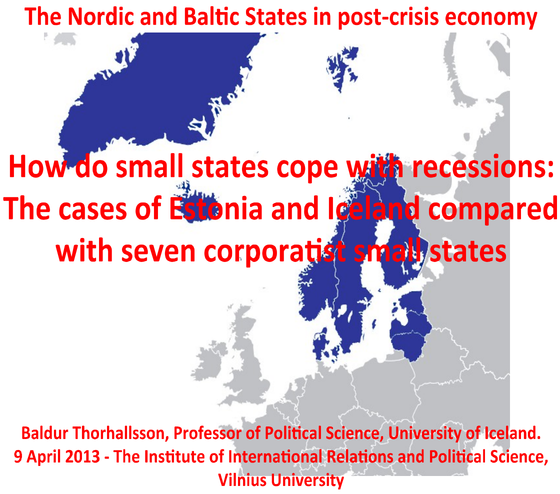
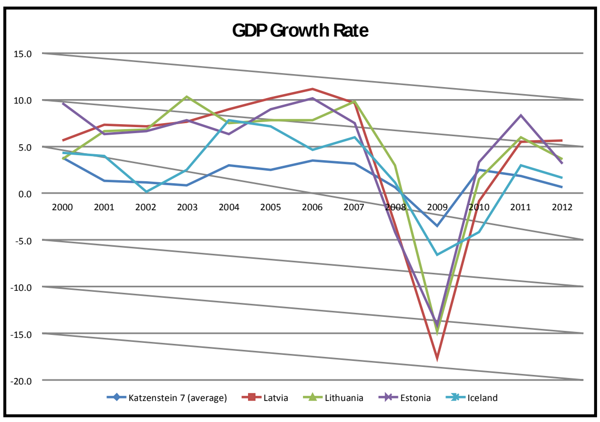


Chair,
Distinguished guests,
First of all, I would like to thank the organizers for the opportunity to speak at this important seminar.
We were asked to address a number of questions related to the seminar's topic. Many of those questions are partly addressed for the cases of Estonia and Iceland, in a recently published paper by Professor Rainer Kattle, at the Tallinn Technology University, and myself.
The paper deals with the questions of why these two states were so badly hit by the crisis - and how they dealt with its aftermath.
The paper applies the cases of Estonia and Iceland to the corporatist theoretical framework of Peter Katzenstein, a leading scholar in the fields of political science and small state studies.
I would like to use this opportunity to present some of the findings from the paper – and make an attempt to answer three of the questions posed by the organizers:
Firstly, I will discuss why small economies are said to be more vulnerable than large economies.
Secondly, I will compare the ability of the Baltic states and Iceland to respond to international economic crises on the one hand with the ability of seven corporatist small European states on the other to do so.
Katzenstein seven corporatist states are: the Scandinavian states, the Netherlands, Belgium, Austria and Switzerland.
Generally speaking, corporatism describes a particular culture of cooperation and compromise – solidarity – both at the political level and within the economic system.
- In other works - Corporatism refers to close cooperation and consultation between the government on the one hand and employers' and employees' organizations on the other.
This is related to the second question - What are the key lessons to be learned in order to be better prepared for future recessions?
Thirdly, an attempt will be made to answer whether economic integration is likely to contribute to the convergence of economic and social models in the Nordic and Baltic countries.
- What do the responses of Estonia and Iceland to the crisis indicate?
Finally, there will be a short summery.

1. Lets start with the first point.
Small economies are more vulnerable to international economic fluctuations compared with large economies.
There are several reasons for this. For instance, small states often rely on one or two export products, such as Iceland and Norway.
Their exports are also more concentrated than large states' since most of their trade relies on a particular state or a specific market.
Moreover, they rely more on imports than larger economics due to the smallness of their domestic market.
- Small states have a functionally given need to be open economically in order to facilitate growth.
This is reflected in the fact that Small economies are often the first to experience international economic crises and they are harder hit by them. This may lead to social unrest and political instability.

Having said that, not all small states are the same.
According to Katzenstein's classic studies from the mid-80s, democratic corporatism is the key to the success of seven small European states.
- These states have formed a comprehensive domestic decision-making framework built on consensus.
This has created economic flexibility that allows them to respond to the fluctuations in the international economy.
It has also led to political stability, even in times of deep economic recession. A balance has been created between the increased pressure for economic efficiency and concerns to maintain equality between different social groups. The state has deliberately restrained itself from exercising its unilaterally.
- The small corporatist states tell an important story of how, despite considerable economic fluctuations due to their open economies, small societies have become economically and politically successful.
Moreover, they are better equipped than large states to deal with the instability of the international economy.
They are, in fact, economically and politically more successful than large states according to Katzenstein.
Furthermore, they were much better prepared to deal with the 2008 economic international crisis than the Baltic states and Iceland – **according to this picture.**

GDP growth rate (at market prices) in European small economies, 2000–2012.
7 small states average compared with Lithuania, Latvia, Estonia and Iceland.



This slide shows real GDP growth rates in Katzenstein's seven corporatist economies during the crisis compared with the Baltic states and Iceland.

The sharp contrast between the hard-hit economies of the Baltic states and Iceland, on the one hand, and the smoother adjustment to the international recession of the small corporatist states, on the other, is striking.
- The big question is whether there is not more to it than oil, Volvo, Nokia and Swiss chocolate and watches !

-This leads us to the question of whether a lack of democratic corporatism based on consensus decision-making contributed to the scale of the economic crisis in Estonia and Iceland.
-It also invites us to ask whether a lack of corporatism in dealing with the aftermath of the crisis created political instability in the two countries.

2. Now to the second point.
The Baltic states and Iceland were hailed as prime examples of the successful small states in the new globalized economy of the twenty-first century. The rapid economic boom was seen by many as proof that small states should adopt the neo-liberal agenda rather than follow the democratic corporatist model.

However, now the sustainability of their economies has been called into question.
In fact, Estonia and Iceland went through a governmental crisis as well - and Iceland, also, experienced strong social unrest. – There were violent protests in the streets of Reykjavik.
Their laissez-faire policies have increasingly been questioned.
This was also the case with the governments' limited consultation and consensus building with other domestic actors in forming their economic policies.
From the early 90s, the Estonian and Icelandic governments implemented their neo-liberal policies - and systematically sidelined those who stood in the way of their agendas.

This was in sharp contrast to the small corporatist states. Katzenstein identifies three characteristics of strong corporatism within them - that can be contrasted with the weak or non existence of corporatism found in our two cases.

First, an idea of social partnership prevails in the corporatist states.
This emphasizes consensual decision-making between all key actors in the society.
Labor-market organizations and the government come to joint decisions regarding economic policy and finances.

Second, generally speaking the smallness of the society means there are fewer important economic sectors and fewer important organizations compared with larger states.
The seven states have made as much out of this as possible. - Decision-making is characterized by centralization and concentrated interest groups, - and it is easier to reach a compromise and consensus than in Estonia and Iceland.

Third, a formal political bargaining framework is set up. All important interest groups participate in policy formation - and implementation of the government's policy.

There are also historical reasons for the success of these seven small European states according to Katzenstein. - Proportional representation and the fact that political parties on the right are divided have led to a distinctive party system and encouraged a system of coalition, or minority, governments. This has created a system of consensual decision-making and has given opposition political parties considerable influence over policy formation.

To summarize this second point, - small states' democratic corporatism is the result of historical choices and the smallness of a society. The political elite has come to the conclusion that inclusive decision-making based on consensus is best suited to minimize conflicts and maximize economic gains.
This inclusive nature of the seven corporatist states stands in sharp contrast to the American neo-liberal trend towards exclusion.
In the American model, the role of labor-market organizations in forming government policies is restricted and the government plays a more limited role in shaping living standards. - The market prevails.
- The question is whether we cannot learn from these corporatist features and how they have helped the others in previous economic crises.

3. We now proceed to the third and final part of whether economic integration is likely to contribute to the convergence of economic and social models in the Nordic and Baltic countries?
The answer is simply No – at least not in the short run.
The Nordic states and Baltic states have largely kept their domestic decision-making structure unchanged whether or not they have joined the EU.
In order to answer this question with Estonia and Iceland in mind - we have to look at their responses to the crisis.

Estonia was able to respond very quickly by adopting radical fiscal retrenchment policies in order to adopt the euro.
In fact, Estonia hardened its neo-liberal stance and political relations, and thus further weakened coordinative and cooperative structures within government and with social partners.
IN the paper we conclude that the way the Estonian government handled the crisis has resulted in two wider political consequences.

First, Estonia has become an even less corporatist. In fact, it is difficult to name even one policy area where the government is engaging in significant coalition-building, negotiations, or coordination with the opposition, unions, or civil society partners.
Second, the role of Parliament, and especially that of the opposition, diminished during the crisis.
Another interesting development also related to the crisis is the emergence of a left-right divide in the Estonian Parliament after the 2011 general elections.

IN the case of ICELAND – Just like in Estonia - There is no official stable framework for bargaining on economic and societal issues. There is no comprehensive framework where consensus can be reached between competing interests.

The political aftermath of the Icelandic crash bears a clear hallmark of a missing democratic corporatist decision-making system based on consensus. As the crisis hit in early October 2008, the government and the Central Bank took decisive decisions without consulting one another or other relevant actors. We can speak of a certain chaos.

Iceland has witnessed historic political changes -with the first ever left-of-center government - without changes to its political culture of conflict - and in fact with a weakening of social partners. In fact, there seems to be a much clearer divide between the left and the right in Iceland that before the crisis - just like in Estonia.

There have been more conflicts between the largest labor movement and the left of centre government since the crash than in the period 1995 to 2007 - under conservative rule.
Furthermore, the relationship between the government and the fisheries, agriculture and aluminum sectors has been characterized by conflict ever since the government took office. For instance, over the application to join the EU, over environmental concerns regarding the building of new power plants, and over tax increases.

In fact, the close relationship between the Icelandic government and particular sectors in the past – those of fisheries, agriculture and aluminum - seems to contribute to the conflict-oriented culture of Icelandic politics.
-Decisions on important economic measures are hardly ever taken by consensus or a qualified majority in the Althingi.
This conflict-oriented political culture has made it more difficult for the government to respond to and manage the crisis.

To conclude, - I have argued that neither Estonia nor Iceland can be characterized as corporatist states, - and that their lack of corporatism made each country particularly vulnerable to the 2008 economic crisis.

We argue that the economic crisis was particularly deep in these countries because non-corporatist, neo-liberal political features deepened the economic crisis.

In both cases, the neo-liberal agenda was a political choice against corporatist developments in order to further strengthen privileged interests, as in the case of Iceland,

- and in order to drive economic liberalization further and keep social partners, such as unions, weak, as in the case of Estonia.

- That said, Small states can use domestic arrangements to limit external economic risks associated with economic openness.

Our findings indicate that it makes a big difference if a country enters the international neo-liberal economy with a corporatist set of economic and political structure.

It is not about Volvo and Nokia – the form of domestic decision-making is the key to success.

Estonia and Iceland versus the seven corporatist small states

- Lack of corporatism made Estonia and Iceland vulnerable
- Non-corporatist, neo-liberal political features deepened the economic crisis – and social unrest/political instability
- Political choice / policy choice
- Corporatist domestic arrangements limit external economic risks
- Best to enter the neo-liberal international economy with a corporatist set of structures