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VARIETIES OF CAPITALISM IN INDUSTRIALIZED ESTONIA 1870-2016

Master's thesis

Technology Governance

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I hereby declare that I am the sole author of this master's thesis and it has not been presented to any other university for examination.

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Abstract

This thesis gives a historical overview of the development trajectories of capitalism in industrialized Estonia. While according to several publications from the varieties of capitalism (VoC) approach, Estonia is often classified as a relatively pure liberal market economy; historical research suggests that this has not always been the case. To date, studies placing the Estonian case into the VoC framework have lacked historical perspective and overlooked its past developments across various time periods. As the current thesis is looking to analyze the long-term trajectories of institutional change, it aims to fill a gap in this research area. The theoretical framework interrelates comparative capitalisms literature with historical institutionalism to analyze the long-term trajectories of institutional change and highlight the critical junctures that altered these trajectories. The thesis adopts a case study design and utilizes both quantitative and qualitative secondary sources. Its primary finding is that Estonian capitalism appears to be very diverse across different time periods. In particular, it appears that the transition from the Czarist Empire to independent statehood was much more gradual than subsequent transitions to and from the Soviet regime. From individual institutional domains, financial systems and corporate governance appear to more stable over time when compared to industrial relations, education, welfare and industrial policy. The thesis concludes by highlighting some more general inherent characteristics of Estonian capitalism, which are its relative openness towards foreign markets, investments and financing; diverse elites across various time periods; high level of education and disproportionately modest role of the labor movement.

Key words: comparative capitalisms, critical junctures, Estonia, historical institutionalism, varieties of capitalism

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1. Introduction

Throughout centuries, the political history of Estonia has been one of conflicts and conquests. As a result, the economic and institutional development of the country is perhaps not best described as a process of linear and consistent development following a certain trajectory, but rather its development has been forged by several historical events acting as critical junctures, which in turn have each severely altered preexisting trajectories. Even though recent years have witnessed the emergence of several publications categorizing the Estonian case as a relatively pure liberal market economy (e.g. Bohle and Greskovits 2007; 2012, 96-137, Buchen 2007, 65-89; Feldmann 2006, 2007, 2013), these accounts have primarily focused on the post-Soviet period and thus lacked historical perspective. To date, studies within the varieties of capitalism (VoC) framework that take into account historical influences that go beyond the Soviet era and analyze the long-term trajectories of institutional change across several different time periods in a summarized way, have not been published yet. Herein, the current thesis attempts to fulfill this gap in existing historical literature, while also contributing to the scholarly debate on comparative capitalisms (CC) in Central and Eastern European (CEE) countries.

In doing so, the aim of the current thesis will be to investigate the effects of four most influential critical junctures on the development of capitalism in industrialized Estonia. These four critical junctures are: the loss of Crimean War by the Russian Czarist Empire that sparked industrialization in Estonia; the collapse of the same empire following World War I (WWI) which allowed Estonia to declare its independence; World War II (WWII) that resulted in a Soviet occupation and the collapse of the Soviet Union that allowed for Estonia to regain independence. The primary research questions that will be answered by the current thesis are: what are the long-term institutional trajectories and inherent characteristics of Estonian capitalism and how did the aforementioned critical junctures affect these? In order to answer these questions, based on the theoretical framework, six different institutional domains will be under review across four different time periods separated by the aforementioned critical junctures. These institutional domains are financial systems, corporate governance, industrial relations, education, welfare state and industrial policy.

The research strategy of the current thesis is to use the exploratory research method. This is grounded in the notion that the subject of the current study remains relatively unexplored to date, especially from the theoretical angle of CC and the VoC approach. Using the exploratory research method also means that the thesis does not focus primarily on developing a comprehensive model to understand cause and effect, but is rather meant to illustrate the Estonian case in-depth. By doing this, the current thesis opens up further possibilities for future research and establishing more concrete hypotheses. With regard to research design, the study adopts a case study design, with qualitative research being used to gain an understanding of the impact of different critical junctures that potentially severely altered the long-term trajectories of Estonian capitalism. Regarding data and sources, the current thesis will utilize both qualitative and quantitative data and will rely on secondary sources.

In terms of structure, the thesis is divided into five chapters. The current chapter offers an explanation for the need for research, but also an overview of the research problem, methods and structure of the current thesis. The second chapter then presents a brief and synthetic overview of previous research in the field of CC, the limitations of existing conceptual frameworks and also the theoretical framework used in the current thesis that is based on six selected institutional domains (Jackson and Deeg 2006; 2012). The third chapter is the empirical part of the thesis. In this chapter, empirical findings are presented, systematized and analyzed based on the theoretical framework that was established in the previous chapter. The fourth chapter is then meant for concluding remarks and includes a comparison of the six selected institutional domains in Estonia and a subsection that highlights the inherent characteristics of the Estonian type of capitalism. Lastly, in the final chapter of the thesis, primary findings will be summarized.

2. Theoretical framework

In order to gain a position for analyzing Estonian capitalism through various time periods, the research already carried out on CC needs to be scrutinized. The CC literature deals with institutional diversity and with the change of institutions across different countries (Jackson and Deeg 2008). According to this literature, institutional diversity is associated with distinct logics of economic action and as a result, it is believed, that there are comparative institutional advantages for different types of economic activities in different institutional contexts (Jackson and Deeg 2012, 2). In other words, the comparative institutional advantages are apparent, when the institutional context of a particular country provides actors with advantages for engaging in specific types of economic activities there (Hall and Soskice 2009, 51). At the same time, it has to be noted, that institutions themselves are merely socio-political compromises built on a complex distribution of power among different economic actors (Jackson and Deeg 2012, 1109). This essentially means that distinctive institutional varieties develop as a result of economic and political competition between different kinds of social actors and hence are always subject to further reformulations, because of pressures from different groups and rationalities (Whitley 1999, 19). When these reformulations take the form of sudden, rapid movements of institutional change, in which case old trajectories are broken and a new path is begun, these events are also known as 'critical junctures' (Pollitt 2008).

When investigating such critical junctures, it is important to understand that all studies of CC must inevitably be based on a solid theoretical framework to note and compare the diversity of institutions and institutional change over time. However, despite the growing number of publications in recent decades, developing a universally accepted framework in the field of CC has failed to materialize and therefore the CC literature currently lacks agreement, when it comes to the number of distinct types of capitalisms, the key institutional domains and the conceptual dimensions used to compare institutions within these domains. As a result, it can be stated that the literature on CC is currently fragmented and consequently it offers a number of competing theories and conceptual frameworks about institutional change and how socio-economic dynamism and politics affects this process (Jackson and Deeg 2012, 1110). In the following section, some of these existing conceptual frameworks, along with their limitations, will be briefly reviewed.

2.1 Limitations of existing conceptual frameworks

The varieties of capitalism (VoC) approach, inaugurated by the seminal work of Hall and Soskice (2001), is perhaps the most influential strand of CC literature emerging in recent decades. It is largely built upon the key concept of 'institutional complementarities' between political systems, production regimes and types of welfare state (Soskice 2007, 86-121). The main argument of the VoC is thus that "the presence of several 'correctly calibrated' institutions that govern different markets determines the efficiency of the overall institutional framework" (Hancke 2009, 3). Based on the balance between market and non-market strategic coordination in labor relations and corporate governance, the theory identifies two basic varieties of capitalism: liberal market economies (LMEs) and coordinated market economies (CMEs) (Hall and Gingerich 2009, 145). LMEs are characterized by the prevalence of arm's length, competitive relations, formal contracting and supply-and-demand price signaling. Its antitheses, the CMEs are dominated by non-market relations, collaboration and credible commitments among firms. (Hall and Soskice 2001; Hall and Gingerich 2004) Although revised typologies of capitalist varieties have increased the number of institutional domains and types of capitalism (Hancke *et al.* 2007, 3-38), the explanatory strength of VoC's still lies in its simplicity. However, the reduction of institutional diversity to a small number of dimensions has also been its main liability, because by categorizing too much diversity under broad labels, the VoC approach has been criticized for over-emphasizing institutional continuity and thus for missing important aspects of institutional change (Jackson and Deeg 2012, 1111).

For this reason, alternative frameworks, originating form literatures on governance (Crouch and Streeck 1997; Hollingsworth and Boyer 1997) and comparative business systems (Whitley 2007) or social systems of innovation (Amable 2003), have also sprung alongside the VoC approach. Such frameworks introduce a number of different domains for understanding institutional diversity. For example, both the business systems and governance approach to institutional analysis are focused on how economic activity is coordinated, governed and regulated (Crouch 2005, 44; Whitley 1999, 26-27), while the social systems of innovation framework highlights the formation of coalitions among unequal actors with divergent interests (Amable 2003, 7-11). Furthermore, existing conceptual frameworks fail to categorize the capitalist varieties emerging in transition economies, such as the CEE countries (Bohle and Greskovits 2007; Hancke *et al*. 2007). Thus, recent years have seen the emergence of a new strand of literature, meant for analyzing post-socialist regimes (King 2007; Myant and Drahokoupil 2010; Bohle and Greskovits 2012). Among this literature, there exists a general notion that CEE countries are a form of 'dependent market economies', where institutions have developed in ways very reliant on foreign direct investments (FDI) and transnational companies (Nölke and Vliegenthart 2009). Altogether, the alternative conceptual frameworks discussed here have adopted a specific and narrow view for analyzing institutional diversity. However, the focus and timeframe of the current paper, demands for a more comprehensive framework, which is also suitable for analysis of long-term trajectories of institutional change and this will be presented in the following section.

2.2 Selected institutional domains in capitalist economies

For the purpose of analyzing long-term trajectories of institutional change, within the history of capitalism in industrialized Estonia from the 1870s onwards, the current study must adopt a theoretical framework which is comprehensive enough to describe the most important institutional domains in capitalist economies, but is, at the same time, also designed for a dynamic analysis across different time periods. Out of the abundant literature on CC, the most suitable framework for these purposes, is the one developed by Jackson and Deeg (2006; 2012), as this framework focuses on the core domains of capitalist economies and is exclusively developed for research with a long-term historical perspective. Therefore, this approach is also deemed suitable for and will be used in the current study. Based on Jackson and Deeg (2006; 2012) then, the theoretical framework of the current thesis will focus on six institutional domains: firstly financial systems; secondly, corporate governance; thirdly, industrial relations and labor market institutions; fourthly, education and training systems; fifthly, the welfare state and finally, industrial policy. Instead of using a common dimension for each institutional domain, each domain is characterized by institutional typologies drawn from specific literatures on these domains (Jackson and Deeg 2006). Selected institutional domains, the typologies used and examples of key areas for political reform are all summarized in Table 1 and will also be elaborated further in the following section.

Table 1. Selected institutional domains in capitalist economies

Institutional Domain	Typology	Examples of key areas for political reform
Financial systems	Bank/market-based/FDI-dependent	Stock marketing listing-rules; separation of commercial vs. investment bank activities
Corporate governance	Insider/outsider or stakeholder/ shareholder	Board independence; executive compensation; share buy-backs; privatization
Industrial relations	Conflictual/pluralist/ corporatist	Board-level codetermination; works councils; recognition of unions
Education and skill creation	State/association/market/firm-based skill formation	Rules governing apprenticeships
Welfare state	Social democratic/ conservative/liberal	Benefit levels and scope; eligibility rules
Industrial policy	*Dirigisme*/ developmental state/neo-liberal	Product market regulation, subsidies, state ownership

Source: Jackson and Deeg 2006; 2012.

Financial systems are institutional ways of transforming household savings into investments, which are then used in the real economy of goods and services. In general, this process can be mediated through two basic channels that act as intermediaries between savers and investors. The first channel is the direct transfer of savings to investments via the securities markets. The second channel is indirect and thus mediated by banks that aggregate savings and, in turn, offer credit, by matching the maturities of savings and investments. Although contemporary capitalism accepts both of these channels as common ways of turning savings into investments, historically banks and security markets have played relatively different roles, when financing industrialization in different institutional contexts. (Jackson and Deeg. 2006, 13-14) While early industrial powers such as the United Kingdom (UK) and the United States (U.S) developed securities markets with high market capitalization, industrial late-comers, such as Japan or Germany, relied mostly on credit-based systems that functioned as a substitute for well-established capital markets (Gerschenkron 1966; Zysman 1983, 72). Therefore, since any given institutional context has some channels of finance that are usually dominant to others, it is also possible to form a very common dichotomy of credit-based and market-based financial systems (Berglöf 1991; Deeg 1999; Edwards and Fischer 1994). However, the current paper will also outline a third model of finance, namely the FDI-dependent financial system, which characterizes transition economies with underdeveloped securities markets and banking systems.

Corporate governance is also a very central institutional domain for many classic CC authors. Within the framework of agency theory, the studies of corporate governance investigate, how shareholders (principals), control the company executives (the agents of the principals), to act in their interests. There are many various mechanisms for doing this. These mechanisms are designed to reduce the costs associated with control and to involve different trade-offs between liquidity and control. Examples of such mechanisms include reputation building, monitoring by banks, incentives contracts and markets for corporate control. (Jackson and Deeg 2006, 15) The CC literature mostly highlights two possible approaches to control agency costs. Firstly, there are the outsider or shareholder systems, which are usually characterized by a widely dispersed ownership and have a CEO-dominated board (Börsch 1991, 176). In shareholder systems, markets are the dominant mechanism for corporate control (Berglöf 1991; Edwards and Fischer 1994). Classical examples of shareholder systems include the U.S and the UK (Dore 2000). Secondly, there are the insider or stakeholder systems, which usually have a consensus-oriented management board and are characterized by concentrated and cross-ownership patterns (Börsch 2007, 176). In stakeholder systems, banks play a crucial role by monitoring corporate management through a combination of debt and equity stakes (Berglöf 1991; Edwards and Fischer 1994). Textbook examples of stakeholder systems include Japan and Germany (Dore 2000).

Comparative studies of industrial relations are engaged in comparing the roles of employers' associations, labor unions representing the employees, and the state, in governing employment transactions. In different institutional contexts industrial relations may be governed at different levels: at the firm level, industrial sector level, national level or even international level. The CC literature identifies a large number of country-specific patterns along a wide range of dimensions. (Jackson and Deeg 2006) For instance, there can be crucial differences in the structure of labor unions, the organization of employers, the institutions of collective bargaining, the degree of state intervention, the extend and form of industrial conflicts and between different forms of workplace participation in managerial decisions (Bean 1994; Bamber and Lansbury 1998; Baglioni and Crouch 1990; Streeck 1992). When analyzing the patterns of industrial relations the current paper will rely on three broad models of interest intermediation: conflict relations, pluralist bargaining and corporatism (Crouch 1993). These three models differentiate with regard to the general pattern of how labor unions and employers are organized, whether there is collective bargaining on firm/sectorial/state level and to what extent there is state intervention. For example, countries with pluralist bargaining systems, such as in the UK, have market-reliant and decentralized bargaining accompanied with weak unions, while conflictual systems, such as France and Italy, have state-controlled bargaining and whereas the corporatist countries, such as Sweden and Germany, rely more on coordinated tripartite negotiations (Amable 2003; Jackson and Deeg 2006, 16-17).

Education and skill creation is an institutional domain relatively less considered in the CC literature. However, the education and training system is still a key institutional domain, since it has a significant influence on other areas such as work organization, corporate governance and industrial relations (Thelen 2004). At the same time, education and training systems are also subject to considerable variation across different national and sectorial contexts and such diversity has made it a major public policy concern, because of gaps between countries with high-skill and low-skill equilibriums (Soskice and Finegold 1988). When analyzing the different patterns of education and skill creation, the current paper will adopt the framework developed by Crouch *et al.* (1999). Based on this framework, the current thesis will distinguish between two ideal-type models for creating initial and further vocational training, respectively. These ideal-type models are: firstly, provision by corporatist associations or the state and secondly, provision by firms themselves, while being subject to market mechanisms.

Welfare state is another essential institutional domain of the political economy that heavily impacts labor markets and helps to define the dominant strategies of economic actors in different institutional contexts. Herein, the current paper draws on Esping-Andersen's (1990) classification, which distinguishes between three types of welfare capitalism. These three models are the social-democratic, liberal and conservative welfare states. Out of the three, social democratic welfare states provide the most generous and universal support, conservative welfare states make extensive payments for particular social or occupational groups based on their employment or contributions and liberal welfare states provide only low and flat benefits on a universal basis. (Esping-Andersen 1990) These differences directly impact the labor markets and thus also the employment patterns in various countries by shaping the employment rates, gender gaps in participation and earnings, the duration of employment, the proportion of skilled/unskilled employment and entering/exiting the labor market (Jackson and Deeg 2006).

Industrial policy is a set of official measures designed to encourage the development and economic growth of a country (Graham 1994, 3; Bingham 1998, 21; Rodrik 2004, 2). With regard to different types of industrial policy, the current thesis will distinguish between active interventionist systems, such as *dirigisme* and the developmental state model, and the more passive neoliberal regulatory state model. In large respects, *dirigisme* and the developmental state model are very similar, as both rely on the interventionist powers of the state to guide investments in a way that promotes a certain solidaristic developmental vision of the national economy (Loriaux 1999, 235-275). The difference is that *Dirigisme* has been traditionally associated with post-WWII France, while the theoretical concept of the developmental state can be seen as an explanation for the industrialization of East-Asian countries (Woo-Cummings 1999, 1). Contrary to these models, the neoliberal regulatory state is primarily concerned with regulation and refrains from direct state intervention, thus limiting itself from pursuing industrial policies on a grand scale.

3. Empirical research

The current thesis will distinguish between four distinct time periods in the history of industrialized Estonia, starting from the 1870s and leading up to contemporary times. Each of these periods have been elicited by revolutionary historical events, conceptualized as critical junctures, which have severely altered the existing power structures in the Estonian society, often thus also altering existing trajectories for the six selected institutional domains under review. The first period under review is dated from 1870-1913 and concerns the beginning of industrialization in Estonia, which started to take off from the 1870s onwards. During this period, Estonia was part of the Russian Czarist Empire, which collapsed as a result of defeat in WWI and subsequent revolutions in 1917. Such revolutionary events led way to the second period, which began with another important critical juncture, the national declaration of independence in 1918. The second period concerns the Republic of Estonia during the interwar period and dates from 1918-1940. This period ended with the beginning of WWII in 1939 and the forceful incorporation of Estonia into the Soviet Union in 1940. These critical junctures begin the third era, which concerns the Estonian Soviet Socialist Republic (SSR), *de facto* part of the Soviet Union from 1940-1991. The final critical juncture under review will be the restoration of independence in 1991, which led to the second independence period ongoing currently. All of these four periods and corresponding critical junctures are also presented in table 2 below and will be analyzed in the current section.

Table 2. Time periods and critical junctures

Time period	Periodization	Critical junctures
Estonia as part of the Czarist Empire	1870-1918	Crimean War (1853-1856) Industrialization in the Russian Empire (1870s-)
Republic of Estonia during the interwar period	1918-1940	WWI (1913-1918) Estonian War for Independence (1918-1920)
Estonian Soviet Socialist Republic	1940-1911	WWII (1939-1945) Soviet occupation of Estonia (1940/1944-1991)
After regaining independence	1991-	Dissolution of the Soviet Union (1991) Regaining independence (1991)

Source: author.

3.1 Estonia as part of the Czarist Empire (1870-1917)

The effects of the Industrial Revolution only started to reach Estonia from the 1870s onwards. At the time, Estonia was part of the Russian Czarist Empire, which was one of the last European countries to witness the impact of industrialization. Russia embarked on a course of industrialization in the mid-nineteenth century, after its defeat in the Crimean War (1853-1856) clearly showcased its economic backwardness, compared to the industrial countries of Western Europe. Nevertheless, the development of industry still remained modest up to the 1890s, when finance minister Sergei Witte replaced the ruling paradigm of liberal free trade policies, tailored after England, with Listian ideas of economic nationalism. This shift in policies resulted in active state intervention through massive infrastructure investments and protective tariffs, which eventually accelerated the development of large-scale industry, both in the Czarist Empire and Estonia. (Pihlamägi 1999, 13-23) However, this period of industrial development in the 1890s was cut short by the depression of 1900 and the following years of war and civil strife. When Russia finally emerged from the revolutionary years of 1905-1906 and again reached high rates of industrial growth, the character of industrialization was fundamentally different. Infrastructure investments by the state were on a smaller scale and mainly associated with military expenditure, while the overall significance of the state was greatly reduced. (Gerschenkron 1966, 21-22)

During this period, Czarist Russia had a credit-based financial system, heavily dependent on foreign investments. During early industrialization, the financial system was clearly underdeveloped and thus a major institutional bottleneck in the industrialization process. The scarcity of capital was even such that no banking system at the time could realistically attract sufficient funds for financing industrialization. Therefore, the central government itself decided to fulfill this role and acted as an industrial bank, providing long-term credit, until the domestic commercial banking system was being built. (Gerschenkron 1966, 19-22) However, this alone was still not enough to overcome the capital scarcity and Witte fully comprehended that an influx of foreign capital was needed to speed up the industrialization process. In 1897, a currency reform, taking the ruble on to the gold standard, was conducted, in order to attract more foreign investment (Pihlamägi 1999, 20). Without substantial foreign investment, the great industrial boom of the 1890s would have been impossible. Therefore, it is not surprising that the industrialization process in Estonia was also in large parts carried out with foreign investments, technology, machinery and management, while also being to a great extent facilitated by the local Baltic German elite acting as connectors between the East and the West. By 1914, foreign capital constituted already 28% of the total capital in all Estonian joint-stock companies (Torpan 1984, 172-173 cited in Pihlamägi 1999, 34). The majority of these foreign investments originated from countries like Germany, United Kingdom and France (Karma 1963, 420; Pihlamägi 1999, 34).

Industrialization was also accompanied by substantial organizational changes. Starting from the 1870s and 1880s, joint-stock companies became the dominant organizational form of capitalist production in Estonia, as all of the large-scale industrial enterprises established during the industrial boom of the 1890s were joint-stock companies and many previously established manufactories were also increasingly reorganized in such a way. Back then huge industrial enterprises, like the Kreenholm Cotton Manufacture in Narva that employed over 10,000 workers, were the norm, as the industry of Czarist Russia was characterized by an extremely large concentration of production and workforce due to its economic backwardness, capital scarcity and lack of skilled personnel. (Pihlamägi 1999, 29-31) Corporate governance at the time, resembled more a German stakeholder than a Anglo-American shareholder system, which was only natural considering the overall economic backwardness and the fact that many of the local bankers and entrepreneurs were of Baltic German origin. Out of the capital scarcity, a system of mutual dependence between banks and industrial enterprises evolved through the mechanism of cross-holdings. As the domestic banking system developed, banks gradually became the primary financers of industrial enterprises and started to take growing interest in the economic situation and activities of their clients. In practice, this meant that in order to ensure long-term credit, industrial enterprises would cede a part of its shares to the bank and, at the same time, the bank representatives would also take part in management and controlling of these enterprises. (Karma 1963, 235-236)

Throughout the period, industrial relations were highly conflictual, as the exploitation of workers resulted in numerous strikes, which became an inherent side effect accompanying the industrialization process. The czarist Empire was not a democratic country, where citizens could fully enjoy the freedoms of expression, assembly and association. Because of this, the work of trade unions was also severely obstructed and social dialogue between employers and employees was almost non-existent. In these conditions, the strike movement offered the only viable alternative for expressing the demands of the workers. Herein, Estonia was no exception, as the strikes of 1872 and 1882 at the Kreenholm Manufacture were very important for the sake of the entire labor movement throughout the Empire (Karma 1963, 199). Although, strikes like these were able to achieve the gradual improvement of working conditions, it was by no means a constant progress without any setbacks. When the rapid industrial boom of the 1890s, was replaced by a depression in 1900, workers were massively laid off and working conditions severely deteriorated once more (*Ibid.* 243-247). Only after the revolutionary events of 1905, were trade unions finally fully legalized, although their work continued to be severely obstructed (*Ibid.* 264-265). Nevertheless, by the end of the period, labor unions had become established as the primary institutions for wage bargaining in Estonia (Kiik 1995, 16).

In education, firm-based skill creation dominated, as the lack of skilled engineers, specialists and managers was another major institutional bottleneck hindering the industrialization of the Czarist Empire (Karma 1963, 105). This was mainly due to the lack of corresponding domestic educational institutions. Although the University of

Tartu had been established since 1632, it had little direct impact on the Estonian economy, as its primary purpose was to train civil servants and other professionals for the Czarist Empire (Drechler and Kattel 1997, 323). From technology-related schools, only the Tallinn Railway Technical School, established in 1880, was operating at the time (Gussarova *et al*. 1970, 53). Therefore, it was only natural that most Russian or Baltic-German engineers, specialists and managers working in Estonia had been trained outside of it, while the usage of foreign migrant workers, especially in higher positions, also became commonplace at the time (Karma 1963, 105-106). The local population had to mostly settle for lower occupations. Nevertheless, the high rate of literacy made Estonians a highly suitable industrial workforce. Furthermore, cheap labor was highly available in Estonia, as roughly 60% of the rural population were landless peasants and this contingent made up a large potential workforce for the industrial enterprises. (Pihlamägi 1999, 32-34) Those recruited to factories were usually expected to hold some previous work experience and relevant skills for their profession. A popular way of obtaining such skills were apprenticeships with master craftsmen. However, there was no national system for regulating apprenticeships at the time. (Karma 1963, 254)

Although during this period, the welfare state as we now know it, had not quite been established yet, Estonian welfare regime bared most resemblance to the conservative welfare state model. During this era, some welfare functions were divided between different social institutions, while others were non-existent. Similarly to other early welfare regimes in countries like Austria and Germany, health insurance and sickness benefit funds in Estonia were often established beside large industrial enterprises to serve their workers and their families. These funds were either run by representatives appointed by the administration of the companies or elected by the workers (Karma 1963, 440). Furthermore, after the revolutionary events of 1905, when the trade union movement became fully legalized, unions based in large industrial enterprises also took on many welfare functions. Besides representing the interest of the employees, trade unions were at the time, among other functions, also responsible for economic assistance to its less fortunate members, providing low cost or free health care and legal advice, libraries and organizing different courses and public events. However, while all of these tasks were often written in the statute of the trade unions, in reality most labor unions in Estonia actually lacked the funding to fully offer all of these services, as they were funded not by the state, but from membership fees alone. (Kiik 1995, 13)

Industrial policy at the time was constantly evolving. In the 1860s and 1870s the central government tailored its policies after Western-European industrial countries, especially England. However, simply copying and de-contextualizing these liberal free-trade policies did not lead to rapid economic development, because Czarist Russia had a completely different economic environment. A breakthrough in the industrialization process occurred in the 1890s, when finance minister Sergei Witte made industrialization a main policy priority and started to employ the Listian ideas of economic nationalism. (Pihlamägi 1999, 14-15) Witte stressed that no country could be politically strong without developing national industrial capacity and that in the conditions of economic backwardness inherent to Russia, the government had to actively intervene to support private entrepreneurship (Yarmolinsky 1921 cited in Pihlamägi 1999, 16). His plan to accelerate industrial development relied on two main pillars: firstly, a massive construction of railways to improve connections between different parts of the Empire and secondly, high tariffs to serve as infant industry protection (Pihlamägi 1999, 16). These policies proved to be very successful and strongly contributed to the industrial boom of the 1890s, during which industrial inputs grew approximately 7-8% yearly (Gatrell 1986, 143 cited in Pihlamägi 1999, 21). However, this magnificent period of industrial development was dramatically cut short by the depression of 1900 and the following years of war and civil strife. After years of crisis and intermittent, a new industrial rise began in 1911, this time strongly associated with militarization (Karma 1963, 284).

In conclusion, during this period large-scale industry was developed in Estonia and by 1913, Estonia, together with the St. Petersburg region, had become one of the most developed industrial areas of the Czarist Empire (Kirby 1995, 472). This was only possible thanks to substantial inward investment, facilitated by the networking of the local Baltic German elite with both political and business circles in Moscow and St. Petersburg, as well as with foreign partners residing in Western Europe. One of main drivers behind investment that spurred Estonia’s rapid industrialization was its favorable geopolitical location. Since Estonia had several ice-free ports and good railway connections to other regions, a considerable part of East-West transit took place through its territory. Industrial enterprises were established here for processing imported raw materials to save on the shipping costs to the East. In terms of marketing its products, Estonia was also in an advantageous position because of its proximity to St. Petersburg. (Pihlamägi 1999, 34) As the inevitable war drew closer, Estonia's favorable geopolitical location supported industrialization once more, as Tallinn was selected as the Czarist navy's main base on the Baltic Sea and this was accompanied by extensive warship building programs (Karma 1963, 287). However, even despite all of these industrialization efforts, Estonia still remained a predominantly agrarian country, as the share of agriculture in the gross national income clearly exceeded that of industry approximately two times (Pihlamägi 1999, 21-22). This also affected domestic elite-formation, as the local bourgeoisie was still only emerging (*Ibid.* 26).

3.2 Republic of Estonia during the Interwar Period (1918-1940)

The newly established Republic of Estonia inherited an economy devastated by war and revolutions. Transforming Estonia into an independent country proved to be difficult at first, because compared to other European countries it was only a minor province of an economically backward former empire and it clearly lacked many of the financial and administrative mechanisms needed for independent statehood. In this new political reality, Estonian industry suddenly found itself with very limited access to raw materials, fuel, operating capital and export markets. (Pihlamägi 1999, 74-75) At first, there were high hopes associated with the eastern transit trade, but by 1924 it was realized that markets of Soviet Union would remain severely restricted for Estonian producers and thus a reorientation towards domestic and Western markets was undertaken. By 1928, Estonian economy had stabilized and achieved its postwar peak. (*Ibid. 216).* However, the collapse of world trade during the Great Depression (1929-1933) soon followed, severely harming the domestic economy and especially the export sectors. Only in 1933, after the devaluation of the Estonian kroon, did the economic situation start to improve. However, even this could not heal all the social and economic grievances developed by then and prevent the *coup d'état* of 1934, that saw an authoritarian regime emerge. During the authoritarian period, there was a shift in policy towards economic nationalism with the aim of further industrialization through processing of domestic natural resources, such as oil shale (Kõll and Valge 1998).

The Republic of Estonia inherited a credit-based financial system mostly relying on government credit, Russian banks and foreign investments. Therefore, at its birth, independent Estonia was reliant on financing from the outside and the newly established republic had no independent monetary and banking system to speak of (Pihlamägi 1999, 74). Although, during the next two decades, an independent financial system gradually developed, it still remained credit-based and reliant on foreign investments. The first step in building up a domestic financial system was the establishment of the Bank of Estonia in 1919. During the initial postwar reconstruction period, the government ran expansionary policies with the central bank acting as the primary credit provider. Such policies eventually triggered a domestic credit crisis, when it became clear that the central bank had issued extensive loans to insolvent enterprises which were still oriented towards eastern markets. (Kõll and Valge 1998, 32) As a consequence, the central bank had to adopt stricter policies and its role in the domestic financial system was gradually reduced. This was both due to the development of domestic commercial banks, but also due to the establishment of specialized national banks, namely the National Mortgage Bank and the State Land Bank, whose role in the domestic credit system increased over time (Karma 1999, 91-92). In the conditions of capital scarcity, foreign investments remained vital with English, German, French, Dutch, Swedish and Danish capital remaining dominant throughout the period in most large-scale industrial enterprises not owned by the state (Pihlamägi 1999, 93-104).

Similarly to the financial system, corporate governance in interwar Estonia was also largely affected by the legacies of its Czarist past. In the newly independent republic, the property relations of several Estonia’s largest industrial enterprises were suddenly ambiguous, as these had been previously owned by the big banks of Moscow and St. Petersburg that now had been nationalized by the Soviet government. Thus, in many Estonian corporations, shareholders were missing and in others only a negligible part were present. Nevertheless, despite the unclear situation, the Estonian government decided against the nationalization of such enterprises and had to later acknowledge the fact that control over these enterprises had shifted to foreign ownership through shady and undocumented deals. As a result, the overwhelming dependence of Estonian industry on foreign capital continued also during the interwar period. (Karma 1999, 13) Compared to the previous period however, domestic ownership increased, as during the early years of independence, attempts were made by the emerging Estonian bourgeoisie to occupy leading positions in all business areas (Karma 1999, 30). These attempts were further reinforced by the early expansionary lending policies of the central bank, who mostly granted loans to enterprises owned by Estonian senior politicians (Valge 2003, 220). At the same time, the number and scope of state-owned enterprises was also growing, especially during the years of economic nationalism. However irrespective of ownership, the interdependencies between enterprises and the financial system remained very strong and thus Estonia still very much resembled a stakeholder system.

For most of the period, industrial relations remained conflictual, although towards the end of the interwar period, a direction towards establishing more corporatist relations was taken. During the early years of 1918-1924, trade unions were mostly subjected to the control of the communist party led from the Soviet Union and used to politically and economically weaken the newly independent republic (Kiik 2002, 10). However, when this intent proved to be futile in the light of the failed communist *coup* in 1924, a more moderate and social democratic view eventually prevailed within the trade unions (Kiik 1995, 166-167). Already in the 1920s a well-functioning system to resolve labor disputes and wage-bargaining was established. In this system, government representatives were the mediators between employees, represented by trade unions, and employers, usually represented by the Estonian Manufacturer's Union. (Kiik 2002, 12) With the end of the Great Depression, labor relations deteriorated and a large-scale strike movement emerged in 1935-1936, after the devaluation of the Estonian kroon had substantially increased the cost of living. Thus, resolving labor relations in a non-antagonistic way also remained a priority during the authoritarian era. For this, the government created the Commission of Labor Conflicts, consisting of various economic experts that essentially had the legal force to stop conflicts. On the one hand, such corporative organization strengthened the position of employers' organizations, while also fairly representing liberal trades. On the other hand, the influence of common workers was hardly proportional to their numbers. (Kõll and Valge 1998, 66)

In education, firm-based skill creation continued to dominate at least until the mid-1930s. The lack of highly qualified labor force remained to be a major issue hindering the industrial development of the newly established republic. This was also recognized by members of the Estonian Manufacturer's Union, who in the 1920s often claimed that the lack of government regulations to govern apprenticeships, had led to a decrease in the quantity of qualified labor available (Kiik 2002, 27). In addition to this, the low quantity and quality of domestic technical and vocational schools also remained to be a major issue, although the situation gradually started to improve from 1918 onwards, when the Estonian Engineering Society opened an Estonian-based engineering school called the Special Engineering Courses in Tallinn. In 1936, this school was officially granted university status and renamed the Tallinn Technical Institute. Developing vocational education only reached significant results during the authoritarian era when it was made a made a major policy priority, as the domestic labor shortage elicited a policy change in favor of increasing the provision of vocational education by the state and employers' associations (Pihlamägi 1999, 119). Another reason for improving the qualification of Estonian workers, was also the nostrification agenda accompanied by the policy of economic nationalism. This was reflected in far-reaching legislation against foreign workers, which meant that the participation of foreigners in the boards of enterprises or as high-skilled specialists was severely restricted. (Kõll and Valge 1998, 199)

In the welfare dimension, interwar Estonia continued its previous trajectory of moving towards establishing a conservative welfare regime, as the majority of social benefits continued to be offered to workers and their families through social insurance funds and labor unions which operated alongside large-scale industrial enterprises. New social benefits were introduced as early as 1918. Since the newly established republic lacked many social benefits, such as children's allowance and old-age pensions, both state-owned and private enterprises introduced family benefits early on, to support large households whose financial situation was relatively worse. (Kiik 2002, 7) Following the initiative of the Estonian Manufacturer's Union a system of worker's accident insurance was also developed (*Ibid.* 17). However, most notable of the reforms, conducted during the interwar period, was probably the health insurance reform, which saw private health insurance funds, that had originally existed at larger industrial enterprises, transformed into universal health insurance funds that also had to serve the more general public (Kiik 2002, 30). Although further reforms that would have centralized the management of these health insurance funds and included larger social groups into the insurance system were discussed several times in the national parliament, these were not able to gather the necessary political support (*Ibid.* 14).

In industrial policy, the direction of economic nationalism of the late 1930s ultimately overcame the liberal free-trade model, which during the early years of independence, had been more favored. From the outset, a liberal free-trade model could not be applied, because the state of war called for the implementation of a licensing system and high protective tariffs (Pihlamägi 1999, 92). Furthermore, derived from the unfavorable international economic climate, protective tariffs remained high throughout the entire interwar period. Industrial policy during 1920s was mostly incidental (Valge 2003, 337) and thus the lack of coordinated efforts was often criticized also by the Estonian Manufacturer's Union (Kiik 2002, 33). A shift towards coherent industrial policy occurred only after the *coup* of 1934, when state intervention into the economy increased substantially. While in the 1920s and early 1930s, the state had provided financing for industry in order to overcome the backwardness of the domestic financial system, since 1934 public investments became part of purposeful industrial policy to increase state intervention and the share of state-owned enterprises in the domestic industrial structure (Pihlamägi 1999, 92). For this, the government introduced a new development and investment program, which focused on rapid industrialization, based on the exploitation of domestic natural resources (Kõll and Valge 1998, 92). As part of the program, large-scale public investments were made to guarantee full-employment and prevent new financial crises from occurring (Pihlamägi 1999, 217). The overall policy goals were expansionist and characteristic to a developmental state (Kõll and Valge 1998, 198-199).

In conclusion, despite being in a difficult starting position, the Republic of Estonia was able to achieve quite a lot in just two decades, as during the interwar period the newly formed domestic elite that took over from the Baltic Germans was able to develop an independent political, legal and financial system. During the early 1920s growth remained sluggish, because of the necessary reorientation from East to West, but also because of faulty and expansionary monetary and credit policies (Valge 2003, 362-363). Still, by 1924, a strong foundation for future development had been laid, when Estonia managed to stabilize its currency and economically separate itself from Russia. Future attempts to integrate itself into Europe were also successful, as indicated by the increasing volume and diversification of foreign trade throughout the period (Pihlamägi 2004, 86). Similarly to many other European countries, Estonia also emerged from the Great Depression as no longer democratic country, as democratic and liberal principles were replaced with corporatism and economic nationalism (Kõll and Valge 1998, 12). During the authoritarian era, industrial policy became more purposeful and national program of industrialization based around the processing of local natural resources was pursued, resulting in rapid industrial development. While in the late 1920s industry constituted around 19% of the gross domestic product (GDP), by the late 1930s this figure had risen up to 32%. Nevertheless, even despite the rapid industrialization, agriculture still remained to be the overwhelmingly dominant sector in Estonian economy. (Pihlamägi 1999, 218)

3.3 Estonian Soviet Socialist Republic (1940-1991)

By 1939, Estonian economy had gone through a successful reorientation and was fully incorporated into global markets. As a result, economic and social development was increasingly converging to other Northern-European countries. However, with the outbreak of WWII and annexation of Estonia by the Soviet Union, such developments came to an abrupt end. Reorientation policies were quickly undone, as liberal trade relations and self-regulating market mechanisms were replaced by planned distribution based on the state monopoly of foreign trade. Estonia was effectively cut off from Western markets and Eastern markets once again emerged as ever-important. For the next five decades, Estonian economy would be integrated into Soviet Union’s eventually inefficient and strictly centralized command system. (Kala 1995, 280) Sovietization, including nationalization of private property and collectivization of agriculture, was the first order of business (Lugus and Hachey Jr 1995, vii). Post-war decades also witnessed large-scale industrialization with special emphasis on heavy industry to serve the needs of the Soviet Union (Tomson 1999, 74). Nevertheless, by 1970s the limits to extensive growth in Soviet agriculture and industry had been met (*Ibid*. 103) and the country entered a period of stagnation, lasting up until the late 1980s by which the strictly centralized distribution system had totally exhausted itself (Kala 1995, 280-281). By 1987, the need for economic reform was evident and thus policies of decentralization and liberalization were launched (Tomson 1999, 113). Inadvertently, these policies contributed to both the restoration of economic self-sufficiency in Estonia and the ultimate collapse of the Soviet Union.

During the interwar period, Estonia had developed a well-established banking system, where both state-owned and commercial financial institutions operated side-by-side. However, this system was largely destroyed after the annexation of Estonia by the Soviet Union. From 1940 onwards, a new and highly centralized financial system was being built in Estonia, following the Soviet model and reflecting the needs of the centralized command economy. At the core of the Soviet model, was a highly centralized system of state-owned banks that had been created already in 1930-32. Although the original aim of this system was to exterminate market capitalism in the Soviet Union altogether and to establish state monopolistic socialism, it never actually succeeded in doing so, as many elements of capitalism still prevailed. (Sõrg 1995, 71) It did nevertheless, facilitate the complete subordination of the financial system to centralized state bureaucracy, as market-based financing and FDI were unimaginable in the Soviet context. Thus, in essence, only a single monopolized credit market, regulated by the Banking Committee under Gosbank, functioned. (Shmelev and Popov 1989) Gosbank was heavily influential, as not only were 80% of all loans in the Soviet Union issued by it, but it also acted as the sole note issuing authority and was made responsible for working out instructions and plan targets (Sõrg 1995, 72). For Estonia, the transformation to the Soviet model thus meant that the former dependence on FDI was simply replaced by dependence on Gosbank and the centralized system of state-owned banks in Moscow.

Similarly to the financial system, corporate governance also saw comprehensive restructuring, as private ownership was abolished and replaced with state-cooperative ownership (Vitsur 1995, 209). Post-war years saw the introduction of the administered economic system with the state acting as a primary stakeholder. In such a system, the Soviet bureaucracy would carry out the all-encompassing directive management of all economic activities. Prices were set from above and other market mechanisms replaced by orders, directives and fixed capital allotments. (Shmelev and Popov 1989, 53) Although cooperative property was formally public property, in reality, it was actually pseudo-cooperative and entirely subordinated to state bureaucracy (Vitsur 1995, 209), who were also in charge for management in all branches of the Soviet economy (Venesaar and Vitsur 1995, 188). This system was very concentrated and centralized and thus predominantly favored large enterprises that acquired a monopolistic position in production of goods and services. For Estonia this meant that a large number of small and medium-sized enterprises that had been established during the interwar period, simply diminished. (Venesaar and Vitsur 1995, 188) Another side-effect of the administrative economic system was that it was extremely wasteful and contained high agency costs. According to Kovacs and Tardos (1992, 73), agency costs resulting from the separation of ownership and control are limited by the existence of three markets: the capital market, the market of corporate control and the market of managerial labor. However, in the Soviet system these markets did not exist and thus agency costs also increased significantly.

Under the new rule, industrial relations were also subject to noticeable change, as in the Soviet model they quickly became fully administered by the state (Shmelev and Popov 1989). In this new system, previous attempts to establish economic tripartism involving negotiations between business, labor and state interest groups were deemed redundant, as there simply were no private businesses left and the Supreme Soviet was declared to be the perfect reflection of the will of the proletariat. In reality however, labor's position remained disproportionately weak, because from the get-go trade unions were simply employed to the service of constructing communism (Kiik 2000, 11). While unionization rates were at an all-time high, this was only due to quasi-mandatory participation (Shmelev and Popov 1989). While historically labor unions had been born as institutions of wage bargaining, in the Soviet system the protection of workers' interest actually took a back seat to the protection of employer's interests (Kiik 2000, 54). Although it was possible to submit earnings-related complaints (*Ibid.*), wage-bargaining as such did not exist, as all elements of individual wages and the usage of payrolls in enterprises were regulated by the state (Püss and Aedna 1995, 252). Even though the policies of full-employment guaranteed all workers employment opportunities, wages still remained relatively low (Shmelev and Popov 1989).

In education, the forceful incorporation of Estonia into the Soviet Union also meant that Estonia gradually converged its educational system to Soviet standards. This process had both its positive and negative effects. From a positive side, thanks to compulsory secondary education and the extension of tertiary education, overall educational levels of the Estonian population rose significantly. Because of this, according to many formal indicators, Estonia education levels in 1991 were comparable to developed countries and exceeded those of many other CEE countries. (Sirk 2005, 253-254) From a negative side however, the Soviet system was deemed less successful in improving the quality of vocational education and matching the actual needs of the society. Although technical university curricula were developed to match the needs of Estonian industry (Högselius 2005) they were never entirely in accordance with the local employment structure (Sirk 2005, 249). Efforts to develop vocational education were often contrary to the ideology of general secondary education, as, in practice, vocational schools simply proved to be inferior in terms of providing general skills, but also not adequate enough in advancing specific polytechnic skills (*Ibid.* 240-246). Even though the pursuit of full employment guaranteed apprenticeships for all, it also resulted in surplus employment and thus decreased overall efficiency (Shmelev and Popov 1989). In general, however, despite the questionable success rate, a certain policy shift from previously mostly market-based provision of vocational education towards increased state provision and establishment of uniform rules governing over apprenticeships, was clearly evident.

In the welfare dimension, a welfare state with high-benefit levels and universal scope was established in Estonia for the very first time. From Esping-Andresen's typology, the communist system most resembled the social democratic model, as everyone was eligible for benefits, regardless of their relative contribution to the society (Shmelev and Popov 1989). A wide variety of benefits were offered, as during the communist period education and healthcare were free of charge and foodstuff, housing and transport services were being heavily subsidized by the state. Old-age and disability pensions were established according to the Soviet system of pension laws and state benefits were also granted to mothers with three or more children and single mothers. Furthermore, benefits in case of temporary disability and pregnancy, birth grants and birth and nursing benefits, until the child becomes a year old, were also paid from the social insurance budget. (Püss and Aedna 1995, 259-260) These benefits were mostly administered directly by state institutions or in some cases indirectly though quasi-state institutions such as trade unions (Kiik 2000, 62) or collective farms (Püss and Aedna 1995, 273).

With regard to industrial policy, *dirigisme* reigned supreme, as the state possessed an absolute role in the administered economic system (Sutela 1991). Product markets were extremely regulated, various subsidies widely used and additionally the state also exercised almost total control over all enterprises (Shmelev and Popov 1989). For Estonia, the Soviet era meant remarkable investments, primarily to complete the industrialization process that already began during the interwar period. However, unfortunately this process was mostly being orchestrated from the outside, as the budget of the Estonian Soviet Socialist Republic (SSR) had to be formally validated by the Supreme Soviet in Moscow. In addition to this, many of the largest industrial enterprises in Estonia were also beyond the control of the local government, receiving financial resources directly from ministries in Moscow. (Tang and Nilgo 1995, 92) For the sake of local developement, this meant that Soviet investment and industrialization policy largely ignored domestic needs and preferences, but was instead catered to vested interests of the state apparatus in Moscow. As a result, although throughout the Soviet period, Estonian industry developed immensely, it was mostly done in large-scale facilities that used low-level technologies (Vitsur 1995, 208). At the same time, the high socio-economic costs of mass immigration from other regions of the Soviet Union and environmental costs assosciated with the extraction of natural resources were being largely ignored.

In conclusion, following Estonia's annexation by the Soviet Union in 1940, sovietization proceeded in all spheres of economic and social life. This resulted in a comprehensive transformation of the Estonian economy from a typical market economy similar to neighboring Scandinavian countries into a Soviet centrally planned system. (Lugus and Hachey Jr. 1995, vii) One of the most prominent legacies of the Soviet era was the completion of industrialization that had started already during the 1930s. However, for a small and relatively resource-scarce country like Estonia, post-war industrialization meant the enforcement of a perverse and irrational economic system that eventually resulted in declining productivity, depletion of natural resources, environmental pollution and corruption. By 1970s it was becoming increasingly clear that the Soviet model of extensive growth had completely exhausted itself. Although economic indicators of Estonian SSR still exceeded other parts of the Soviet Union, stagnation also became increasingly evident in Estonia. In addition to this, the negative consequences of decades-long industrialization such as environmental degradation and mass immigration from other parts of the Soviet Union, finally started to present itself.

(Tomson 1999, 86-103) Eventually popular opposition to such developments, along with a liberal shift in the overall Soviet policy context, were key factors contributing to the gradual restoration of economic self-sufficiency and independent statehood. Nevertheless, economically speaking, the 50-year Soviet occupation had set Estonia back enormously and parts of its Soviet heritage continued to resurface even following the restoration of independence in 1991.

3.4 After regaining independence (1991-)

In August 1991, the Republic of Estonia was restored as an independent country. Shortly after, a new and democratic constitution, that created the legal preconditions for the protection of property rights and economic freedoms, was adopted in 1992. During the same year, Estonia also conducted a currency reform which effectively meant leaving the ruble zone and adopting its own national currency. (Lugus and Hachey Jr. 1995, vii) These reforms marked the beginning of a radical transformation period, which was needed for the desired transition from a planned economy to a market economy. Similarly to most Eastern European transition programs, Estonia also adopted three basic measures: economic liberalization through the abolition of price controls, macro-economic stabilization through balancing the government budget and privatization of state property (Kregel *et al.* 1992, 14). However, at least in the beginning these measures brought about a considerable recession which resulted in declining output, bankruptcies and rising unemployment (Tomson 1999, 115). A primary reason for this recession was the loss of Eastern markets in former Soviet Union and subsequent need for reorientation towards Western markets (*Ibid.* 128). This time around, reorientation was completed rather quickly and by mid-1990s economic growth had returned. Similarly to economic reorientation, political reorientation towards the West was also on the agenda, as Estonia actively targeted accession in to EU and NATO. Both of these aims were finally realized in 2004, which marked the beginning of a new era for former post-Soviet country.

With regard to the financial system, a gradual transformation approach was chosen. Banking reform in Estonia, aimed at replacing banks of the command economy with independent commercial banks, started already in 1988. Because this reform focused primarily on sanitizing the old system, rather than destroying it, it also helped other economic changes to be carried out less painfully. (Sõrg 1995, 89-90) As a sign of gradual transformation, during the early 1990s, the banking sector would clearly dominate over the newly established securities sector. However, since 1994 the role of the securities sector started to increase and (Tarmak 1995, 310-311) by early 2000s Estonia's stock market capitalization was already among the highest in the transition world (Sutela 2001; Prašnikar *et al.* 2002), while the relative role of bank finance had decreased (Feldmann 2006). Even despite all these developments, capital markets remained underdeveloped and therefore the domestic financial system remained FDI-dependent. During the early 1990s Estonia followed the widespread belief that economic development financed only with domestic capital would be too slow, therefore foreign investments into the Estonian economy were heavily favored by the government (Vitsur 1995, 216). This is also reflected in the Bank of Estonia's commitment to a fixed exchange rate policy and the currency board system (Rajasalu 1995, 42-44) that prevailed over other more traditional policy goals such as controlling unemployment or the GDP growth rate (Kallas and Sõrg 1995, 62). Unlike prewar periods, a vast majority of FDI now originated from neighboring Sweden and Finland (Varblane 2010, 32-39).

Extensive reforms were also conducted in the corporate governance domain, where private ownership was once again permitted and as a result a majority of the formerly state-owned enterprises were privatized. Given Estonia's strong commitment to liberal free-market policies, many have also been quick to classify it as a country that has primarily followed the LME model and thus assess the Estonian corporate governance system as being primarily a shareholder system (Sutela 2001; Prašnikar *et al.* 2002; Feldmann 2006). However, other accounts are not entirely sure whether the Estonian corporate governance system actually corresponds to the LME model (Feldmann 2013). For example, Buchen (2007) implies that post-Soviet Estonia could be viewed as an imperfect stakeholder model, because of its prominent dual board system and high ownership concentration, resulting from the outsider privatization model adopted in the 1990s. Indeed such characteristics do not seem to fit the traditional LME model, but are, at the same time, very much in line with the experience elsewhere in the CEE region. In conclusion, it can be argued that since CEE countries such as Estonia are relatively capital-scarce, they are also therefore more likely to be relatively more dependent on foreign investments and corporate governance models (Feldmann 2013, 498).

With regard to industrial relations, the transformation during the last two decades has been at least equally radical. While membership in trade unions had been quasi-mandatory in the Estonian SSR, labor relations in post-Soviet Estonia have become increasingly decentralized ever since and pluralist bargaining has become commonplace. In contemporary Estonia, wage bargaining occurs mostly on company level, if at all (Feldmann 2013, 496). Unionization has also decreased rapidly. While in 1995 unionization rates were still around 40% (Venesaar 1995, 330), by 2009 they had decreased to only 6,7%, which was the lowest figure among all CEE countries. Similarly, in the same year, membership in employers' associations was also relatively low at 23.8% and the coverage rate of collective bargaining agreements was only 19% (Feldmann 2013, 496). Employers' organizations such as the Estonian Chamber of Commerce and Industry that primarily acts as service organization for employers, are also relatively less organized and hence their role as a social partner has not been emphasized (Venesaar 1995, 330). All in all, social dialogue between labor organizations and employers' associations plays a relatively limited role and so do tripartite negotiations at the national level (Feldmann 2013, 496).

In the educational domain, many of the Soviet-style reforms regarding vocational education and rules governing apprenticeships have been rolled back and, as a result, market-based provision of vocational education and firm-based skill creation are once again prevalent. While previously, the Soviet system had introduced initiatives to place heavy emphasis on fostering specific vocational skills, such efforts were rather quickly undone in post-Soviet Estonia by major educational reforms conducted in 1998. These reforms were designed to promote general skills by bringing about greater harmonization of vocational training and high school education (Feldmann 2006, 842). Furthermore, the apprenticeship system which was in place during the communist period, has also largely been dismantled in contemporary Estonia. As a result, the role of vocational secondary education has remained comparatively small and even diminished further. (Feldmann 2013, 497) As a testament to this, there has also been a falling number of graduates since 2000, most notable in programs related to ICT and computer sciences, which, in turn, have now become more popular as university subjects (Tiits and Kalvet 2012, 15–17). Contrasting to the fall in vocational education, there has been a significant expansion in higher education during the transition period, as during the first years of the transition, fifteen new private institutions of higher education were opened (Tomusk 1996).

In the welfare dimension, being heavily influenced by the Washington Consensus, many wide-ranging benefits of the former communist state were abandoned in post-Soviet Estonia and replaced by low and flat benefit rates of the liberal welfare state model. At the same time, some functionally new benefits were established as well. A prominent example of such are unemployment benefits, which had not existed in the Soviet system, since officially there had been no unemployment (Püss and Aedna 1995, 276). However, even despite new types of benefits being developed, the overall cuts in social spending have been massive. Thus it is safe to say that ever since the early 1990s, the commitment to the liberal welfare regime has been a pervasive characteristic of the Estonian welfare state, as it has consistently had one of the lowest levels of social spending in the EU. For example, from 2000 to 2004 Estonia spent on average 13.6% of GDP on social expenditures, which was also comparatively the lowest share of GDP among CEE countries (Bohle and Greskovits 2007). Although, right after the economic crisis in 2008 and 2009, social spending rose somewhat, this was mostly a result of the very severe economic downturn and number of benefit recipients that grew. This however did not damage the commitment to the liberal welfare model, but in fact inversely strengthened it, as in fact many benefit entitlements were cut back during the crisis. (Feldmann 2013, 497)

With regard to industrial policy, post-Soviet Estonia has predominantly been a policy-taker rather than an independent policy-maker and has thus adopted decontextualized policies taken from the outside - during the early 1990s from the Washington Consensus toolbox and after 2004 from the EU toolbox (Kattel and Karo 2009). In terms of industrial policy, post-Soviet Estonia corresponds rather well to the neo-liberal regulatory model, as throughout the independence period, governments have effectively refrained from conscious efforts of industrial policy, having rejected it on ideological grounds (Sommers and Woolfson 2014) or simply because they lack the necessary policy capacity to contextualize it (Karo and Kattel 2009). At the same time, policy emphasis has been on creating a regulatory framework and ensuring macroeconomic stability. Sommers and Woolfson (2014) describe this development as the hands-off approach towards economic policy, according to which the governments effectively believe that sound macroeconomic fundamentals would create the investor confidence needed for FDI, which, in turn, would generate vigorous economic development. However, since EU accession, this approach has been subject to some change, as external pressures for developing coherent industrial policy have increased. For example, during the accession process the European Commission suggested Estonia to work towards developing an integrated industrial policy, notably by promoting competitiveness, stimulating innovation and regional dispersion of foreign investment beyond its capital city (European Commission 2003). Furthermore, the recent rise of smart specialization in the EU, has also been accompanied by need to develop more targeted sectoral strategies in Estonia.

In conclusion, since regaining independence in 1991, Estonia has gone through a remarkable transition in all six core institutional domains. In just a couple short decades, the country has comprehensively transformed itself from once being a part of the communist Soviet Union to a country that is now part of every major international organization and considered by many to be the Eastern European archetype of a LME (Feldmann 2006; Buchen 2007). This transformation was facilitated by radical neoliberal free-market policies that already since the early 1990s proceeded with rapid liberalization, both domestically and internationally. As a result, after the transformational recession and initial reorientation towards the West in the early 1990s, Estonian economy grew rapidly and living standards gradually converged with those in Western Europe, eventually earning Estonia the nickname of a Baltic Tiger. (Feldmann 2013, 498) As it later turned out, much of this growth had been largely due to unsustainable capital inflows and credit growth that eventually reversed and led to a one of the most severe economic downturns in recent history. However, remarkably, instead of facilitating institutional change, the recession actually produced an opposite policy response that ended up re-producing the neoliberal Baltic model.

4. Discussion

When all four distinct time periods are analyzed side by side, it can be said that the Estonian VoC and its six institutional domains under review have been found to be very diverse across different time periods. From an historical institutionalist perspective, this is due to the effects of the critical junctures that lie between the aforementioned periods. These historical events namely, WWI and subsequent revolutions that led to the declaration of independence in 1918, WWII and the incorporation of Estonia into the Soviet Union in 1940 and the collapse of it that opened the way for regained independence in 1991, severely altered old institutional trajectories and thus oftentimes a new institutional path was begun. Based on previous empirical findings however, it can be concluded that in some institutional domains and between some time periods, the transition was more linear and gradual than in other cases. Looking at the four time periods, it seems that the transition from the Czarist Empire to an independent Estonia was rather gradual, while the same certainly cannot be said for transitions to and from the Soviet regime. When looking at individual institutional domains across the four time periods, we can conclude that while the fundamental traits of Estonian financial system and corporate governance remained mostly unchanged throughout, industrial relations, education, welfare and industrial policy domains certainly offered a greater degree of variance. A short overview of these developments across the six institutional domains under review is given in the following section and table 3.

Table 3. Selected institutional domains in Estonia

Periodization	Financial systems	Corporate governance	Industrial relations	Education and skill creation	Welfare state	Industrial policy
1870-1918	Bank-based and FDI-dependent financial system	Stakeholder system	Conflictual relations	Firm-based skill creation	Conservative welfare state	*Dirigisme*
1918-1940	Bank-based and FDI-dependent financial system	Stakeholder system	Conflictual relations; moving towards corporatism	Firm-based skill creation	Conservative welfare state	*Dirigisme/* developmental state
1940-1991	Bank-based financial system	Administered stakeholder system	Administered industrial relations	State provision	Social democratic welfare state	Absolute *dirigisme*
1991-	Bank-based and FDI-dependent financial system	Imperfect stakeholder system	Pluralist bargaining	Firm-based skill creation	Liberal welfare state	Neoliberal regulatory model

Source: author.

4.1 Selected institutional domains in Estonia

With regard to its financial system, it was established that Estonia was dominated by bank-based financing across all four time periods. From the outset, Estonian industrial enterprises were dependent on big nationwide Russian banks and their local subsidiaries for credit (Pihlamägi 1999, 13-23). However, during the interwar period a well-functioning domestic financial system was built, where smaller domestic state-owned and commercial banks operated side-by-side (Karma 1963, 91-92). Nevertheless, during the Soviet occupation, the Estonian financial system would once again fall under extreme dependence of Gosbank and the centralized system of large state-owned banks ran from Moscow. After regaining independence, the Bank of Estonia and numerous domestic commercial financial institutions were re-established. In addition to having a bank-based financial system, the Estonian financial system could also be characterized by its very heavy dependence on FDI, barring the Soviet occupation period which acts as a natural outlier in this regard. During the first two periods such FDI was mostly coming from large Western European countries such as Germany, United Kingdom and France, while in the most recent period smaller neighboring Nordic countries such as Finland and Sweden have dominated (Karma 1963; Pihlamägi 1999; Varblane 2010).

In the corporate governance domain, Estonia mostly resembled a stakeholder system, however during different periods, the relative importance of various stakeholders varied quite a bit. Already since the early industrialization of the 1870s joint-stock companies became the dominant organizational form of capitalist production in Estonia (Pihlamägi 1999, 29-31). This first period was also characterized by a large concentration of production and workforce into large-scale industrial enterprises, which also developed a system of mutual dependence with large banks who acted as important stakeholders through the mechanism of cross-holdings (Karma 1963, 235-236). This system of mutual interdependencies between industrial enterprises and the financial system remained very strong even throughout the interwar period. However, the average size of these enterprises was somewhat reduced and the share of domestic ownership was also on the rise (Valge 2003, 220). These trajectories were broken by the Soviet occupation, during which private ownership was abolished and replaced with state-cooperative ownership (Vitsur 1995, 209). This gave rise to the administered economic system, in which the Soviet state apparatus emerged as the primary stakeholder. Such a path was once again reverted with the restoration of independence, which was accompanied by large-scale privatization. Because of its prominent dual board system and high ownership concentration, resulting from the outsider privatization model, corporate governance in post-Soviet Estonia was classified as an imperfect stakeholder model, where foreign investors and bankers are once again seen as important stakeholders (Buchen 2007).

Industrial relations were found to be an institutional domain that developed a lot during the four time periods. However, compared to other European countries the relative position of labor compared to capital remained disproportionately weak throughout. During the first period, industrial relations were highly conflictual, strikes were inherent, the work of trade unions severely obstructed and social dialogue between employers and employees almost non-existent (Karma 1963, 199). Nevertheless, by the end of the period, labor unions had become established as the primary institutions for wage bargaining in Estonia (Kiik 1995, 16). These trends also continued during the interwar period, although after the Great Depression, a direction towards establishing tripartism and more corporatist relations was taken (Kõll and Valge 1998, 66). This trajectory was subject to noticeable change, as under the Soviet rule industrial relations quickly became fully administered by the state (Shmelev and Popov 1989). Although formally tripartism remained, the protection of workers' interest actually took a back seat to the protection of employer's interests and labor's position actually remained disproportionately weak, despite unionization rates that were at an all-time high due to quasi-mandatory participation (Kiik 2000). Perhaps as a reaction to these quasi-mandatory but weak unions, after regaining independence, unionization rates dropped massively leading to decentralization of unions and the adoption of a pluralist bargaining model (Feldmann 2013, 496; Venesaar 1995, 330).

In the educational domain, overall education levels were high throughout, while in vocational education the lack of regulation over apprenticeships meant that firm-based skill creation mostly dominated over state provision. During early periods, the lack of skilled engineers, specialists and managers, was found to be a major institutional bottleneck hindering industrialization (Karma 1963, 105). This continued also during the interwar period, despite some efforts of improving the quality of domestic vocational education (Pihlamägi 1999, 119). During the Soviet era, Estonia gradually converged its educational system to that of the Soviet Union, which also meant further efforts to improve vocational education and a policy shift towards increased state provision with uniform rules governing over apprenticeships. Still, vocational schools often simply proved to be inferior in terms of providing general skills, but also not adequate enough in advancing specific technical skills. At the same time, thanks to compulsory secondary education and the extension of tertiary education, overall educational levels of the Estonian population rose significantly during the Estonian SSR. (Sirk 2005, 249-254) However, after regaining independence many Soviet-style policies have been rolled back with educational reforms aiming to promote general skills through a greater harmonization of vocational training and high school education (Feldmann 2006, 842). Furthermore, the apprenticeship system, in place during the communist period, has also largely been dismantled and the role of vocational secondary education has thus diminished once more (Feldmann 2013, 497), while, at the same time, there has been a significant expansion in higher education (Tomusk 1996).

The welfare state, similarly to industrial relations, was another domain that developed a great deal during the four periods under review. During the first period when Estonia was part of the Czarist Empire, the welfare state as we now know it, had not quite been established yet, but was only showing first signs of development. Since most welfare functions at the time were taken on by insurance funds and labor unions that operated alongside large industrial enterprises and labor unions (Karma 1963, 440), this developing regime could be classified as an emerging conservative welfare state. For the most part, similar trends were prevalent also during the interwar period, although there were some unsuccessful attempts to establish more wide-ranging and universal benefits (Kiik 2002). Old trajectories were broken during the Soviet occupation, when a social democratic welfare regime with high-benefit levels and universal scope was established in Estonia for the very first time. However, after regaining independence, many wide-ranging benefits of the former communist state were rolled back in post-Soviet Estonia and replaced by low and flat benefit rates of the liberal welfare state model, which is also corresponded to having one of the lowest levels of social spending in the EU (Bohle and Greskovits 2007).

When it comes to industrial policy during these four periods, different approaches to policy making were dominant during different eras. Under the Czarist rule, industrialization in Estonia was heavily influenced by Sergei Witte's *dirigisme*, according to which industrial development relied on the construction of railways and protective tariffs that served as infant industry protection (Pihlamägi 1999, 16). Although during the interwar period there were many that advocated for more liberal and merely regulatory policies, *dirigisme* also remained heavily influential in the newly established Republic of Estonia (*Ibid.* 92). This was especially true after the *coup* of 1934, when a shift towards more purposeful industrial policy was made with a new development and investment program, aiming to rapidly industrialize the country and fully exploit its natural resources (Kõll and Valge 1998, 92). During the final years of the interwar period the state took on a role of a developmental state (*Ibid.* 198-199). Although the Soviet occupation brought about a change in the political power, *dirigisme* ruled even more supreme in the Soviet Union and industrialization in the Estonian SSR continued very rapidly even under the new political regime (Sutela 1991; Tang and Nilgo 1995, 92). However, after regaining independence a conscious change in policy making can be documented towards a neo-liberal regulatory model (Sommers and Woolfson 2014).

4.2 Inherent characteristics of Estonian capitalism

In addition to the individual development of the six selected institutional domains, the previously presented empirical research also allows for some more general conclusions about the inherent characteristics of Estonian capitalism that have remained true across all four time periods. Herein, the current thesis would like to point out four. The first inherent characteristic of Estonian capitalism is found to be its general openness and high dependence on foreign markets, investments and financing. The dependence on foreign markets has had a cyclical nature, as during the Czarist and Soviet periods Estonia was heavily orientated towards Eastern markets, while during the two independence periods a re-orientation towards Western markets took place. At the same time, the dependence on foreign investment and financing manifested itself mainly through the high degree of FDI and foreign capital in the Estonian economy. The second inherent characteristic of Estonian capitalism has been it diverse economic and political elite, ranging from the local Baltic Germans and Estonian bourgeoisie to Soviet bureaucrats and foreign investors. The third inherent characteristic of Estonian capitalism has been the generally high level of education, which originally made Estonians a highly suitable industrial workforce and still continues to offer comparative advantages over other CEE countries. The fourth and final inherent characteristic of Estonian capitalism is found to be the relatively modest role of the labor movement. While ever since the early XX century, labor unions have officially operated, their relative position compared to capital has always remained disproportionately weak.

5. Conclusion

The aim of the current thesis was to investigate and analyze the development of the Estonian type of capitalism from 1870-2016. For this purpose a theoretical framework interrelating elements of CC literature and historical institutionalism was developed. Based on this framework, the analysis of six core institutional domains was conducted across four different time periods. The six core institutional domains under review were financial systems, corporate governance, industrial relations, education and skill creation, welfare state and industrial policy, while the four time periods included were periods under the Czarist and Soviet rule, as well as the two independence periods between them. In its results, the research concludes that the Estonian type of capitalism appears to be very diverse across different time periods. In particular, it appears that the transition from the Czarist Empire to independent statehood was much more gradual across all six institutional domains than subsequent transitions to and from the Soviet regime which created a lot more institutional variance and led to radical changes in long-term institutional trajectories. From individual institutional domains, financial systems and corporate governance were also seen to have more stable trajectories than industrial relations, education, welfare and industrial policy. The thesis concluded by highlighting some more general inherent characteristics of Estonian capitalism, which were found to be its relative openness towards foreign markets, investments and financing; diverse elites across various time periods; high level of education and disproportionately modest role of the labor movement.

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