

“Just Do It” Interview with Mart Laar

Editor’s Note: Mart Laar and his wife Katrin were in Mexico by invitation of the foundation that was born from the citizens’ coalition, which brought president Vicente Fox to power in July of 2000, to speak about the Estonian transition. Estonia is considered by several organizations as perhaps the most successful post-communist transition, relative to the progress the country made since it became independent from the USSR in August of 1991. Of the former communist countries, in recent surveys Estonia was ranked as the least corrupt by the World Bank and Transparency International; as the most economically free (even in Europe, while being fourth in the world) by the *Wall Street Journal/Heritage* Foundation; as number one in property rights by the European Bank for Reconstruction and Development; as the lowest in country-risk by the Economist Intelligence Unit; and as the country that has made the fastest progress in the worldwide history of the United Nations’ Human Development Index (which measures quality of life). The country has also enjoyed one of the fastest economic growth rates of the transition economies as well as the third highest per capita cumulative foreign direct investment after the Czech Republic and Hungary. Former Prime Minister Laar is considered the architect of this transformation, and in this interview he shares the philosophies and practical measures his government adopted to turn Estonia into the oft-called “Baltic tiger.” Laar speaks about the lessons of transition, taxes, Estonia’s tutors, lustration, judicial reforms, constitutions, the banking system, the importance of political parties, privatization, crime, and the environment.

Demokratizatsiya: How did you find Estonia, and how did you leave it now?

Laar: When I came to power in 1992, Estonia had had a 30 percent drop in economic production, and unemployment of between 30 and 40 percent. At the beginning of that year we had most foodstuffs rationed, such as bread and milk, and people had to stand in line for hours to get them. There was no gasoline, because most people couldn’t buy it, so the streets were empty of cars—which is not so terrible considering how the streets are now! The gasoline prices went up 10,000 percent in one year, there was inflation of 1,000 percent per year, and lots of other bad things when we took over.

Mart Laar was prime minister of Estonia from 1992 to 1994, then again from 1999 to 2002. He is currently a member of parliament. The interview was conducted by *Demokratizatsiya* founder Fredo Arias-King in Mexico City, 13 and 14 April 2002.

When we left, the economy was growing fast, 5–6 percent, then later—because these reforms take time—it went to 10–11 percent. Inflation decreased to 10 percent, and unemployment to 3 percent. There was a balanced budget. Of course, nothing was rationed, and no lines. Estonia made a huge jump in the Human Development Index of the United Nations.

There was a problem with the budget deficit, since that is how we inherited things in 1992. The government before that election had decided to campaign based on giving everybody money, and they destroyed the stability and the budget. Unemployment was rising fast. So the image of Estonia was a bit damaged. We were lagging behind in our aspiration to join the European Union and NATO. Now the budget is completely balanced. Our finances are in very good order. In terms of foreign investment, we are also doing quite well—even despite September 11, those last figures are still surprisingly positive. And we will make membership in both the European Union and NATO after the next sessions, with the EU this year and an invitation at the Prague summit for NATO. Of course, we cannot be totally sure about anything, but there is a 99 percent possibility that we will achieve this.

And in the coming years the reforms will continue to give good results, because they are not dependent upon who is in power.

Demokratizatsiya: What can Estonia teach Mexico and other countries in transition?

Laar: There are some lessons that are quite universal and are the same for every transition whether it be Estonia, Russia, Mexico, or wherever. The one thing that is universal in these lessons is that you cannot only deal with the economic reforms. Your economic reforms can only be successful if you are also pressing ahead with the political agenda as well. Don't underestimate the importance of politics.

This means that you have to work on the constitution, build the political parties, build a political consensus that is necessary to pass your reforms in the parliament. You must strengthen the rule of law, property rights, and such things.

Without this you will find that even if you are doing economic reforms, they will not last. You cannot build your house on mud. You cannot use too much of the people from the old regime, from the old system, because their way of thinking is just different. It's very hard to have people in government offices who only think of power. Actually, those parties that we belong to are trying to do something constructive. And to combine those two understandings is quite simply not possible. Use your time wisely. You must do these decisive reforms in the first year or two, because after this, the people start to get bored, and so will your staff.

The second very clear lesson is that if you have decided to do the reforms, then just do it. You must be decisive, and pass those reforms with the goal to make them irreversible. Don't be afraid of such short-term pains or short-term political results, because otherwise the pain will be worse. Besides, there is only one sure thing in politics—you will be ousted anyway. And if you are too afraid, then you will just be ousted earlier, and what's more important, you will be ousted

without having done anything. It's better to have the option to have at least seen your country changed.

The third lesson is that the simpler the reforms are, the more successful. I have experience in this. As we did simple reforms, they were successful. But as we then got some very smart advisors from other countries who in some areas suggested some very complicated, big reform packages, in reality they did not work. I have seen this in every country. So keep the reforms very simple.

So think with your own head—this perhaps can be the fourth and most important advice. I can suggest other ideas, but these are dependent on the local context. But these three things that I have talked about are the universal things for transitions in the world.

Demokratizatsiya: What about consensus between the different political forces to pass these reforms?

Laar: Better than consensus you need a majority. I have never seen a country where you can achieve a consensus at the time when you are doing the reforms. You can have the consensus three or five years after the reform, when everyone says “oh that was a beautiful reform,” but if you do this, you will always fight and you must put your will through. You need a strong party that can build a consensus to have a majority. In Russia, nothing happened until the reformers started to control the parliament. Tax reform was impossible in Russia until the parliament passed it.

Demokratizatsiya: How do you do this in a presidential system?

Laar: Your president can play the different political groups against each other to form a majority, or you can of course win the parliament as well. In the parliamentary election you need an effective party that can actually form coalitions. You may have to do some compromises along the way, but you need to have a clear program of what you want to achieve in the end or not achieve. For example, Ronald Reagan did not have a majority in Congress and still got his agenda through, still was a very good president. Even if you can't get everything passed, you can still start with some things and get them done. Also, if your legislative proposals are simple, the less political groups you have arguing against it. If they are complex, then you have a lot of political interests there. But if they are simple, then there are fewer and easier to pass through. And if your reforms are simple, then you have less bureaucracy and less corruption and more benefits for society.

It's important to sell these reforms to the people, to wake up the people and have them with you, to make them part of those reforms.

Demokratizatsiya: Your cabinet had an average age of thirty-three. You mentioned that you cannot build your house on mud. How important is it to replace the nomenklatura in a transition?

Laar: The replacement of the nomenklatura is very important, especially if you are building a new government, then this one has to be built on the people you really trust, you must have a coalition with the parties that share your program and that

promise to fulfill this program. There will always be opposition, and you cannot please that opposition by trying to appease them or invite them. You will not only not appease them, but you are getting yourself into trouble. So this means that you must have the people that can really work. And secondly, by keeping the nomenklatura you cannot do your reforms, not only because they resist them but also because they cannot think in other ways from which they are taught. That means you need a lot of replacements. But it is not good to replace the old nomenklatura with a new nomenklatura, which means that you must de-politicize the bureaucracy, which means not to put just your party members instead of communist party members—the most important is that you simply find new good people.

Demokratizacija: How far do you go? How does a Václav Havel or a Mart Laar know which people to replace, how far down, and in which bureaucracies?

Laar: You couldn't do everything by yourself. You must start from the top and then put the people that can finish the job. But it must actually go quite deep. As we did the cleanup in the government and built a quite good government, a quite good administration, initially the problem was that in the local level we still did not have a good bureaucracy. But in the last election we were able to change the people there too. But the second thing, this does not mean that you have to change all the people. But even the smaller parts of this machinery can destroy it. All it takes is one small part and it won't function. But the most important is to then make the changes irreversible. This means passing laws to create a system where corruption has no place, to have such laws, to have a simple system with no possibility for corruption; otherwise you can run into the same problems again and again. We also built a professional public service on the principle of open competition, meaning that we passed laws so that every place in the public service which is not political—we had divided the political from the non-political positions—is chosen by independent bodies with very clear standards, what standards those people running those offices should have. And through such things we made this irreversible because this system worked even when we were not in power. After we installed this public competition system, those old-guard officials from the previous regime were replaced.

Demokratizacija: The democrats are sometimes afraid to replace people in the government they inherited, because they think they don't have the experts to replace them. Is this fear unfounded? Also, how did you find your people to make such replacements? Like Jaan Manitski [director of the privatization agency in the Laar government], who had been the manager of ABBA in Sweden?

Laar: Manitski was the easy choice, because he was quite a well-known good manager, but if I put someone young like a twenty-five-year-old, then people started to question their experience. But I always have to ask, "Experience *in what?*" I am afraid that most experience is coming from areas that are not very useful in modern society. Which means that we started with people that were inexperienced in the public administration, but we also gave them a lot of possibilities to train and learn, so we used most of the foreign aid programs for courses

of study for these young people. And if you are honest and work, you will manage. It is not so complicated that if you lack experience but you study and train, you will manage very well.

Demokratizatsiya: Havel once mentioned that he prefers temporary inexperience to permanent sabotage. Do you agree?

Laar: Yes.

Demokratizatsiya: How much did you learn from the other Central European transitions such as Poland’s, Hungary’s, Czechoslovakia’s, that came two years before Estonia’s? Which in retrospect was the most instructive, which one taught you to do what?

Laar: I think there was a large amount of different experiences, both good and bad. First of all, each country must work out its own program. You can use the experiences, but always look in your own context as well. We looked very much at Poland, their decisiveness to make the shock therapy was very impressive. At the same time, Poland showed some very weak points. First of all, they did not give any attention to the constitution and had huge political problems as a result. Also, they started trying to work out ideal laws on privatization. But there is nothing ideal in the world, which means that they could not work out ideal laws, and if you start wasting too much time, time is the most valuable thing. Poland lost a lot of time in privatization, because they tried to do it perfectly. You must just do it. In Hungary they were moving very gradually—which we later saw did not work very well—but what was good for them was their foreign investment policy, which worked better than in Poland. In the case of Czechoslovakia, there was this positive decisiveness, and in the beginning we were very impressed with the voucher privatization. And then we saw the negative side of this privatization, so we changed the model a little bit. But the main characteristic was that you should not try to save those enterprises, don’t waste your time and money trying to rebuild them, this is where the Treuhand failed in eastern Germany. From Slovenia we learned the monetary reform, that you can have the convertibility from the beginning. We saw that good monetary reform was not enough, because they also could not balance the budget. There were other transitions that were earlier. Namely, we learned from the German post-war economic miracle, which was clearly one of the best in the area.

Demokratizatsiya: The Estonian privatization is quite unique, since it has the best of both worlds, it is majority strategic investor and minority vouchers for the people.

Laar: We were lucky, since we had the example of both the Treuhand and of [Czechoslovak finance minister then Czech prime minister] Klaus, so we combined both, and it’s really working.

Demokratizatsiya: The Treuhand actually advised against it, and you did it anyway.

Laar: We didn't listen very much to some foreign advisors.

Demokratizatsiya: Such as when the IMF told you not to get out of the ruble zone?

Laar: Precisely. They also told me to save the banks that were going bankrupt, and I said no, I will not save them. That sent a very strong message: Don't mess with the money, and don't expect help from the state with problems of your own making. It was very well understood.

Demokratizatsiya: Of the Western institutions, of the Western leaders, which is the one who most helped you and which is the one who most hurt you?

Laar: I could not say that anyone hurt me, but the one that most helped was [former Swedish Prime Minister] Carl Bildt, that I can say very clearly. He was very supportive in many different areas.

Demokratizatsiya: Anyone else who comes to mind?

Laar: There were good friends everywhere. Actually, [former German Chancellor] Helmut Kohl was very good as well. And there were a lot of British politicians that were very helpful at different times. [Former Prime Minister] Paavo Lipponen of Finland was also very helpful. But Carl Bildt actually organized most of this group, and it was very positive.

Demokratizatsiya: Estonia had the most liberalized economy in all of Eastern Europe and all of Europe actually. However, Toomas Hendrik Ilves, the former Estonian foreign minister, told Anders Åslund that if he could do the liberalization all over again, he would keep the option to retaliate against European Union dumping. If you could do the liberalization all over again, what would you change?

Laar: I would not change this. I think it helped to build strong competition in the area. We have fought in the courts with the European Union quite effectively actually. I would do some things differently because in some areas we did quite complicated reforms, especially in the land registration and so on. We went for the German model of registration, and it was a little bit too complicated and we lost time, and time in all these reforms are very valuable. And mostly I am only sorry about the things I didn't do, I don't think there were any big mistakes in the reforms I did. Of course in some small details, there are a lot of things I can say. But major mistakes, only that we tried to do some reforms [that were] too complicated.

Demokratizatsiya: As we were talking about the Estonian privatization model, which combines efficiency with fairness, a model now being used by Finance Minister Bozidar Djelic in Serbia, but it is also a bit complicated for the average person to grasp. Now you always talk about simplicity and making things easy to understand, like the flat tax. In retrospect, what are your observations about privatization?

Laar: Privatization is a thing that the public does not understand, anywhere in the world. It is an unpopular thing that must be done anyway, which means that if

you are in the position to do it fast, then do it fast. Because if you are losing time, then you run into trouble. Because in this time the more groups are developing, lobby groups, your own industrialists, then the harder and harder it gets. So in this context, Václav Klaus was completely right to do it very fast. And unfortunately he didn't do it fast with the banks, and he paid the price—a very high price.

Demokratizatsiya: A top U.S. expert on organized crime, Louise Shelley, has mentioned that the lower crime in Estonia as compared with Latvia and Lithuania, can be explained because of the Estonian *de facto* lustration, the cleansing of the administration and the bureaucracy and the breaking of those networks.

Laar: That is one reason, but there are many other reasons as well. It was very clear as we started to analyze our situation in 1992 that our police forces were so young, we couldn't use them to fight the criminality or the organized criminality—that needed time. You could not do it fast. So we had to find other areas where we had to stop them. It was very clear we had to use other methods. When we started to analyze what went wrong in Russia, why this organized criminality is taking everything over, . . . we realized that all the bad things were starting from the banks. That means that they first take over the banks, then they take over the industries, and then all political life. So we decided not to let them into the banks. And to stop this we just bankrupted those banks which were taking over. We made a very strong banking regulation and control, and regulations on dirty money that was coming to these banks, and when we found problems that some people were taking over these banks, we moved the state budget out of the banks, and so on. But the message was understood: Don't come to this country with your dirty money. And as a result of this we have the strongest banks in the Baltics. But of course it was connected, because as I bankrupted the first bank, all I said was that the bank was in bankruptcy, and he came to the government to ask for money, and he was totally sure that he would get it because he always had gotten it, and he didn't understand me at all, he didn't believe me. He said that I would be out of office in two weeks. But we also did other creative things to fight organized criminality as well. For example, we got the excise taxes on alcohol and tobacco very low for a long time, which means that we got the market from the smugglers, and they lost again, a lot of income. And there are many other things. But we made them not like Estonia, in many ways. At first the political system was weak, the police were weak, so we used alternative methods. But the message was understood, and this was important.

Demokratizatsiya: How did you reform the justice system? One legal expert called it “legal shock therapy,” and he mentioned that Estonia was the model on how to do this. What did it consist of?

Laar: It consisted of changing an old court system—we remodeled it totally. Of course, most important is that we remodeled not only the courts but the legislation at the same time, to build modern civil codes and everything. This combined with the very tough education programs and so on. These reforms were really very successful. We just remodeled everything. The old judges were

replaced by new ones. There was a big cleanup. Some people in Estonia said we had to clean more—but it still works, and works better all the time.

Demokratizatsiya: Czechoslovakia and Poland retired a lot of communist-era judges, and they used a system whereby they would take a year to re-hire justices, and those that were not re-hired essentially were fired. How did Estonia deal with this issue?

Laar: We did it such that as we had a new constitution, then our new president had to appoint all justices. So it looked a lot milder, but it was actually quite tough. Some of them he named and some he didn't.

Demokratizatsiya: What percentage of the old judges stayed on?

Laar: Not much, maybe 10 percent. Maybe at the lower levels more stayed on, but of the older judges, maybe just 5 or 10 percent.

Demokratizatsiya: More and more they are discovering that you cannot have a true capitalist, free-market economy without a working legal system, because you need contractual enforcement.

Laar: Exactly. That is why I started from here and not from the economic reforms. The faster you do these reforms the more successful they are, because you must start them in a parallel way. With property reform, if you do it right, it will help very much. The privatization is important as well. You can start with the smaller privatization, just to take care that people will own all those small businesses where they cut hair or repair cars or cosmetic shops, just say "you can have these." No sense in getting money from those people. And then you go to bigger privatization.

Demokratizatsiya: Former Bulgarian prime minister Philip Dimitrov mentioned that property restitution—giving back to the previous, pre-communist owners—was a way to privatize quickly and to bring life to a city early on. In Estonia, what were the main issues on restitution?

Laar: Restitution is excellent because you get a lot of investments immediately, but at the same time you must also have the social guarantees for the people who are living in those buildings. So you must have a clever law. With restitution, so that the people who have been living in those buildings for twenty or fifty years are losing their homes, you get problems. So you must find a balance. The restitution must be limited. That was a mistake we made—we made restitution too large. Restitution must be limited to the direct former owners and not to the very large relative rings. But it must happen very fast because it is the most effective way of privatization. Your property will change very fast, and people can start to invest. But the laws must be ready. I imagine that in Cuba restitution will be a problem, because there are people who had property confiscated. But of course they must be looked through because I don't know how far they can go. As far as I know, in Cuba there were big plantations, maybe too big. So there must be some kind of half-way restitution so that you are not getting all this land

back, otherwise you can run into difficult problems. So you must look at the situation and then make the choice on how far you go. But the principle is that property rights must be proclaimed, because otherwise people won't understand property, what property is, and if you don't have fixed property then the market economy will not work as well.

Demokratizatsiya: Some analysts, Marshall Goldman of Harvard in particular, mentioned that the Polish privatization was more successful than the Czech privatization because they accidentally waited so long to do it, that by then the Polish people had money to buy the big state-owned enterprises from the money they had from small businesses. What do you think about this view?

Laar: I have strong doubts. Why would they think that the Polish privatization is more successful?

Demokratizatsiya: It was mentioned that the Czech full-voucher system created a corporate governance problem.

Laar: That is true. But the possibility for the Polish people to buy their shares will create even more problems, because it will be even harder for them to build clear governance.

Demokratizatsiya: What do you think of the investment funds of Poland? They had fifteen investment funds that teamed up with Western investment banks. Do you think that this privatization component was a model?

Laar: We will see. But to be frank, I have some doubts. I would not suggest this because if something happens, those will be the first that will go down, because they are not controlled. If you look to Polish industry, to Polish development during the last years, it's very surprising to analyze, because they are not doing so well. The investment funds were created because a lot of people are thinking that the bank regulations are too tough. But you can lose your money anyhow in those investment funds; they are not responsible enough. The banks, actually, if you have proper regulations, they are more responsible and they have to be more careful where they put their money; they couldn't take high risks. If those funds are not connected with the banks, I would not suggest them too much.

Demokratizatsiya: How do you do pension reform?

Laar: First of all, don't do it too fast. The Germans did it ten years after the beginning of the reforms, and we did it exactly at that same time. You do not have enough money to do it at the beginning.

Demokratizatsiya: What should be the ideal pension reform? Is it the Chilean, pay-as-you-go system?

Laar: More or less. What we are doing is a variation of the Chilean model, which is quite tough, and it is organized very much on private funds. We have a three-options system. The first is a state-owned system. The second is obligatory investment funds, which means that you have to invest somewhere. And the

third option is voluntary, totally voluntary. The Chilean model is based largely on this third. It depends on the country. If the country is socialist then the people are very afraid of these investment funds and they are not very eager to put their money there if they are not pressed. But I think the three-pillar system is giving better guarantees for the future, since this system allows you to better check and control the investment funds, because it's enough for a major reform to fail if just one of those goes bankrupt.

Demokratizacija: On the issue of political parties, you and Václav Klaus were the pioneers in postcommunist Europe, practically the only reformers that saw the importance of political parties, when the rest of the reformers wanted to keep their amorphous, non-party, national liberation movements, thinking they could continue ruling through them. However, Klaus formed the ODS, you formed Isamaa. In retrospect, how important was this party-building?

Laar: It is enormously important. Because without a political party, you cannot have a lasting government. Of course, the governments in Central and Eastern Europe are changing very fast. But if you don't have the parties, a clear party system, then you don't have much hope to stay in politics with your ideas. But we are not really the pioneers. If you look to [Hungarian Fidesz party leader and prime minister from 1998 to 2002] Viktor Orbán, I must say that he was the most successful party-builder among us.

Demokratizacija: But he was in opposition. . . .

Laar: Even now as prime minister, he built a very strong party. In that sense he was more successful than we were, since he united the similar-minded parties. So if you want to talk about the best experience in party-building, then Viktor Orbán is the best example, not Klaus and I.

Demokratizacija: The first postindependence elections in both Estonia and Lithuania were held more or less at the same time. Yet, in Lithuania, the ex-communists won both the parliament and the presidency, whereas in Estonia, the former nomenklatura lost both. Why is that?

Laar: First of all, in Lithuania the political circle started a bit earlier. In 1990 the conservatives [the anti-communists] won the elections. In Estonia, we didn't. Here, we had a different kind of opposition. But we actually had a political party to do the good campaign, because we won much through the campaign. I don't think the majority of the Estonian people actually supported those ideas that we presented, because it was enough for us to be in power two weeks, doing nothing yet, but people understood what we were planning to do, and our popularity went down. We lost half of our popularity in two weeks, doing nothing. Because it suddenly became clear that now those crazy guys will really do it—they will balance the budget, they will cut those subsidies, they will do all those nasty things! The problem is that we really meant what we said. But during the election campaign it looked really nice, it looked enormously beautiful. We played it well, and we were well organized. We ran an excellent campaign, and so we won.

The campaign was written in the Anatol Lieven book on the Baltic revolutions, where he depicts two election campaigns at the same time, and if you read that you will understand why we won. This takes us back to the importance of political parties.

Demokratizatsiya: I guess Lithuanian leader Vytautas Landsbergis was one of those liberators who did not see the importance of forming a political party until after his defeat. He thought that Sajudis would be enough. Because only after their defeat did he and Gediminas Vagnorius form their party.

Laar: That is probably right.

Demokratizatsiya: Estonian human rights advocate Aadu Oll told me that the replacement of the KGB with entirely new secret services in Estonia was a success for democracy itself. What are your thoughts on secret service reform?

Laar: I totally support this. It was my decision to start from nowhere, from totally new people, even those without any police experience.

Demokratizatsiya: Even the regular police went through this process?

Laar: The police not as much, but maybe 60 to 70 percent were replaced. But with the secret police—100 percent. And again, we understood one thing—that if you could not build all your police forces strong, then build one strong one. We built the secret police strong, so that they could check the police activities as well. Which means that we doubled the salaries there—you couldn’t bribe those people. We made them really motivated. To be very frank, that is the place where we put a lot of our friends. Because you have to put there the people you can trust, whom you know who they are, because you have been with them in the resistance. And it has been quite a big success. Even [expert on KGB Oleg] Gordievsky said that the only professional secret service in all the former USSR is the Estonian one. He knows what he’s talking about!

Demokratizatsiya: Victor Yasmann, another expert, mentioned that of all the Baltic countries the Estonian secret services had by far the highest *esprit de corps*.

Laar: In Latvia they made this mistake that they decided to have the old-guard “experienced” people. I remember very well a personal story. As a historian I studied very much the Estonian resistance movement. When I was first elected to the Estonian Supreme Council in 1990, I had this red “miracle card” that said “Estonian SSR,” which opened all the doors in the Soviet Union, like being part of the nomenklatura. I got it and I decided to have some fun. I took this card and I walked directly to the KGB headquarters. I walked to the officer who was on guard duty and I showed the card, and told him I wanted to use their library. He was so shocked because those types of cards were for such high-ranking nomenklatura, so he let me in. I went to the library and I showed the card again and said, “I want such and such files.” I wanted the history files about such persons I was researching. The lady looked at me shocked but she brought me the files. I made my notes and then this lady finally came over and

said, “Comrade Laar, our officer wants to talk to you when you are ready.” So I went over there and it was the typical KGB office like in the movies, there was [Soviet Cheka founder Feliks] Dzerzhinsky on one wall, Lenin on the other, green carpet on the table, two old fashioned lamps, like in the movies. I sit on one side, mostly where they interrogate, he sat on the other, looking at each other. Then I noticed how this man had the typical look of the KGB man of those times in Estonia, and his hands were sweating. Then he said, “Comrade Laar, I wanted to tell you, that I have always been an Estonian patriot. I hate the Russians. Just give me the chance, I will destroy them so! Just give me the chance!” The Latvians believed them.

Demokratizatsiya: That is typical. Here, when Fox won, the next day so many of the PRI people came over to see the president-elect to beg him for mercy and jobs, claiming that they had always been for him, and quietly did things in their bureaucratic corners to help him. Fox also believed them. It’s sad.

Laar: You couldn’t believe those people. And even if they are trying—and it’s quite possible that they are trying, I believe that not all those people are traitors, at least at the beginning, they can be traitors afterwards, but even if they are trying they will fail because they don’t understand, because of their experience. I have asked this question a lot of times, when they ask me why I chance experienced people with newcomers, and I always have to say, experience *in what?*

Demokratizatsiya: You prefer temporary inexperience to permanent sabotage.

Laar: Exactly. But it’s not only sabotage. They just can’t.

Demokratizatsiya: What were some of the secondary reforms or follow-up reforms to the Estonian flat tax?

Laar: The flat rate tax will have its tenth anniversary soon. But two years ago we did the next radical step, which is also still unique in the world, but it is working so well in Estonia that maybe some other countries will follow soon. Namely, we abolished the corporate income tax, mostly. If you are making investments, you don’t pay the corporate income tax. And if you are getting money out of your business like for example paying dividends, then this is taxed by the same 26 percent. That has had a huge success in Estonia. Right now as you know Europe is in recession, so we are getting a lot of investments. They are bringing their factories and their production to Estonia. Because if you don’t pay tax on your investments, then you develop. At the same time, that money we get back—because those companies that are re-investing their money are doing very well—from taxing dividends, compensates for the other tax we are not charging. So this tax is being recouped very quickly through another way. It’s even better than we expected I must say.

Demokratizatsiya: How does tax federalism work in Estonia in that context?

Laar: The situation was so bad that we just did it. Of course part of the taxes collected go to the local governments—54 percent to be exact; 46 percent going

to the central government. Maybe we will change it, giving more to local governments, we will see. Indeed it was complicated when we started, but the truth is that you have to make your tax system as simple as possible, because if it is not understood then the people will just avoid it. But if people understand the tax system and what it's for, then they are more eager. Of course, paying taxes is never popular, but it is more popular if the people understand what they are paying them for more or less.

Demokratizatsiya: On what basis did you determine the 54:46 ratio?

Laar: We just decided it. It used to be 50:50, but then we decided to give a little bit more to the local governments, to make it more interesting for them to enforce tax collection, too.

Demokratizatsiya: Has the flat tax and the simplicity helped the credibility of the justice system and the government in general?

Laar: The simple tax system can change many things in a society, even if you do not readily notice them. Because if you have a fair and simple system that you can understand and that is transparent, then all those ways that some people can use bribes and economic influence to get their way are not so efficient and active any more. Of course the tax system alone cannot change a bad situation. You also need to change an enormous amount in the political system, in the legal system—rule of law, of course, being one of the most key points. This is one place where many reformist countries have failed. They did not understand how important it is to reform for example the judicial system. The first law we passed in Estonia was to start reforming the legal system and our courts and so on, because without reforming the courts, we will fail in the transition very easily, because if you have those corrupted court systems, then it's very hard to believe that you can have a functioning market economy. This means that to have successful economic reforms, you need enormous amounts of reforms in the political and legal areas. You can be successful in some areas, but they will not give such a complete result, and this is a mistake very often made by many countries, and it depends of course from the context how badly these countries will fail—some have failed very badly.

Demokratizatsiya: What about the environment?

Laar: Looking to the future is very important, and this issue is also very often underestimated as well. There are the countries that are in the process of development like Estonia, and then we see big industrial countries. I think that we are having some good chances in some areas, because those countries do not have an environment anymore, they do not even have frogs. And this normal environmental attitude, this balance between people and environment, is gone, which means that in twenty or thirty or fifty years if we can keep our environment, we will be very competitive in the world, because they will run into more and more trouble with these mistakes that they have made in the past. In the context that Estonia is in, it is enormously important to have tough environmental legislation, and be very clear with it, starting from every company that is coming to invest,

you tell them they can do many things, but these are the rules, and you will follow those rules. Because there are many bad companies and much bad dirty capital that is only looking for a wastebasket. We also had such an attempt early on, and the best way to stop them is to have clear rules. One of the biggest advantages fifty years from now will be the environment. When companies were beginning to invest in Estonia, we added environmental cleanup clauses to the negotiations with them. There are many very polluted areas in Estonia, because the Soviet Union did not make any attempt to take care of the environment—a typical industrial attitude of them. But we have had enormous changes in these ten years in this context.

Also, we have very clear rules in this context and don't change them often. We don't have many exemptions because then everybody expects an exemption too. But at the same time we don't demand too much, don't go to the extreme of funny ideas. Since some people go crazy over the environment, you can end up making stupid demands. You have to know what is good and what is bad. Don't go the populist way; go for clear laws. Because companies like the clear rules, they will most likely come to your country rather than to a country that lacks clear rules and has exemptions, where one thing is true today and tomorrow it isn't. Long-term investments are looking for stability. If you have very stable environmental laws they will come—especially those that are serious and good—because they don't want to lose their investment. If it changes all the time, then they can lose their money.