

ESTONIA AND THE EUROPEAN MONETARY UNION (instead of introduction)

This research publication *Discussions on Estonian Economic Policy* is already the 19th annual collection. The full versions of the papers have been published on CD-ROM, and the collection on paper contains the abstracts of the papers in other languages and the chronicles.¹ To ensure the quality, the papers have first been anonymously peer-reviewed by Estonian and foreign economists. Since 2001 this collection has been published in mutual cooperation by the publishing house Berliner Wissenschafts-Verlag and the Estonian publisher Mattimar OÜ. The aim of the papers is to analyse and assess the current economic developments in the European Union and to draw conclusions from them from the aspects of economic policy and also concerning the main elements of the political order, if appropriate. This has acquired particular importance in the period after the global financial and economic crisis.

From 1 January 2011, Estonia has been the 17th EU Member State to adopt euro as its national currency. Estonia had met the euro-accession criteria already years ago without any difficulties, apart from the inflation criterion. For instance, the budget deficit could be kept constantly under three per cent of the gross domestic product (GDP). Besides, the national debt before and after transition to euro was approximately eight per cent of GDP, being without any doubt the lowest in the whole European Union. Also the actions of the Estonian Government during the crisis were justified as it did not give in to speculations about the need to devalue the Estonian kroon. Considering the relatively low exporting capacity of the Estonian economy, it would not have allowed the Estonian kroon to achieve any significant expansion effects. On the other hand, Estonian debt obligations to other countries would have dramatically increased as more than 90 per cent of foreign loans consist in factoring based on euro. Continuing strict adherence to the regulations of the currency board system therefore also ensured the fulfilment of the currency exchange rate criterion.

The impact of the global financial and economic crisis was particularly severe for Estonia. While in 2000–2007 the average GDP growth in real terms was still over eight per cent, it decreased by almost 19 per cent in total for 2008 (minus 5.1%) and 2009 (minus 13.9%). It was the most severe setback among all EU Member States. The crisis particularly hit construction activities which accounted for 21% of the economy. Such developments led to an increase in unemployment: it increased 3- or 4-fold in comparison to the 4.7 per cent in 2007. Therefore it is no wonder that consumer prices which had increased in 2008 by 10.6 per cent in comparison to the previous year, remained almost stable in the next year.²

¹ Either in Estonian, English or German at the author's choice.

² Source: European Commission, Eurostat; from: Informationsdienst des Instituts der deutschen Wirtschaft (Köln), 16.12.2010, nr. 50, p 8.

The dramatic slow-down of the increase in prices was thus caused by the marked deterioration of business prospects. Considering this fact it is very questionable whether such a stabilisation trend in the development of prices has a permanent nature. The decision to join the euro was based on the Eurostat information according to which the price level in Estonia decreased by 0.7 per cent in Estonia from April 2009 to March 2010 with which also the inflation criterion of joining euro was formally met.

The future will show to what extent the adoption of euro will stimulate the Estonian economy. Despite the relatively low volumes of trading in the Tallinn Stock Exchange, its developments at least indicate the rapid recovery of the economy. After the sharp fall during the economic decline, the main index OMX Tallinn rose again last year and namely by the surprisingly high rate of 73 per cent.³

Joining the euro zone also brings along risks for Estonia which are inherent in the system. André Szász who has been a member of the Executive Board of Nederlandsche Bank for a long time and has been directly involved for 40 years in the various events in the European currency markets, has once mentioned sarcastically: „Not one of the politicians who agreed the Maastricht Treaty on the introduction of the common currency understood what they were doing.“ This statement is surely a little exaggerated but still justified in essence as the basic principles for the creation of the European Monetary Union have led to crisis situations as recent developments have shown.

According to Jacques Delors, the former President of the European Commission, from the very beginning „the main structural error in the monetary union“ was to join countries with soft and hard currencies through political will into a common currency union. By doing it the parties acknowledged the fact that in quite a few countries the benchmark interest rates of the European Central Bank do not conform to the actual economic situation. Common interest rates are inevitably too low for countries with more rapid development where therefore the trend to higher price increases is prevalent. On the other hand, benchmark interest rates are too high for countries which have remained stagnant. The interest rates proved to be too low for instance in such countries as Spain and Ireland where the too fast development led to an economic bubble. Common financial policy was expected to have an impact on general developments which can balance such differences. But as experience has shown, these expectations were false. Incorrect evaluations led to the appearance of more and more trouble spots in the European Union.

Besides, the evaluations proceeded from the assumption that distortions of competition, which inevitably appear in the common currency space due to different development levels of salary rates, labour productivity and the respective costs, can be eliminated only with the functioning of market forces. According to OECD statistics, differences in labour costs have led to the situation where, for instance, in

³ Estland, Lettland und Litauen auf der Überholspur. – *Handelsblatt* (German economic and financial newspaper), 06 January 2011, p. 18.

Germany, the production structures reconditioned in the years of lower economic growth have enabled businesses to achieve a 10% global competitive edge. At the same time the competitiveness of Greece, Portugal and Spain considerably decreased. Such differences cause balance surpluses in more advanced countries and a balance of trade deficit in less developed countries in the situation of common currency exchange rates. The belief that self-healing forces level the flaws in competitiveness without any problems and that deficits can be financed turned out to be another illusion.

The financial and economic crisis has made many traditional basic principles of national economy sound absurd, particularly the neoclassical/monetarist assumptions about the functioning principles of free markets,⁴ stable balancing factors and unerringly rationally operating economic subjects, also the opinion that state intervention causes more damage than it brings benefit. Developments in the recent years have demonstrated, however, that without adequate state regulation, the human desire to reap maximum benefit will lead to catastrophic crises. Bearing that fact in mind, we should recall the basic truths of the so-called “new economics”⁵ and define the role of the state in the new light.

Experience teaches us that abnormal developments in national economy have been closely related to non-functioning capital markets. Measures for overcoming the crisis which are limited only – although no doubt urgently necessary – reforming of money markets and capital markets⁶, will only have a short-term effect. It is not enough to have Brussels so-to-say „give its blessing“ to draft state budgets of EU Member States in the future, i.e. start controlling budget deficits and monitoring their reduction to allowed limits. Insufficient coordination of national economic policies in such an economic space as the euro zone will inevitably lead to destabilisation of real economies. In order to avoid such gaps between the economic development levels of EU Member States as in the recent years, also tax policy, employment policy and social policy should be removed from the discretion of each member state and transferred to the higher authorities in addition to central financial policy – analogously with the European Central Bank.

This research publication consists of two parts in 2011 – the first issue is published in June and the second issue in autumn. Hopefully it will be so also in the future. The first issue includes also the names of authors and titles of papers that will be

⁴ I.e. „through the invisible hand of the market“ (Adam Smith). Joseph Stiglitz, on the other hand, states: „the reason that the invisible hand often seems invisible is that it is often not there.“

⁵ 1930s; cf.: Skidelsky, R. Die Rückkehr des Meisters – Keynes für das 21. Jahrhundert. München: Verlag Antje Kunstmann, 2010.

⁶ Cf.: Eesti majanduspoliitilised välitused – 18/ Estnische Gespräche über Wirtschaftspolitik – 18/ Discussions on Estonian Economic Policy – 18. Berlin, Tallinn: BWV, Mattimar, 2010, (Introduction).

published in the second issue in autumn.⁷ The publication „Eesti majandus-
poliitilised väitlused“ (*Discussions on Estonian Economic Policy*) has been
registered with the international ISBN (International Standard Book Number)⁸ and
ISSN (International Standard Serial Number)⁹ systems and with ETIS (Estonian
Research Information System) under the research results classification numbers
1.2¹⁰ and 3.1.¹¹

Since 2001 the publication has been registered also with ISBN in Germany.
Discussions on Estonian Economic Policy (with papers in English, German and
Estonian) has been represented in the Federal Republic of Germany, in the *ECONIS*
Database of the German National Library of Economics ((Deutsche
Zentralbibliothek für Wirtschaftswissenschaften – ZBW) of one of the best-known
economic research organisations among economic communities, the Institute for
World Economy (IfW-Kiel) of the University of Kiel¹² and in the *EBSCO* Database
Central & Eastern European Academic Source (CEEAS) of Massachusetts, USA.¹³

We are currently making efforts to increase the international distribution even more
and to be represented in additional recognised databases.

February/ March 2011

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⁷ As there will be a considerable time interval between the publishing of the first and the
second issue, there may be certain changes in the second issue due to circumstances related to
the author, peer review, editing, etc.

⁸ ISBN is an international 13-digit standard code, identifier of a book, etc., including
periodicals with unique titles, electronic publications (e.g. CD-ROMs), etc.

⁹ ISSN is an international standard code, unique eight-digit identifier of a periodical publication.

¹⁰ Number 1.2 – Peer-reviewed articles in other international research journals with an ISSN
code and international editorial board, which are circulated internationally and open to
international contributions.

¹¹ Number 3.1 – Articles/chapters in books published by the publishers recognised by ETIS.

¹² www.zbw-kiel.de

¹³ <http://www.ebscohost.com/thisTopic.php?marketID=1&topicID=1284>, in the list of
academic publications <http://www.ebscohost.com/titleLists/e5h-coverage.pdf>