary markers of identification will eventually decrease. At the same time the emergence of *civic identity* or transition from *cultural nation* to *state nation* (Ruutsoo 1998, pp. 38-45) will not completely replace *ethnic identity*, but will rather complement it, still significantly influencing ethnic identification. National culture as a token of identity is going to weaken (as the position of our self-culture will be surrendered to the global culture and the logic of global capitalism), but even more essential is the expectation that during this process some aspects of national culture may even strengthen. Whether this is an emergence of an artificial *safari*-culture or something more vital/sustainable should be answered by time. It is rather believable that Estonian national cultural identity and Estonian Russians' territorial-cultural identity will become ever closer to each other, but not converging into the same. This process will take place in the circumstances accompanying the formation of the new European common culture. It is possible and rather probable that new identification bases will be found in the world that becomes homogeneous in another way. A comparable process is taking place in Europe now, which is seeking for its own "face" in a globally convergent world and trying at least to be distinct from its main competitor – North America. Alas, this is a situation in which the European-ness has to be absorbed into the Estonian identity – or vice versa. The interpretation of the process depends on the observer's position. But it is certainly not a struggle between equals.

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EU development influence on the intellectual capital of Lithuania

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Introduction

The convergence of Lithuania in the EU conditioned the fact that it has been turned from an economy based on production and trade relations to an economy of knowledge, informational promotion, market activation, and the model of a cluster economy based on partnership. Therefore, an economy based on knowledge becomes the priority objective of Lithuania, and its citizens become the most important resources of successful business. It is possible to state that the human factor influences new technologies, business models, while ideas and innovations guarantee economic growth. In a society constantly changing due to the increasing progress of science and technology, greater requirements are imposed on employees' qualification, so inevitably the people's objective to invest in intellectual capital becomes more important. It is obvious that the knowledge society must be characterized by production based on flexibility and learning, the demand for human capital, and the principles of innovation, integration, and establishment of new businesses, as well as on strategies based on risk, lifelong education, cooperation, and teamwork. Therefore, one of the conditions of the functioning of the knowledge society would be investment in intellectual capital.

At the Lisbon Summit, in March, 2000, the European Union set for itself ambitious goals: “in the nearest decade Europe must become the most competitive and dynamic knowledge-based economy in the world.” The goal illustrates the dominant attitude that the ability to gain and use knowledge, in other words, accumulation and increase of intellectual capital, must become the essential factor conditioning competitive advantage (Building Knowledge Economy, 2002).

The object of the article – intellectual capital.

The aim of the article – to present the concept of intellectual capital and its importance in the context of EU development.

The objectives of the article:

1. To present the concept and importance of intellectual capital;
2. To identify the features of the impact of integration into the EU on the intellectual capital of Lithuania.

The methods of the research refer to the systemic method of scientific and statistical analysis and generalization.

The conception and importance of intellectual capital

The analysis of intellectual capital (IC) begins from its literal translation. Not many problems arise concerning the first part of the concept, i.e. “intellectual.” It is almost monosemantically understood as an adjective showing that a noun belonging to it is related to intellect or its use. One of the main products of the use of intellect is knowledge. Therefore, intellectual capital is often identified with knowledge, and some authors (Alee, 2000) even suggest changing the IC concept itself to the concept of knowledge capital.

The use of the term capital is more complicated. At first sight it seems that the concept of capital is very familiar to everyone, and many scientists of today do not feel the need to analyze it more deeply looking for the meaning of capital or observing its change over time. Capital was already analyzed by scientists such as Smith (1776) and Marx (1867). With the passing of time, the term capital lost its primary meaning. Therefore, trying to better understand the meaning of IC, it would be expedient to analyze the definitions of IC formulated by various authors. Becker (1993), in defining intellectual capital, stated that education, courses on computer literacy, expenses on health care, etc. should also be considered as capital in the sense that they improve health and increase pay. His thoughts correspond with the traditional conception of intellectual and human capital, because expenses on education, training, and health care are investments in human capital. Edvinsson and Sullivan (1996) think that intellectual capital is knowledge that may be converted to value. The definition of these scientists emphasizes static characteristics of expressed knowledge, observed in inventions, ideas, software, etc. In Huang's opinion (1997), intellectual capital consists of information, property, experience, wisdom, and ideas that are structurized in order to reuse and provide value to clients and shareholders. Wig (1997) states that intellectual capital is property created in the process of intellectual activities, beginning with acquisition of new knowledge and inventions, to making useful contracts. According to Bontis (1998) IC is the pursuit to use knowledge (finished product) efficiently, contrary to information (raw material). However, Bontis identifies intellectual capital with the management of intellectual capital, emphasizing not its creation but only its use, which is rather limited. Husz (1998) defines intellectual capital as follows: “By human capital we mean the time, experience, knowledge and abilities of an individual household or a generation, which can be used in the production process.” According to his definition intellectual capital consists of several components: time, experience, etc. Husz distinguished only the human capital which may be used in the production process; however, there exists social capital that includes not only time, experience, etc. In Lovingsson’s (2000) opinion, intellectual capital is knowledge and creativity available to a company for implementing business strategy, maximizing value for interested persons. Such a broad definition comprises any profit the organization may accumulate in the value chain by applying knowledge and creativity. Going into more detail with IC, employees’ abilities, research and development, prestige, trade-name, licensing possibilities, innovative use of clients’ databases, and relations in the supply value chain are included. According to Heng (2001) intellectual capital is knowledge of a special type or property based on knowledge existing in the organization beside the basis of its essential competence and influencing its survival and development of continuous competitive advantage.

So, summarizing the results of the analysis of the conception of intellectual capital, it is possible to state that IC is a new object of management and is still understood variously. However, most definitions have the same characteristics. First, intellectual capital is something invisible. Second, it is closely related to the knowledge and experience of employees as well as to the customers and technologies of an organization. Third, it offers better opportunities to succeed in benefits in the future. Intellectual capital usually is divided into three basic forms: human capital, structural capital, and customer capital. In this article the authors analyze only those components of human capital, which include knowledge, skills, expertise, motivation, innovation, entrepreneurial spirit, leadership qualities, vocational qualifications, education, and training.

In the new environment that got the name of the “knowledge era,” “knowledge economy,” or simply new economy, an especially important question became how to appropriately use the possessed intellectual resources and also how to manage to attract external accessible intellectual results and join them into the chain of value production. Intellectual capital is distinguished from other production factors by the fact that in organizations it is a strategically important factor of the value creation chain. It is its potentiality to create value that distinguishes it from other objects that are emphasized under new business conditions: knowledge, innovations, networks, and intellectual or immaterial property. However, the rise of intellectual capital as a new management object is most related to the need to distinguish strategically important intellectual resources including their main group – knowledge, from all other resources in the organization and its environment, as well as also to cover and integrally manage the objects belonging to several areas of “soft” management: knowledge, culture, intellectual property, innovations, and market relations. The majority of the components of intellectual property may be considered strategic property;

however, having applied strict conditions of the resource theory, the list is shortened to intellectual capital.

Although the European Union conditions the political, economic, social, and cultural transformation of Lithuania, and the free movement of persons regulated by EU law is an essential presumption for this transformation, it is possible to state that the impact of the free movement of persons on various areas of Lithuania is ambiguous and variable. Membership in the EU gives Lithuania many advantages: it encourages the democratization of the society, the increase of welfare and of industrialization, the growth of the economy, the development of communications, and it ensures greater safety. On the other hand, certain features of “modernization” tendencies and specifics of globalization and social and cultural differentiation have many negative consequences, and one of the most important and controversially evaluated consequences of the membership of Lithuania in the European Union is the emigration of experts, or the “brain drain”.

Features of the impact of the integration to the EU on the intellectual capital of Lithuania

In the agreement of the establishment of the European Economic Community (1957), the free movement of persons is considered one of the most important elements of the common market. Apart from the free movement of capital, the free movement of persons (of labour force and self-employed persons) becomes one of the most important production factors (Stepanauskas, 2003). When Lithuania became a full member of the EU after the transition period all regulations related to the free movement of persons became in force:

Lithuania must allow the labour force leave the country's territory, while other states must let it in and implement the main rights of the migrating labour force.

These rights are as follows: the right to come, settle, move, and stay without any discrimination from the national point of view (citizenship). In the EU the free movement of persons from spontaneous economic migration became a regulated process giving to the migrating labour force the same social guarantees as to the national labour force.

The records about the real migration flows since 1990 differ, depending on the sources and methods of calculation. The Lithuanian Department of Statistics (LSD) estimated that 20-30,000 people emigrated annually in 1990-1996, whereas in 1997-1999 the migration balance was insignificantly positive. After the census was taken, the LSD adjusted the previous data which showed that since 1990 the migration balance was negative and consisted of more than 20,000 emigrants per year. Table 1 displays the data about the migration of citizens of Lithuania in 2003-2004.

Table 1. International migration of inhabitants in Lithuania in 2003 – 2004

	Immigrated to Lithuania		Emigrated from Lithuania		Saldo of migration	
	2003	2004	2003	2004	2003	2004
EU	1215	2516	4385	8987	-3170	-6471
Ireland	39	188	276	1009	-237	-821
The United Kingdom	122	541	980	3525	-858	-2984
Germany	257	629	1204	1727	-947	-1098

**Source: Lietuvos statistikos metraštis 2005.*

The main states that accepted emigrants were Germany, Spain, the UK, and the USA. In analyzing the international migration of inhabitants of Lithuania, it has been noticed that during the period analyzed the migration from Lithuania to the EU countries increased by 48.7%. The biggest part (39%) of the Lithuanians immigrated to the United Kingdom. In 2004, when Lithuania entered the EU, the portion of people who emigrated to the countries with an open labour market, to Great Britain and Ireland, increased twofold.

Analyzing the distribution of the emigrants according to age groups, it has been noticed that the majority (20.9%) of persons were 25-29 years of age.

Table 2. Distribution of emigrants according to age groups

	18 – 19	20 – 24	25 – 29	30 – 34	35 – 39	40 - 44
2003	295	1466	1935	1345	1038	935
2004	505	2425	3169	1891	1305	1101

**Source: Demografijos metraštis, 2004.*

Because of emigration, the country loses mostly its youth of employable age. In 2005, 20% of migrants were 25 – 29 years old, 16.3% were 20 – 24 years old, 12.9% were 30 – 34 years of age, and 8.8% were in the age group 35 – 39, while just 2.9% were aged 60 years and over.

It is not possible to calculate the exact number of emigrating inhabitants and to estimate their education because of the free migration regime within EU, illegal migration, and natural limitations of statistics itself. The Department of Statistics of the Government of the Republic of Lithuania does not provide official statistics on the education of migrating people. Therefore, this article gives information on the education of the whole of the Lithuanian population aged 15 and up with reference to migrated people's ages (see table 3).

Table 3. Labour force survey data, average annual number, thousands

	2001	2002	2003	2004
Population aged 15 years and over	2800,4	2816	2826,6	2837,1
Higher	348,4	361,9	381	408,5
Professional colleges	131,9	122,9	122,5	129,4
Special secondary (technicum)	442,5	459,1	448,9	418
Vocational post secondary	148,8	136,2	142,2	149,7
Vocational upper secondary	174,9	186,8	192	193,7
General upper secondary	534,3	560,2	583,6	586,6
Vocational lower secondary	102,2	83,9	79,6	77,2
General lower secondary	393,7	424,2	428,4	450,9

**Source: Lietuvos statistikos metraštis, 2005.*

There appeared better opportunities to migrate and to get a legal and also better-paid job when Lithuania entered the EU in 2004. If you want to meet requirements in new labour markets, you need to be well qualified and at an education level that is one of the most important elements of intellectual capital. Table 3 data shows that during the period analyzed, the number of persons with higher education increased by 2 percentage points; persons with secondary education increased 1.6 percentage points. On the other hand, the number of persons with special secondary education and with vocational lower secondary education decreased.

A survey conducted in Great Britain at the request of the Ministry of Social Security and Labour revealed that the greatest portion of emigrants (37%) have secondary education, 14% of respondents have vocational education, 18% have further education, and 10% have unfinished secondary education. Approximately one fifth of migrants have university education. The survey shows that the country is deprived of part of its intellectual capital.

So, summarizing the results of the analysis of the statistical data about education, it is possible to state that education achieved in the native country can influence the emigration flow of skilled labour and qualified specialists to foreign countries and increase labour force competitiveness.

The “brain drain” is discussed as a separate phenomenon. Brain drain is defined by the Encyclopaedia Britannica as “departure of educated or professional people from one country, economic sector, or field for another usually for better pay or living conditions.” The report of the Organization for Economic Co-operation and Development (OECD) in 1997 on the movement of highly skilled people identifies two main basic concepts regarding brain drain: it is “brain exchange” and “brain waste.” Brain exchange means a two-directional movement of competence between a sending country and a receiving country. However, when one direction of movement is obviously predominant, the terms “brain gain” and “brain drain” are used. The term “brain waste” describes the waste of skills that occurs when highly skilled workers migrate into forms of employment not requiring the application of the skills and experience applied in the former job. It is also necessary to distinguish two different phenomena: temporary departure in order to widen one’s scientific outlook and departure for good.

A new concept, “brain circulation,” has recently come into use when speaking about the movement cycle: one goes abroad to study, is employed there, and then returns to his/her country in order to use the possibilities that have since appeared in the native country. Supposedly, this form of migration is spreading more and more as economic disparities between states are decreasing and new possibilities open due to the free movement of persons within the EU.

When the international processes of the liberalization of the labour market take place, Lithuania encounters not only the problem of emigration but also the very important problem of brain drain. When the best professionals in various areas find that the work environment is not satisfying their expectations, they leave the country; and thus the intellectual capital of Lithuania decreases. Meanwhile, the growth of general living standards and the solution to socioeconomic problems of the country depend on the efficient use of this most productive part of the society. The conception of brain drain is quite wide and includes not only the physical departure of highly skilled people from one country to another, from one region to another, from one organization to another, from one subdivision of the organization to another, but also any other loss of one economic subject's skills and knowledge necessary for economic growth and development on behalf of another economic subject.

Brain drain occurs under the influence of the factors of attraction and repulsion of migration of high-qualified employees, scientists, and students. Attraction factors influenced by globalization and Europeanization form the zones of attraction of talented and gifted individuals from all over the world. When Lithuania joined the EU, the problem of brain drain became more acute. Recently the demand of highly-qualified specialists (managers, technicians, administrators, lawyers) has been increasing more and more; a greater number of firms demand mobile employees due to the processes of globalization and internationalization. When Lithuania became a member of the EU, its citizens came to have the same rights of freedom of employment as the "old" citizens of the EU, the wave of emigration of highly (and not only) qualified employees from Lithuania caused especially negative consequences to it.

Emigration of inhabitants with the highest qualification is harmful to the state economy; however, it may also be useful. Neither the harm nor value of this phenomenon in Lithuania has been calculated.

As society in the developed states of Western Europe is getting older and older and thus lacking a qualified labour force, problems also encountered by the USA, their governments turn to the qualified labour force in developing states and establish better conditions to attract this labour force. When the developing countries cannot compete in labour payments with the developed one's the experts foresee that, in some certain time, due to the decrease in the qualified labour force, the development of the economy may slow. In Lithuania scientists also are anxious because the most talented young scientists flee from Lithuania when by working in Lithuania they could contribute to the growth of the economy.

During globalization and integration processes, the zones of brain attraction are formed, and such states as Great Britain, Germany, Sweden, and recently Ireland attract the bigger part of the most talented and gifted employees from the rest of Europe and other states. Every year the most gifted scientists, doctors, engineers, and other highly-qualified specialists leave Lithuania. The same situation is also observed among students who go abroad for studies and often do not come back. These processes became even quicker when

Lithuania joined the EU, because quotas and restrictions are decreasing, and Lithuanian students may apply to general scholarship funds of the EU.

However, it is difficult to evaluate the real situation because the brain drain makes up a small part of all the process of the movement of persons statistically. One more problem is that there is no statistical data about the level of emigrants' education.

According to the calculations of the science forum of Lithuanians abroad, during the years of independence about one thousand citizens of Lithuania defended their Ph.D. theses abroad or are going to (for comparison, about 150 Ph.D. theses are defended in Lithuania every year).

Undoubtedly, the departure of Lithuanian students and young scientists to EU countries also has positive aspects: there they gain education and experience which would be hard or impossible to gain in Lithuania. Almost in all cases this education is financed not by Lithuania but by the receiving countries. The problem for Lithuania is the students' unwillingness to come back and use the education thus gained in their country. Scientists working in foreign countries try to contribute to the rise of the state of science in Lithuania. However, without strategic state support these initiatives are doomed to disappear.

The reason for the brain drain is not only general the economic lag of Lithuania. The brain drain is also stimulated by the ingrained problems of education and the study system of Lithuania. Analyses performed by the World Bank show that Lithuania is one of the most backward countries in the area of scientific production and innovations (Stepanauskas, 2003).

On of the most important factors encouraging brain drain is the attitude of the state of Lithuania towards science. The dynamics of the financing of scientific research in Lithuania are as follows: in 1993-2001 the financing of scientific research grew from 0.43 to 0.68 % of GDP. In the business sector the financing of scientific research reaches 0.14 % of GDP. In the recent years from 2001, the percentage of GDP for the financing of scientific research stabilized and even started to decrease.

Lithuania, as well as other countries of Middle and Eastern Europe, encounters the so-called "paradox of higher education," when a better level of higher education creates the supply for the drain and even accelerates it.

Conclusions

To summarize EU development influence on the intellectual capital of Lithuania, it is possible to emphasize both its positive and negative effects. Negative outcomes of free labour migration result in the skilled labour scarcity that decreases the potential for manufacture development and the more active use of investment; however, a certain amount of skilled labour scarcity is considered a positive factor that allows the employers to use the labour force in a more effective way that accords maximally with the strategy of EU social policy.

The intellectual capital emigration process is critical to Lithuania as it could negatively affect social infrastructure and quality of life. Specialists that analyze the brain drain problems agree that in order to keep intellectual capital within the country and even to increase it, measures should be taken at the state level to allow high quality specialists and scientists to work in their own country, i.e. to ensure the appropriate social and economic environment. The other very important factor in encouraging specialists not to migrate is an attractive higher education system and research infrastructure which reveals the potential for improvement of and utilization of their competences.

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The Perception of Quality of Life of Latvians and of Russians Living in Latvia.

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Quality of life is a sociological category that is applied to show the degree of satisfaction with materialistic and cultural needs of people in all aspects of social life. (Shuessler, Fisher 1985, p.131.) The interest in this scientific concept has been growing since the mid ‘60s of the 20th century. This time period is characterized by the change from an industrial civilization to a post-industrial civilization. Sociologists have concluded that the causes for such global social changes are not only the transformation of production technologies, principles of social stratification, and types of social institutions predominant within an industrial society. Post-industrial civilization is also a new type of social human orientation. According to Ronald Inglehart, “cultural changes take place when materialistic preferences of values are transformed into post-materialistic ones: the attention paid to prosperity, well-being and security is exchanged for quality of life.” (Inglehart 1989, p.250).

The quality of life of a person who is free from the pressure and obligation to provide physical and material security for oneself and one’s family, is aimed at social contacts, participation in political activities, creation of a favorable ecological, psychological, and cultural environment, and development of an unbiased opinion. At the same time, the quality of life is not just a growing interest in the social values of an individual's life; it also develops social standards important for those who are willing to gain success in the individual process of socialization. As Talcott Parsons put it, social standards in a society can contribute to the integration of a social system as well as differentiate and stratify the society into groups that are different in their unequal degree of comprehension of the requirements of social standards. (Parsons 1953/2000, c.574). According to T. Parsons, stratification into ethnic groups is one of the aspects of the system of social stratification depending on the degree to which and peculiarities of how the common social standards are arrived at. (Parsons, 1953/2000, c.616-617)

The ethnic issue as a social resource of life quality is very topical for the Latvian community due to its multiethnic structure. According to statistical data for 2006, out of 2.3 million inhabitants of Latvia 58.8% are Latvians, 28.6% – Russians living in Latvia, 3.8% – Byelorussians, 2.6% – Ukrainians, 2.5% – Polish, and 1.4% – Lithuanians. (Latvijas Republikas Ministru Kabinets, 2006)

In the given situation the question concerning possible national or ethnic differences in the quality of life is very important. If ethnic differences do exist, it is necessary to decide whether they are essential and whether they cause social inequality between ethnic groups within the standards of the quality of life.

In this article, the differences in the quality of life of the two major ethnic groups – Latvians and Russians living in Latvia – are considered. Such a choice was made in order to reflect the distribution of major ethnicities in the given community (Latvians, N=601, Russians, N=322). The source of sociological data is the research, “The Quality of Life in Latvia,” conducted in 2005 by professor Talis Tisenkopfs.

The differences in the quality of life of the ethnic groups are analysed according to the following principles:

1. The perception of the representatives of the ethnic groups about life conditions;
2. The perception of the representatives of the ethnic groups about life objectives and values;
3. The perception of the representatives of the ethnic groups about the network of social interaction, which shows the level of social integration of this group within the civil society.

1. The perception of existing life conditions

The respondents’ evaluation of life conditions can be dividend into two parts – objective and subjective. The objective part of the evaluations is the evaluation of respondents’ existing life conditions. The subjective part is the respondents’ evaluation of their abilities to set life goals and their satisfaction with the results of their efforts to achieve these goals.

There are differences in this respect in the answers of Latvian and Russian respondents. Russian respondents’ evaluation of their life conditions was more positive than that of the Latvian ones. But it turned out that the same Russian respondents were less satisfied with their efforts to achieve their life goals (Tables 1 and 2).

Table 1. Attitude to social opportunities in a local area (%)*

		very good opportunities		good opportunities		small opportunities		very small opportunities		no answer		Mann-Whitney U Asymp. Sig.
		L	R	L	R	L	R	L	R	L	R	0,213
1.	To receive education	14,3	15,5	26,1	30,7	25,0	23,9	28,1	19,9	6,5	9,9	0,003
2.	To get a required professional qualification	7,8	10,6	17,0	26,7	24,0	24,2	43,8	25,5	7,5	13,0	0,044
3.	To find a job	2,7	5,3	10,3	15,8	35,9	33,5	45,4	37,3	5,7	8,1	0,209
4.	To find accommodation	4,3	6,5	26,1	30,1	35,9	30,7	23,0	21,1	10,6	11,5	0,852
5.	To spend free time	10,3	11,5	27,0	33,4	37,3	23,9	19,3	17,1	6,2	13,7	0,008
6.	To use everyday services	10,5	14,0	32,6	40,4	23,8	18,9	24,3	15,5	8,8	11,2	0,008

**The source of sociological data is the research "The Quality of Life in Latvia" 2005 (L – Latvians, R - Russians) (Significance p < 0, 001)*

Table 2. Satisfaction with one's life spheres (replies: «satisfied with» and «fully satisfied with») (%)

		All the respondents	Latvians	Russians	Mann-Whitney U Asymp. Sig.
1.	His/her present working place in general	41	46	35	0,000*
2.	His/her s salary on the main place of work	22	23	20	0,055
3.	Work environment and conditions on his/her main place of work	37	42	29	0,000*
4.	His/her income	21	23	19	0,109
5.	Welfare of the person and his/her family	24	25	24	0,650
6.	The level of his/her qualification	44	45	42	0,314
7.	The level of his/her education	51	52	48	0,781
8.	His/her health	51	54	49	0,215
9.	His/her flat, lodging	55	55	55	0,891
10.	Life environment in his/her city, region, village	54	59	51	0,019
11.	Work resources in the place where he/she lives	18	16	24	0,406
12.	The possibility to run business in the place where he/she lives	9	9	11	0,075
13.	Safety in the place where he/she lives	43	48	36	0,000*
14.	Social integration, equal possibilities in the place where he/she lives	31	35	24	0,012
15.	Ecological situation in the place where he/she lives	49	54	42	0,001*
16.	His/her family life	64	66	61	0,484
17.	Support and protection that he/she gets from relatives, friends, colleagues	66	69	61	0,024
18.	Support and protection that he/she gives to relatives, friends, colleagues	56	57	56	0,743
19.	The amount of time that he/she can dedicate to his/her family	53	48	51	0,838
20.	That amount of time that he/she can dedicate to him/herself	51	52	49	0,802
21.	Possibilities to realize his/her hopes and objectives on the working place	27	29	25	0,009
22.	Possibilities to realize his/her hopes and objectives in the family	40	39	44	0,191
23.	Possibilities to realize his/her own hopes and objectives	37	37	36	0,837
24.	Possibilities to spend free time as he/she wants	39	40	38	0,973

**Significance* $p < 0,001$*

At the same time both Latvian and Russian respondents gave a similar evaluation of their subjective abilities to set life goals in different spheres of life (Tables 3).

Table 3. Subjective ability to affect different spheres of life. (replies: "to a considerable degree" and "to some extent") (%)

		All the respondents	Latvians	Russians	Mann-Whitney U Asymp. Sig.
1.	Situation on the labour market	21	24	19	0.004
2.	Salary at the main place of work	13	12	14	0.306
3.	Work environment and conditions at the main place of work	16	17	15	0.007
4.	Income	23	22	26	0.429
5.	Welfare of the person and his/her family	30	31	29	0.388
6.	The level of his/her qualification	49	51	47	0.400
7.	The level of his/her education	51	54	48	0.241
8.	His/her health	49	51	50	0.767
9.	His/her flat, lodging	57	58	56	0.252
10.	Life environment in his/her city, region, village	10	11	10	0.019
11.	Work resources in the place where he/she lives	6	6	6	0.857
12.	The possibility to run a business in the place where he/she lives	5	4	6	0.882
13.	Safety in the place where he/she lives	9	11	7	0.316
14.	Social integration, equal possibilities in the place where he/she lives	7	6	8	0.200
15.	Ecological situation in the place where he/she lives	15	16	13	0.536
16.	His/her family life	68	69	67	0.501
17.	Support and protection that he/she gets from relatives, friends, colleagues	50	49	52	0.691
18.	Support and protection that he/she gives to relatives, friends, colleagues	67	67	68	0.178
19.	The amount of time that he/she can dedicate to his/her family	65	67	63	0.471
20.	That amount of time that he/she can dedicate to him/herself	66	67	66	0.870

Significance p < 0, 001

Apart from instrumental resources for personal development, social conditions include also symbolic values, which are related to the identity of the state and civil society. The results of the sociological research prove that there are significant differences between Latvians and Russians in the attitude towards symbolic values, such as the feeling of belonging to Latvia (Table 4).

Table 4. The feeling of belonging to territorial units. (reply– "belong to a considerable degree") (%)

		All the respondents	Latvians	Russians	Mann-Whitney U Asymp. Sig.
1.	Town, district, village	45	51	37	0.002
2.	Latvia	46	54	37	0.000*
3.	European Union	11	11	11	0.751

** Significance p < 0, 001*

However, Russian respondents who are employed in the spheres of high technology have a higher education, and those who belong to the middle layer show higher rates of the feeling of belonging to territorial units (Table 5).

Table 5. The feeling of belonging to territorial units among Russians living in Latvia.

		All Russians	Russian group of paid employees, specialists, businessmen, and those self-employed	Russian group with high education	Russian group of people working with finances, immovable property, rental, computer services, state admin. and protection, compulsory soc.insurance, educ. and science, health and social care, public, social and indiv. Services
1.	Town, district, village	37	38	42	46
2.	Latvia	37	48	41	46
3.	European Union	11	10	14	16

2. The perception of life objectives and values

The perception of life objectives and values is an important index of the quality of life. The development of life objectives of Latvian social and ethnic groups is much influenced by the environment, and the aggregate of institutions, norms, values, and widespread social practices. At the same time, the results of the research show that life objectives of ethnic groups in Latvia to a considerable degree depend on the level and on the character of their adaptation in the existing social and economic conditions, and in the information and culture space which has developed in Latvian community. The character of life objectives of ethnic groups in Latvia, thus, depends on what attitude to the existing life conditions is predominant: adaptive, which is oriented on the acceptance of the established conditions as a standard example, or innovative, which is related to the critical evaluation of established social conditions, and to the improvement of these social conditions with the help of his/her potential. It is obvious that an important element of the innovative strategy is a person's willingness to get an education, to search for information sources, to acquire modern information technologies, to develop his/her personality, as well as to take care of his/her health, etc. Tables 6 - 7 show that this kind of strategy is more characteristic for Latvians than for Russians.

Table 6. Motivation to continue to study. (%)

		All the respondents	Latvians	Russians	Mann-Whitney U Asymp. Sig.
1.	Provision of well-being	61	57	72	0.010
2.	To receive a professional qualification	13	14	12	0.954
3.	Personality development	13	15	10	0.787

Significance p < 0, 001

Table 7. Use of the library during the last year (%)

All the respondents	Latvians	Russians	Mann-Whitney U Asymp. Sig.
39	47	26	0.000*

Significance p < 0, 001

As to realization of life plans, the results of the research show that there is no significant difference between the major ethnic groups in Latvia – Latvians and Russians – during the last year. Concerning the realization of plans in the search for a better work place, purchase of real estate or expensive property, and enlargement of social contacts, the results are practically the same among both Latvians and Russians. However, Russian respondents take less care of their health than do Latvians, they less frequently attend seminars and courses, are less interested in the improvement of their qualification, do not so often insure their property, and are not so much interested in signing contracts for the second and third pension levels.

The respondents' perception about the desirable development of a major sphere of the national economy in the place where they live is mainly based on some practical reasons, one of which is interest about the sphere of their employment. The perception about the necessity to develop this major sphere of the national economy similarly to other social spheres is also related to the number of representatives of the concrete ethnic group employed in the sphere (Table 8).

Table 8. The spheres, which, in the opinion of respondents, could be developed (%)

		All the respondents	Latvians	Russians	Mann-Whitney U Asymp. Sig.
1.	Food processing	29	31	25	0.057
2.	Wood processing	34	39	26	0.000*
3.	Extraction of minerals	3	4	3	0.755
4.	Craft	31	35	25	0.003
5.	Trade	27	26	29	0.222
6.	Agriculture	34	37	26	0.001*
7.	Tourism and entertainment	57	61	49	0.001*
8.	Culture	37	39	34	0.139
9.	Education	33	32	34	0.697
10.	Construction	33	31	39	0.018
11.	Information technologies	18	18	17	0.731
12.	Transport and storage	15	14	17	0.209
13.	Financial services	16	16	18	0.399
14.	Health care, rehabilitation	45	48	37	0.001*
15.	Other	2	2	2	0.633

**Significance p < 0, 001*

The table shows that Latvian respondents are more interested than Russians in the development of such spheres of the national economy as food and wood processing, different kinds of crafts, agriculture, tourism and entertainment, culture, health protection and rehabilitation. These are the spheres which give jobs to a greater number of Latvians than Russians. At the same time, Russian respondents more than Latvians would like to see the development of such spheres as trade and construction, the spheres which employ a larger number of Russians.

Among Latvian respondents, there are slightly more people who would like to run their own business or to choose an independent kind of professional activity. Specifically, 21% of Latvians and 26% of Russians want be employed, 30% of Latvians and 27 % of Russians wanted personal economic activity.

3. The perception of the network of social interaction in the society.

The well-developed network of social interaction provides a person, as well as social and ethnic groups, with wide possibilities to find partners in order to fulfill life objectives. Social interaction includes the system of institutions, norms, and values which facilitates the social integration of a person into the society, as well as widespread practices and the system of motivated viewpoints which is oriented to the creation and maintenance of social relations.

The materials of this research help to find diverse respondents' attitudes to the whole network of institutions, values, and social subjects which are connected with the functioning of the social interaction system in the Latvian community. The research shows respondents' attitude to such structural elements of social interaction as:

1. The subjects of the public sphere of social life – state authorities, local governments, European Union, nongovernmental organizations;

2. The subjects of the economic sphere of social life – employers, employees, colleagues, partners from Latvia, partners from abroad;
3. The subjects of the private sphere – friends, relatives, members of the family;
4. Social values and norms, which are regulated by scientific discoveries, patriotism, religious beliefs;
5. Subjective viewpoints of the participants of communication – reliance on destiny, reliance on one's forces, readiness to take a risk, common sense.

The research showed that the network of social interaction established in social and private life is used in different ways by Latvian and Russian respondents in order to fulfill their life objectives. Contrary to Russians, Latvian respondents to a more considerable degree use the network of interaction, which is represented in social life (Table 9).

Table 9. Aspects which affect the ability to act and to fulfill hopes and objectives. (Reply – "positive affects")(%)

		All the respondents	Latvians	Russians	Mann-Whitney U Asymp. Sig.
1.	State institutions	7	8	5	0.662
2.	Local government	12	15	6	0.179
3.	Employers	19	22	15	0.089
4.	Employees	6	6	5	0.011
5.	Scientific discoveries	32	35	27	0.124
6.	EU	19	21	14	0.177
7.	Belief in God	32	30	34	0.186
8.	Reliance on destiny	24	24	26	0.314
9.	Reliance on oneself forces	72	77	68	0.015
10.	Member of the family	67	70	64	0.080
11.	Relatives	49	49	52	0.534
12.	Colleagues	30	32	28	0.189
13.	Friends	47	48	47	0.903
14.	Nongovernmental organizations	10	11	7	0.372

(Significance $p < 0, 001$)

Latvian respondents more often than Russian ones marked various public institutions, individual motivation, and social partners as aspects which help them to fulfill goals. This includes state authorities, local government, employers, scientific discoveries, the EU, nongovernmental organizations, partners from Latvia and foreign partners, as well as patriotism, common sense, and readiness to take risks.

As to such aspects as employees, religious beliefs, reliance on one's destiny, relatives, friends, and colleagues, there is no significant difference between the attitude of Latvians and Russians. Having analyzed established elements of the network of social interaction in the social and private sphere, it is possible to say that such differences prove that the Latvian part of the society has greater potential and communication possibilities. That is why the Latvian population has a higher level of social integration, which is an important index of the quality of life in the information society. At the same time, it turned out that Russian respondents have a higher level of autonomization than Latvians and, consequently, are at a lower stage of social integration.

Table 10. Political collaboration. (reply: «participated in») (%)

		All the respondents	Latvians	Russians	Mann-Whitney U Asymp. Sig.
1.	Parliamentary elections	62	79	40	0.000
2.	City council elections	66	83	43	0.000
3.	Organisation of election campaigns	6	9	3	0.006
4.	Persuaded someone to vote for a particular political party	13	14	12	0.568
5.	Participation in referendum organization	23	31	9	0.000
6.	Participation in meetings, pickets, demonstrations	10	10	10	0.710
7.	Participation in strikes	2	3	2	0.264
8.	Writing letters to president and prime-minister	2	2	1	0.283
9.	Writing letters to ministers and top officials	5	6	3	0.076
10.	Writing letters to city council	8	9	5	0.033
11.	Writing letters to newspapers	8	9	5	0.080
12.	Meeting with members of parliament	13	17	7	0.000
13.	Meeting with members of city council	25	32	12	0.000
14.	Meeting with ministers and top officials	12	15	6	0.000
15.	Meeting with reporters	16	19	9	0.000
16.	Discussion of social activities	14	19	8	0.000
17.	Participation in the discussion of city or region. devel. planning	10	14	4	0.000
18.	Political party membership	2	3	1	0.015
19.	Non-state organization membership	5	7	2	0.001
20.	Purposeful distribution of politically-oriented information	4	4	2	0.194
21.	Giving charity to political parties	1	2	0	0.028

(Significance $p < 0, 001$)

An important sign of the development of social interaction in the society is its manifestation in political life, in the sphere of citizens' political collaboration. However, an obstructive factor of the development of social interaction in political life is the fact that a large part of minority representatives have no citizenship of the Republic of Latvia. As a result, according to the materials of the research, the number of Latvian respondents as conventional and non-conventional participants of diverse political life is higher than the number of Russian ones (Table 10).

An especially large difference can be seen in such kinds of political interaction as participation in the elections to the Saeima and the local government, letter writing to the President, Vice President, Ministries, local governments, meetings with the deputies of the Saeima and the local government, ministers, officials and journalists, participation in public discussions, strikes (in 2 occurrences), referendum convocation, work in nongovernmental organizations, participation in discussions about the development of the town or region (in 3 instances), membership in a political party.

The difference between Latvian and Russian respondents in such a sphere of social interaction as political collaboration is very significant. However, as to the sphere of work and economic life, the difference is minimal or there is no difference at all. Both Latvian and Russian respondents rely in the same way on various social subjects as on information and help resources while searching for work (Table 11).

Table 11. Actions while searching for work (reply– "certainly"). (%)

		All the respondents	Latvians	Russians	Mann-Whitney U Asymp. Sig.
1.	He/she would turn to the employer	59	62	56	0.031
2.	He/she would turn to the State Employment agency	39	37	40	0.706
3.	He/she would look through advertisements in newspapers	64	65	64	0.522
4.	He/she would use Internet	39	40	40	0.501
5.	He/she would use help of members of the family	47	48	48	0.564
6.	He/she would use help of relatives, friends, or neighbours	52	51	54	0.680
7.	He/she would try to start his/her own business	11	9	13	0.838
8.	He/she would try to become self-employed	15	15	16	0.277

Significance p < 0, 001

Social interaction in a society with various ethnicities helps a person to develop communication skills in different languages. The respondents' answers show, first of all, that 98% of both Latvians and Russians have the Latvian or Russian language as their mother tongue, respectively. It means that both Latvians and Russians have linguistic identity as their ethnic identity. Secondly, both these languages are widespread between both ethnic groups: the Latvian language among Russians and the Russian language among Latvians.

However, there are 58% of Latvians who said that the level of their Russian language knowledge is "very good", but only 26% of Russians gave the same evaluation to their Latvian language knowledge. There was also found the following peculiarity of Latvian language knowledge among Russian respondents. In Riga, Zemgale, and Latgale, the level of Latvian language knowledge was similar to the average indices in the country (25%, 29%, and 26%, respectively). In Vidzeme the level turned out to be higher – 40%, but in Kurzeme it was lower – 17%. Latvians whose knowledge of the Russian language is "very good" live mainly in Riga (74%) and in Latgale (71%); as for Zemgale, Vidzeme, and Kurzeme the numbers are 60%, 47%,and 44%, respectively. As is clearly seen from the data mentioned above, the highest number of Russians who know the Latvian language very well is in Vidzeme – 40%; however, it is lower than the number of Latvians who speak Russian at the same level in either region of Latvia.

Concerning respondents' knowledge of the English, German, and French languages, the level among both Latvians and Russians is approximately the same. As to the English language, 26% of both Latvian and Russian respondents answered that their knowledge is "very good" or "quite good"; as to the German language, the same level was marked by 9% of Latvians and 6% of Russians; as to the French language, 1% of representatives of both ethnic groups claimed to know it very well.

4. Quality of life in Latvia: ethnic differences or ethnic inequality?

The materials of the sociological research show that in Latvia there already function or are just in the development stage such aspects as values and standards of quality of life, as well as behaviour patterns, which are related to the information society. For this society it is characteristic to move the emphasis from material wealth and institutional conditions of a person's life to the personality itself, to the development of a person's talents and skills.

As the materials of the research show, transition to the principles of the information society, which correspond to the values and standards of the quality of life, does not happen simultaneously in all social and ethnic groups. It is obvious that those social professional groups which are related to innovative economics and realize high potential of maintenance of information accept standards of the information society much faster than those social professional groups which fit perfectly well into the industrial type of society. In the same way, the proportion of social professional groups related to the information society in social or ethnic groups establishes also the proportion of the values and standards of the quality of life of the information society in the country in general.

The materials of the sociological research allow the following conclusions:

1. Latvians and the representatives of the ethnic minority community have similar or practically an identical level of subjective motivation to acquire prestigious values and standards of quality of life.
2. The difference between Latvians and the representatives of the ethnic minority community in acquisition of the modern standards of life quality depends on the realization level of subjective motivation of the representatives of these social groups. It gets higher in several levels of social stratification of the Latvian community – economic, social, and political life.
3. The social professional structure of present ethnic groups, the level of the Latvian language knowledge of various ethnic groups in Latvia, as well as the proportion of the citizens of the Republic of Latvia in ethnic groups have the most significant influence on Latvians and the representatives of the ethnic minority community in acquirement of the values and standards of the quality of life of the information society.

4. What concerns acquisition of the values and standards of life quality in each ethnic group, the main difference is correlation to the social professional structure, but if both ethnic groups are compared, the difference is in the level of the official language knowledge and the proportion of the citizens of the Republic of Latvia among the representatives of either ethnic group.

The case of Latvia shows the interconnection of ethnic stratification and social stratification. This phenomenon has a historical foundation in the system of the division of labor between Latvians and ethnic minorities, and as differentiation of social behavior and attitudes to the dominant values and standards of the life quality. The data of sociological research demonstrate significant influence of the standards of life quality to social stratification in the multiethnic society of Latvia. How would this interconnection of ethnic stratification and social stratification in Latvia be estimated?

According to J. Rothschild, for a society with various ethnicities it is characteristic to have both socio-economic and ethnic stratifications. Moreover, ethnic stratification quite often appears as socio-economic stratification – they overlap each other (Rotčailds 1999, 35. lpp). J. Rothschild fairly notes that in a society with various ethnicities the overlapping of ethnic and social economic stratifications can lead to the politicisation of the ethnic issue. That is why it is necessary to encourage the development a system of ethnic stratification which would not lead to the social economic discrimination of the representatives of ethnic minorities.

J. Rothschild distinguishes 3 models of ethnic stratification:

- vertical model, in which ethnic stratification is based on the subordination of ethnic groups into economic life, as well as into the system of political power;
- parallel segments, when ethnic groups exist as relatively autonomous social, economic, and political communities;
- cross-patterned reticulation, in which "each ethnic group has a range of economic functions and specialities, and each economic category and sector includes members of numerous ethnic groups" (Rotčailds 1999, 74.lpp).

J. Rothschild thinks that for a democratic society with various ethnicities, the reticulation model of ethnic stratification suits best of all. In the conditions of the reticulation model it is possible to reach the optimal integration of ethnic minorities – integration of "life possibilities", when the differences of such indices as mortality, number of literate people, quality of lodging, rate of people employed in economic sector, etc., between the ethnic groups decrease (Rotčailds 1999, 94.lpp).

The sociological research "The Quality of Life in Latvia" shows different elements of ethnic stratification (vertical model, parallel segments, cross-patterned reticulation). Moreover, standards of life quality stimulate the common traits of social behaviour for ethnic groups, and also differentiate the ethnic stratification in Latvia to a greater degree.

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Reflections on the benefits of living in a democratic society. The Anthropologists and the Kashubians - the European Union and a new life

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Anthropology under socialism

During the socialist period Polish anthropology, known generally as *etnografia* at that time, faced serious problems trying to address searching questions related to social topics, which were to remain under the strict control of the state. In that sense it shared the fate of all the social sciences. The new Polish state, established after the Second World War and fully depending on the Soviet Union, received a new name: People's Republic of Poland. The new name reflected the new ideology and its icon: the People, not the Nation – as it had been before in history. *Etnografia* was pushed into a marginal position, but at the same time there appeared among scholars a kind of self-censorship, which eliminated the topics which seemed, to the communist powerholders, to be too sensitive to be researched. Paradoxically, though this situation resulted in the fact that *etnografia* developed slowly during the socialist period, it did not, however, cooperate with the regime in any way – it did not function as a useful tool in supporting the communist state and propaganda. No theories rooted in Marxism developed in the milieu of Polish anthropologists; a marginal discipline of a small number of both scholars and students maintained its *status quo*. Professor Aleksander Posern-Zieliński, anthropologist, describes the limited freedom of Polish anthropology under socialism: “Polish anthropology, in sharp contrast to other social sciences and humanities disciplines, was not strongly influenced by Marxism-Leninism or Soviet anthropological models. The discipline did not come under strong ideological pressure from institutions such as committees of the Communist Party, the Ministry of Higher Education, or the university administration. We experienced no strong pressures to incorporate basic principles of historical materialism into our methodology and discourses. Instead, Polish anthropology drifted between the intellectual traditions of the pre-war period, supervised by the generation of older professors, and a minimal adaptation to the new politics of sciences and education. The result was a discipline characterised by methodological eclecticism, including only minor influences from officially sanctioned Marxist philosophy” (Posern-Zieliński 2005, p. 110). Social life in research was treated in a descriptive manner in order to avoid interpretation or posing questions, which were considered to be political activities. Careful examination of topics related to the state could become risky both to researchers and interviewees, and was recognized as an activity of the state security service (in fact the ambiguous term *informator* – ‘informant’ is hardly used by Polish anthropologists even today). Thus “[n]ot only did Polish anthropologist[s] concentrate on ‘exotic’ themes such as traditional folk culture and the cultures of more distant countries, but there was also a tendency within these fields to focus on politically and ideologically neutral topics. When contemporary changes in rural Poland were examined, it was done mostly in a descriptive manner, without serious interpretation of causes and consequences, in order to avoid any risk of official critique and accusation of spreading anti-socialistic propaganda. A tendency towards self-censorship developed, along with a preference for themes as far away as possible from the political. This explains why the majority of studies were concentrated on traditional folk culture, folklorism, folk art, folklore, and national cultural history. Those who studied traditional African, Asian, Oceanic, and Native American peoples, in many cases from a distance, on the basis of the literature, shared the same bias. The discipline came to function as a kind of isolated island, free of direct ideological pressure and political manipulation. This made it attractive to young people looking to escape from ‘actually existing socialism’ and disciplines associated in one way or another with its legitimation” (Posern-Zieliński 2005, p. 111-112).

Anthropology during the time of social transition

The changes of 1989 could be illustrated well with the example of change in the title of probably the most known anthropological magazine in Poland. Along with the change of the state system, the magazine replaced the title “Polska Sztuka Ludowa” (Polish Folk Art) with the new one – “Konteksty”[1] (The Contexts), which was considered to be an expression of the shift in the magazine’s subject matter as well as in the scholarly approach.

The new era of transition brought into Polish society new phenomena, never before seen and now experienced with an overwhelming enthusiasm. The beginning of the 1990s was a time distinguished by open public debate on any subject, previously considered taboo, now enabled by the abolition of state censorship and the establishment of state-independent media, both

[1] http://ispan.pl/konteksty/

public and private. Debate was supported by independent social research for the first time.

Freedom of speech and the free choice of subjects to be researched and discussed that were suddenly gained by Polish society in its very first step towards a civil society, contributed both to the development of the discipline of anthropology and the recognition of its area of study: other peoples/minority groups. The map of Polish society was reshaped, highlighting groups previously excluded from public discourse as well as the new identities of the groups whose previous labels suddenly proved to be fictitious, constructed, and imposed by social engineers.

The emergence of ethnic and social problems

The collapse of the socialist regime in 1989 cancelled the sharp division of the society into the governing minority of the 2 million party elite and the 36 million "society", and uncovered a whole variety of attitudes and identities. During socialism the official statistics did not show any minorities – neither national nor ethnic. This was the result both of the state's unifying policy and ideology supporting the study of the Polish diaspora (considering that the studies of the ethnic factors within the country were not in favour, especially concerning groups suspected of German sympathies), as well as the fact that the groups themselves did not wish to reveal themselves in public or did not recognize their own dissimilarity. As professor Cezary Obracht-Prondzyński puts it in the article *Czy w Polsce powstają nowe narody? Przypadek Kaszub i Śląska* (Are there new nations emerging in Poland? The case of the Kashubia and the Silezia regions): "the number of minorities did not increase (except of the case of the immigrants). The minorities rather revealed their presence. In a way they became attractive to those, who in new [political] settings realized their ethnic origin, or started to admit it in public. This made it seem that there was more minorities then before, which to many Poles became a surprise (Kempny et al. 1997, p. 7). Social sciences describe such process with the term «revealed cultural diversity», treated «as the problem of coexistence of various – both old ones and the ones in the building phase – cultural minorities, related not only to the nationality and ethnicity, but also to confession, region, attitude toward the history, the status of a disabled person, sexual orientation, etc.» (Kempny et al. 1997, p. 8). Such «manifestation» was a natural reaction to the actually existing doctrine of political-moral unity of the nation spread by the socialist state (one of its foundations was constant message that People's Republic was free from national tension, typical for the II Republic [before 1939]) (Pudło 1997, p. 273). It was also meant to manifest that Polish society is by no means homogenous in the ethnical, or broader – cultural sense.

The effect of it was, as M. Ziółkowski put is, the fact that «in contemporary Poland ethnic and confessional groups, cultural minorities and alternative groups gain the importance and begin to compete with the traditional classes as the centers of the group identity and loyalty, setting not individual, but group goals and values based on the sense of community and affiliation» (Ziółkowski 2000, p. 165; see also Obracht-Prondzyński 2003)

The cultural diversity revealed in the beginning of the 1990s became a part of public discourse, but at the same time it proved to be "problematic". Any phenomena differing from the "canon" of Polish national identity were termed ethnic problems, which raised the question of the canon, and created a need for redefining it. Slowly but consequently, some previously absent minority identities found their place in the new reshaped model of the Polish identity. These were the first steps the society took in order to learn all the details of its contemporary real picture.

The new emancipation of the Kashubians

One of the groups which won the opportunity for demonstrating their problems after 1989 was the regional group of Kashubians (Pol. *Kaszubi*), inhabiting the Gdansk Pomerania region, a former Polish-German borderland. Before that date the Kashubians existed only as an insignificant, relatively small, peasant ethnographic group, which could be seen only rarely in regional or Skansen museums. Their spoken language was roughly considered to be a regional dialect. The Kashubians lived on the outskirts of the public sphere controlled by official state policy. Without manifesting their dissimilarity, they maintained their folkloristic *status quo*.

The emancipation of the group has been a slow process, done in a “safe” manner, showing the trouble with overcoming the feeling of being inferior. One of the reasons is perhaps the burden of the past: the Kashubians were building their identity in a very specific historical context. At the time of the restoration of Polish independence in 1918, there were plebiscites in which inhabitants of the regions bordering Germany voted whether their land should become part of Poland or not. The Kashubian region was not selected to take part in the plebiscite – as were the Silezia and the Mazuria regions or the Powisle region bordering the Kashubian Kociewie. However, communities of the Kashubians living in the counties granted in Versailles to Germany – namely Lębork (Lauenburg) and Bytów (Bütow), where they constituted a significant ethnic group – were making demands for introducing the plebiscite in their area as well. The demands were not taken into account and, despite the protests of the Kashubians, these counties eventually stayed within the German borders.

The Kashubians tried to produce their own model of existence in Polish society, on the one hand underlining their devotion to the freshly restored homeland – Poland, on the other, trying to maintain their ties with the local homeland; however, they did not gain the confidence of the rest of society nor of the powerholders. The Kashubians' double identity – Polish and Kashubian at the same time – seemed to be suspicious and created fears as to whether the Kaszubians would be loyal to the state. The emancipation of the Kashubian culture and identity was almost impossible at that time[1]. When the Second World War started in 1939, it was precisely the attack directed at the Polish watchtower on Westerplatte which opened one of the very first army fronts situated in the Polish Pomerania region. The problem the Kashubians had with presenting their identity to Polish society endured attempted manipulation by Germans, who divided the occupied Polish society into different categories according to the so-called *Volkslist*. Following this rule, Poles were separated from the Kashubians, the Silezians, and the Tatra

[1] "During the period of the II Republic of Poland (1918-1939) there was a constant message going to the society, that Silezia and Pomerania are two «symbols of our independence», as this was the title of one of more interesting papers published by Instytut Bałtycki in Toruń. At the same time both of these groups – the Silesians and the Kashubians – were treated in a suspicious manner by the authorities, precisely because of their location and possibility – as it was imagined – of being open to «German influences»" (Obracht-Prondzyński 2003, p.102-141.

mountain people called Górale, classified as *Goralenvolk*[1]. For most of those groups the fact of being on the *Volkslist* was very dramatic and its consequences were felt for many years[2]. During the war they were forced to fight on the side of Germans, which still is a part of their public image, and for a long time has been called a national betrayal. After the war many

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[1] Goralenvolk was the name of the Germanization action taken in the prewar county of Nowy Targ during the II WW. When the Germans occupied Podhale in September of 1939 – Dr Henryk Szatkowski started (with the help of Germans) to propagate the idea, that Górale were of German origin: Goralenvolk – the people of the mountain. With the help of local activists there was created so called Goralenverein, which was supposed to be the continuation of the prewar Union of Górale (Związek Górali). In June of 1940 there was a census carried out in the Podhale region, which was used for agitating for the idea of Goralenvolk. It is estimated that, with different motivation (i.e. releasing the relatives from a POW camp, access to a food ration), ca 20% of population declared the affiliation with the Goralenvolk. However, apart from the action of issuing the Goralenvolk IDs, the activities of the Goralenkvolk committee were a surface reality. The attempt of creating the Goralischer Waffen-SS Legion in the second half of 1942 was a complete fiasco. From the very beginning Goralenvolk was fought by the Polish resistance movement. On 20th of January of 1945 the Polish Underground State passed a sentence by which Wacław Krzeptowski, the leader of Goralenvolk, was hanged for treason by the partisans of the Home Army. The other activists of Goralisches Komitee were sentenced by court (3 to 15 years of prison) on 22nd of November of 1946 in Zakopane. Part of the activists, including Henryk Szatkowski, avoided the judiciary by escaping with the Germans. (see: Smoleński 2002; Szatkowski 1940).

In relation to the Kashubians Germans formulated the idea of so called Kaschobenvolk. It was a Hitlerian Germanization action, which, by contrast with the Goralenvolk action, was a fiasco: despite the efforts of Hitlerian authorities the Kashobenvolk list was accepted only by 2% of the Kashubians. Because of this there was an action of compulsory conscription into the Volkslist in order to supplement the losses in the German army after 1941.

[2] One of these consequences was an incident which happened in 2005 during the presidential election campaign. One of the two candidates, Donald Tusk, who officially admits his Kashubian origin, was accused in public of hiding the information of his grandfather, a voluntary Wehrmacht soldier. In Poland, where the memory of cruel German occupation in 1939-45 is still fresh and painful and the easiest way to insult someone is to call him – or his family – a Volksdeutsch, such an accusation (which turned out to be false) means public and social death. The little knowledge of the Polish society about tragic fate of the Kashubians and the Silezians during the Second World War is a result of policy of the People's Republic of Poland and its vision of history, where the only Wehrmacht soldiers were Germans and the collaborators.

institutions in the Pomerania region – i.e. shipyards in Gdan´sk and Gdynia – were prohibited to employ persons of the Kashubian origin[1].

As *Volksdeutsches,* they were banned from social life. The Kashubians stopped expressing their cultural needs, limiting themselves to the maintenance of their own folk culture within the official pattern accepted by the state. The burden of German sympathies became a source of the feeling of being inferior, along with the need for being invisible to those who might use the 'double identity arguments' in the German context. The Kashubian language – 'peasant', 'incorrect' – disappeared from the public sphere for years. The stereotype of a Kashubian still bears the negative stigma of an uneducated peasant, disloyal *Volksdeutsch*.[2]

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[1] The author of this paper was a participant of the international conference "Problems and challenges of intercultural education. Polish and German Experiences" in November 2005, organised by Kaszubski Uniwersytet Ludowy, Instytut Kaszubski and Instytut Współpracy Międzynarodowej Niemieckiego Związku Uniwersytetów Powszechnych, during which he was granted a chance to be the witness to emotional discussion concerning difficult post-war fate of the Kashubians. Kashubians as well as historians (prof. Cezary Obracht-Prondzyński, University of Gdańsk) present there reported hardly acknowledged fact of the difficulties with finding the employement in the Gdańsk and Gdynia shipyards, experienced in the post-war period by those Kashubians, who were given the status of a Volksdeutsch in 1939-1945.

[2] I would like to share my personal experience, as I, as a very young person, also had a chance to test the power of the image the Kashubians had during the socialist period. The Kashubian region (one of its parts is called the Kashubian Switzerland – Szwajcaria Kaszubska) situated on the seaside has been a very attractive tourist part of Poland, with a beautiful landscape, full of sandy beaches, lakes, hills, rivers. I spent there the entire summer vacation of 1988, a year before the collapse of the communist regime. The only language one could hear was Polish, until the end of summer, when all the tourists returned to their homes and I was the only one left. To my shock, no Polish was spoken anymore, there was only the Kashubian language, which I could not understand at all. Let my surprise be the comment on what was the general knowledge about this people.

The controversies over revealed emancipation of the Kashubians

One of the benefits of democracy is the prevailing awareness of social diversity. Such awareness emerged in a continuing, emotional, and exhausting public debate, in which all the controversies related to the emancipation of minority groups were raised. The difficulties encountered in the social debate were reflected in the way the legal regulations on the status of minority groups were created. This was especially the case of those groups which were given the label of "the nations" by the social researches – for several years of the process of establishing democracy in Poland this question has not been described in a satisfactory way nor has satisfactory legislation been provided, despite the work of various legal bodies, including the parliamentary National and Ethnic Minorities Committee (Komisja Mniejszości Narodowych i Etnicznych, MNE). The unique case of the Kashubians, as their attitudes have been changing for the last years, caused probably the most difficulties during the lengthy period of creating the law. Several important episodes on the path to emancipation marked the history of making the law on national and ethnic minorities and the regional language (Ustawa o mniejszościach narodowych i etnicznych oraz o języku regionalnym).

For years since 1989 several drafts of the law have been prepared. When a consensus among all the actors seemed to be finally reached, another emotional conflict was raised. The draft of the law was silent about the use of the second language in the regions where regional languages prevailed, which raised a storm of protests, mainly of the Kaszubian group. "In the special pronouncement of 4th November 2004 Zrzeszenie Kaszubsko-Pomorskie [the

Kashubian-Pomeranian Association] expressed satisfaction with the fact that the law has been made and Kashubian has been recognized as a regional language. At the same time Zrzeszenie expressed amazement that «in the last moment the Diet has cancelled all the entries enabling the introduction of regional language as a language of assistance in the local governments and offices» and «the bilingual names of the villages and towns». Zrzeszenie announced that in the future [they] will address to the Senate, asking to restore those entries in the law which enable maintenance of two languages in the Kashubian region" (Łodziński 2005, p. 11).

As Sławomir Łodziński puts it: "As a result the law defining the terms of 'national' and 'ethnic' minorities, the rights of their members and the principles of the state policy in relation to them was made as late as 6th January 2005. The law defines also the language rights – the entry which raised the greatest emotions in every parliamentary debate" (Łodziński 2005, p. 11).. The very fact that the law has been passed is a final point in the important public discussion over the manner of regulating minority rights and the use of two languages (as a language of assistance and the double-language names of the villages), which concerns also the Kashubian, given the status of a regional language[1].

Formally the Kashubians do not possess the status of either ethnic or national minority; however, they enjoy most of their rights (mainly in the field of

[1] The regional language is defined as: 1) the language traditionally used on the territory of given country by group of its citizens, which 2) differs from the official state language; is not a dialect of the official state language nor a language of migrants", Wyrównanie czy uprzywilejowanie? Spory dotyczące projektu ustawy o ochronie mniejszości narodowych (1989 - 2995), Raport 232, Warszawa 2005, p. 12.

culture and public education in the Kashubian language). They objected to being classified as a minority, explaining it with their unique cultural character – they are the regional ethnic group, identifying itself with the Polish nation, and in the Kashubian region they form a majority, not a minority. They depict themselves with the term 'ethnoregional group', cultivating their ethnic and language specificity at the level of the region, and at the level of the nation demonstrating devotion to the Polish nationality. As Łodziński writes it: "The solution applied in the law, which recognized Kashubian as a regional language, has been accepted."

The changes which have been taking place within the Kashubian group for the last several years of establishing an independent, democratic Poland, mirrored the changes in demands and postulates of the Kashubian leaders. Within the Kashubian milieu there is a constant debate over the direction in which the group should head. No matter the decision over the group's direction, the core issue of the Kashubian policy is clear: it is the status of the Kashubian language in the reality of Polish culture. The is why "[t]he regulations concerning the use of two languages are substantial for the Kashubian community. According to the last census Kashubian is used as a home language by over 50,000 people, although the estimations of researchers indicate the number to be 350,000. An increased presence of Kashubian in the public sphere is the crucial task for the leaders of the group. As Artur Jabłoński (the President of Zrzeszenie Kaszubsko-Pomorskie) puts it: «we have been experiencing the language revival for many years, and this happens thanks to the schools, parishes and various organizations. The aim of all these efforts is to make Kashubian language one of those used in the public life» (Mamy prawo być narodem… 2004)”. This can be proved by the establishing of the first Kashubian radio station, creation of the first Kashubian text editor[1] (important in the routine of the local offices) or the possibility of taking the school leaving exam (*matura*) in Kashubian language.

“In the law on the minorities Kashubian language has been recognized as regional language, which can be interpreted as an attempt of solving the problem of the ethnic status of the Kashubians within the framework of the state and to guarantee their rights. According to this regulation local governments will be allowed to introduce Kashubian as a language of assistance in their offices on the territory of 10 administrative units in the surroundings of Puck”[2].

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[1] „The Kashubians have their own text editor. It could be the secret weapon of the Kashubians in the fight for using the language in offices. Several thousands of internet users have downloaded the computer program KaszEd editing the Kashubian orthography into their PCs. The first Kashubian text editor was created by a group of enthusiasts, young Kashubians, who decided to promote their language in this way. – There are several thousand websites dedicated to the Kashubian region. Some of them are in the Kashubian language, so we decided to create a program which would make writing in this language easier – says 30 year-old Piotr Szymczyk, a computer program designer from Gdansk, the author of KaszEd. The authors of the Kashubian text editor met online in 2000, also their work was conducted through e-mail. – We are all Kashubians, but we live in different places, different countries even, so we never had a chance to meet in the real life – says the program designer. Language consultations, ideas, and work concerning the Kashubian names for the software options were conducted online by 5 authors. It was ready after several months. KaszEd is very simple, requires only 0.6 MB of free space and anyone can install it. It works with the operating systems of Microsoft Windows 9x/ME/2000/XP and is absolutely free. During the last couple of months several thousand people downloaded it from http://kaszed.zk-p.pl, P. Piotrowski, Kaszubi mają własny edytor tekstów, “Gazeta Wyborcza”, 30.11.2004.

[2] Exact wording:„W ustawie o mniejszościach język kaszubski został uznany w niej za regionalny, co jest próbą rozwiązania statusu etnicznego Kaszubów w ramach państwa i zagwarantowanie im określonych praw mniejszości. Zgodnie z ustawowymi rozwiązaniami,

The law on national and ethnic minorities and the regional language, accepted by the Parliament on 6th January 2006 and signed by the President on 24th January 2005, ends one of the most important phases of the public discussion over the way in which minority rights should be defined.

Under socialism "studying peoples in the People's Democracies" was a task with clear ideological implications, leading inevitably to the question of social responsibility. Such involvement's necessitating an alliance with the totalitarian state led most of the anthropological milieu in Poland to the conclusion that perhaps staying on the outskirts of the social sciences and dealing with the narrow range of topics accepted in the "safe" public discourse was the only solution for the discipline. The new era of democracy has brought new life to the minorities of Poland as well as to the discipline which made the subject of minorities its main area of study. Social anthropology in contemporary Poland, as well as minority groups, have undergone serious changes since the fall of the communist regime in 1989, now facing new challenges of the reality of the transition period, and in many ways benefiting from the opportunities offered by the emerging democracy.

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samorządy lokalne będą mogły wprowadzić do swoich urzędów język kaszubski jako pomocniczy na terenie 10 gmin (okolice Pucka)" (Łodziński 2005, p. 26-27).

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Estonian Television Channels' Programme and Legal Regulations: Situation one year after the Accession to the EU

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The article summarizes the process and presents the results of research conducted in the form of content research in spring 2005 with an objective to give an overview of Estonian television channels' programming structures and examine to what extent the stations follow the regulations set forth by legislation.

With joining the European Union in May 2004, Estonia entered into the sphere of European common media policy, and its legislation regulating the broadcasting activities was adjusted according to the European directives. The research focuses on the implementation of these legal requirements by the television stations and brings out the fact that more that two years after the quotas defined by the Television Without Frontier Directive became fully in force, private television stations are still violating certain rules.

Introduction

After a decade of instability and problematic developments, the Estonian television landscape has recently shown certain signs of stabilization. The current model - one public broadcaster, ETV, and two nationwide commercial channels, TV3 and Kanal 2 – is, in light of the economic success of private channels and qualitative improvement of the programming on

ETV, arguably the optimal solution in the conditions of the limited market of Estonia.

The important developments that led to the current situation are: Private channel TV1 stopped its broadcasting activities after it declared bankruptcy in October 2001. By the decision of Riigikogu, ETV abandoned its current financing model and stopped selling commercial airtime as of July 2002. In return, the broadcasting licenses of commercial stations were taxed. In addition, the decision practically closed the television market as no more than two broadcasting licenses would be given out simultaneously.

Both events helped to create a more stable market situation by loosening the tight competition, hence increasing the audience figures, and thereby attracting and concentrating more advertising money on privately owned stations, which became the basis for their financial well-fare. On the other hand, these developments enabled the start of airing clearly distinctive programming, referring to the emergence of a traditional dual broadcasting model, which emphasizes different functions for public service and commercial television channels.

Regardless of the stable phase, which seemingly satisfies all the parties, as ETV concentrates on producing varied programming with emphasis on information and culture, and commercial channels broadcast mainly entertainment-based programs, the broadcasting field cannot be merely self-regulated. On the examples of the legislation in different European countries, broadcasting is generally more strictly regulated compared to traditional press media and is under much stronger control and scrutiny by the governing bodies (Nitsche 2001, p. 34).

While the European Union in general rarely limits its member states' right to decide over matters of culture, then in the field of media the institution has developed rather clear views and standpoints. The common media policy, however, evolved first in the end of the 1980s when the need for cooperation was underlined in order to strengthen the European cultural identity and adopt protective measures against the influence of the American television programs that had started to become prevalent foremost on the numerous private channels that had rapidly emerged after cable- and satellite television technology became available (Nitsche 2001, p. 48; Paraschos 1998, p. 129). Arguably the meanings of terms like "European culture" and "European identity" have questionable value and, according to some authors, were used only as slogans to distract attention from the real reasons behind the call for combating television content of American origin – the economic and financial reasons.

The basic documents that set the framework for the European audiovisual media policy are the European Convention on Transfrontier Television, passed at the Council of Europe in May 1989, and the Television Without Frontiers Directive (TWF), the main document regulating the audiovisual field within the European Union. The latter imposes numerous rules and quotas on television programming in all member states with the purpose of creating a stable market and ensuring free movement of European production within this market.

The quotas have been criticized as being a too radical and artificial method, which is not necessarily serving merely the purposes for which they were imposed. Moreover, these may become difficult to apply in the countries with smaller and multinational markets. The research conducted among media specialists from 10 countries that joined the EU in 2004 underlines the opinion that the Television Without Frontiers Directive takes into account the trans-European needs, but is not capable of protecting the interests of smaller countries and solving the problems on the national level. In addition, limited financial- and human resources, a large number of small private channels (relative to market size), and an underdeveloped advertising market are the reasons TWF quotas are not fully applicable in all European countries (Sein and Rajaleid 2003, p. 6-7).

The most debated provisions of the Directive concern European production and independent production. Article 4 of the Directive states that Member States must ensure that broadcasters reserve a majority proportion of their transmission time for European works. Time devoted to news, sport events, games, advertising, teletext services, and teleshopping is excluded. Article 5 requires broadcasters to reserve at least 10% of their transmission time or, alternatively, 10% of the programming budget, for European works created by producers who are independent of the broadcaster.

In addition, the TWF Directive coordinates Member States' national legislation in areas such as the public's access to events of major importance, placement and amount of advertising and teleshopping, requirements for sponsored programs, etc. European Directives set forth only the minimum requirements; Member States are entitled to impose stricter rules in these provisions and set additional regulations and quotas. The latter is common practice in most Member States' legislation including the Estonian Broadcasting Act.

TWF quotas were added to the Broadcasting Act step-by-step and, after a short transition period, starting from January 2003, the law fully complies with the Television Without Frontiers Directive, obliging television channels to follow the quotas and other guidelines. In addition, the Estonian Broadcasting Act determines numerous other requirements for programming, which do not directly derive from the Directive, but are equally important for guaranteeing the quality and balance of programs and protecting viewers' interests.

Current research focuses on the following provisions of the Estonian Broadcasting Act:

Broadcasting Act, chapter 1, § 41 (abridged):

A broadcaster shall ensure that at least 5 per cent of the daily transmission time of its programs or program service is reserved for the transmission of news programs produced by the broadcaster, except for program services on Sundays and public holidays.

A broadcaster shall ensure that at least 10 per cent of the monthly transmission time of the program service, excluding the time appointed to news, sports events, games, advertising, teleshopping, and teletext services, is reserved for its own production. A broadcaster shall transmit at least 50 per cent of the minimum amount of its own production provided for in this subsection during the prime broadcasting time between the hours of 19.00 and 23.00.

A television broadcaster shall ensure that at least 51 per cent of the transmission time in a calendar year, excluding the time appointed for news, sports events, and games programs and for advertising, teleshopping, and teletext services, is reserved for the transmission of European works.

A television broadcaster shall ensure that at least 10 per cent of the transmission time in a calendar year, excluding the time appointed for news, sports event,s and games programs and for advertising, teleshopping, and teletext services, is reserved for the transmission of European works created by producers who are independent of the broadcaster.

Broadcasting Act, chapter 3, § 17 (abridged):

The amount of advertising and teleshopping spots in the program service of a broadcaster shall not exceed 20 per cent of the daily transmission time of the program service. The amount of advertising shall not exceed 15 per cent of the daily transmission time of a program service.

The amount of advertising and teleshopping time shall not exceed twelve minutes per hour.

Broadcasting Act, chapter 3, § 16 (abridged):

If a television program does not consist of autonomous parts, advertising and teleshopping spots may be inserted during the program unless this prejudices the integrity of the program or the interests of the holder of rights to the program, and there shall be at least twenty minutes between each interruption.

The transmission of feature films and films made for television (excluding serials, documentaries, and light entertainment programs), provided that their duration is more than 45 minutes, may be interrupted for advertising and teleshopping spots once for each period of 45 minutes. A further interruption is allowed if their duration is at least 110 minutes.

Even though all the abovementioned requirements have been fully in force for years, the implementation of the new quotas has in reality not been fully successful as numerous violations in several provisions have been observed. On an academic level two studies have been done on this topic at Concordia University. Hanna Sein briefly studied the situation in her course project "Comparative Structural Analysis of the Programming Distinctiveness of Estonian Public and Private Television" in 2002 (Hanna Sein 2002). Tarmo Rajaleid repeated a similar study in 2003, when he defended his course project "Estonian Television Stations' Readiness to Follow the Principles of EU Television Without Frontiers Directive" (Rajaleid 2003).

These works mention as the biggest problems the unacceptably low share of European works on TV3, ETV's incapability to meet the quota for works by independent producers, and the problems on both commercial channels with broadcasting enough news and their own production on prime time (Rajaleid 2003, p. 34-35). In addition, extensive violations of the provisions regulating the amount and placement of advertising have been observed. The results of these studies should, though, be regarded somewhat critically as the method of the studies (the very limited time period of observation) does not enable one to draw absolute conclusions. For example, even though Rajaleid's research noted the percentage of independent production on ETV to be lower than 10%, the annual report of ETV in 2003 does not support these figures (ETV Majandusaasta aruanne 2003).

The regulatory body executing supervision over the program and the fulfillment of the legal requirements is the Media and Copyright Department of the Ministry of Culture. Starting from 2004, the practical program monitoring has been assigned to the media monitoring company TNS Emor. According to the agreement between the Ministry and the company, Emor is responsible for presenting random results upon request and a more thorough report every second month (Schank 2004). Such reports have continuously denoted various violations, most frequently in exceeding the amount of advertising and in failing to broadcast enough news programs; though, interestingly, not in the question of placement of advertising, which, according to the scholarly studies, was the most frequent violation.

Regardless of the fact that the Broadcasting Act allows to penalize each instance of a violation with a fee of 40 000 EEK, this punishment has, according to the information available to the author, not been used very often. The Head of the Media and Copyright Department of the Ministry, Peeter Sookruus, has, according to newspapers, emphasized that punishment is not the best way of assuring that the channels follow the law; and, therefore, the principle measure until recently has been sending letters of warning (Schank 2004). On the other hand, television stations generally do not admit deliberate violations, and the main hindrance to applying real measures becomes the fact that in many points the law allows several interpretations.

For example, the managing director of TV3, Toomas Vara, has explained that while the bodies executing supervision have rather conservative definitions for news, the channel itself takes into account also the late night re-runs of "Seitsemesed Uudised" (Seven o'clock news) and even the entertainment news included in the youth program ZTV ("TV3 näitab…"). In addition, the station does not classify sponsor announcements as commercial advertising, while Emor includes this category when calculating the amount of advertising (Schank 2004). In the author's opinion, some sort of agreement in these problematic questions should be achieved, whether by settlement by both parties or by the help of a court ruling.

The law offers numerous different ways for interpreting the requirements also in other points. For example, the phrasing of chapter 3, § 16 (3) of the Broadcasting Act uses words with different meanings in the Estonian and English versions. While the English version allows interrupting the film for advertising "once for each period of 45 minutes" the Estonian wording permits inserting a commercial block "once after every period of 45 minutes". The same provision confuses also with the words "duration", which is used in the Broadcasting Act, and "scheduled duration" of the program, which is used in the TWF Directive. The Estonian law allows, therefore, less advertising during one program, because the wording of the Directive permits to treat the commercials as part of the program length, while the Estonian version excludes this option.

A similar problem arises also in the provision which regulates the interruption of shorter programs that do not consist of autonomous parts. The law states that "there should be at least twenty minutes between each interruption", but does not specify whether the rule applies only to commercial breaks during the program or whether the first interruption has to consider also the advertisements blocks shown between programs. The TWF Directive seems to support the first interpretation as it says that "…a period of at least 20 minutes should elapse between each successive advertising break within the program". However, such interpretation does not defend the interest of the viewer, because it allows inserting two blocks of commercials into programs with a duration of less than 30 minutes, making the first interruption already a few minutes after the start of the program. Whether the channels take into consideration the interests of the advertisers or of the viewers, none of the stations currently uses this tactic.

It is important to note that while the legislation of the Member States has no obligation to follow the exact wording of the Directive, the minimum requirements of the Directive should be still granted. In addition, in the light of the confusions pointed out in this passage, a more precise wording offered in the Directive could be suggested.

In addition to the several problems related to the inadequate wording of the law, the Broadcasting Act is also incapable of regulating modern types of advertising like split-screen and banner advertisements. Similarly, the definition of advertisement fails to distinguish sponsor announcements from traditional advertising. In these matters, though, the modernization process of the TWF Directive has already been initiated and the more distinct definitions could be added to the current regulations in the future.

Constant violations of the regulations seem to indicate that besides problems deriving from the inadequacies in the phrasing of the law, the quotas are also not fully applicable in the conditions of the limited market of Estonia. The relatively small size of the market is well depicted in the following figures. According to data from 2002, Estonia had the smallest annual turnover in the audiovisual sector out of all ten new member states – 43.6 million Euros. While the main limitation to the market size is the small population, then in Estonia's case the even more significant factor is our relative poverty. For example the same figure in Cyprus was twice as big, at the same time as the population is only half of that of Estonia (Landscapes… 2004).

However, what eventually create conditions for continuous violations of the Broadcasting Act are the insufficient control mechanism and the lack of one strong regulatory body. The Estonian system is unique in Europe in that these responsibilities are shared by two organs. The Estonian Broadcasting Council gives guidance and executes supervision over public service broadcasters Eesti Raadio and Eesti Televisioon, while the Ministry of Culture has the right to decide over the distribution of broadcasting licenses and executes control over the program of the private television stations. The shared responsibility has been treated as a weakness, and the idea of constructing a common regulatory body – a National Broadcasting Council – has found support among the heads of the television stations as well as among other media experts.

Methods

To enable comparisons with the results of the previous similar studies, the current research largely used the methodology developed by Hanna Sein and Tarmo Rajaleid.

The administered research is by its nature a content analysis trying to document and study the actual programming. For this purpose all the programs of ETV, Kanal 2, and TV3 were recorded during the period of one week (February 28 – March 6, 2005), using three simultaneously running VHS recorders. Material was stored on 63 VHS cassettes; each of which contained 8 hours of programming. Due to technical problems, some of the initially recorded material turned out to be unusable and was replaced with the programs that were aired two weeks later exactly on the same day and the same time. The author does not believe that this substitution influenced the outcomes of the research or the validity of the results to any noteworthy extent.

In the second phase of the research all the recorded material was coded according to the guidelines, criteria, and category systems that were developed and used in the previous studies. In the coding process the members of the research team measured the actual length of the different parts of the programming day and marked the commercial interruptions in the program. VHS-players were used for measurement, which allows the preciseness of +/- 1 second. Even if taking into account the human factor and eventual mistakes made by the researcher, the internal validity of such a method cannot be seriously questioned as most of the programs last for more than 20 minutes. The other factor, which may have influenced the outcomes a little bit, was the procedure for changing cassettes. As each cassette could record a maximum of 8 hours of programming, three changes had to be made in each period of 24 hours. The length of such procedure was measured and for each such instance one minute was added to the length of the program.

While the method very accurately documents and reflects the actually aired program, the external validity of the results and their applicability to greater samples and periods of time could be questioned. The sample was chosen in order to be large enough to enable making certain generalizations and at the same time small enough to allow qualitative processing of material. One week as a period should be sufficiently representative since all the days of the week, with their different programming, are studied. Technical restrictions did not allow to enlarge the study period and to select a random sample for increasing the external validity of the results. A week in February-March was chosen with the consideration that the programming in this part of the programming year should be rather stable compared, for example, with the more specific periods of summer and Christmas.

The main limitation to the results' relevance to the research aim is the fact that most of the studied provisions of the Broadcasting Act define longer periods than one week for fulfilling the requirements and meeting the quotas. For example, 10 per cent of the program in one calendar month has to be the television station's own production, and the share of European works and works by independent producers is observed during the period of one year. Therefore a comprehensive study would require monitoring programs for 12 months or repeating the one-week studies at least 5-6 times during one calendar year. The research timeframe and limited human capacity, however, made such a method impossible, as analyzing the material is rather time-consuming.

In categorization the program the definitions employed were those presented in the Broadcasting Act, as it offers rather comprehensive explanations for terms like "European production" and "European independent producer". In cases where the legal act did not specify the classification, current research used the definitions of the program types presented in the publication by Hagi Sein "Estonian Television Landscape 1991-2001" (Hagi Sein 2002, 317-320). For reasons of clarity, the author wishes to explain that in measurement of the share of news, the first 20 minutes (to the first commercial interruption) of the infotainment program "Reporter" on Kanal 2 were classified as news, the rest of the program as infotainment. Such classification derived from the topics covered in the program – the first part consists of "serious" domestic and foreign news, the latter part of the program does not under any circumstances qualify under the category of news.

Regardless of the research's limitations pointed out above, the results should quite adequately reflect the situation on Estonian television channels in spring 2005, more than five years after the European Directive quotas were incorporated into the legislation, more than two years after the quotas became fully in force, and almost a year after Estonia's accession to the EU.

Results

The study proved that years after Estonian legislation in the audiovisual media field was amended to comply with the European Directive, private broadcasters still violate certain provisions of the Broadcasting Act deriving from the Directive, whereas the research noted no violations of rules in the program of public service broadcaster ETV.

In the following presentation of the results the studies made by Hanna Sein and Tarmo Rajaleid have been taken as the comparison with the situation in 2002 and 2003 (Hanna Sein 2002; Rajaleid 2003). The most problematic provision was, not unexpectedly, the European works quota. According to the results, ETV dedicated more than 80% of total transmission time for broadcasting programs of European origin. Even if the share of such programs has decreased by more that 10 percentage points compared to the similar study of 2003, the channel undoubtedly has no problems with filling the 51% quota in one calendar year (as defined in the Broadcasting Act).

The situation at private channels has altered much more. While in 2003 Kanal 2 managed to meet the quota, airing more than twice as many European programs as TV3 (respectively 61.2% and 29.3%), then, according to the results of the current research, in spring 2005 both channels clearly failed to dedicate the major proportion of their transmission time to European works as required by the Directive. The share of European programs was almost the same on both channels – 43.3% and 34.2% respectively. The explanation for the lower share on Kanal 2 could be the decrease in the number of information society formats – the interactive programs with low production costs, aired oftentimes on late nights and on other low-audience timeslots. Although the experts have predicted a general increase in this type of program (SMS-chat, call-shows, etc.) after the quotas of TWF Directive came fully into force, the research results seem to indicate that commercial channels have abandoned their efforts of artificially and forcedly trying to meet the European works quota by scheduling the low-cost own production shows in their programs. The other similar method that has been used by private channels is replacing the telenovelas produced in Mexico or Venezuela with similar soap operas produced in Spain. Such examples lead to questioning the real meaning and efficacy of quotas, because they do not necessarily improve the quality of programming. According to the information available to the author, the bodies executing supervision over the programming have so far made no remarks in these matters; the channels have obviously chosen to ignore the law on this point.

The other important quota that the EU imposes on its Member States regulates the transmission of independent production. For the purposes of diversity and of developing the internal market, the TWF Directive requires television channels to broadcast programs produced by independent European producers in the minimum amount of 10 per cent of the total transmission time or devote at least 10 per cent of its programming budget to such production. Similarly to other provisions, the time dedicated to news, sport, games, and advertising is excluded. This provision has, according to the previous studies, been most difficult to follow for former state television station ETV that has a tradition of broadcasting mainly in-house production. Whether it is the consequence of the restructuring of production units in

ETV, the emergence of strong independent production companies, or the conscious consideration by the program planners at ETV, the results from the sample week reflect an obvious increase in the share of programs by independent producers (from 9.4% in 2003 to 15.6% in 2005). Kanal 2 has also balanced on the ten per cent line, but fills the quota with 12.7%. TV3 has, according to the previous studies, shown the highest proportion of programs produced by units not dependent on the station and has retained this advantage by increasing the percentage from 25.2 in 2003 to 31.7 in spring 2005. The negative prognosis made by the author of the 2003 research that the limited financial resources of the television companies do not allow growth in the share of purchased programs has thus not found verification (Rajaleid 2003, 26).

It should be noted that the other provisions of the Broadcasting Act that were subject to the current study do not directly derive from the European Directives, but are equally important when evaluating program structures and their conformity to the legal framework.

The most serious violation that the research refers to in this sphere is the failure to meet the requirement for original news broadcasts, which, according to the Broadcasting Act, should account for at least five per cent of the daily transmission time. Similarly to previous studies, the results show that this requirement is violated only by commercial channels. Even though both the news' volume and share in both channel's program has increased compared to 2003 (in Kanal 2 from 2.2% to 3.2% and in TV3 from 3.1% to 3.2%) the requirement of 5 per cent is still a far reach.

On ETV the share of news has, on the other hand, decreased. While in 2002 and 2003 the average share in one week was 9.5% and 7.7% respectively, then according to this study the weekly average is already quite close to the lower limit set by legislation – 5.89%. Moreover, the research even documented a small violation on Saturday, when the share of news was only 4.93% of the daily transmission time. On Saturday the same figure was lowest also on commercial channels – 2.43% on Kanal 2 and only 1.7% on TV3 was reserved for news.

The research pointed out another small violation in the provision regulating the share of a television station's own production. Similarly to the results of the previous studies, all channels were able to fulfill this 10 per cent quota during the sample week. As the programming on this part of the programming year is stable and no major differences between weeks occur, the results of the study in this point should be easily applicable to the period of one month, as the law defines. The share of its own production on ETV is highest, regardless of the fact that there has been a considerable decrease compared to 2003 – from 64% to 51% in spring 2005. The same figure on commercial channels is around 30%.

Although this quota is generally easily met, the law offers a specification to the same provision. Namely, at least half of the minimum amounts of original production have to be broadcast during prime time, which the Estonian Broadcasting Act defines to be the time period between 19.00 and 23.00. Previous studies have pointed out a certain defiance in this subsection mainly in the programs of private channels. The sample week, however, witnessed obvious improvements. Aside from ETV, which filled the quota almost doubly, both commercial channels had increased the amount of their own production on prime time. Kanal 2 succeeded in filling the quota, which had not been accomplished in two previous studies, and only 40 minutes of program during the week was lacking on TV3 to accomplish the same. As the researched monitored the program only on 7 days, the situation may be slightly different during a full month month.

It is, however, clear that if news, sports events, and game shows would be included in the classification criteria of original production, as some expert, according to the final report of the research on the subject "Consequences of Joining EU for Estonian Audiovisual Sector" have suggested, none of the channels would have any problems with meeting the quota.

The study also explored how the amount and placement of advertising in programs correspond to the requirements of the Broadcasting Act and discovered some extensive violations. Even though both commercial channels had increased the total amount of advertising compared to the sample week in 2003, none of them exceeded the 15% limit for commercial advertising or the 20% limit for advertising and teleshopping together.

The reason for not violating the rules of total amount of advertising could well derive from the additional requirements for placement of advertising spots. For example, the law limits the amount of advertising in one hour to a maximum of 12 minutes, whereas the programs that lack clearly distinguishable autonomous parts can be interrupted for advertising only after 20 minutes have passed from the previous interruption. Regardless of the positive hope expressed by the officials of the Ministry of Culture, the results of the study show no improvements in the implementation of the law in the points regulating the placement of advertising.

During the sample week, Kanal 2 violated the 20-minute interruption rule on 69 occasions, while TV3 disregarded the law in the same issue even more frequently, in total, 110 times. To avoid misunderstandings, it has to be emphasized that the research followed the “stricter” interpretation of the imperative (for the sake of results’ comparability), counting all the instances when the first interruption was made before 20 minutes had passed from the beginning of the program. Although the results can therefore be criticized as deriving from the wrong methodology, the “lighter” interpretation of the law would not eliminate the violations. The researcher counted also the occasions when the time between two commercial blocks within the program was less that 20 minutes and found 41 such instances of TV3 and 21 on Kanal 2.

The obvious reason for such violations is the fact that advertisers are most willing to purchase advertising time in the period of the few hours when the audience is the largest, at the same time that channels desire to sell advertising time at the highest price on prime time. But, on the other hand, in a situation where the program is constantly monitored but extensive violations of the law still occur, the bodies that are supposed to execute supervision should be held accountable for their ignorance and incapability in implementation of sufficient means for ending the situation.

The research concentrated on a few other regulations regarding the amount and placement of advertising, but, as noted in earlier discussion, the possibilities for several different interpretations of such rules do not facilitate comprehensive results. For example, controlling the implementation of the provision regulating the interruption of films with a duration longer than 45 minutes becomes difficult as the English and Estonian versions of the Broadcasting Act offer different wordings and therefore also two possible interpretations. The English version is identical to the TWF Directive and allows interruptions once for each period of 45 minutes. The Estonian wording has replaced the word “for” with the word “after”, which does not necessarily allow fewer interruptions, but has great significance for the first commercial break. Even though the Estonian wording of the law is superior, the television stations have previously interpreted the difference in meaning as a translation mistake and generally follow the gross principle. For example, Kanal 2 violated the English version of the law only twice during the sample week, while the number of violations according to the Estonian wording was 14. Similar figures for TV were 5 and 19. The law could be criticized because it does not protect the interests of advertisers nor the audience, as the duration of commercial blocks is in consequence oftentimes 10-12 minutes. Still, the research found proof that Kanal 2 is trying to follow the law as most of the first commercial blocks within the feature films were placed to start between the 43rd and 45th minute. TV3, on the other hand, has obviously refused to follow the rules as presented in the the Broadcasting Act, since most of the commercial breaks started between the 20th and 25th minute of the film.

The provision of the law which has been arguably most strongly monitored by the regulatory bodies, as the Ministry of Culture has sent numerous letters of warning to channels, is the so called 12-minute rule, meaning that the duration of advertising and teleshopping spots in one hour cannot exceed twelve minutes. But since the law leaves room for several possible interpretations of this requirement, the research found it very difficult to estimate the violations objectively. The wording of the law does not define whether the starting point for measuring the hour is the start of the programming day or the clock hour, or does the station have to meet the criteria while starting the measurement from any random spot of time. Not knowing which criteria is the basis for official monitoring; the research found some definitive violations, when within an hour long program more than twelve minutes of advertising was broadcast. On Kanal 2 the number of such instances was four against TV3's five.

It should be noted that sponsor announcements and promotion of one's own programs was not included in the category of advertising in this point; however, it has lately become difficult to distinguish the latter from traditional commercial content. Both private channels actively use the tactics of mixing program promotion clips and advertisements by placing them by turns within the commercials block. This, in the author's opinion, serves no other purpose than trying to mislead the controllers in measuring the length and placement of advertising as the program promotion is not considered as commercial content in the sense of the Broadcasting Act. The situation is made even more difficult by placing the sponsor announcements with a duration of a few seconds' directly before and after the program introduction clip. For reasons of obvious difficulty, these instances were disregarded in this research when depicting the placement of advertising.

The research clearly proved that the commercial television channels continuously violate several provisions of the Estonian Broadcasting Act. While certain improvements can be noticed in the points regulating the structure of the program and the quotas for European works, independent, and one's own production, then the private channels still extensively violate the provisions regulating the amount and placement of advertising, regardless of the implementation of the monitoring mechanism.

Discussion

The author strongly believes that the situation where the regulations exist but the violations of these rules regularly occur is the consequence of more than just one circumstance. As the earlier discussion underlined, partially responsible for current state of affairs are the discrepancies and inadequacies in the legislation. In addition, one can point out the inefficiency of the current regulatory system. Continuous violations are noted, but no serious penalties are enforced. This gives ground to the speculation that both parties - television stations and the officials at the Ministry of Culture that executes supervision - have silently agreed on the inappropriateness of the requirements of the European Directive (for example in the case of the European works quota) for applying these on the local very limited market. Finally, defining the violations is also not facilitated by the long time periods that the law sets for fulfilling the quotas. Monitoring the program for one year in order to monitor whether the channel meets, for example, the European works quota is simply a very time consuming process. Therefore, adopting stricter timeframes for fulfilling the requirements would be more practical.

For all the above-mentioned reasons, revision of the Broadcasting Act should be initiated. It is suggested to specify the terms and coordinate the wording. Moreover, some additional requirements could be adopted. A justified criticism of the European works quota points out that such a requirement can hardly protect the cultural aims of a small nation, nor provide any basis for the development of the local audiovisual sector. Therefore, a special quota for Estonian works in terms of culture and language is proposed. The current law puts the responsibility of preserving and developing "the Estonian nation, language and culture" only on the public service broadcaster. The private stations' violations of the Broadcasting Act can hardly be explained by the limited financial resources, but may rather be seen as an inevitability in the light of the considerable weaknesses of the regulatory mechanism.

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SECTION IV
BOOK REVIEWS

Inside the Dreamtime: Reflections on the European Dream

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In Aboriginal societies in Australia, dreamtime is sacred. Ordinary everyday life is mundane, while the life in our minds is filled with mythical meaning. Jeremy Rifkin's latest book, *The European Dream: How Europe's Vision of the Future is Quietly Eclipsing the American Dream* (Rifkin 2004) is a sociological attempt to understand American and European dreams. In his comparison of the two societies, Rifkin argues that the dream of the European Union is better suited to meet the challenges of a globalized information age. The European Dream is 'quietly eclipsing' the boldness of the American Dream. While his book sometimes wanders into journalistic anecdotes, the general argument is provocative and original.

Comparing societies is difficult because one easily runs into the problem of oversimplification and reducing complexity into national character stereotypes. Rifkin plays with the stereotypes of American and European, much like Robert Kagan, in his book comparing the foreign policies of the

US and the EU in response to the Iraqi War. However, unlike *Of Paradise and Power: America and Europe in the New World Order* (Kagan 2003), which focused on how power has been understood by political elites, Rifkin compares the mythological foundations of the US with the EU. It is less concerned with how policy decisions are reached and more with the cultural differences of the two societies. Such cultural differences manifest themselves in different attitudes towards work, social responsibility, state intervention and quality of life. For Rifkin, the American and European dreams go beyond political elites and are carried by ordinary citizens.

With its numerous references to "We Americans", Rifkin is clearly writing for a wide American audience. As a discussion of the unraveling of the American dream, Rifkin continues in the sociological tradition of Marcuse, Adorno, Horkheimer, Habermas and Daniel Bell – all of whom from the 1960s onwards criticize the inherent contradiction within late-capitalist societies: Capitalist accumulation of wealth occurs with a simultaneous breakdown of moral order and loss of tradition. What makes Rifkin different is his argument that the modern world in which the American dream was conceived is waning, while a new global interconnected postmodern world is emerging which requires different socio-political structures. "We Americans used to say that the American Dream is worth dying for. The new European Dream is worth living for."(Rifkin 2004, p. 385)

The American dream is passing into the dustbin of history because it is *too closely* connected with the modern vestiges of nation-state, individualism, free market capitalism and privacy. While the frontier spirit of Manifest Destiny continues to foster creativity, innovation, risk-taking and entrepreneurship, the darker side of excessive individualism produces increasing gaps between rich and poor, high crime rates and fundamentalism.

“The American Dream is far too centered on personal material advancement and too little concerned with the broader human welfare to be relevant in a world of increasing risk, diversity, and interdependence. It is an old dream, immersed in a frontier mentality, that has long since become passé.”(3)

The American dream is rooted in the time and space of the American Revolution. Since that world no longer exists, the American dream has to adapt or face failure. The European dream, born out of the carnage of World War II is better suited, according to Rifkin, to the challenges of the 21st century. Mixing nation-state and supranational structures together, the EU offers an alternative to the darker side of the American dream. What is it in the European dream that Rifkin finds so attractive?

“The European Dream emphasizes community relationship over individual autonomy, cultural diversity over assimilation, quality of life over the accumulation of wealth, sustainable development over unlimited material growth, deep play over unrelenting toil, universal human rights and the rights of nature over property rights, and global cooperation over the unilateral exercise of power.” (3)

While the American dream is based on a tabula rasa and is fixated on the future, the European dream explicitly links the past to the future. The EU is built unabashedly upon the historical lessons of national aggression and war. Reflecting upon the early visions of Europe, Rifkin finds the common theme of the necessity to move beyond the nation-state. From Churchill’s plea for a

"United States of Europe" led by the moral leadership of Germany and France to Schuman's gradual process of European solidarity, Rifkin emphasizes the necessity of union in the advancement of peace. These ideas were later crystallized in the work of Jean Monnet, who argued for the necessity to move beyond the traditional framework of the nation-state.

"For five years, the whole French nation had been making efforts to re-create the bases of production, but it became evident that to go beyond recovery towards steady expansion and higher standards of life for all, the resources of a single nation were not sufficient. It was necessary to transcend the national framework." (Monnet 2004, p. 21)

Like Kagan, Rifkin traces the origins of the European dream in the social contract theory of Immanuel Kant. In order to achieve perpetual peace in Europe, nations had to give up some of their sovereignty and bind themselves together in a new post-national entity. Such visions translated into the policies of Adenauer and de Gaulle with their decision to form the European Coal and Steel Community (ECSC) in 1957. The future of European nation-states is embedded within their common economic and political structures. The nation is still the main political actor, but is structurally bound within the confines of an increasingly federalizing EU. Here Rifkin is correct, the problem however is can one reconcile European dreamtime with everyday reality? Often times we tend to forget our dreams and are left with disorientation and fragments of a dream that we cannot fully grasp. Does the resounding rejection of the EU constitution in France and Holland in 2005 reflect a disconnection between the dreams of political elites in Brussels with their citizens? Have ordinary Europeans already forgotten their own dreamy foundations?

When one tries to reconcile the EU of 2006 with its original members (Germany, France, Italy, the Netherlands, Belgium and Luxembourg), Europe becomes increasingly difficult to define. People cannot agree on whether Europe is an idea, geographical territory, or culturally Judeo-Christian. Numerous books have been written tracing the identity of Europe. Most notably, *What is Europe?* written by Danish, Dutch and English academics examines the question within four volumes*: The History of the Idea of Europe, Aspects of European Cultural Diversity, European Democratic Culture, Europe and the Wider World.* The first volume, *The History of the Idea of Europe* examines the self-perception that Europeans have of themselves through the media, history and education. The authors argue for a fusion of how Europeans perceive themselves historically and how they project themselves into the future. Basically it argues that Europeans have many overlapping identities: regional, national and European. The project of the EU is thus well-suited to this reality because it doesn't privilege any particular identity over another.

Within Europe, the division between old and new is starkly visible in the differences between how capitalism is understood -- as neo-liberal or a more social democratic model – there seems to be more diversity than harmony. Given the fact that the demographics of Europe has changed since the 1950s, with the arrival of guest workers in the 1970s, immigrant waves resulting from de-colonization, asylum seekers – a European dream, shared by both political elites and citizens is increasingly difficult to describe.

Rifkin argues passionately that Americans live to work, while Europeans work to live. Yet such truisms do not adequately reflect the growing reality of some new EU member states. At times, Estonia with its neo-liberal economic policy and emphasis on individual self-reliance increasingly displays the pathologies of that old dream on the other side of the Atlantic. Aggressive capitalism fosters accelerating gaps between rich and poor, retreat into private space, deterioration of public spaces and growing risks of drugs and crime. While one might argue that Estonian economic policy may change once it catches up to old Europe, the fact remains that the widening of the EU in 2004 occurred for different political, economic and social reasons than its origins. Because the complexity of Europe in Rifkin's book is understated, Europeans are often reduced to generalizations and stereotypes (predominantly German and French). Those criticisms aside, Rifkin is at his most interesting when arguing for the potential novelty of the EU as an intergovernmental and supranational structure. The different visions of the future represented by the American and European dreams may be complementary rather than only antagonistic. Competition between the old nation-state represented by the US and supranational governance represented by the EU is perhaps fruitful because it prevents the stagnation of both societies. After all, as Rifkin notes, "dreams reflect hopes not achievements." (Rifkin 2004, p. 214)

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