

By Ben Rooney

Bold Decisions After Soviet Era Provided Essentials For Estonia's Success, Says Tech-Savvy President

TALLINN—On his desk in the presidential palace in Estonia's capital, President Toomas Hendrik Ilves, the third elected president of Estonia in modern times, has an iMac and a MacBook Air. He can also write computer code. Estonia has won itself a reputation for being a tech-savvy nation, a country that produces more digital start-ups per head of population than any other in Europe. And that starts at the top.

Mr. Ilves, in his second and final five-year term, was recently in the news for a very public spat with the economist Paul Krugman. It says something about Mr. Ilves's embrace of technology, and his belief in openness, that he chose the public

Mr. Ilves won't be drawn but instead produces two graphs plotting Estonia's gross domestic product: The one used by Mr. Krugman that covers the years 2007–2012, showing GDP to be at little more than 90% of peak value, and another charting from 1996 onward. This tells a different story, namely that, despite the dip, GDP has doubled.

When you look at Estonia's path from throwing off Soviet occupation in 1991 to the highest per capita GDP of any of the three Baltic states today, it is hard not to be impressed by how much this tiny country—its population at 1.3 million, only the size of Copenhagen's—with an obscure language and unenviable weather has achieved. Mr. Ilves pays credit to the decisions made two decades ago as the country returned to the map.

"You need to hold certain strictures that set you on the right path; economic, fiscal and constraints on power," he says. "It is very telling that no government that came out of the Communist period with a presidential form of government today is rated as free. None of them. The only countries to emerge from the Soviet Union with a clean bill of health are the three

Baltic countries all of which have parliamentary systems with a president as head of state but with most formal powers vested in the prime minister and parliament. "One clear thing about parliamentary systems," says Mr. Ilves, "is they dissipate power so that it never concentrates in the hands of one person.

"It is very difficult for Americans to understand this," he says. "They say 'but the [Estonian] president has no power.' But thank God the president has no power. You have a prime-ministerial system so that, at any time, the guy can fall."

As well as setting strict limits on power, another of those founding decisions back in the 1990s occurred when Estonia withdrew from the ruble zone and introduced its own currency, the kroon. Rather than establishing a central bank, Estonia formed a currency board, pegging the kroon to the deutsche mark, and backing the currency 1:1 with foreign currency. "We had no choice. We wanted a sustainable currency. What we faced was a complete cut-off of liquidity in one day."

But pegging its currency rigidly to the mark and requiring 100% backing, coupled with a slashing of all trade tariffs, was a politically bold move. Says Mr. Ilves: "Be occupied by the Soviet Union for 50 years, and then it is a lot easier to do a lot of stuff."

He elaborates: "The crucial element here is clearly the psychology of having been oppressed. You will get rid of everything you had before and you are much more willing... to be an early adopter, because few people in Estonia found any value in maintaining the traditions of the Soviet system."

Another key decision made in those early days was the introduction of a flat tax. Estonians pay 21% of their income in tax, irrespective of how much or little they earn. "Of course everyone will say it was ideological," says Mr. Ilves, "but a lot of it was about 'how the hell do we do a progressive tax?'"

Coupled with the flat tax was the decision to encourage Estonians to submit their tax returns electronically. At present, some 93.5% of income tax declarations are made online.

"[U.K. Minister] Francis Maude was here [on an official visit] and said 'why is it that everyone in your country loves using computers and trusts the government, especially given your background, and why is it that we don't?'

"The answer hit me. The first government service we offered on the web was doing your taxes. People hate doing their taxes. But it was so easy and it was so transparent they could do their taxes in three minutes. It became a way to make life easier. On top of that, of course, there was this trick that if you did it [your return] on a computer you got your refund in a week and if you did on paper, well, we'll see..."

Mr. Ilves's route to the presidency has been unorthodox. He was born in Sweden after his parents fled following the Soviet invasion of the country in 1940. He learned to speak Estonian from his parents, who settled in New Jersey when he was 3, and where his father worked for a paper company while his mother was a librarian.

He is a psychologist by training with degrees from Columbia and the University of Pennsylvania and ended up in politics after a spell at the Baltic desk of Radio Free Europe. In 1993 Mr. Ilves was appointed by the then president to become Estonia's Ambassador to the U.S.

"I was one of the few people who knew something about Estonia and the United States who did not have a background in the KGB," he said. "I had to renounce my United States citizenship, and take a tenfold cut in pay." he said in a 2008 interview.

From there he has variously been elected to Estonia's parliament as a People's Party member, served as minister of foreign affairs (twice) and a elected to the European Parliament, elected on an Estonian Social Democratic Party ticket.

Given this varied background, and the overview of European and international affairs it provides, how does he feel about the great issue of the day, the future of the euro? In particular, does he have any regrets about being the last country into the club—Estonia joined in January 2011? "I would much rather have Estonia inside the euro zone no matter what happens than to be out of it," Mr. Ilves says. "Outside the euro zone we are a small country" and he thinks that small countries appear unreliable to the outside world. "[People think], 'maybe they have very good policies, but you never know, they might be a bunch of weirdoes, they might do something

crazy and devalue.' Inside the euro zone we are the ones that follow the rules. I think we are much safer—we are in a safe harbor, especially as a small country."

As tensions in Europe continue to grow, the divisions on the continent appear to be widening between the countries around the Baltic Sea and those around the Mediterranean.

"The people in the north are more responsible" Mr. Ilves says "because if they didn't plan ahead they would die, they would not survive the winter. It is quite clear that there are countries that have one attitude toward fulfilling contractual obligations, and telling the truth then there are countries that have different attitudes.... Certainly in our area, if you say 'I will do this' we feel a sort of nagging obligation to do what we say we would do."

With Greece still teetering on the brink of having to withdraw from a currency union does he have any advice to give Athens based on Estonia's own experiences of leaving the ruble? "Follow the rules," he whispers.

"It is hard to convince people that they are not as rich as they think they are—that leads to bubbles. People in Estonia in 2007 felt a lot richer than they were. Then we ended up de-leveraging and found out it was all illusory. Our standard of living has fallen because of the crisis. Well that is true, but maybe we were not living in the real world."

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