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Estonia in the eurozone – a strategic success

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The adoption of the euro in January 2011 topped off Estonia's integration policy. In the opinion of Estonian politicians, this country has never been so secure and stable in its history. Tallinn sees the introduction of the euro primarily in the political context as an entrenchment of the Estonian presence in Europe. The process of establishing increasingly close relations with Western European countries, which the country has consistently implemented since it restored independence in 1991, has been aimed at severing itself its Soviet past and at a gradual reduction of the gap existing between Estonia and the best-developed European economies. The Estonian government also prioritises the enhancement of co-operation as part of the EU and NATO as well as its principled fulfilment of the country's undertakings. It sees these as important elements for building the country's international prestige.

The meeting of the Maastricht criteria at the time of an economic slump and the adoption of the euro during the eurozone crisis proved the determination and efficiency of the government in Tallinn. Its success has been based on strong support from the Estonian public for the pro-European (integrationist) policy of Estonia: according to public opinion polls, approximately 80% of the country's residents declare their satisfaction with EU membership, while support for the euro ranges between 50% and 60%.

Since Estonia joined the OECD in 2010 and adopted the euro at the beginning of 2011, it has become the leader of integration processes among the Baltic states. The introduction of the euro has reinforced Estonia's international image and made it more attractive to foreign investors. The positive example of this country may be used as a strong argument by the governments in Lithuania and Latvia when they take action to meet the Maastricht criteria. Vilnius and Riga claim they want to adopt the euro in 2014. The improving economic situation in the Baltic states will contribute to the achievement of this goal, while an excessively high inflation rate, as in 2007, may be the main impediment[1].

[1] The three Baltic states were planning to introduce the euro in 2007. However, none of them met the Maastricht criteria at that time due to excessively high inflation rates. At present, Lithuania and Latvia have been unable to introduce the euro due to overly high budget deficits, which significantly exceed the admissible level of 3% of GDP.

The adoption of the euro as the implementation of a strategic choice

Estonia became the seventeenth member of the eurozone. It was the third of the new EU member states, after Slovenia and Slovakia, and the first of the former Soviet republics to adopt the euro. In January 2011, Estonia became the only country in the Nordic-Baltic region to be a member state of the EU, have the European currency and belong to NATO.

Estonia has made consistent efforts to join Western organizations, believing that this is the most effective way to secure its interests as a small country with an open economy which heavily relies on exports (the share of exports in the country's GDP reaches approximately 70%) and a modest military potential (4,000 soldiers, almost half of whom are conscripts). From among the Baltic states, Estonia has placed the strongest emphasis on its cultural, economic and political affiliation to Western Europe and has integrated with Western European organizations in the most effective way. It was the first to start accession negotiations with the EU and the first to replace its national currency with the common European currency.

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Estonia's aspirations towards integration have determined its economic policy. Since the country restored independence and embarked on political system reforms, this policy has been to a great extent a reflection of the recommendations and expectations of international financial institutions and foreign investors. On the one hand, this has contributed to building trust in the Estonian economy and attracting investments, and on the other this has entailed the necessity to meet certain standards and requirements. Guided by the opinions of the International Monetary Fund and the World Bank subsequent Estonian governments took special care to maintain the stability of public finances[2]. This care for state finances enabled Tallinn to meet the Maastricht criteria and adopt the euro in January 2011.

How residents of Estonia see the introduction of the euro

Most Estonians supported the introduction of the euro despite their attachment to the Estonian kroon, which the public saw as a vivid symbol of restored independence. The level of support for the adoption of the euro in the first weeks since its introduction reached around 60% and was slightly higher than before the introduction of the euro.

Representatives of the Russian minority, who account for approximately 25% of the country's population, were the most sceptical about the euro. According to the results of a poll conducted in January 2011, only 39% of them supported the euro (as compared to 70% of ethnic Estonians). The Russian minority's reluctance towards the euro was reinforced by the left-wing Estonian Centre Party, which is supported by ethnic Russians and which, being an opposition party, has criticised the government for the overly high social costs which the need to meet the Maastricht criteria entails. Another reason why ethnic Russians in Estonia are reluctant to embrace the euro is their negative perception of the centre-right government of Estonia and of Prime Minister Andrus Ansip.

The Russian minority's opposition to the euro has confirmed that as a consequence of the frequent use of nationalist slogans to mobilise the electorate the Estonian government has brought about a situation where most ethnic Russian residents of Estonia do not identify themselves with their state and do not support the goals implemented by the government in Tallinn[3]. On the other hand, the Estonian centre-right, which has governed the country with short breaks since the early 1990s, by drawing on nationalist rhetoric has been able to gain public support for radical reforms and related readiness to financial sacrifices shown by the Estonian public.

[2] According to Eurostat data, Estonia was the only EU member state to have a budget surplus (0.1% of GDP) in 2010, and its public debt was lower than 7% of GDP.

[3] Andrus Ansip, who has held the post of prime minister for 6 years, enjoyed his highest public support after he fulfilled his electoral promise of moving the monument commemorating Soviet soldiers from the centre of Tallinn to a cemetery in 2007. This was strongly opposed by Moscow and the Russian minority in Estonia. This decision consolidated ethnic Estonians around the centre-right government led by Ansip, but at the same time it clearly deepened the ethnic divide in Estonia and reinforced the dislike of state institutions among local Russians.

The social and economic consequences

The adoption of the euro is likely to have a positive effect on the small, open and export-oriented Estonian economy. Exports account for approximately 70% of Estonia's GDP, more than two thirds of which goes to the EU market. The development of the Estonian economy depends on exports of goods and services, especially now that the country is recovering from a deep recession. After the boom on the domestic market, which was leveraged by cheap loans, the heavily indebted Estonian public[4] is unable to generate domestic demand as a significant alternative to exports. The introduction of the euro, in which most foreign trade deals in Estonia are settled, will reduce the costs incurred by entrepreneurs. The replacement of the Estonian kroon with the euro has reinforced the positive perception of Tallinn among international rating agencies[5]. Furthermore, this also strengthened the trust foreign investors have in Estonia, which should attract more investment to this country.

The adoption of the euro will not directly reduce the high unemployment rate, which is currently at around 15%. Thus the financial situation of the Estonian public, which has deteriorated over the past two years due to the imposition of higher taxes and wage reductions, will not improve fundamentally.

However, the introduction of the euro is not a cure all for the ailments of the Estonian economy and is not the only element which decides on the country's competitiveness and attractiveness to investors. Estonia has a small internal market, its labour is not so cheap as it used to be in the past, and there is a deficiency in qualified specialists on the market despite the high unemployment rate[6].

The adoption of the euro will not directly reduce the high unemployment rate, which is currently at around 15%. According to forecasts of the Estonian Ministry of Finance, it will be possible to reduce the unemployment rate to below 10% in 2014 at the earliest. Thus the financial situation of the Estonian public, which has deteriorated over the past two years due to the imposition of higher taxes and wage reductions, will not improve fundamentally[7]. One of the positive effects of the introduction of the euro will be the liquidation of the currency risk for people who have loans, most of which were taken out in euros.

Regional implications

Estonia has become the leader of integration processes among the Baltic states as a result of adopting the European currency. The introduction of the euro has made the Estonian economy more competitive than the economies of Latvia and Lithuania. However, at the same time, Estonia's membership of the eurozone has improved the rating of the region as a whole and strengthens investor confidence also in Latvia and Lithuania. The positive example of Tallinn can also become an additional boon for Vilnius and Riga, reinforcing their aspirations towards membership of the eurozone.

Since Estonia met the Maastricht criteria and introduced the euro, the differences between it and the other two Baltic states have become more evident. Estonians themselves locate their country among the Scandinavian states and point out that they are now more Nordic than Baltic in such areas as public finances, the implementation of new technologies or the level of corruption. The existence of differences between Estonia and Latvia and Lithuania is proven by the economic results and various kinds of ratings which analyse the socio-economic situation. According to Eurostat data, in 2010 Estonia's GDP per capita was at 65% of the EU average, while those of Lithuania and Latvia reached 58% and 52% re-

[4] The value of the debts incurred by Estonians increased almost fourfold during the economic boom in 2004–2007 and reaches now over 7 billion euros; Estonia's GDP in 2010 was 14.5 billion euros.

[5] Estonia is ranked the highest in terms of creditworthiness when compared to Latvia and Lithuania. When the final decision to accept Estonia in the eurozone was passed in July 2010, Fitch immediately lifted its rating from BBB+ to A. At present, Estonia is also rated at the same level by Moody's and S&P.

[6] It is estimated that the IT sector will have a shortfall of over 6,000 specialists in the immediate future. This will result in a reduction of investments and the slowing down of this high-priority sector of the Estonian economy.

[7] Estonia's GDP fell by 13.9% in 2009. The Ansip-led government had to take radical measures to keep the budget deficit below 3% of GDP, the level countries wishing to join the eurozone may not exceed. Some taxes were also increased, payments to the second pillar of social insurance were partly withheld and wages in the public sector were reduced

spectively. Estonia was ranked 14th in the Innovation Union Scoreboard 2010, while Latvia and Lithuania were ranked 27th (last) and 25th, respectively. Estonia is also significantly distant from the other Baltic states in ratings of the level of corruption.

The governments of Latvia and Lithuania want to introduce the euro in 2014. However, politicians in these two countries are emphasising that this goal may not overshadow the social costs of this process. Such declarations are made partly because the levels of support for the introduction of the euro among Lithuanians and Latvians are lower than among the residents of Estonia. An improving economic situation will contribute to the meeting of the Maastricht criteria; according to forecasts, the Baltic states will see their GDP grow by several percent over the next few years. Increasing budget revenues may help Vilnius and Riga bring down their budget deficits to the required level. However, an excessively high inflation rate may impede again their adoption of the euro[8].

[8] According to the president of the Lithuanian central bank, Lithuania will be ready to introduce the euro only in 2016 due to an excessively high inflation level.

Estonia's stance on eurozone reform

Since Estonia met the Maastricht criteria and introduced the euro, it has been referred to in Europe as an example of a responsible budget policy. Now that the eurozone is plunged in crisis, Estonia has been shown in contrast to the heavily indebted member states and those which are facing serious financial problems. Estonia is reproaching the wealthier member states for their financial imprudence and living on credit and, at the same time, since it has the lowest public debt in the EU, it is using this to build its international image.

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During the debate on the reform of the eurozone, Estonia has suggested introducing mechanisms and sanctions for those countries which incur excessive debt. Notwithstanding this, Estonian politicians have supported the creation of an aid fund for those eurozone member states which are facing financial problems, seeing this as a realisation of the EU's solidarity principle, which is important for this small country which is working its way up. On the other hand, although Estonia has not criticised out loud the way in which contributions to the fund are to be made by individual member states, it has been actively participating in developing solutions which are most beneficial for the poorest members of the eurozone, including itself.

Estonian politicians have emphasised that the adoption of the euro has enabled them to participate directly in the decision-making process concerning the future of the European currency. This means for them achievement of their strategic goal, namely being at the forefront of integration processes in Europe.

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