ESTONIA
SASCHA KRAUS

March 2013

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The Estonian Tiger[*] fighting the European Debt and Economic Crisis

INTERVIEW WITH ANNELY AKKERMANN MP

Annely Akkermann MP (40) is a member of the parliamentary group Isamaa ja Res Publica Liit (IRL) in the Estonian Parliament (Riigikogu) since 2011. She studied economy at the University of Tartu and has years of fiscal experience in local administrations. In the Riigikogu she is a member of the Select Budgetary Committee. With her economic background and years of political experience on a local and national level she answers various questions regarding Estonia, the Euro as well as the European Debt and Economic crisis.

Do you still feel that Estonia is affected by the current European Debt and Economic crisis?

I remember that the first signs of the financial crisis in Estonia emerged in 2008 and were connected to the failure of Lehman Brothers and some Icelandic banking houses, consequently, the financial crisis transformed into a European Debt and Economic crisis and fully gripped Estonia from 2009 to 2011. Tax income and GDP decreased significantly. The liberal-conservative coalition had to undertake severe measures in order to counter the effects of the crisis. Nowadays, we are not affected by the crisis anymore. Last year we had an economic growth of 3 percent, this year prognosis vary from a growth of 3 to 3.5 percent; further future projections are equally positive. I am very glad that we do not feel the crisis anymore. Furthermore, Estonia has been two years, since joining the quickest growing economy in Eurozone, and we are proud of it.

Could you briefly outline these measures the Estonian government has undertaken in order to counter the effects of the crisis? Did they work as indented?

First of all, there is no magic formula to overcome a financial crisis. In 2008, I was Vice Major of Finance for the local government in Pärnu and due to the financial crisis and the financial politics of the previous administration we had to take immediate action. At that time, the city had taken to many loans and we almost had zero growth in the district. In total, we cut 28 percent of the city's approximate 600 million Euro annual budget; for example, we cut salaries by 17 percent, reduced the number of public employees by 10 percent, cut infrastructure and mobility spending, decreased public tenders in scope and quantity, we even turned of every second street light in the city in order to decrease the

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[*] From the restaration of independence until the first financial crisis in the end of the 1990s, Estonia was called one of the Baltic Tigers due to its dynamic economic growth and structural reforms.

budget. Even though it was painful, we did everything we could without collapsing the local economy.

In essence that is what our coalition did when the crisis fully hit in 2009 and the following years. The main reason Estonia recovered fairly quickly from the crisis and generates sustainable economic growth today was a though yet necessary policy of austerity: Though choices were made, the general state budget was cut, salaries of public employees were reduced as well as the number of public employees in general. Of course the Estonian people did not like those cuts and some had to suffer a time of economic hardship, but in general people understood how important those choices were for our country. Besides, Estonians do not just quit their job due to a salary reduction of 20 to 25 percent. Austerity measures we easier imply because there was a big aim to join euro. Estonia needed to fulfil Maastricht criteria. The people understood the importance of regulations and values in the Eurozone.

However, these implemented austerity measures are only part of our recovery. Another important factor is significant financial influx from European structural and cohesion funds; the money is mostly meant for infrastructure projects. For example, a lot of kindergarten, school and university buildings have been renovated. In the period of 2007 to 2013, Estonia receives a total of 3.2 billions Euro from the European Union. This money annually accounts for approximately 20 percent of our 6 billion Euro general budget. This is a great help for Estonia; however, I am an economist and among many others this number concerns me very much. I believe that we have to change the overall structure of our budget and find ways to reduce the financial dependence from the EU. Furthermore, Finland and Sweden invested a lot of money in order to counter the crisis and Estonia is an important trade partner of those countries; therefore, especially the Estonian private sector benefited greatly. In general, the Estonian economy is export orientated due to our competitive prices and 70 percent of those exports go to EU countries. For all those reasons we are recovering fairly quickly from the European Debt and Economic crisis.

The measures the Estonian government implemented were successful. How did the crisis as well as those austerity measures effect the Estonian people?

Yes, the implemented measures worked well and this year we have a projected growth of GDP of approximately 3 percent or more. However, the crisis and the austerity measures as well as general economic developments have been hard for our people. For example: From January 2013, the Estonian electricity market was fully liberalized in line with EU agreements, now, corporate and private consumers are obliged to purchase electricity on the open market. As a result, electricity prices jumped by 30 to 50 percent and, consequently, a lot of consumer goods noted rising prices as well. That hurts and people feel that even though the economy is growing they are not benefitting from the though austerity measures they endured before; in fact, they feel that their purchasing power and capacity is declining. Although real salary has been rising 6 quarters already, people just do not feel it. I understand these concerns, but as mentioned before, it is not just due to the European financial crisis and our austerity measures; this decline also results from general economic developments.

You highlighted the rather quick recovery of the Estonian economy due to austerity measures. Would you describe these measures as a specific Estonian or Baltic way of crisis management? Could this be a model for other countries in Europe?

It is funny, that you ask this question for there was a heated debate between our President Toomas Hendrik Ilves and the American Economist Paul Krugman. In essence, Krugman said that what the Baltic States have done is not a miracle as many suggest and it might seem successful on the outside; however, he believes that the austerity measures and our budgetary discipline are not sustainable and a danger for the economy. Ilves replied that the recovery was indeed not a miracle, but the austerity measures were the right thing to do. Estonia had to cut its budget in order to maintain competitive prices during and after the crisis. However, I believe that the same measures would not have worked in Nordic countries or Germany. They don’t have such high influx of European money; furthermore, Estonia did not have to bail out banking houses for we do not have own banks anymore. Most banks in Estonia are from Sweden and we saved a lot of money for not having to save them. We have a common currency in Europe, but there was and is no universal solution to this crisis. Some countries flooded their economy with money, we implemented severe budgetary cuts. It does not work, if everybody does the same. We did what was best for Estonia.

What are Estonia’s contributions to the *European Stabilization Mechanism (ESM)*? Does Estonia have the economic capacity to show solidarity with debt-stricken countries?

The stability of our common currency is crucial to Estonia’s economic competitiveness and, as a part of the *European Monetary Union (EMU),* we naturally participate in the *European Stability Mechanism (ESM)*. The ESM is funded to 700 billion Euro, with Estonia's contribution totaling 1.3 billion or 0.19 percent of those funds. With the treaty's passing in September 2012, Estonia is obliged to pay 149 million Euro into the fund and guarantee another 1.15 billion Euro in loans. I think that the ESM is not practical for a small economy with a general state budget of approximately 6 billion Euro and a GDP of approximately 17 billion Euro in 2012. However, as an economist I believe the ESM is the least harmful option to counter the European Debt and Economic crisis on a larger scale. On the contrary, it facilitates inflation because ESM loans are not sterilized from the market. Inflation is bad, but it is not the worst thing that can happen. Greece with its riots and strikes is one example of what can happen if the cash flow in a modern European country stops. In reality, hardly any country would be able to pay for all the guarantees they made to the ESM; therefore, inflation is one other option to handle this problem.

Having said this, I would like to remind that Estonia joined the EU and the EMU for the promises of peace, stability and prosperity. Therefore, we need a fiscal union to accompany the monetary union and, of course, Euro countries must adhere to the Maastricht criteria at all costs! We need sufficient sanctions, if a country breaches these criteria. With a common currency, emitting additional money is no longer an option for countries such as Greece, Italy and Spain. However, Estonia sees the necessity to help those debt-stricken countries, but only if they fully cooperate with the EU and accept certain proposals.

In an interview at the German Council on Foreign Affairs Estonian President Ilves said that Estonia is willing to help and make its contributions to the EMU and ESM. However, Estonians are sceptic towards certain countries receiving huge funds and at the same time not implementing the necessary reforms, or at least implementing them much slower and less compassionate than Estonia did during its domestic crisis between 2009 and 2011.

I think that EU and EMU Member States have to make two very fundamental decisions upon and during their membership. On the one hand, such countries have to address a cultural issue or a question of monetary philosophy: One can only spend the amount of money one has, making debt is neither a long-term nor a sustainable solution to financial shortcomings. Besides that, there are serious political decisions to make: Estonia’s secret is budgetary discipline; here, philosophy and politics mingle. In order to join the EU and the EMU, we decided to fight inflation by balancing our budget and have been rather successful in doing so. There are three steps to be considered and implemented. It is equally important to cut costs and to implement structural reforms in order to strengthen competitiveness. Lastly, if public employees lose their jobs, it is important to encourage them to find a new job in the private sector. In conclusion, a philosophy of monetary restraint and price stability as well as structural reforms will create economic growth and competitiveness; with these measures, debt-stricken countries such as Greece can get back on track.

However, I think that Southern European countries are not aligning with this kind of thinking. For many years politicians in Southern Europe made promises in order to be elected; in fact, governments printed money all the time and created huge debt and inflation. It was a vicious circle. With a common currency, printing and emitting money is not possible anymore. Politicians as well as people who were happy about higher salaries or pensions have to adjust their way of thinking if they want to overcome the crisis as well as if they expect Estonian and European solidarity. It is not fair that some countries wish to receive the benefits of their Euro membership, but are then reluctant to pay the price. If they cannot or do not want to change, they eventually have to leave the Eurozone. There cannot be two philosophies and two worlds within the Monetary Union.

Latvia and Lithuania are probably going to join the European Monetary Union soon. What should the applicants really consider regarding the structure of their economy and society?

I think Latvia and Lithuania are more or less ready to join the EMU. In the last few years they have been supported by the EU as well as by the *International Monetary Fund (IMF)* in order to counter their domestic crisis and save the banking sector. More importantly, they had severe budgetary cuts comparable to Estonia and showed that they are responsible and ready to follow the rules of the EMU. Besides, for such small countries it is almost compulsory to be members of the Eurozone; trust is the key factor to foster trade and attract *foreign direct investments (FDI)*. Their own currencies do not enjoy such high rates of trust and there is the risk of devaluation; those risks are expressed in higher interest rates for loans. This is why small economies are always under pressure; however, I am sure they will adopt the Euro soon and perform and develop well within the Monetary Union. In fact, they have a similar philosophy of budgetary restraint, low inflation rates and the stability of prices as Estonia and Germany.

A survey published in the magazine of the German-Baltic Chamber of Commerce suggests that the 2011 introduction of the Euro in Estonia has had a positive impact on business in the country. Do you share this view?

I fully agree. The Euro has greatly helped us to increase our competitiveness and the trust of foreign investors; furthermore, loan conditions are far better with the international trust the Euro enjoys. I believe that joining the EMU was compulsory for us; monetary nationalism is no use in the 21st century. Especially private companies that import or export goods have benefited from the introduction of the Euro. They do not have to pay for currency exchange commissions and could reduce administrative workload; in fact, 30 percent of Estonian import and export are with EMU Member states. Furthermore, 70 percent of our trade is with EU Member states and even when we trade with our Nordic neighbours such as Sweden, the Euro has brought us stability on exchange rates and made it a lot easier for entrepreneurs to calculate and conduct business.

How did *foreign direct investments (FDI)* develop after the adoption of the Euro in 2011?

One important issue with FDI is trust both in the currency and the state itself with the quality of rule of law etc. With a strong and European currency, an excellent educational and higher educational system, lean and efficient bureaucracy as well as a (business) friendly environment and society, Estonia is very attractive for foreign investors. In 2012, almost half of the total amount of the 14.3 billion Euro FDI came from EMU Member states, especially from Finland and Sweden. The most preferred fields of activity for foreign direct investment in Estonia were financial and insurance activities, manufacturing, and real estate activities as well as investments in the agricultural and forestry sector.

How do Estonians see the future of the Euro? How are saving accounts performing in Euro?

Estonians believe in a stable European currency and feel very save about the Euro, myself included. We would not have joined the EMU if we had not believed in this unique instrument of European integration. There are many advantages for the average citizen: Travelling without money exchange and no more difficult calculations in order to work out the price of a product in our own currency; nowadays, we have full access to the common European market. Export became easier and, even more importantly, it is the only reasonable approach towards a globalized and multipolar world with a strong China and the United States of America. Macro-economically, you have to play in this league. The Estonian people are currently getting used to the new currency and believe in its strength, even though we had some increasing prices, but with the Estonian Kroon it would have been quite the same due to fixed exchange rates vis-à-vis the euro. I think those rising prices mainly resulted from increasing energy prices.

Saving accounts are performing well in Euros. The latest statistics issued by the Estonian Bank indicate that the number of savers is growing. After the economic boom in 2006 and 2007 and the ensuing crisis, people started saving money rapidly in 2009, because they realised that the boom would not last forever. In my opinion, rapidly growing savings in Euro are yet another indication that the Estonian people have confidence in the common currency.

Let us have a look into the future of our Monetary Union. How do you see the medium- and long-term perspective of the Euro and the EMU?

I do not think it will break apart, a common currency is an excellent instrument of European integration and the price of losing it would be too high. On the contrary, I think we should not be so afraid that some countries might have to leave the Eurozone. Of course they do not want to, but some might have to in order to regain economic competitiveness and sustainable growth. The struggle of those countries that should leave, but remain in the EMU might also compromise the trust and stability of the Euro. However, the countries who have chosen the path of price stability, low inflation and budgetary discipline will remain in a Monetary Union with a strong currency. Our common Euro is a symbol for an integrated and united Europe, for Greeks, Germans, Dutch, and Estonians!