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The Estonian Forest Sector in Transition: Institutions at Work

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Interim Report

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**The Estonian Forest Sector in Transition:
Institutions at Work**

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Abstract

This paper is a case study based on forest sector development during the first ten years of economic transition in Estonia between 1991–2000. The study attempts to shed light on the significance of social norms, beliefs and conventions for the implementation of Government policies. The format of the analysis relies on the description of consecutive steps in the evolution of the country's forest sector, allowing speculations and conclusions on why some policy actions are more successful than others. Using Douglass C. North's ideas on the factors that most influence economic progress, the author follows the interplay between the formal and informal institutions during the above-mentioned era in Estonian forestry. The author finds that the so strongly advocated participatory policy making procedures alone do not necessarily guarantee the achievement of socially acceptable policy outcomes. Individual decision-makers' actions may alter the course of policy-making and contribute significantly to uncertainties related to successful policy implementation.

Acknowledgments

I should like to express my thanks to everyone in IIASA's Forestry Project for the friendly atmosphere, the freedom of thought, and the help that was generously provided during the summer 2000. Appreciation is also due to the staff members from other projects, as well as fellow YSSPers, who found time and interest to delve into numerous drafts of this paper.

Special thanks goes to three people had a major role in shaping the contents of this paper. The first is Michael Obersteiner, who inspired me on several occasions during the summer through our very insightful conversations in the archways of Laxenburg castle. The second is Esa Puustjärvi, who used his vast knowledge in the field of forest policy-making, obtained from experiences all over the world, to help me identify what is crucial in these processes, and is worthwhile stressing in this paper. And finally, Andres Onemar who, through his own and his employees' continuous readiness to respond to my inquiries, provided me with invaluable sources of information while I was writing this report.

About the Author

Aigar Kallas is currently a graduate student at the University of California, Berkeley. Between 1995 and 1998 he was involved in the National Forest Policy formulation in Estonia, serving first as an Assistant, and thereafter as a National Coordinator in this process. The biased view on the role of the Government organizations in the sector's development is inherited from this period.

The Estonian Forest Sector in Transition: Institutions at Work

Aigar Kallas

1. Introduction

The “countries-in-transition” of Central and Eastern Europe have undergone tremendous political and economic change over the past decade. From the onset, it has been clear that there was no universally applicable blueprint for the transition from a centrally planned to a fully functional, market-driven economy (Trudeau, 1991). Not surprisingly, the process has proved difficult everywhere and it is not complete anywhere (Kolodko, 1998; Stiglitz, 1999a). The comparative analyses have, however, resulted in the identification of both “winners” and “losers” of transition (Ellman, 1997).

This uneven development provides scientists and policy makers with an opportunity to examine the causes of successes and failures in economic transition. Three sets of possible explanations have been proposed to understand the differences in this process: (i) initial conditions; (ii) choice of macroeconomic policies; and (iii) performance of institutions.

Stern (1998), Chief Economist for the European Bank of Reconstruction and Development, lists a variety of initial conditions — per capita income level, degree of environmental degradation, energy use efficiency, etc., to shed light on the progress of transition. He also states that “those countries that moved ahead most quickly and firmly with the implementation of reforms have generally seen the most rapid economic recovery” (Stern, 1998, p. 4). Stiglitz (1999a), former Chief Economist for the World Bank, is much more pessimistic in terms of how much economic progress has actually been achieved. He argues that all countries in Central and Eastern Europe are, in fact, confronted with a transition failure. The primary cause for this is the misunderstanding of the institutional reform process (Stiglitz, 1999a).

More thorough research on institutional development has allowed Hira and Hira (2000) assert that differences in institutions are the primary causes for differences in economic outcomes: “[b]y implication, some institutions in some countries are more efficient in reaching social outcomes, which explains, *ceteris paribus*, why some countries enjoy higher standards of living than others” (Hira and Hira, 2000, p. 270). Hudson (1999) argues that successful economic development models are embedded in specific regional and national cultures and social structures showing, at least in part, how institutions affect economic prosperity.

Nobel prize winner Douglass C. North defines social structures as “a complex mixture of rules, norms, conventions and behavioral beliefs, all of which together form the way in which we operate and determine how successful we are in achieving our goals” (North, 2000, p. 7). Earlier, North (1997) also stressed the importance of time, policies and, what he calls the “scaffolds,”¹ to the improvement of transition economies’ performance (Figure 1). In this framework Policies are meant to direct people’s perceptions and expectations to common targeted action and will produce the desired results only if the informal norms are complementary to rule changes. It can be argued that formal rules are just a reflection of social norms, the execution of which shapes the evolution of rules. In this process the social norms themselves are altered, creating a dynamic, mutually interdependent and continuously changing social structure.

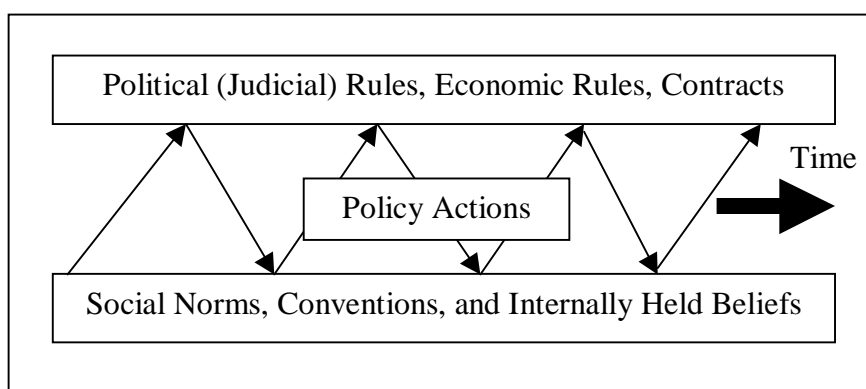


Figure 1: Time, Policies, and Scaffolds.

Separately grouping formal (political and judicial rules, economic rules, contracts) and informal (social norms, conventions, and internally held beliefs) institutions, the implementation of policies from “above” and the reaction to those from “below” determine whether an economy will progress or stagnate. Time extends along the horizontal axis and, together with the number of policy exchanges, tells us how capable are the institutions of achieving desirable outcomes. More actions reduce efficiency and therefore translates to less success. Counting the actions and investigating their origins allows us to understand why some policies bring about quicker progress than others. The critical question is, what exactly are the informal institutions that decide on the direction of society’s policy actions, and knowing those, can they be targeted in a manner that guarantees the achievement of policy objectives?

Stiglitz (1999b, p. 33) wrote that “an institutional infrastructure — including not just contract enforcement, but also competition policy, bankruptcy law, and financial institutions and regulations” are the prerequisites of a market economy. He claims that a lack of formal institutions, such as banks and other potentially interested parties capable of monitoring reforms, artificial competition and ambiguous rules of privatization, have caused the failure of transformation in most transition economies. After several years of

¹ North translates scaffolds as “the political structure that specifies the way we develop and aggregate political choices; the property rights structure that defines the formal incentives in the economy; and the informal constraints of norms, conventions, and internally held beliefs” (North, 1997).

extensive research on the institutional development in Russian forestry, IIASA concludes that, indeed, on the constitutional level this claim holds water (Nilsson, 1999; Carlsson, *et al.*, 2000). However, using Kiser and Ostrom's (1982) categorization of institutions, Carlsson *et al.* (2000, p. 25) argue that on the collective and operational choice levels, other explanations have to be found for Russia's poor economic performance. IIASA's work with the individual entrepreneurs, policy makers, local government officials, etc., in Russia has revealed that the undefined mutual relations between the market players and a shortage of respective institutions are prevailing in the country's present day forestry. The natural outcome of the described situation is "widespread and deeply rooted lack of trust" that characterizes relations between business partners in Russia. Lehmbruch (2000) reaches a similar conclusion when describing the widespread web of informal organizational ties that the actors of the Russian forest sector have established as a part of their survival strategy.

2. Case Study

This paper considers the evolution of forestry organizations in one republic of the former Soviet Union — Estonia — to investigate the transition progress. The forest sector's development throughout the transformation period from the year 1990 to 2000 involved two major phases: (i) the establishment of a private sector, and (ii) an attempt to introduce stakeholder-based participatory policy making practices.

The first part of this paper ties the first five years of transition in the forest sector to Estonia's general political and economic framework. It was observed that the regained independence and reorientation to the private sector gave rise to individualistic behavior within society, substantially affecting relations between the emerging social groups. It will be argued that the separation of the State and enterprises played a crucial role in determining the fate of the country's forest sector. It will be claimed that the emergence of a private sector coincident with a weakening of public governance provided the foundation for an exceptionally rapid progress of the Estonian forest industry during the 1990s. Two examples of social restructuring, the decentralization of power in the State forestry administration and the not yet completed re-establishment of private forestland ownership, provide evidence to the importance of organized action in public policy making.²

Trust-building and social learning form the core of the second part of the paper, which considers the process of participatory policy formulation and implementation that characterized the Estonian forestry sector during the second half of the 1990s. The connecting link between policies and policy-making in this period will be investigated through separate examinations of the personal and organizational performance of the principal actors in this process. Using information obtained from personal interviews with the stakeholder representatives, it will be shown that the choice of a policy formulation tool alone did not guarantee successful policy implementation. It was observed that the manner in which policy making was conducted turned out to be crucial for achieving desirable outcomes. It was found that in the policy formulation

² From here on policy making is referred to as a three-component process entailing a formulation, an implementation, and a monitoring phase.

process stakeholders reacted quickly and adjusted their behavior to that of other groups. It will be argued that interaction between the social groups during the policy making process had an enormous impact on the evolution of social norms and, consequently, on the fate of Estonian forest policy.

3. First Policy Action — Privatization

Åslund (1997, p. 454), referring to Kornai (1992), defines the ultimate aim of post-communist transition as the building of capitalism — de-politicization of the economy, activation of markets, and the institution of private ownership of the means of production. The public sector constituted up to 90 percent of the East European national economies by the end of the socialist era (Purju, 1996). The overall shift from the public to the private sector became the focus of economic restructuring, necessitating a policy to transfer State property to private ownership. A large number of privatization schemes were proposed or attempted in different countries, varying in their speed, degree of restructuring, etc. Stern (1998) claimed that these schemes profoundly influenced the future economic prosperity in the region. It is important to notice that, in addition to the economic significance of privatization, the change of ownership pattern became a means for the redistribution of power and the establishment of new political focal points (Major, 1993).

3.1 Remnants of the Soviet Era

Like any other sector in the Soviet Union's economy, the forest sector was regulated by a single decree across the entire country. In principle, each Soviet Republic had its own forest code but there were no significant differences between the Union and Republic level documents (Etverk, 1998). The Soviet Estonian forest code, being replaced by the new Forestry Act (1993) no earlier than November 1993, was very general however, and all forest management operations were actually regulated by numerous individual directives. The latter were either prepared or approved by the central public forestry authority in Moscow.

In addition to the detailed forest management directives, Soviet-style forestry was also administratively very complex (Figure 2). The pre-war Estonian Forest Service was taken over and maintained intact until the very beginning of the country's re-establishment. Private forests, which constituted a relatively small share of the country's total forest area in 1940, were thereafter left to be taken care of by the agricultural sector (by the state and collective farms). Under this arrangement, 50 years of declining agricultural production led to an increase in the area of farm forests until farms accounted for half of the country's total forest territory.

Oversight of the principal forest management and wood processing operations in Soviet Estonia was split between two government ministries: one responsible for the industry and energy sector, and the other for nature conservation and resource management. The former ministry had seven large-scale forest enterprises (*metsakombinaat*) under its supervision. These enterprises were in charge of final felling and also conducted primary wood processing operations.

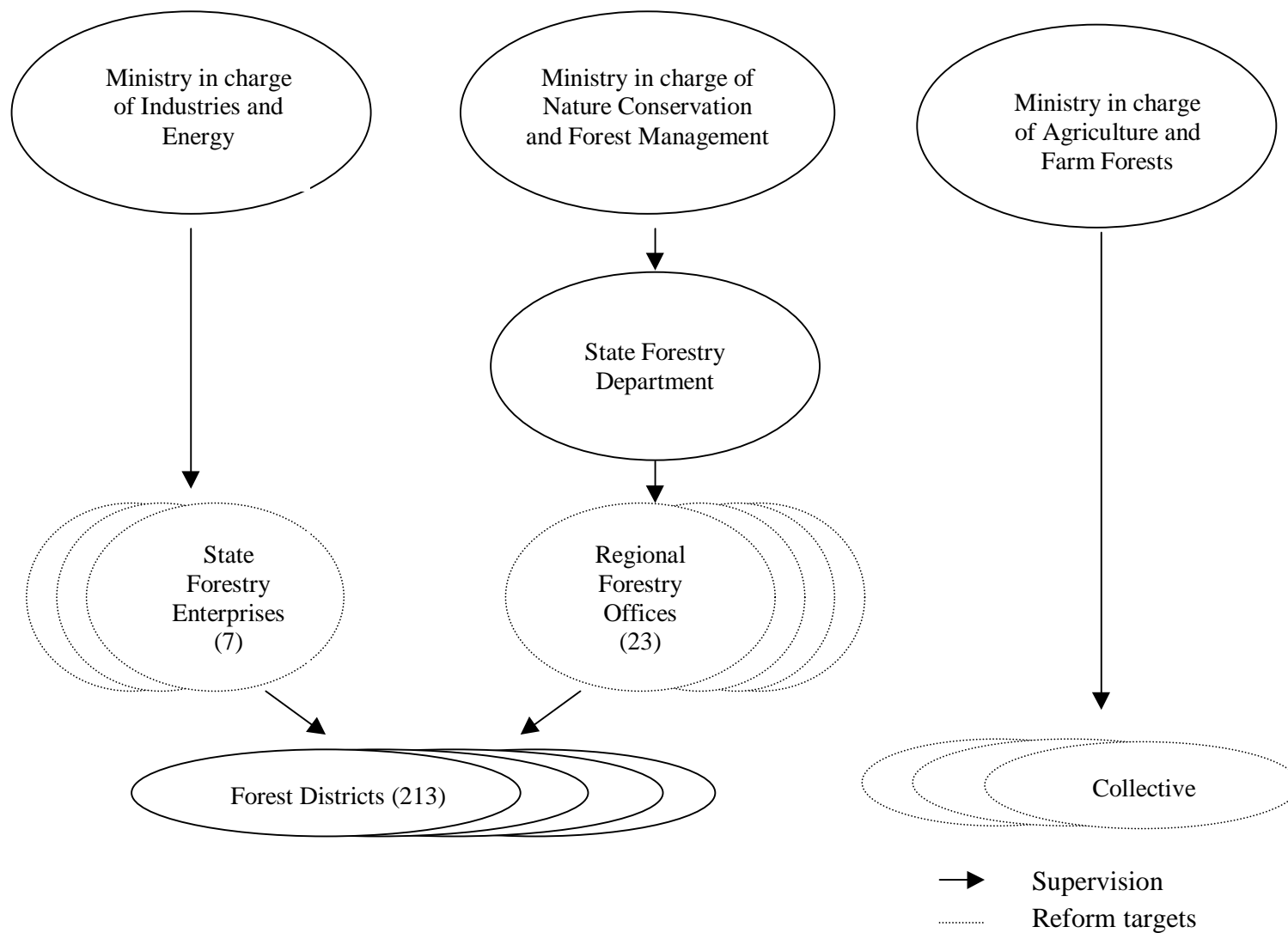


Figure 2: Structure of the Estonian Public Forestry Administration Prior to and After the Reforms.

The latter ministry's supervisory tasks were more complex. Since 1947, the initial structure of the public forest management organization consisted of a central administration: the State Forestry Department, 23 regional offices (*metsamajand*), and 213 local forest districts (*metskond*).

One of the characteristics of the Soviet planning system was its extraordinarily high degree of centralization. For example, orders regarding final felling were issued directly from Moscow, on the reasoning that the output was part of the Union-wide harvesting plan. A related feature of the Soviet era planning mechanism was the requirement to increase harvests in each management period. The massive storm damage in Estonia in the 1960s, which brought significant additional wood supply to the market, provided a rationale for Moscow to set even higher output goals for the 1970s. The strong focus on harvesting output was later identified as a primary reason for the poor quality of forest management in Estonia during the Soviet era (CTS Consulting, 1992).

3.2 Changes in the Forestry Administration

The Estonian forestry sector was under heavy pressure by the end of the 1980s and the beginning of the 1990s. Many influential political players, such as the Government authorities in charge of resources and manufacturing, political figures close to the Cabinet, etc., advocated quota-based distribution as the primary means of allocating timber to wood processors. The unstable economic conditions and the fall of the *ruble* in particular made the State Forestry Department extremely skeptical of such suggestions. Resisting the outside influence, the Department headquarters, supported strongly by the regional managers, established open bidding as the sole method of selling timber from the State forests (Klaos, 2000).

The 1990 Estonian Government saw forestry as a significant source of income for the Treasury. A Government decree was prepared to unite the seven wood manufacturing enterprises (which were already organized into a single organization, *Eesti Territoriaalne Tootmiskoondis "Eesti Metsatööstus"*) with the regional forestry offices of the State Forestry Department. Subsidies were anticipated to be allocated to the organization in order to ensure a quick re-establishment of the sector's export potential. The forest districts were to be separated from commercial forestry operations and funded directly from the Government's budget.

This decree was never passed, but it nevertheless played an extraordinarily significant role in the future development of Estonian forestry. The first months after the decree was proposed served as a period of trust-building among district forest managers. The period culminated when the newly established district managers' association (*Eesti Metsäülemate Ühing*)³ entered the debate on the future of the country's forestry. Owing to the political connections of its nearly 200 members, the organization became an influential player in the Government's corridor lobby. Under pressure from the district

³ The association of district forest managers (*Eesti Metsäülemate Ühing*) was, similar to many other organizations at the time, actually re-established. A similar association already existed during the country's first independence period 1920–1940.

foresters, a separate Inter-Ministerial Committee was formed to find an alternative solution to the further development of the country's forest sector.

Since *the Eesti Metsaülemate Ühing* argued that the country's public forestry had become too focused on timber output, the Committee made a recommendation to organizationally separate forest management from the wood processing operations. In this way, the Government's earlier plans were largely reconfirmed, the only difference being that the forest districts were promised exclusive rights over the forest management in their respective territories. This solution was acceptable to all parties, the actual implementation, however, led to quite different results.

Restructuring of the public forestry organizations was finally undertaken at the end of 1991 and the beginning of 1992. As has often been observed during the first years of such a transition, the top management of the forestry administration saw a business opportunity rising in the planned change. By that time, the first private timber companies had already been established and the State-owned wood export organization, ESTIMPEX, had started fading away. The people involved in it had captured the existing contracts and connections and transferred them to the private sector. In order to maintain access to the foreign markets, the State Forestry Department decided to unite the regional forest management offices into a single public company, the "Estonian State Forests" (*Eesti Riigimetsad*). This would have created not just a marketing, but also a strong forest management enterprise, as the new organization absorbed all the forestry equipment in public possession. The Chair of the Department decided to step into the promising money boat and become the head of the new enterprise. The "robbery" of the forestry equipment that then occurred, pushed the forest district managers to a revolt. To maintain peace inside the public forestry, the minister ultimately established the forest districts as separate administrative units. The Department was appointed a new Chair, and the forest districts were subordinated directly to him. An important piece of information here is that the new Chair was chosen from among the district managers themselves. Believing that an organizational structure of this kind would have no chance for effective performance, the rest of the Department's core management left office to join the private sector.

The "Estonian State Forests" never succeeded as an independent venture. Even though a central marketing administration was established and some joint capital was accumulated, the Soviet-era logging and processing capacities were never going to be competitive on the open market. A year later, the organization was transferred to the ministry in charge of industry and energy and was, piece by piece, privatized along the seven State forestry enterprises originally supervised by the ministry. Since the form of privatization was always open tendering with a preference for investors making commitments for additional strategic investments, no question was raised if the enterprises were acquired by local or foreign capital. Currently, due to obsolete technology and poor management, many are bankrupt. Approximately half, mostly owned by foreign investors, have been reconstructed and are still in business.

The forest districts emerged from this process with a considerable degree of independence. Even though the district managers had lost the battle to become the sole manager of the State forests, they were only obliged to sell the stands for final felling via public auctions, retaining control over the disposal of thinning and half of the auction revenues. The reorganized State Forestry Department with only 20 employees,

was ill equipped to serve as a watchdog over the activities of the nearly 200 districts. The situation resulted in decentralization of power in public forestry, inevitably weakening the Government's ability to take any initiative in the sector's development.

The forest industries, on the other hand, were in a very different situation. The overall government policy favored a complete privatization of State owned enterprises and strongly supported foreign capital inflow. Moreover, the introduced economic shock therapy cut all the subsidies to industrial production. The split between the State and the enterprises tore apart the network relations that had been established between the mix of Government offices during the Soviet era, leaving private industries not only without direct public support, but also without access to the raw material.

3.3 Re-establishment of the Private Forestland Ownership

The Soviet Estonian farming sector was primarily comprised by the state and collective farms (*sovkhoses* and *kolkhoses*). Individual families had been granted small plots of public land for household use. These plots helped people to sustain their livelihoods and likely contributed to the pressure to re-establish private farm based agricultural production in the country soon after independence was again declared.

The Farmstead Act of 1989 (Farmstead Act, 1989) served as a trigger in this process. The first private farmers were given land simply upon request. This method did not take into consideration any historical property boundaries, nor were the new owners necessarily related to the people who used to own these lands prior to nationalization which took place after World War II. The subsequent Law of Land Reform (1991), endorsed by the newly elected (1990) Parliament in 1991, determined the land restitution in the first order to the pre-war owners. Compensating the former owners the land value in the case of restitution was not practical, but avoided a series of potential complications. As opposed to several other countries in the region (e.g., Russia), the establishment of private forestland ownership was never submitted to any legal restrictions. Currently, the process is under way and is expected to end with a share of 52 percent private and 48 percent publicly owned forests (EFDP, 1997a).

The new Forestry Act of 1993 had a significant impact on the management of private forests. Most importantly, the Act, acknowledging the existence of private forestland ownership, determined the conditions for utilization of private forests. Forest management plans were envisioned as the primary tools for guiding private owners' activities.⁴ The owners were to be provided plans free of charge; the preparation of plans was to be carried out by the State-run forest survey organization. At the same time, the authorities also required prior endorsement of the forest management operations the owners were planning to undertake. In 1998, it was reported that 300,000 hectares of private forests (22,624 holdings) were covered by management plans (Yearbook, 1999).

⁴ In short, the plan was the result of an on-site forest survey, listing the stand inventory data and describing the recommended forest management operations. The plan was mandatory in stipulating a maximum ten-year cutting volume. In addition, a few other restrictions, such as the obligation to regenerate and the application of forest protection measures, were made compulsory (Forestry Act, 1993).

The fiercest political battle over the 1993 Forestry Act was fought between the public forestry administration and the representatives of the private forest owners. The latter group was strongly opposed to public control over private forest owners' activities, and was suggesting several measures for activating individual owners' joint cooperation. The organizations even went as far as attempting to influence the President to refuse the declaration of the proposed Forestry Act (Etverk, 1998). The opinions that were later expressed by the public forestry organization's employees described this conflict more as a power struggle between certain individuals than an ideological debate over private forests *per se* (EMÜ Sõnumid, 1995). The private forest owners were also supported by the Ministry of Agriculture, whose status was then endangered by the rapid decline in the agricultural sector. Despite the combined efforts, the State Forestry Department was determined to maintain oversight over private owners' forestry operations.

3.4 Lessons from the First Wave of Change

Two distinct conclusions emerge from considering the first wave of restructuring in Estonian forestry — the changes in the forest sector were very much in line with the general economic policy, and only the policy actions that had significant support from below were successfully implemented. The political power that the newly elected Parliament had achieved as a result of promising to reconstitute/privatize the Soviet era public sector was actually translated to concrete actions. The land reform undertaken was the most time and resource consuming in all of Eastern Europe. At the same time, it gave the Government the credibility it needed to execute more radical steps in other sectors, like the introduction of barrier-free trade, the abolishment of State subsidies, and the frequent privatization of industries to foreign strategic investors.

The events that transpired in the forest sector followed the same general pattern. Wood processing output went into rapid decline right after the beginning of the 1990s. The foreign markets were pushed wide open and, as the roundwood export skyrocketed, the newly privatized wood industry immediately lost its access to cheap raw material. The decision to introduce tender-based timber sale methods in public forestry was certainly radical for the time. The initiative for this decision, however, came from inside the State Forestry Department. Despite the change of leadership in 1992 and continuous external pressure to abolish this rule, the auction principle stayed in place.

The effect of the complete replacement of leadership in the State Forestry Department — the top management of the organization had stepped down from office — is still a matter for speculation. The myth of endless opportunities that the private sector was ready to offer, clearly had detrimental effects on the public sector's performance. For several years the graduates from forestry schools did not show any interest whatsoever in public sector recruitment. Inevitably, momentum was lost in the development of public forestry organizations. The uncontrollable decentralization and the establishment of numerous independent management units within the State Forestry Department probably caused significant efficiency losses in public forestry. As the local wood market faced steep increases in timber prices, the public forestry organization lost momentum, the consequences of which surfaced in 1996.

On the other hand, left without any State support, the private sector was able to come up with a very effective strategy to cope with the situation. The European Bank of Reconstruction and Development (EBRD) transition report claims that "as private sector

participation in the industry grew, companies developed connections on export markets and accumulated capital, and timber traders looked into downstream investments to provide greater value-added, high margin products” (EBRD, 1999). The basis for this success can be found in the very early period of transition in the Estonian economy that prevented the emergence of particularistic networks between the Government offices and the business sector (for a contrasting example see Lehmbbruch, 2000). The Estonian timber industry became vertically disintegrated, the processors were separated from the forest owners, and the former had to compete for raw material on an open market. Hence, the pattern that can be observed in most other former Soviet Union republics — the reliance on raw material exports with considerable Government involvement — did not become the norm for Estonia. Indeed, new export links were established (and old ones maintained), not by the Government, but by the local harvesting industry and foreign entrepreneurs who expanded their wood processing operations.

The gradual strengthening of wood industries and the subsequent increase in timber prices in the country also provided an incentive for the newly established private forest owners to increase harvesting (Diagram 1). Theoretical calculations have indicated that the annual net revenue (excluding capital costs) from private forests reached as much as USD 38 per hectare in 1996 (EFDP, 1997a). Poor leadership and individualism, however, resulted in weak performance of private forestland owners in the policy arena. Even though the number of private forest owners has gradually increased, only 1 percent of them have joined in organizations. Lack of cooperation incentives seems to be the main reason for the expressed low interest in joint activities. As these organizations were not well established, their voice was not strong enough to successfully defend their interests in the public decision making process. It has been speculated that “the economic potential of forest owners’ organizations should come into effect as soon as a sufficient legal framework and judicial capacity eliminates incentives for illegal timber trade and consolidated timber sales from private forests become attractive for timber merchants” (Tõnisson, 2000).

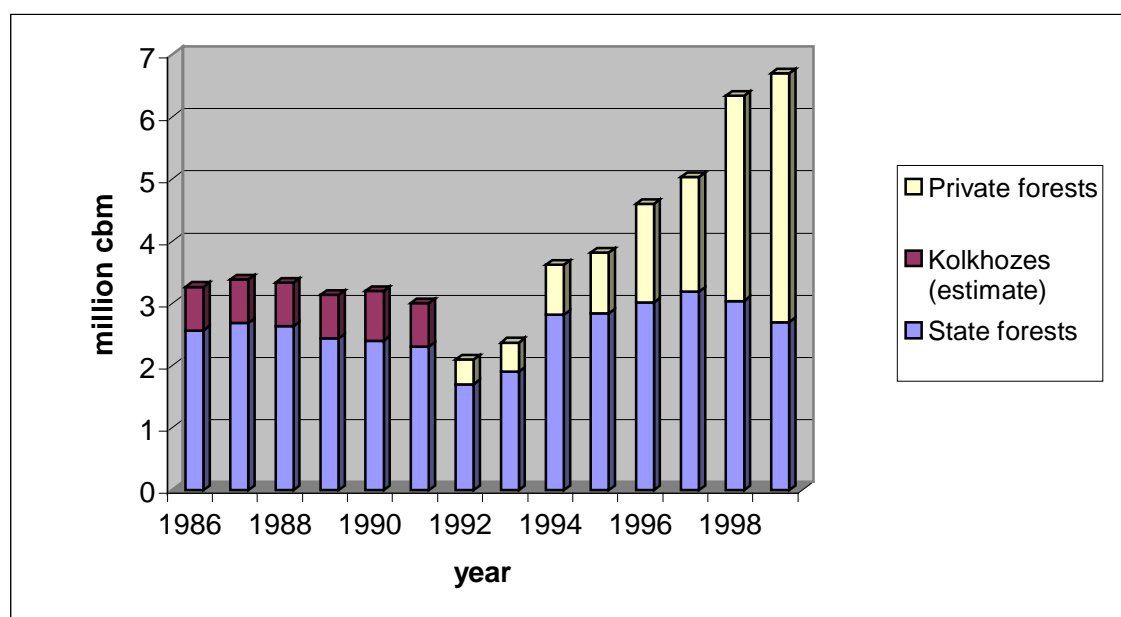


Diagram 1: Forest Harvesting Volume in Estonia by Ownership Category 1986–1999 (Source: EFDP, 1997a).

4. Second Policy Action — Participatory Policy-Making

Earle and Cvetkovich (1995) claim that social trust and cosmopolitan leadership, that recognizes and makes wise use of human limits, are the keys to a better society. Objecting to McGarity's (1986) suggestion that (lost) trust in public governance can be (re-)created by involving full participation in agency decision making, they instead advocate means such as division of labor and guided participation for public policy making. Equal treatment of all participants is, according to Earle and Cvetkovich (1995, p. 149–150), equivalent to saying “no one has anything of value to contribute” and “public debate serves no useful function”.

The World Development Report from 1996 (World Bank, 1996) suggested that social consensus would be crucial for success in economic transition. The international forestry community is in general agreement, advocating participatory policy formulation as the primary means for establishing the sector's long-term development strategies.⁵ Efficiency and effectiveness, ethics, and ability to ensure adequate response to public demand are frequently listed as the advantages of participation, as opposed to other more conventional hierarchical methods (Warburton, 1997). Even though the nature of forest management makes the use of such a decision-making tool in forestry particularly costly, gains in later implementation are considered to by far outweigh the additional time and administrative burden. One of the measures being, for instance, a reduced number of post-decisional appeals (Daniels and Walker, 1997). In several countries, such as the United States and Australia, participation has become a legal requirement in public policy formulation. An analysis of Australia's forest planning processes, however, reveals that participation can lead to varying degrees of success (Buchy and Hoverman, 2000).

4.1 Drivers for Change

Changes in the forest sector would probably have been inevitable even without the collapse of the Soviet Union. Already in 1992, the first analyses of the post-Soviet Estonian forest sector commented on the need to change. “The productivity of the Estonian forestry is relatively low. For example, the average productivity of forest work is two-thirds of the Finnish productivity” (CTS Consulting, 1992). The World Bank-led Estonia Agriculture and Forestry Project reported that “although forest management plans are generally based on reliable data and sound forest principles, forest management declined during the 40 years of Soviet administration. The central planning system was based upon targets for exploitation and silvicultural works were neglected. The quality of stands deteriorated significantly” (World Bank, 1994).

The privatization of forest industries, the limitation of the State's role, and the change of leadership in the public forestry administration laid an excellent groundwork for rapid development in the country's forest sector. Indeed, with the help of free market policies, Estonian timber quickly found its way to the export markets. In 1995, growth in the

⁵ For more detailed discussion on the advantages of participation and social consensus in developing forestry policies see “Formulation and Implementation of National Forest Programmes” (Glück *et al.*, 1999).

wood processing industry was recorded at approximately 15 percent, a year later the annual growth rate came close to 30 percent (Diagram 2).

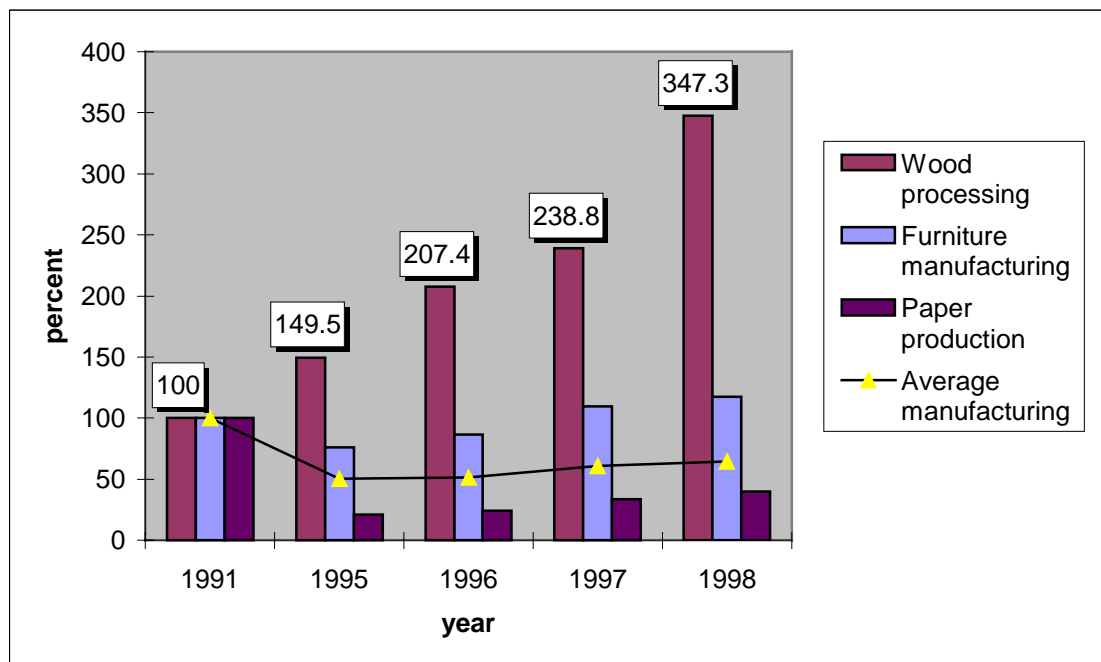


Diagram 2: Volume Index of the Industrial Production in Estonia at Constant Prices (1991 = 100 percent) 1991–1998 (Sources: EFDP, 1997a; ESO, 2000).

Restructuring the remaining elements of the public forestry organization, however, has not proceeded as smoothly as the privatization of the forest industries. The United Nations' Food and Agriculture Organization (FAO) and the World Bank missions to Estonia in 1993 and 1994 identified a number of shortcomings in the country's forest sector, particularly in public forestry. The country was viewed as lacking a long-term vision for forest sector development. Even though it was noted that the State Forestry Department's employees possessed all the necessary technical skills, the Department's staff were overwhelmed by the growing volume of day-to-day tasks, and unable to cope with the urgent needs for administration improvement (Forestry Development Program in Estonia, 1994).

Personal conversations with staff members in 1995–1996 revealed that the World Bank missions had not even touched upon a more severe problem inside the public forestry organization, namely, that the central forestry administration had little operational or financial control over the management of State forests. Furthermore, there were alarming signals from forest enterprises, concerning the waste of resources in some forest districts, and of low-priced timber sales that raised the specter of corruption.

Dissatisfaction with the State Forestry Department's activities grew as private forestland ownership was gaining ground. According to the 1993 Forestry Act, the State Forestry Department was required to endorse the forest management operations of private owners. It became evident that since the authorities were understaffed, they frequently failed to provide prompt service. Another important aspect here was the fact that State and private owners were concurrently operating on the same timber market. This made

the latter group suspicious about the intentions of the public forest officers when those were performing their routine check-ups on private forests.

Finally, the State Forestry Department was unable to protect the forests that were in a state of transition from public to private ownership. The occurrence of forest thefts increased. Similarly, the forest management's violations and noncompliance with cutting regulations (Yearbook, 1999). As a result, non-governmental organizations (NGO's) began to pay closer attention to forestry issues. In 1995, the environmental NGO's, strengthened by earlier successes in Government lobby, started voicing their concerns about the deficiencies in public forest management.

4.2 The Estonian Forestry Development Program

Under pressure from local industry, private forest owners, environmental NGO's, and the World Bank mission, the State Forestry Department was finally convinced to launch an overhaul of the Estonian forest sector. The Finnish Government agreed to provide necessary technical assistance for the endeavor. The two countries made a three-year commitment under the condition that each would support the development project with an annual budget of one million in their respective currencies.⁶ The opening meeting of the Estonian Forestry Development Program (EFDP) was held in September 1995. Two goals were set at the onset (EFDP, 1997b):

- (i) to define general objectives for the development of the Estonian forest sector; and
- (ii) to determine the actions that needed to be taken by the public sector in order to reach these objectives.

It was decided that the Program should be a participatory undertaking, allowing for an open dialogue among the stakeholders on all matters concerned. The pressing question was how to ensure public participation in such a process. As the goal was not only to come up with a national policy but also to introduce a different concept for public decision making that could also be used in future development, a tradition of open process had to be established. The Finnish participants emphasized that an effort had to be made to avoid Government authorities' dominance in the policy-making.

Several measures were taken to cope with the problems at hand. A three-step policy formulation process was set up (Figure 3). First, thematic working groups were formed. Membership in these groups was based purely on stakeholder interest. A national steering committee was established where the major interest organizations were granted equal representation. The committee was given the responsibility for drafting the policy principles. The draft policies were then to be submitted to the Government and subsequently to the Parliament for approval. Several research projects were launched to provide scientific support for decision making. A Program Coordinators' Office was established to facilitate information exchange between the participants and to communicate the draft policies to the general public.

⁶ 1 FIM = 2.63 EEK = 0.16 USD as of 23 June 2000 (Bank of Finland, 2000).

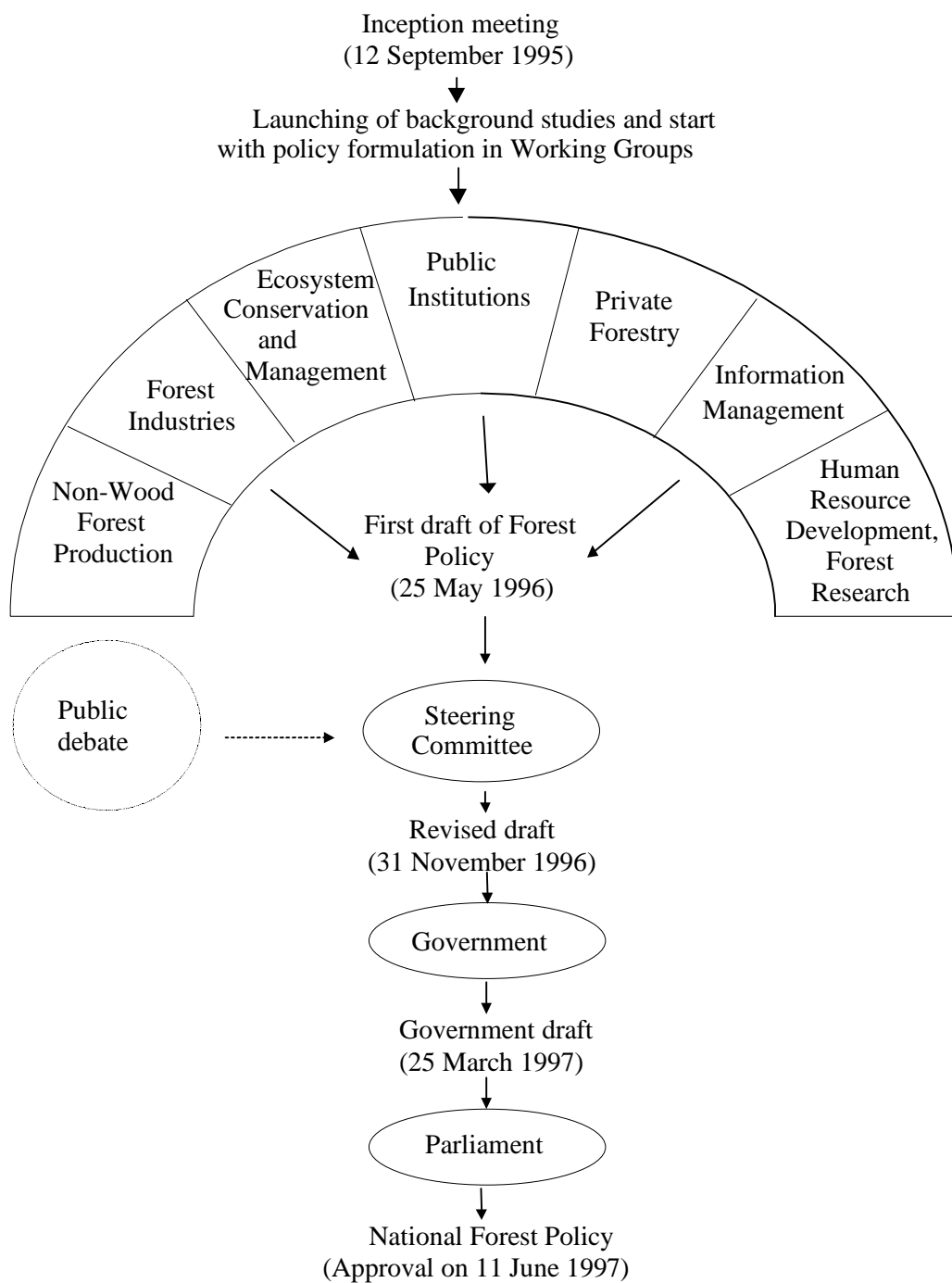


Figure 3: Structure of the Estonian National Forest Policy Formulation Process.

What became clear very quickly was that, aside from the public forestry administration, no other stakeholder could guarantee representation for each thematic group (for stakeholder motivation see Table 1). This immediately created suspicion among the smaller interest groups, as they did not see how they would possibly be able to effectively voice their opinion. In an interview just a few days after the inception meeting, Mr. L. Polli, the Chairman of the Board for the Estonian Private Forest Owners' Association (EPFOA), stated: "a forest policy formulation process, which is financed and organized by the State Forestry Department, does not adequately reflect all forest owners' views, and therefore it is currently not possible to reach solutions which are acceptable to all parties. However, provided that arrangements are based on mutual respect, the EPFOA is willing to participate in the discussion as the forest owners' representative and as an expert in the subject matter" (EFDP Newsletter, 1995/1).⁷

Other stakeholders were more willing to cooperate. Mr. M. Erik, the Chairman of the Estonian Forest Industries' Association (EFIA), answered the question whether or not the industry would participate as follows: "EFIA considers it necessary to formulate a comprehensive forest policy, and will actively participate in its preparation in relevant areas. This ensures that the industries' interests are taken into consideration, and that the outcome of the policy process is useful and applicable" (EFDP Newsletter, 1995/1). The Estonian Green Movement, represented by their Head of the Forestry Group, Mr. R. Ahas, expressed his thoughts a month after the policy formulation process was launched suggesting that: "the ongoing formulation of a Forest Policy, the way it is presently conducted, provides all interest groups an opportunity for active participation. If they do not utilize it, but opt to stay in opposition, it is clear that mutual distrust and accusations will continue" (EFDP Newsletter, 1995/2).

Providing only very little guidance to the working groups on how to deal with matters at hand, the scheduled gatherings immediately became an arena of free speech and hostile accusations. Very few conclusions were reached and a limited number of suggestions for future action were made. With one exception, none of the working groups produced a comprehensive report of their work. As a result, the coordinators' office decided to use the minutes of the working group meetings and the results of scientific studies to prepare a list of ends and means for each relevant subject area. Later, the working groups were asked to comment upon these proposals; the coordinators then tied the results together in one document. In order to avoid the interest groups dropping out of the process, the resolution of conflicting issues was left at the steering committee's disposal.

⁷ To receive more vocal opinion from the yet not fully established and underrepresented private forest sector, the coordinators' office organized a survey among the new and would-be forest owners. Three hundred people were interviewed and their answers on their activities and expectations were recorded. The study was later used for developing a private forestry oriented policy action (EFDP, 1996a).

Table 1: Stakeholders in the Estonian National Forest Policy Formulation Process.

Stakeholder Group	Motivation	Policy actions (other than participation) available to the stakeholder
Private forest owners and their organizations	<ul style="list-style-type: none"> • To gain direct support (subsidies, tax breaks, etc.) from the Government; • To reduce the Government's regulatory power in private forestry. 	<ul style="list-style-type: none"> • Voice dissatisfaction; • Poor forestry performance.
Private forest industries and their organizations	<ul style="list-style-type: none"> • To tighten control over the raw material base; • To achieve direct subsidization of the industry from the Government. 	<ul style="list-style-type: none"> • Voice dissatisfaction; • Financially backing of Government lobby.
Environmental non-governmental organizations	<ul style="list-style-type: none"> • To enhance the forest management performance in the country; • To strengthen the group's role in public policy making. 	<ul style="list-style-type: none"> • Voice dissatisfaction locally; • Voice dissatisfaction abroad.
Local municipalities	<ul style="list-style-type: none"> • To increase regional benefits (rural employment, tax revenues). 	<ul style="list-style-type: none"> • Influence on the electorate; • Influence on Cabinet decisions.
Research and educational institutes	<ul style="list-style-type: none"> • To increase Government funding for research and training; • To clarify the sector development and adjust accordingly. 	<ul style="list-style-type: none"> • Publication of research outcomes; • Voice dissatisfaction.
Public forestry administration	<ul style="list-style-type: none"> • To fulfill the office's responsibilities; • To maintain their status in Government hierarchy. 	<ul style="list-style-type: none"> • Adopt closed-door policy-making.
Ministry of finance	<ul style="list-style-type: none"> • To serve the Government Treasury's needs. 	<ul style="list-style-type: none"> • Increase Treasury's allocation via influence on Cabinet's decisions.
Other government ministries	<ul style="list-style-type: none"> • To fulfill (and expand) their functions. 	<ul style="list-style-type: none"> • Use agency's position in Government hierarchy.

Source: EFDP, 1997b.

The steering committee met three times. The strong representation of different government agencies — representatives from four ministries plus the Director of the State Forestry Department — effectively outweighed the other stakeholders' dispersed interests. The coordinators attempted to alleviate growing dissatisfaction with the process by approaching the interest groups individually for consultations. These 'behind the curtains' negotiations were frequently fruitful, as compromises were made and the voice of private interest groups in the policy preparation increased. Good examples of this were a much stronger involvement of regional municipalities in the local level forestry decisions, and a thorough revision of environmental conservation matters in the policy that the steering group eventually agreed upon. What failed was an attempt to determine the exact judicial status of the Government's forest management organization. The forest industries' effort to make the management of public forests follow the same exact procedures established for the private enterprises was met with strong resistance from the public administration's side. Even though a radical decision to split the State's forestry functions between two organizations — the forest manager and the forest supervisor — was made, the exact legal framework, in which each would operate was left undefined. At the end of the day, the industry's fear of facing a Government monopoly in local wood procurement was not resolved. Conflicts on a personal level also overruled attempts to settle differences concerning the role of government ministries on the assistance to private forestry. A complete exclusion of the Ministry of Agriculture from the country's forestry matters resulted, causing great concern among the latter agency's employees.

Despite the differences in opinions within the steering committee, the group, pressured by its Chair, the Minister for the Environment V. Reiljan, accepted a final wording for the policy recommendations. The Minister thereafter immediately submitted the proposal to the Government, which quickly agreed on the contents of the document and further submitted it to the Parliament for political approval. The endorsement in the Parliament came at the first reading; the document received unanimous support both from the members of the ruling coalition as well as the opposition. By June 1997, a little more than one and a half years after the Program had been launched, Estonia had a new National Forest Policy (for contents see Table 2).

Table 2: Principal Goals of the Estonian National Forest Policy approved by the Estonian Parliament in 1997.

Policy Goal	Means of Achievement	Current Stage of Implementation
Biological diversity conservation	<ul style="list-style-type: none"> • Establishment of forestry information systems. • Creation of a comprehensive nature conservation network. 	<ul style="list-style-type: none"> • Not started • Underway
Increased forest productivity	<ul style="list-style-type: none"> • Improvement of forest management and management planning practices. 	<ul style="list-style-type: none"> • Not started (started only in the state forests)
Qualified labor suitable for conducting forestry operations	<ul style="list-style-type: none"> • Introduction of demand-based forestry research and higher education. 	<ul style="list-style-type: none"> • Not started
Increased public awareness	<ul style="list-style-type: none"> • Public awareness raising programs. 	<ul style="list-style-type: none"> • Not started
Efficient use of private forests	<ul style="list-style-type: none"> • Development of extension service for private forest owners. 	<ul style="list-style-type: none"> • Terminated
Efficient Use of Public Forests	<ul style="list-style-type: none"> • Reorganization of the public forestry administration. 	<ul style="list-style-type: none"> • Underway

Source: EFDP 1997b.

4.3 The Policy Implementation

The most significant, and perhaps the only immediate positive contribution that the Program made to the country's forest sector development was the restructuring of the public forestry administration. A separate State Forest Management Organization was established with the aim of improving efficiency in State forestry. The economic analyses conducted during the policy formulation process indicated that labor productivity in Estonian public forest management was low, achieving just 15 percent of the Scandinavian level (EFDP, 1996b). Moreover, projections indicated that the State Forestry Department was expected to run into deficit by 1998 (Diagram 3). The black scenario that the economists had predicted for the country's public forestry required prompt reaction.

The initiative for this did not, however, come from the top administration but from a group of the Forestry Department's regional and district managers, who were deeply disappointed with the development of the organization by that time. Foreseeable financial difficulties, which the above-mentioned analysis had revealed, meant that nobody was indifferent on the matter. The reaction that came from the lowest level of the forestry organization — the forest districts — was quite the opposite of the ideas that the regional managers had started pursuing. Expectedly, the higher levels of the organizational hierarchy saw a tighter financial and management control as the primary means for improving the situation. Many of the district managers, on the other hand,

already enjoying a great degree of freedom, became very much in favor of loosening the economic ties between the individual districts and the central (budget) authority even further. A revolution inside the Department was imminent. As it turned out, the revolting forest district managers did not have sufficient cohesion or power to seriously affect the process. Since the Department's top administration did not have a solution to offer themselves, the regional managers' initiative to establish a separate public forest management organization became the only viable policy option.

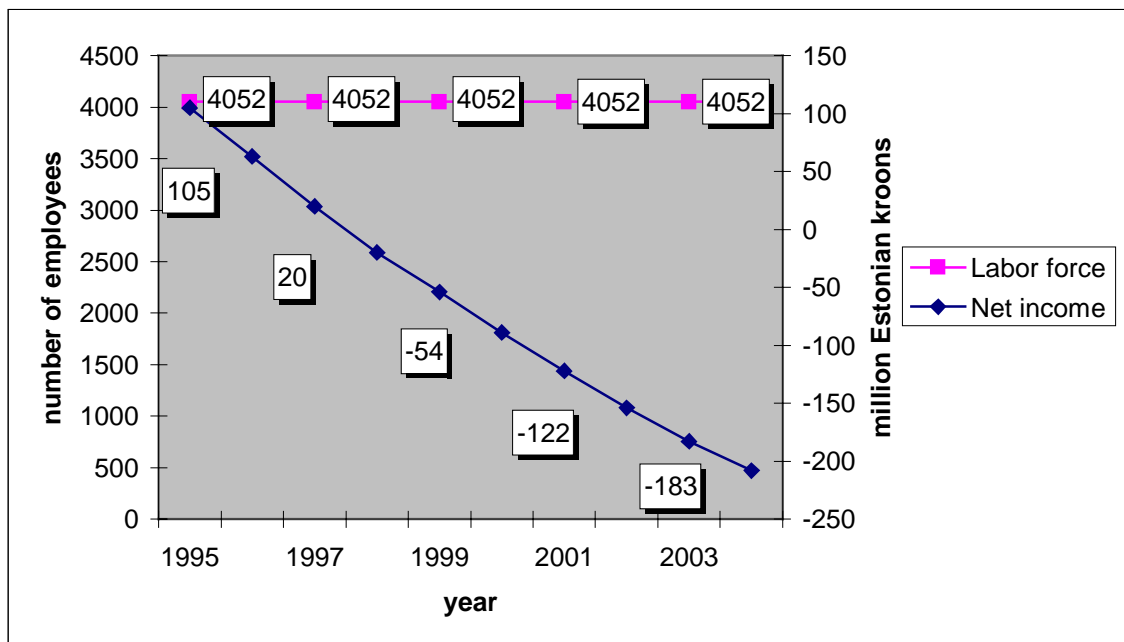


Diagram 3: Predicted Development of the Estonian State Forestry Department in 1996 (Source: EFDP, 1996b).

Using his strong personal leadership skills, the Minister for the Environment, Mr. Reiljan, ensured that the forest policy steering group agreed to split the public forestry functions between two organizations. One was supposed to take over the management of public forests, the other to fulfill the regulatory functions of the State. At that time, the question was more on how to ensure that this reorganization would actually appear in the relevant legislation, and once it was there, to guarantee that the new organizations were capable of executing their responsibilities. Despite the absence of a legal framework a so-called 'project' state forest management organization was established under the direct guidance of Mr. Reiljan. The former regional manager and the National Coordinator of the Forestry Development Program, Mr. A. Onemar, was chosen to become the Project Manager. The core project team was selected via public recruitment. Hopeful for a change, some of the most influential and respected regional and district managers applied and were chosen for the job.

The project organization, still under supervision of the State Forestry Department, was expected to introduce a major shift in traditional forest management in Estonia. It was determined to optimize the structure of the existing management organization (the forest districts), bring law and order to the organization and, ultimately, to avoid the

bankruptcy of State forestry. Once the proper laws were in place, the organization was supposed to be given independence to operate as a government-owned business organization. Today, the State Forest Management Organization is showing much improved performance (Diagram 4).

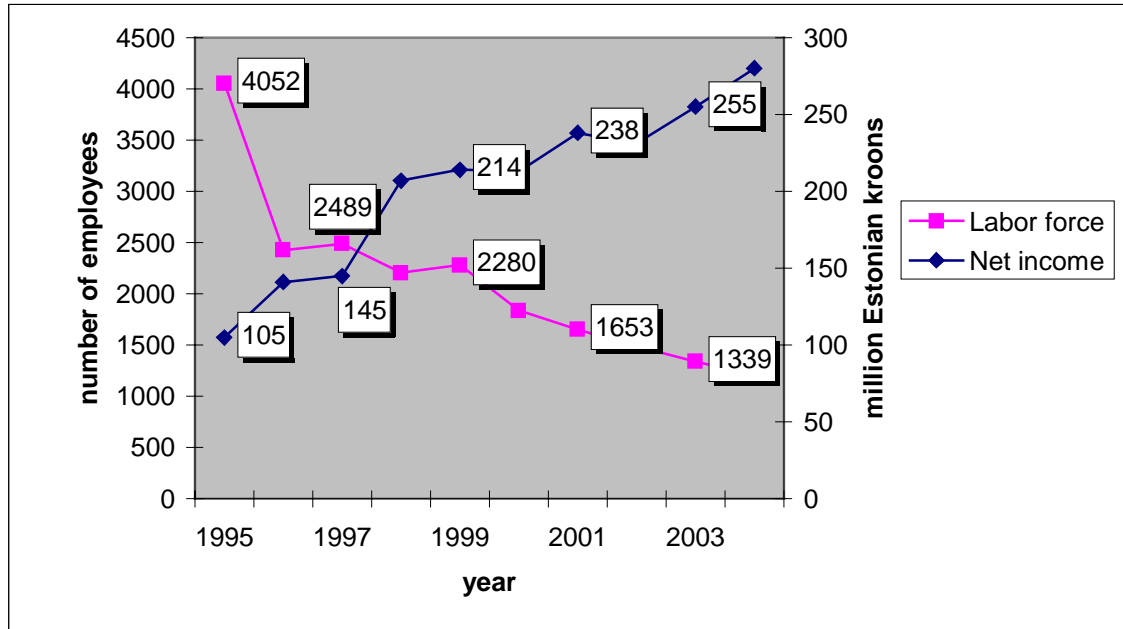


Diagram 4: Actual Performance and Predicted Future Development of the Estonian State Forest Management Organization in 2000 (Source: ESFMC, 2000).

The existing State Forestry Department was supposed to fill the other roles of the State — forest policy revision, supervision of the country’s forests of all ownership categories, and provision of advisory services for the private forest owners. Afraid of losing its dominance in the forestry arena, the State Forestry Department asserted its control over forest policy implementation activities. Due to the lack of interest and poor leadership, the Department had no more influential role than any other stakeholder did during the policy formulation. Now, the Department took the initiative and formed an expert committee for the revision of the Forestry Act. Since the committee only consisted of public sector employees, its activities involved very little stakeholder participation. In addition, the proposed Act hardly made any reference to the National Forest Policy. Vocal dissatisfaction expressed by private interests was ignored (Sootla *et al.*, 1998).

This development was perhaps the first warning sign, indicating that the forest policy implementation was not going to be easy. The new Forestry Act (1998) was passed in December 1998. What is not yet accounted for is the cost of the acrimonious battle between the stakeholders and the Government’s forestry administration prior to the approval, the clipped contents of the Act, and the actual impact of the endorsed principles.

4.4 Lessons from the Second Wave of Change

In order to evaluate the impact of the forest policy formulation and implementation several stakeholder group representatives were interviewed during the summer of 2000. Perhaps due to the survey method — e-mail inquiry, bad timing, and the vacation season — very few responses were received. Those that were received gave the impression that dissatisfaction with the taken course of action in today's forestry might have hampered the interviewees' enthusiasm to respond.⁸ With no exception, all the respondents acknowledged the merits of participatory policy formulation and admitted that their attendance or expression of views were never restricted during the process. However, it was emphasized that democracy and respect for stakeholders' opinions ended once policy formulation reached the steering committee level. According to the interview response from Mr. R. Ahas, the Head of the Forestry Committee of the largest local environmental NGO, "unfortunately, the policy formulation was in many cases dominated by the minister's [the Minister for the Environment] and other politicians' will. In other words, the political parties in power decided on the final design of the document. In that way the meaning of many original proposals was changed."

All respondents stressed that reorganization of the forestry administration had made a significant positive impact on State forest management in the country. On the other hand, none of the interviewees were able to name any other successfully implemented policy measures. As a matter of fact, everyone was disappointed that hardly any action had been taken other than changes in the State forest management. Private forest owners complained about the lack of support for their activities and the fact that even the limited measures listed in the policy document had not been introduced. The environmental NGOs were dissatisfied with the poor regulatory framework for forest management. A representative of the only vocational forestry school in the country criticized the negligible efforts that the Government had made to raise the quality of forestry education and training. Adding to this, she admitted that as the policy document was weak in terms of content anyway, it might even be good that not much had happened in terms of implementation. Most respondents emphasized still non-existent information systems as the main hurdle to policy implementation.

Personal interviews with the members of the Estonian forestry community indicate that support to policy implementation from private stakeholders is currently missing. The fact that the State Forest Management Organization is constantly under lobbyists' attacks and that politicians are bribed to take measures to get rid of it, supports the argument. The Ministry of Agriculture, who had never given up the idea of achieving control of private forestry, has put the issue back on the table. Recently, the local environmental NGOs placed Estonian forestry among the least attuned to preserve biological diversity in the world. Worst of all, the open dialogue that participatory policy making was supposed to create, and the optimism the stakeholders initially showed towards such a process, has been squandered.

The opposite trend can be observed by looking at the only success story of the Forestry Development Program — the establishment of the State Forest Management

⁸ The body of interviewees consisted of members of the Steering Committee and representatives of the stakeholders who participated in the National Forest Policy formulation process. All together 20 questionnaires were sent out and 5 responses received.

Organization. Personal interviews with the staff members prior to the restructuring had revealed a broad-based discontent with the headquarters of the State Forestry Department. The organization's performance has improved and so have the employees' attitudes. The formation of a project organization and the appointment of Mr. Onemar as the Head and several other respected individuals from the lower levels of the organizational hierarchy as a core management team, were clearly the foundations for success there. Strong leadership, personal commitment and an attempt to achieve an open development within the project organization allowed the best ideas to surface. Even if the selected course was not the most favorable from the personal perspective of many of the employees, confidence about the future and trust in the leadership was sufficient to overcome potential opposition.

5. Discussion

Mishler and Rose (1998, p. 29) claim that "as institutional performance holds the key to trust in political institutions, then the process of building trust in institutions can occur much more rapidly than the generations or centuries, suggested by cultural theories." Thompson, *et al.* (1990, p. 218) manifest that "[e]xperience with institutions counts," and argue that political culture, "conceived as ways of life that are continually being negotiated, tested and probed by individuals," explains political change.

Lack of trust towards the Soviet-era administrators was common in the pre-liberalization Estonia. Likely, this turned into the strongest card in the hands of the new era politicians after the country's independence was re-established. Initiating a quick separation of business from the Government was perhaps the action that most significantly contributed to trust-building in the society. Citizens' attitudes were further enhanced by making economic decisions that were acceptable for the majority interest. Clarification of often messy public functions, a reduction of those functions and assignment of rights and responsibilities in a way that did not create conflicts inside the same organization, were the policy actions that guaranteed the actual implementation of chosen policies.

The entire transition period in Estonian forestry supports one very obvious conclusion — people will rarely do anything against what they consider socially acceptable. Reliance on social norms is ultimately what lays the basis for the control over the formal rules that Douglass C. North has identified as being our only available decision variables. In order to be able to do so, these norms have to be supported by many and, even more importantly, by the organized many, who are capable of openly and forcefully expressing their views. Having the opportunity to compare, match, and in some cases also neglect, people's perceptions is the only way to develop an action that is acceptable for those upon whom it has an impact.

The subsequent steps in the development of the Estonian forest sector throughout the ten years of transition articulate these views. Placing the described process in between North's scaffolds offers us some insight to why and how some policy actions succeed, while others do not (Figure 4).

The impetus for much of the described development period was given by the political change that immediately followed the separation of the country from the Soviet Union.

The society indicated its readiness for the shift via the general elections that produced public governance capable of and willing to undertake radical steps in the economic and social restructuring. On the forestry scale the split of old administrative networks took place.

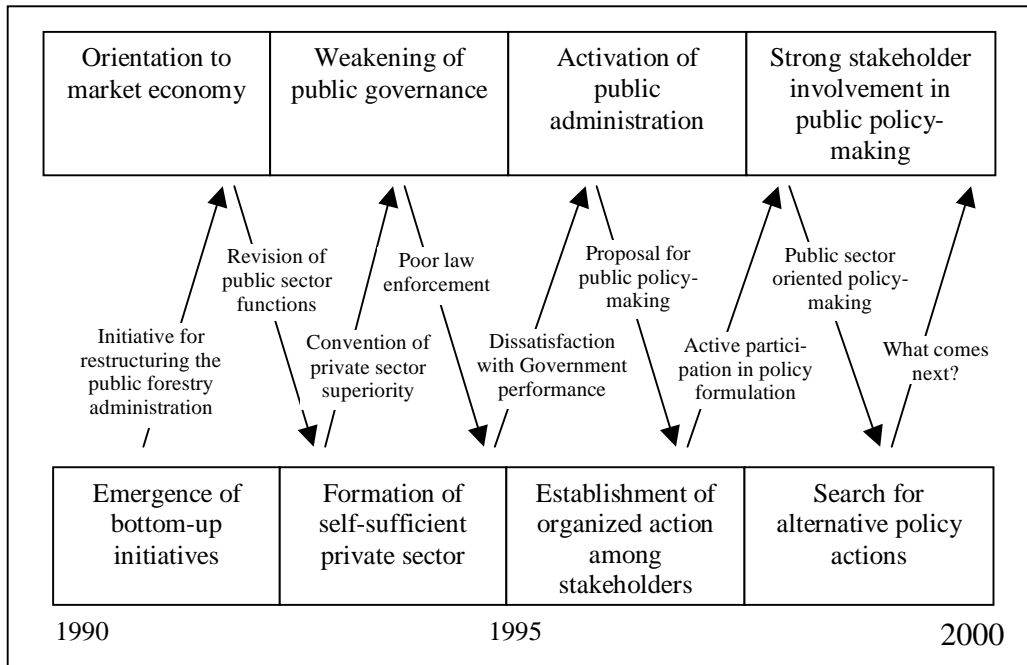


Figure 4: Development of the Estonian Forest Sector in Scaffolds.

The establishment of private property rights and the fast take-off of private business ventures idealized the status of a private entrepreneur within society, resulting in a brain-drain from Government offices. The authorities were unable to fulfill their responsibilities and the implementation of formal rules was hindered. In contrast, the private sector — timber industry and environmental NGO's — was strengthened and became organized, enabling them to independently enter the political debates. Stakeholder discontent became the policy action that initiated the next phase in the forest sector development — public policy formulation. Raised hopes to improve the dissatisfactory situation ensured active participation by the stakeholders.

The policy formulation process had its definite successes, such as the approval of National Forest Policy and the reform of public forestry organizations. It also promoted the empowerment of the stakeholder role within society. However, according to the interviewed stakeholder representatives, forest policy implementation has brought about only limited results in other fields. Also, it has pushed the stakeholder groups away from the public policy-making arena. It can be argued that two actions: (i) the exclusion of stakeholders from the final policy formulation; and (ii) the choice of policy implementation pattern that does not involve stakeholder participation, are the primary causes for these failures. As indicated above, the private groups are already using methods other than participation in public dialogue for achieving their desired goals. Further avoidance of stakeholder involvement in the policy-making process is, perhaps, not going to improve the situation.

Referring to the handful of key individuals whose names appeared throughout the described development process, it could be argued that much of the policy success depends on decision-makers' individual roles. The establishment of timber auctions and the failure to restructure the public forestry organization at the beginning of the 1990s, can both be associated with the top management of the State Forestry Department. The lack of initiative in improving the Department's performance inevitably resulted in more abrupt organizational change in the next phase of the sector's development.

Minister Reiljan's strong involvement in the EFDP steering committee's decision-making process supports the argument. Having greeted the policy formulation initiative with much enthusiasm, the stakeholders, not being able to significantly influence the outcome, have not been supportive of the policy implementation. Misuse of participation makes the policy formulation process in Estonia a pertinent example of how the violation of unwritten rules can trigger unwanted policy actions.

Turning away from open discussion has resulted in a lack of continuity in public policy-making and has certainly not allowed for the establishment of a self-enforcing policy revision process. On the other hand, Mr. R. Ahas' suggestion that politicians should not be involved in modifying experts' policy proposals questions the former group's role in society. Ideally, there should be room for both — for the people from inside the sector, e.g. the forest owners, environmentalists, etc., and for the external interests, e.g., politicians representing the public opinion and other Government agencies. Acceptance of the rules of the game and the role of players, however, has to be reached prior to starting the process. Raising the responsibility for the sector's policy making to a higher hierarchical level than just a respective Government office should provide the means to accomplish this task.

The Estonian forest sector development can be claimed to illustrate that in order to achieve results and introduce changes, the initiative for the change must come from inside the organization whose operations are to be altered. Also, the "right" leaders for the change have to be found. As part of the public policy formulation process, the Estonian State Forestry Department had to give up its position in the Government hierarchy. The Department's regional and district managers, who initiated the restructuring of the public forestry administration in 1996–1997, have gained a strong hold of the country's forest sector. The results that the new organization — the State Forest Management Organization — has achieved depend upon the personal trust that managers were able to build among employees and the commitment the personnel itself has made to support the development.

Earle and Cvetkovich (1995, p. 150) warn us that full participation leads to cynicism, distrust, and withdrawal. Without trying to judge whether this has been the case in Estonia, it is likely that involvement of stakeholders throughout the ten years of transition in the country's forest sector significantly altered its development course. Participation was a tool used in this process, as it allowed to "negotiate, test and probe," contributing to the decision-making. Since the decisions did not always follow what the negotiations had proposed, the outcomes disappointed the decision-makers on several occasions. This seems to suggest that what may guarantee policy success or lead to policy failure is not participation *per se*, but the manner in which it is used.

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