

# Estonia and the European Debt and Economic Crisis

AN OVERVIEW

**With beginning of 2011 Estonia has adopted the Euro and completed its integration into the Eurozone. In fact, this marked the culmination of a drastic re-orientation regarding the Estonian economy: From a former *Soviet Union (SU)* planned economy to a Western market economy. The process has begun in the early 1990s with Mart Laar's government implementing a number of economic and political reforms in order to pave the way towards economic freedom and prosperity and democratic stability. In the beginning of its journey from the SU to the *European Union (EU)*, Estonia faced Soviet Ruble inflation exceeding 1.000 percentages, soaring unemployment and political uncertainty. In 2011, the *Baltic Tiger* enjoyed a solid, well-balanced state budget and a debt of only 6.6 percentages of its *gross domestic product (GDP)*. Recent data by the *European Central Bank (ECB)* indicates that Estonia is together with Luxemburg and Finland one of the few member states in the Euro-Zone that has sufficient financial resources in order to repay its debt.**

## Estonia's path towards the Eurozone

When the SU collapsed in the early 1990s, the Estonian political and economic situation was dire: Inflation of the Soviet Ruble was soaring and exceeding 1.000 percentages, unemployment was on the rise, social inequalities and crime increased swiftly. Furthermore, the transitional government and later Mart Laar's cabinet faced a 30 percentages decline in annual manufacturing output and the complete collapse of the agricultural sector. To add more uncertainty, it was suggested that Estonia should opt a *third path* or *middle way* by extracting elements from both the Western and Soviet economic and political models. The first free democratic elections after the country's re-independence in 1992 resulted in a landslide victory for Mart Laar and his proposition to drastically re-orientate Estonia towards the West.

Mart Laar's implemented measures included a *sweep-the-place-clean* policy to build a modern, uncorrupted state by replacing Soviet officials with "a *generation untouched by earlier experiences*"<sup>1</sup>. Further steps included the establishment of a threefold European style court system. These political measures were accompanied by economic reforms to combat rapidly rising employment rates of 30 to 40 percentages in 1993.

In 1995, Mart Laar's government was voted out of office. However, the incoming government continued the political direction of its predecessor. In fact, Estonia was the first former SU country to be admitted to the first round of EU accession talks in 1997. Following

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the 1998 financial crisis, Mart Laar was elected as Prime Minister for a second term in the 1999 general elections. However, his intention had not changed. A government paper states: *"If between 1992-1995 the objective was to redirect Estonia from the East to the West, then now Mart Laar's goal was to make this change irreversible."*<sup>2</sup> He did so by pursuing Estonia's applications for full EU and NATO membership. Both were obtained on 1<sup>st</sup> January 2004. Defence expenditures were increased from 1.4 percentages to 2.0 percentages of the GDP in order to render Estonia eligible for NATO. The much desired *"accession to the EU was not a goal in and of itself, but a means of guaranteeing the country's stability, security and economic growth, improving welfare of the population and raising the overall standard of living. On an emotion level, people wanted to, once again, be part of Europe, where we had been for centuries."*<sup>3</sup> In 2010, Jean-Claude Trichet remarked that *"for several years, Estonia was also one of the world's fastest growing economies. [...] Estonia's real GDP grew at an average rate of 7.2% per annum over the period from 1995 to 2007."*<sup>4</sup>

However, the economic crisis in 2008 resulted in a 5.1 percentages decline in GDP the same year, followed by a further decrease of 13.9 percentages in 2009. Thus, in order to overcome the crisis and comply with the Maastricht criteria for the Euro adoption, the Estonian government made a number of severe budget cuts, including the reduction of state salaries and unemployment benefits. *"These measures were radical, but it was the right path and there was no real alternative since, and this is very important to remember, the Estonian Kroon was linked to the Deutsche Mark, and then to the Euro, which meant that we could not print more money at our convenience."*<sup>5</sup> This rather conservative and restraint money policy, that was adopted back in 1992 and linked the Estonian currency to the *Deutsche Mark*, further meant that foreign investors could be more confident to invest in Estonia.

The measures that paved Estonia's way into the Eurozone were numerous. In fact, the introduction of the Euro at 1<sup>st</sup> January 2011 must be seen as the culmination of years of economic as well as political reforms initiated by Mart Laar's course of complete re-orientation towards the West. Estonia's integration into the monetary union has certainly been remarkable, or in the words of Estonian president Toomas Hendrik Ilves, the Euro introduction was a *"fantastic idea"*<sup>6</sup>.

### Security mechanisms and Estonia's hesitant solidarity

#### *Hesitant solidarity*

Estonia has always emphasised the necessity for a balanced state budget and compliance with Eurozone regulations. Indeed, *"the euro is not to be blamed for the current crisis but the attitude of some of the governments"*<sup>7</sup>, said president Ilves. Given the budgetary cuts during the crisis in 2008, it is hardly a surprise that the Estonian people demand similar sacrifices in debt-stricken countries such as Greece in return for financial aid. Anneli Akkermann explains that in order *"to win the solidarity of the Estonian people, the government of Greece must implement the very same drastic budget cuts and austerity*

<sup>2</sup> Ibid., pp.15.

<sup>3</sup> Karin Rannu (2009): Estonia's accession negotiations with the European Union, in *Estonia's Way into the European Union* by the Estonian Ministry of Foreign Affairs, pp.37; URL: [http://web-static.vm.ee/static/failid/052/Estonias\\_way\\_into\\_the\\_EU.pdf](http://web-static.vm.ee/static/failid/052/Estonias_way_into_the_EU.pdf) (accessed 19th September 2012).

<sup>4</sup> Jean-Claude Trichet (September 2010): The entry of Estonia into the euro area, in Speech at the Euro Conference hosted by Eesti Pank, Tallinn; URL: [http://www.ecb.int/press/key/date/2010/html/sp100920\\_1.en.html](http://www.ecb.int/press/key/date/2010/html/sp100920_1.en.html) (accessed 26th September 2012).

<sup>5</sup> Anneli Akkermann in an interview with KAS Estonia

<sup>6</sup> Toomas Hendrik Ilves (September 2012): Euro introduction was a "fantastic idea", in *Tiroler Tageszeitung*; URL: <http://www.president.ee/en/media/interviews/6919-qestonian-president-ilves-euro-introduction-was-a-fantastic-ideaq-tiroler-tageszeitung/> (accessed 25<sup>th</sup> September 2012).

<sup>7</sup> Ibid.

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*measures that Estonia did a few years ago."* Furthermore, there is another reason for Estonia's hesitancy to contribute substantial funds to the ESM: It is rooted in the impracticability of financial contributions because Estonia is "*such a small economy and a tiny country.*"

Estonian Chancellor of Justice Indrek Teder shares the understanding of impracticability and questions the ESM's constitutionality. In fact, he claims that Article 4, Paragraph 4 of the ESM treaty is not compatible with the Estonian constitution. He called for re-opening of ESM negotiations, but the Estonian Supreme Court dismissed his appeal: The treaty is constitutional, even though it limits Estonian sovereignty and the financial competence of *Riigikogu*. The government coalition unanimously supported the ESM and - following the decision of the Supreme Court - *Riigikogu* ratified the treaty.

Furthermore, there have been various initiatives opposing Estonia's participation in the ESM, including a Facebook campaign and a protest outside the *Riigikogu* building. However, these were remarkably weak and minor in comparison to the protests against cuts of teachers' salaries.

#### *Pragmatic approach*

Nevertheless, the Estonian people seem to be very much aware of the fact that the Euro has had positive impact on Estonian businesses; in fact, a survey published by the German-Baltic Chamber of Commerce finds: More than half of the people questioned assume that the Euro introduction has influenced their business positively. Main reasons are increased price transparency (71 percentages), the reduction or irrelevance of transaction costs (59 percentages) as well as the reduction of administrative work load (53 percentages). Annelly Akkermann states:

*"The Euro has certainly helped to increase our competitiveness and the trust of foreign investors. Particularly companies that import or export goods of some kind have benefited from the introduction of the euro because they save a lot of money each year by not having to pay for currency exchange commissions or by having a reduced administrative workload because very often there no longer is the need to convert the currency because 30 percentages of Estonian imports and exports are with other Eurozone countries. 70 percentages of our trade is with EU countries and even when we trade with Sweden for instance, the euro has brought us stability on exchange rates; this makes it a lot easier for entrepreneurs to calculate."*

Therefore, "*the Euro is the cornerstone of the Estonian economy*" and Annelly Akkermann considers "*the ESM and our contributions to it as a means of self-defence.*" If the Estonian economy is to further benefit from the Euro, there is just no alternative to participate in the rescue of the single currency. Estonia has agreed to contribute 1.3 billion Euros to the ESM which accounts for 0.1860 percentages of the total funds. This sum is relatively little compared to the estimated 3.4 billion Euros Estonia receives from EU structural funds for the period of 2007 to 2013 in order to improve the country's infrastructure. The current annual Estonian state budget comprises approximately 6 billion Euros; in fact, roughly 18 percentages of the overall budget is so-called *CO2 money* from Brussels, for instance used "*to improve the Estonian infrastructure by renovating schools houses and kindergartens*".

#### **Matter of perspective**

In light of numerous EU funds in its state budget, Estonia's contribution to the ESM and its hesitant solidarity with debt-stricken southern European countries might imply that it only wishes to harvest the fruits of its Eurozone membership. However, such conclusion fails to

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account for the country's economic re-orientation and restructuring efforts to meet mandatory convergence criteria; moreover, Estonian average salary is lower than the Greek one. OECD data finds that Greek citizens earn an average net salary of 898 Euros per month; in contrast, the Estonian Statistical Office calculates the average monthly net salary of Estonians to approximately be 707 Euros. Thus, it is not surprising that Estonia's willingness to fund the Greek debt crisis is utterly dependent upon the readiness of the Greek government to initiate and implement necessary structural reforms and budgetary cuts. In an interview at the German Council on Foreign Affairs, Estonian president Ilves pointed out that Eastern Europeans believe they have *"to work hard, to comply with the rules and then we would survive in the EU. [...] We were not prepared for the current situation where we want a hamburger today but we only want to pay for it on Tuesday."* The president further stated the *"problem"* Estonians have with the current situation is *"the poorer people in the East need to pay for the richer people in the West."*

### Concluding remarks

**Over the course of the European Debt and Economic crisis many suggested that the measures undertaken by the Estonian government as well as by their counterparts in Latvia and Lithuania might resemble a model of how to overcome the crisis in other European countries as well. In fact, it is true that the Baltic countries with their austerity policies managed to overcome the effects of the crisis fairly well and generate moderate economic growth. However, this is only part of the truth: The 3.4 billion Euros Estonia receives for infrastructure projects from 2007 to 2013 by the European Union account for roughly 18 percentages of the Estonian state budget and are not to be underestimated in contributing to a fast recovery; moreover, the economic situation before the crisis hit in 2009 was blown up and overheated. In a way, the crisis and the undertaken austerity measures grounded the economy once more; similar effects could be seen in Latvia and Lithuania. Taking into account the specifics of small economies, Estonia and the Baltic states can only resemble a model on how to overcome the crisis to a limited extent.**

**However, the current economic outlook for Estonia is positive: Economic growth was 3.2 percentages in 2012 and is projected to be 3.0 in 2013. At the same time, the state budget for 2012 with a deficit of only 0.7 percentage of GDP was close to balance and is expected to further decrease in 2013. Nowadays, Estonia has an economy with sustainable growth, an almost balanced state budget deficit well within the Maastricht criteria, resumed economic competitiveness and a declining unemployment rate. In fact, regarding to the Forbes list for *"Best countries for business"* Estonia is currently in 16<sup>th</sup> place which is a remarkable achievement for such a small country. Further news Estonia will make in its future path.**