Lesson 6: Estonia

Introduction

In this lesson, students learn how Estonia is a testament to the productive and ennobling power of freedom. After waves of successive invasions from East and West, the small and fledgling country on the Baltic Sea was dragooned into the Soviet Union in 1940. There its people, about 1 million in total, were trapped for five decades as unwilling subjects of the socialist experiment. The experiment proved a failure. Eventually, Estonia's workers and intellectuals decided they had nothing to lose but their chains. So, they joined hands in revolt. In its place, the Estonians created one of the freest nations on Earth.

Materials

Lesson 6 slide deck:
https://docs.google.com/presentation/d/1K2-RNwqcxaARttiwkeKEPTS4dJB9maoZ/edit?usp=sharing&ouid=116660462288476410506&rtpof=true&sd=true

Optional: Lesson 6 **Background Information**. 1 copy per student (if assigned as student reading)

Key Terms

Control Problem	The difficulty central planners have in controlling human wants and desires.
Incentive Problem	The problem that occurs with central planning when individuals and central planners are not incentivized to serve the general interest.
Inflation	A general increase in the price level.
Knowledge Problem	The idea that the information for economic planning is distributed across individual members of society and cannot be known by central planners.
Market Economy	An economy that relies on a system of interdependent market prices to allocate goods, services and productive resources and to coordinate the diverse plans of consumers and producers, all of them acting according their self-interest.
Pathologies of Privilege	The problem that occurs in central planning when bureaucrats gain power, and some are privileged over others.
Price System	A decentralized system in which the forces of supply and demand determine the prices of goods and services.
Property Rights	Legal protection for the ownership of tangible or intangible resources. Property rights give the holder the ability to do with that property what they choose, including holding on to it, selling it or transferring it to someone else.
Shortage	When the quantity demanded of a good or service exceeds the quantity supplied at the prevailing price.
Tariff	A tax on an imported good or service.

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Totalitarianism	A form of government that attempts to assert total control over its citizens' lives.
Tragedy of Commons	The overuse, waste or mistreatment of things owned in common.

Objectives

Students will be able to

- Define shortage.
- Explain the relationship between shortages and black markets.
- Identify the institutions necessary for the Estonian economy to recover after totalitarian socialist rule.

Time Required

45 minutes

Voluntary National Content Standards in Economics

CONTENT STANDARD 7: Markets and Prices

Students will understand that a market exists when buyers and sellers interact. This interaction determines market prices and thereby allocates scarce goods and services.

- Benchmark 2: A shortage occurs when buyers want to purchase more than producers want to sell at the prevailing price

CONTENT STANDARD 8: Role of Prices

Students will understand that prices send signals and provide incentives to buyers and sellers. When supply or demand changes, market prices adjust, affecting incentives.

- Benchmark 4: Government-enforced price ceilings set below the market-clearing price and government-enforced price floors set above the market-clearing price distort price signals and incentives to producers and consumers. Price ceilings can cause persistent shortages, while price floors can cause persistent surpluses.

CONTENT STANDARD 10: Institutions

Students will understand that Institutions evolve and are created to help individuals and groups accomplish their goals. Banks, labor unions, markets, corporations, legal systems, and not-for-profit organizations are examples of important institutions. A different kind of institution, clearly defined and enforced property rights, is essential to a market economy.

- Benchmark 1: Property rights, contract enforcement, standards for weights and measures, and liability rules affect incentives for people to produce and exchange goods and services.

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CONTENT STANDARD 17: Government Failure

Students will understand that the costs of government policies sometimes exceed benefits. This may occur because of incentives facing voters, government officials, and government employees, because of actions by special interest groups that can impose costs on the general public, or because social goals other than economic efficiency are being pursued.

- Benchmark 4: Price controls, occupational licensing, and reductions in antitrust enforcement are often advocated by special interest groups. Price controls can reduce the quantity of goods and services produced, thus depriving consumers of some goods and services whose value would exceed their cost.

Procedures

- Prepare by reading the **Background Information** included at the end of this lesson.
- Use the **Lesson 6 slide deck** to teach about Estonia's shortage economy under totalitarian rule and it's successful recovery thereafter.
- Alternate Activity: Assign the **Background Information** as a student reading.

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Background Information

The following background information is taken directly from the Fraser Institute publications of "The Road to Freedom: Estonia's Rise from Soviet Vassal State to One of the Freest Nations on Earth" published as a part of the Realities of Socialism materials. For a complete copy of the readings please go to RealitiesofSocialism.org.

INTRODUCTION

Estonia is a testament to the productive and ennobling power of freedom. After waves of successive invasions from the east and west, the small and fledgling country on the Baltic Sea was dragooned into the Soviet Union in 1940. There its people, about 1 million in total, were trapped for five decades as unwilling subjects of the socialist experiment. That experiment proved a failure. Eventually, Estonia's workers and intellectuals decided they had nothing to lose but their chains. So, they joined hands with Lithuanians and Latvians—literally—in revolt. In its place, the Estonians created one of the freest nations on Earth.

In contrast with others who had been trapped behind the Iron Curtain, the Estonian break from socialism was swift and bold. It avoided the long, fitful, and often corrupt transition that bogged down so many other nations. Despite the widely held belief that freedom and equality are incompatible, something of the opposite is true: government dominion and discrimination often go together.

HISTORICAL BACKGROUND

The small country of Estonia sits at a literal crossroads. On the eastern shore of the Baltic Sea and the western edge of the East European Plain, it is where ancient north-south and east-west trade routes meet. In the Middle Ages, its largest communities, Tartu and Tallin, were focal points for international trade under the protection of the Hanseatic League. Its location has made it the locus of both peaceful and violent exchange.

Tsarist Russia had conquered most of present-day northern Estonia in 1710 in the Great Northern War. And Russia was still in control in the 1850s when a movement known as the Estonian National Awakening began. The movement encouraged national consciousness, and eventually led to a push for political self-determination.

In the early 1860s several teachers and peasants founded an Estonian-language school in Viljandimaa County. They named it Aleksandrikool (Alexander's School) after Tsar Alexander I. The name reflects two important facts. First, it was an homage to freedom and the tsar, whom Estonians credited for liberating them from serfdom in 1816. Second, it indicates that the Estonians saw no contradiction in emphasizing their national identity while remaining a part of the Russian Empire. The efforts to educate Estonians paid off. By 1897, ninety-six percent of all Estonians ten years of age and older could read, and the literacy rate of males and females was roughly equal.

Beginning in the 1880s, the Tsarist Empire moved to take over Estonian schools, courts, and local governments. Their campaign of "Russification" extended to civil society as well. They pressured national organizations, the Lutheran church, and the press to emphasize Russian rather than Estonian identity. This, however, only emboldened a younger and more radical generation of Estonian national movement leaders.

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INDEPENDENCE

In February 1917 Russians were in revolt. As Russia's losses in World War I continued to mount, 40,000 Estonians gathered in Petrograd in March 1917 to demand greater autonomy for their region. It worked. The region was granted a degree of autonomy over its own affairs and was organized into the autonomous Governate of Estonia, which was now expanded to the south, swallowing up what had previously been Livonia.

In February of 1918, the Imperial German Army forced the Russians out of Estonia. Taking advantage of the power vacuum in Russia, the Estonians declared their independence from Russia on February 24, 1918, and formed the Estonian provisional government. The very next day, however, the German army moved in. In November 1918, Germany accepted defeat in World War I and transferred power to the Estonians.

Just days later, on November 28, 1918, the Soviet 6th Red Rifle division attacked the border town of Narva, initiating what became known as the Estonian War of Independence. With the help of Finland and the United Kingdom, the Estonians fought Soviet Russia. They finally exhausted the Red Army and in 1920 Estonia and the Soviets signed a treaty recognizing the independence and sovereignty of Estonia.

LAND REFORM

Before they had even established a constitution, the Provisional Government moved to address the land problem through redistributive land reform. The reform expropriated 1,065 of the large estates, including private estates of the Baltic German nobility, tsarist state lands, and agricultural lands owned by the churches. The expropriated land was then redistributed to peasants, transforming large estates into small family farms and creating close to 56,000 more small holdings.

THE INTERWAR ECONOMY

The economy of Estonia faced many challenges throughout its 19 years of independence. It was suddenly cut off from Russia, its main trading partner. And the assets of many of its companies, held in Russian banks, had been confiscated when Russia nationalized the banks. Estonia's leaders were tasked with formulating new economic policies.

Although Estonia's early leaders spoke favourably of free trade, they maintained a high protective **tariff** throughout the interwar period. Then, with the onset of the authoritarian era in 1934, government leaders explicitly embraced protectionist tariffs, economic nationalism, corporatism, and planning.

Estonians enjoyed a degree of economic freedom. Domestically, they were able to trade with whomever they wanted to, on whatever terms they wanted. They were able to acquire and use property without much government interference, and they could count on courts to recognize their **property rights**. Estonians were able to start and run their own businesses, and they had developed a reputation for entrepreneurial spirit.

BETWEEN TWO WOLVES: 1940-1944

In August of 1939 the Molotov- Ribbentrop Non-Aggression Pact was signed between the Soviets and the Nazis. Deep in its secret protocols, denied by the Soviets for a half century, it reshaped the Eastern Europe. The new allies carved up Eastern Europe, splitting Poland down the middle, and granting Finland, Estonia, Latvia, Lithuania, and Romania to the Soviets.

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In June 1940, Soviets accused their Baltic "friends" of plotting against them. The Soviets demanded that the Baltic nations form pro-Soviet cabinets and permit unlimited entry of Soviet troops. All three nations capitulated, and two months later Estonia was annexed to the Soviet Union. Estonia was now the Estonian Soviet Socialist Republic (ESSR), a territory of the Soviet Union. During the first occupation the Soviets capped the size of each farm at 30 hectares, expropriating, without compensation, all land in excess of that amount. They also took any land belonging to cities or to churches. Private noncommercial property was also taken, including the contents of safes, houses that were larger than 2,000 square feet, and bank accounts that had more than 1,000 rubles (about US$834 today). Dwelling spaces, which in 1940 had averaged about 15.5 square meters per person, were now limited to no more than 9 square meters per person. Families who had larger living spaces than this were forced to let strangers into their homes.

By forcing people to share communal apartments, the Bolsheviks believed that they could make them communistic in their basic thinking and behavior. Private space and property would disappear, the individual ('bourgeois') family would be replaced by communistic fraternities and organizations, and the life of the individual would become immersed in the community. In a word, their aspirations were totalitarian. The twentieth century's most sophisticated student of **totalitarianism** was the German American historian and philosopher Hannah Arendt. In her penetrating analysis, the goal of such a state is to create a "totalitarian personality," a "completely isolated human being who, without any other social ties to family, friends, comrades, or even mere acquaintances, derives his sense of having a place in the world only from his belonging to a movement, his membership in the party,"

The Soviets, however, only managed to hold on to Estonia for a year. In June 1941, the Germans turned on their erstwhile allies and invaded the Soviet Union and by October the Germans were in control of all of Estonia. The Germans consolidated all three Baltic states into a single occupied German territory they called Ostland which they occupied until 1944 when the Soviets retook the Baltics. Estonia lost about a quarter of its population through death, deportation, and exile during World War II.

THE SOCIALISTS RETAKE CONTROL OF THE ECONOMY

During this second occupation, the Soviets, initiating a new round of expropriations. All commercial enterprises were taken over by the government, with only state and co-operative stores permitted. Nationalized firms were subordinated to one commissariat or another, and all operations were directed in accordance with the overarching all-Soviet economic plans. These plans dictated "the quantity and assortment of output, purchases of inputs (from whom, and in what quantities), the delivery obligations of the enterprise, prices, wages, staff establishments, costs, and much else besides, depending on the industry in question".

Blinded by the **knowledge problem** and hamstrung by the **incentive problem**, central planners had a difficult time knowing how and where to direct hundreds of thousands of workers and assets. This just meant that they doubled down on totalitarianism to implement their plans (the **control problem**). Now, fully impacted by the failures of socialism Estonia was subjected to rampant **shortages**, misallocation of workers and raw materials and the absence of market prices to signal true human desires. As in so many socialist experiments, unable to control the economy, the government turned to controlling the populace.

One way to control the populace is to isolate an individual and turn him against his family. To that end, the state poured enormous time and attention into re-educating the young. Socialists believed that

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human nature could be remade, and that education was the key to this transformation. The three instruments of change were public schools, the Pioneers (which had replaced the outlawed boy scouts), and the Komsomol (officially, the All-Union Leninist Young Communist League, a sort of youth division of the Communist Party).

As was the case across the Soviet Union, receiving foreign mail or listening to radio stations became a crime. This was especially concerning to the Soviets in Estonia because Finland lay just 50 miles across the water from Estonian shores. Much like in Berlin, the Soviets constructed a coastal defense series of watch towers and fences to keep the enemy out and the citizens locked in.

Through the 1970s and into the 1980s as the socialist plans continued to be a drag on economies across the Soviet Union Estonia managed to be slightly more productive and better off than their Soviet counter parts. This was in part because of the stronger economy they had decades before and in part because of their proximity to the west. By 1984 Estonian income per capita was about 16 percent greater than Russian income per capita.

However, the story was significantly different when Estonia was compared with Finland. In 1934 the average Estonian earned about 84 percent more than the average Finn, but by 1984 the Estonia earned just 22 percent of what a Finn earned. And these figures do not account for the shoddy products Estonians had to buy as compared to the products the Finns could purchase.

Aside from falling output and incomes other facets of Estonian life were also in dismal shape by the 1980s.

SOCIAL SERVICES

Surprising as it sounds, socialist governments typically devoted a smaller share of their economies to the provision of social services than did Western capitalist governments. Most of the government's energies were devoted to running factories and farms. And since it ran those factories and farms so inefficiently, few resources were left for social services. Even if they had more resources, however, it isn't clear that socialist planners were interested in spending much more on social services. As an example, in 1990 the Finns devoted more than 41 percent of their economy to public services while the Estonians devoted a little over 23 percent of their economy to public services.

HOUSING

Housing in late socialist Estonia was limited, cramped, and mediocre. the socialist dream of communal living had corralled Estonians into small, shared spaces, abused and neglected through a decades-long demonstration of the **tragedy of the commons**. Adult children often still lived with their parents. Strangers who often didn't get along had to live together. Divorced couples who more than likely did not get along often had to live together. for the first several decades of the socialist reign, planners had simply neglected housing, just as they had neglected consumer goods. To top it off rents had been set in 1928 and remained the same for five decades.

HEALTH

Both Finland and Estonia offered state-subsidized and state-provided health care services to their citizens, either free of charge or for nominal fees. Compared with Finnish health care, Estonian care was generally characterized as backward and inferior: the facilities were dated, there wasn't enough support staff for the number of physicians, doctors were poorly compensated, and shortages of diagnostic

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equipment, surgical instruments, and medicines were common. The consequences such underfunded healthcare was that while Finnish life expectance increased by six years between 1970 – 1994, Estonian life expectance declined by more than three years. By 1994, Finns could expect to live 10 more years than their Estonian neighbors.

THE ENVIRONMENT

Marx had once declared that capitalist progress was "progress in the art, not only of robbing the worker, but of robbing the soil." Yet by almost any measure, socialist states were more rapacious environmental bandits than capitalists. Indeed, the deplorable state of the Estonian environment likely contributed to the population's declining health. In a market economy with well-defined **property rights**, the **price system** encourages efficient and responsible stewardship of resources. This was not the case in Estonia. The biggest causes of pollution were the lack of sewage treatment, phosphate mining, and thermal power plants. Ironically, it was protests over plans for expanded phosphate mining that united Estonians in a spirit of protest against the Soviet government

FROM SINGING TO REVOLUTION

After the protests against phosphate mining and protests over the hidden protocols of the Molotov-Ribbentrop Non-Aggression Pact of 1939, the country united through song at the national song festival. Over 100,000 Estonians showed up to challenge Soviet control.

The Estonian desire to be independent grew quickly over the next couple of years in Estonia and the other Baltic states. By 1991 Gorbachev was ready to make the USSR into a confederation of independent states. But on the eve of signing a treaty that would bring that into being a coup took place in Moscow that threw Gorbachev out of office.

At the same time the Estonians were declaring their own independence and broke free from the decades of socialist rule.

THE CHALLENGES OF A FREE SOCIETY

With independence came the challenges of tearing down old institutions and building up new ones. The need for a constitution, a court system, a banking system, establishment of property ownership and protection of property rights along with the establishment of a **market economy** all had to be addressed. Not all were in favor of change, those who had profited from the **pathologies of privilege** of the Soviet era resisted policy and institutional change.

It was not an easy transition, shortages of goods and services, misallocation of labour and resources and sky rocketing **inflation** all hit Estonia head on. Estonia turned to the West for help in many areas of the economy but went their own way in others. The establishment of the world's first flat rate income tax was opposed by the IMF but has proven to be a success.

ESTONIANS JUST DO IT

Estonia is known for pushing forward rapidly with a number of reforms. Perhaps because of the market economy they had enjoyed in the 1920s they had the confidence to "Just Do It" when it came to economic and political reforms. These reforms included monetary, tax, regulatory reforms as well as spending restraint, fiscal balance, establishment of free trade, privatization of state-owned firms and establishment of the **rule of law**.

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The results by 2020 were dramatic. They have maintained balanced budgets more often than other economically developed countries and have kept their ratio of government spending and debt to GDP much lower than those same countries. Privatization of formally state-owned businesses and assets has been completely accomplished and at the same time the social safety net has been expanded without increasing social spending as a share of GDP. This has included education reform that has produced very good results and choice in, and private funding of, many social services.

In 1990 Estonia's ranking on the Economic Freedom Index was 92nd, by 2020 it had risen to 8th. Other indicators of growth include a tripling of economic output per person, a drop from 54% to 2.6% of the population making less than $10 per day, increasing life expectancy, and falling infant mortality rates. And perhaps most telling of all is the fact that by 2020 they had more business start-ups per million persons than any other European country.

But economies don't run on formal rules and institutions alone. They also require certain habits of thought, cultural norms, and shared understandings (McCloskey, 2011; Storr, 2013; Mitchell and Boettke, 2017). The economist Deirdre McCloskey has argued that a thriving market depends on the "bourgeois virtues" of courage, justice, temperance, prudence, faith, hope, and love. Like all peoples, Estonians had the capacity for these virtues. But they hadn't been used in quite some time.

CONCLUSION

What lessons can we learn from this history? The first and most important is that socialism does not work. The reality of socialism is far from the promised ideal of material abundance and social equality.

As the Estonians can attest, when the state owns and controls the means of production, real incomes stagnate. Workers are exploited. The soil is exploited. Goods and services—including social services—disappear. Unable to find what they want in the state stores, people commodify their relationships, using friends and family to obtain what the command economy will not give them. While official incomes may grow more equal, new pathologies of privilege arise.

It is possible to turn back. Even in a society where the state controls nearly everything, it is possible to return power to the people—to permit them to control their own lives, their own labour, and their own property. The last 30 plus years of Estonian independence are testament to the transformative power of economic freedom. By embracing private property, rule of law, international trade, fiscal responsibility and entrepreneurship, Estonians now enjoy significantly longer life spans, lower infant mortality, and better healthcare than they did under stifling socialist system of the Soviet Union.

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