

Matti RAUDJÄRV

DEVELOPMENTS OF ESTONIA AND PERSPECTIVES IN THE EUROPEAN UNION

Introduction

Both the causes and consequences of the economic crisis which can be delimited with the period 2008–2010 (with the main emphasis on 2009, however) and the recovery from which started in 2010, probably need to be analysed more thoroughly and in more detail, when the duration of the crisis can be more specifically determined (although the main positions are generally known). On the other hand it is necessary to take measures everywhere already today to ensure rational steps with respect to the choice of measures of economic policy and orientations in exiting the economic crisis and in achieving the development, without leading national economies to setbacks or unsuccessful (wrong) directions very soon. This is topical today also for the sake of the future.

The objective of this paper is to give a brief overview of the recent developments of the Estonian economy, its actions related to economic policy in overcoming and exiting the economic crisis, and the further orientation and problems (which have often been the reasons for aggravation of the economic recession) in the development of national economy as a EU Member State.

This paper has been written based on different evaluations, experience of other countries as it concerns Estonia as well, several research studies in analysing the economic crisis, author's own positions which are based on official statistics and materials and long-term personal assessments of the economic situation, also on years of working with many students in seminars of different subjects related to economic policy.

1. General situation of the Estonian economy in 2009–2010

Evaluations of the economic crisis cannot be based on specific economic analyses yet, however, as exiting from the economic crisis is not over yet, although the economy is recovering. And there are surely dozens of future scenarios. There are very different evaluations of the crisis in Estonia – is the situation already stabilising; is the recession continuing in some respects or has already the upswing began to some extent? If we draw parallels to the economic crisis of 1930s, its analysis and many evaluations were performed often years after the end of the crisis (Amin *et al.* 1982; Berton 1990; Klein 1987; Varga 1974 and many others).

We should also take into account the fact that the economy of Estonia as a small country depends to a very great extent on the economic situation of other and above all larger countries. Factors of the economic growth, possible crises and the reforms which contribute to exiting from them are necessary for the success. Many economists (such as Krugman, Obstfeld 2006: 780-824) have pointed that out. In Estonia, exiting the crisis does not just mean recovery of the economic growth but also extensive integrated activities which should cover also such areas as the administrative and territorial reform, edu-

cational reform, social reform, hospital reform, completion of the long-drawn-out land reform and many others.

2009 as the first full year of the current economic crisis brought along important changes, limitations, restrictions, cost cutting, cancelling of plans and other forced steps and reorganisations in the existence of the state, local governments, organisations and many individuals and their households. These were often "efforts to survive". Many companies terminated their activities or went bankrupt. Sometimes even individuals had to declare themselves bankrupt. The Bank of Estonia has also not taken definite positions and not all necessary possibilities were used to set conditions for the operation of commercial banks. Also the extremely liberal economic policy applied in Estonia has given an additional push towards the economic crisis. The most important (although not the only) processes in 2009 were the following:

- expenditures of the state budget had to be considerably cut¹ as the revenues remained lower than planned;
- unemployment considerably increased as many companies had to reduce or even terminate their activities;
- economic growth slowed down, i.e. the economic recession caused by a decline in demand was considerable;
- investments and exports of businesses dramatically decreased (there were no possibilities for exporting the production as also other countries suffered from the economic crisis);
- business development was severely inhibited (while in Estonia the estimated proportion of entrepreneurs operating with the profit is ca 2% of the labour force, the same estimated proportion in more developed countries is ten or more times higher);
- the products manufactured and the services offered often proved too expensive due to high labour costs (one important reason was also the unacceptably low labour productivity);
- local governments got into financial difficulties and often because their obligations were not in conformity with the financing, i. e. had not been secured with their budget; also numerous cases of corruption were suspected in local governments;
- activities related to real estate were in a situation of considerable decline (real estate issues can also largely be regarded as an important trigger of the economic crisis).

Based on the statistics presented by Statistics Estonia and the Bank of Estonia, many economic indicators considerably declined in 2009 in the Estonian national economy. For instance, GDP declined by 14.1% in 2009 compared to 2008, industrial production decreased by 26,1% and the volume of construction works even by 34.2%. The number of new cars taken into use decreased by 55.6% compared to 2008 (and even by 70.9% compared to 2007). The unemployment rate was 13.8% in 2009. The role of tourism decreased: the number of foreign tourists decreased by 6.5% in 2009 compared to 2008 (even by 51.6% compared to 2007). The number of inhabitants of Estonia who took foreign trips in 2009 decreased by 28.8% compared to 2008. Capital investments of businesses located in Estonia decreased by 27.6% in 2009 compared to earlier times. (Eesti majandusnäitajad ... 2010; Enim ... 2010 a,b)

¹ If we compare, for instance, the state budget of the Republic of Estonia initially passed for 2009 and the state budget after passing the negative supplementary budgets, we can see that the revenues decreased by 13.8% and the expenditures by 7.7% (calculations by the author). Thus, the state budget of 2009 was negative as the higher amount of expenditures was largely covered from reserves.

Based on the above-mentioned statistics (but also other information) and the background information (increase in unemployment, decline of salaries, decrease in demand, budget cuts) we can state the following about Estonia:

- the added value created in manufacturing and in other sectors of national economy decreased as businesses got fewer orders;
- volumes of construction works decreased as the demand for new living space (but also office and other space) had decreased;
- as incomes decreased, the pressure on repayments of bank loans increased; also the possibilities for and interest in buying new cars and many consumer durables and travelling decreased;
- the sales volumes of consumer goods and food products decreased as people bought less and chose more carefully and also bought cheaper goods more;
- prices of certain goods and services were reduced to stay in competition; often campaigns with low prices and discounts were used in trade and services (incl. in food products, consumer goods and construction materials, hotels, restaurants, etc.);
- businesses were not able to make the required investments, therefore product development and product innovation suffered;
- as a consequence of reduced resources of businesses both their import and export volumes declined.

Considering also comparisons with 2007, it turns out that considerable economic downturn (in some areas also slowing down of growth) was evident already in 2008 but the Government of the Republic of Estonia unfortunately did not take it seriously. We have to note here that no information has been presented on the increase in labour productivity or its comparison with the increase in the average salary level. Thus we were in a situation (partly unfortunately also today, in 2011) where the increase in incomes is the primary objective rather than achieving higher quality, more productive and more competitive work, products and services.

Registered unemployment crossed the line of 90 thousand people in the first months of 2010 and there were additional 20–25% of people who had not been registered. Based on that situation we can estimate that more than 1/5 of the Estonian population capable of work was unemployed.¹ Persisting high unemployment levels constitute a risk for the society as social tensions are increasing, leading to higher crime rates, migration, etc. At the end of March 2011 the number of registered unemployed people in Estonia was 65,831, i. e. 10.2% of the labour force from the age of 16 years until retirement. (Registreeritud ... 2011)

The activities of Estonian institutions of economic policy (above all the decision-making institutions) before and during the economic crisis were often characterised by untimely decisions and constant delays.

Sometimes, however, delays were followed by unacceptable hurrying (e.g. raising the VAT rate in mid-June 2009 by increasing the VAT rate on most goods and services from 18% to 20% in just ca two weeks as it became effective already from 1 July 2009). Probably both the government and politicians lacked the proper will in economic policy, adequate evaluation of the situation and clear objectives. At the beginning of the economic crisis they were not able to evaluate the situation adequately or respond to it in due time.

¹ In 2010 the employment rate of 15–74-year-olds was 57.4% in Estonia. The highest employment rate in the period 1995–2009 had been in 2008, namely 63.0% (Eesti majandusnäitajad ... 2010).

2. Activities for the alleviation of and exiting the economic crisis

Emergence from the economic crisis requires purposeful and effective actions and adoption of the respective decisions on economic policy. The structure of national economy will certainly not be the same after the economic crisis, there will be important shifts both in the proportions and content of different economic sectors and branches of the economy. This will certainly assume a comprehensive and intensive retraining and further training of labour all over the country, which the state should coordinate and encourage through its institutions. Until now the state has been quite half-hearted in its activities.

Although there have been some salary cuts and several government agencies and institutions have been merged. It would now be necessary for officials to take comprehensive measures that would be more effective in all respects; besides, until now, activities of several agencies have often been overlapping.

Foreign experts (well-known economic newspapers and journals, international central banks and foundations, etc.) have made different forecasts concerning the Estonian economy. These forecasts have been both positive and negative by their nature. At the same time we can state in general – **such positions are surely interesting, sometimes even necessary but one should not take them very seriously as such evaluations usually contain subjective and sometimes also misleading conclusions because such experts do not have sufficient information about Estonia and do not know or perceive thoroughly the actual situation and conditions in Estonia.** It is not possible to make adequate evaluations based on just single statistics, **it is also necessary to know the background and the factors influencing it.**

In order to exit the economic crisis, Estonia has had to focus the attention on the following:

- Favouring of the development of production activities, incl. manufacturing. This area has not received sufficient attention in Estonia until now. It has often been thought that intermediation, transit, tourism, real estate activities, IT development, etc. would be enough. These are important areas of development as well but real economic growth can only be achieved by creating above all production jobs, including by making efforts to develop national industries;
- Improving labour productivity on all levels (this assumes also the use of modern engineering and technology, access to information, etc.), it is important to monitor constantly the ratio between the growth of productivity and the increase in salaries.¹ Also the creation of a favourable investment climate should be considered important here;
- Improvement of the economic and business environment and favouring their functioning in all respects;
- Favouring long-term investments also in municipalities (incl. support to borrowing considering the weightiness of different projects);
- More specific definition of functions between the state and municipal levels, therefore also the accounting of financing should be divided into two parts;
- Improved use of the EU funds.

¹ The ratio between the growth of productivity and the increase in salaries is not taken into account, however, in Estonian economic policy making. At the same time it is very important to bear it in mind and ensure that the growth of productivity is faster than the increase in salaries. Statistics Estonia has not paid sufficient attention to the labour productivity indicator either. Also the General Director of Statistics Estonia supports the need for constant calculation and publishing/monitoring of the above-mentioned indicators (Potisepp 2010).

The above-mentioned development orientations can be implemented better if the need for balanced regional development and also for the conduction of the administrative-territorial reform are taken into account. The situation of regional development in Estonia is extremely unstable (this is confirmed by regional comparisons of almost all Estonian economic indicators). Besides, there have been a lot of discussions in the Estonian society about the need to reform education, hospitals and health care and several other areas (which is, however, not within the scope of this paper).

3. Adoption of euro and price dynamics in Estonia

Transition to euro (which has often been regarded as an important objective for enlivening the economy and achievement of economic growth but which is in the opinion of the author of this paper rather a tool of monetary policy which will show its actual impact only in a few years from now or even later) was related to many activities in Estonia: budget cuts, fulfilment of the criteria for the adoption of euro; alleviation of the economic crisis and exiting from the crisis; many other further decisions and actions of economic policy due to the above-mentioned activities.

The current evaluation – was the adoption of euro at such a price for the situation of national economy as in Estonia (high unemployment rate, extremely low quality of life of many people and their families, including children, and many other social problems) a timely step (or maybe too hasty) to ensure the development of the small country. Maybe the interests related to party politics were on the foreground here, rather than stable welfare growth of the population, improvement of the quality of life of people and achievement of economic development?

It is interesting to look at the results of the households budget survey in Estonia, conducted by statistics organisations of all EU countries according to harmonised methodology.¹ A household member spent less in Estonia in 2010 than in 2007 but the proportion of compulsory expenses increased in a household budget. According to the households budget survey, each household member spent on an average 265 euros (4,139 kroons) monthly in 2010, including 45%, i.e. 119 euros of compulsory food and housing expenses. The proportion of compulsory spending has increased in the household budgets in the recent years. According to the last comparable survey of 2007, a household member spent 278 euros (4,358 kroons) monthly, including 40%, i.e. 108 euros of compulsory expenses. Compulsory expenses are inevitable housing and food expenses, and the increase in their proportion in the budget shows a lower quality of life as less money and opportunities are left for other expenses. (Sundkultuste ... 2011)

In 2010, a household member spent money most of all on food (69 euros monthly), which accounted for 26% of total expenses. 50 euros were spent monthly on housing, 29 on transport, 25 on spare time, 16 on household expenses, 12 on clothes and footwear and 10 euros on health care per household member. Compared to 2007, housing expenses have increased by approximately a quarter. Also spare time expenses have somewhat increased. Expenses related to clothes and footwear have decreased most of

¹ The evaluations are based on the results of the households budget survey of 2010 of Statistics Estonia. The last comparable information is from 2007, no surveys were conducted during the years in between. In 2010, more than 3,600 households participated in the survey. A household is a group of persons living at the same address and using money in common, whose members regard themselves as belonging to the same household. Different from a family which is based on blood relationship or relationship by marriage. In 2010 there were approximately 600,000 households in Estonia, the average size of a household was 2.3 persons. (Sundkultuste ... 2011).

all, i.e. by more than a third. Also transport expenses and eating out have decreased. (*Ibid.*)

Price increases in Estonia during the transition to euro are characterised by some examples brought in Table 1. We can agree that here the price increase was partly driven by the increase in the price of raw materials in the world market but on the other hand the reason surely simply lies in taking advantage of the adoption of euro by businesses and traders.

The purchase price of milk was 23% higher in Estonia in January 2011 than a year earlier (the price has increased 29% compared to January 2009). The purchase price of bread wheat has increased 112% in 2011 compared to 2010 and the increase is 84% compared to the price two years ago (i.e. 2009). The purchase price of pork increased 1.4% during one year. Compared to February 2010, dairy products, bread, potatoes and vegetables have become considerably more expensive for consumers. For instance, milk in plastic packaging was 46.9%, sour cream 32.7%, coffee cream 29.9%, cheese 20.4%, kefir 18.2% and butter 12.9% more expensive than a year ago. The prices of pork and pork products decreased in the course of 2010 but the prices of beef, chicken and minced meat and frankfurters increased. The prices of white bread products in shops increased 15.8% and black bread prices 7.5%. The prices of all fresh vegetables increased in shops, including head cabbage 226.3%, imported tomato 17.8%, carrots 17.5% and fresh cucumber 1.4%. The price of unpacked potatoes increased 112.7% during the year. The price of eggs decreased 5.6% during the year. The average retail price of motor fuel (95E) in automatic gas stations was 1.20 euros/litre in February, which was 12% higher than a year ago. Diesel fuel prices increased 18% during the year. (Toidukaupade ... 2011) This is another example of the actual price increases.

Table 1

Dynamics of certain prices in Estonia in 2010–2011 before
and at the initial stage of adoption of euro

| Order No. | Goods / services | Price in December 2010 (EUR) | Price in February 2011 (EUR) | Price increase (%) |
|-----------|--|------------------------------|------------------------------|--------------------|
| 1. | Rakvere frankfurters, 1 kg | 2.70 | 3.61 | 34 |
| 2. | Main course of pork chop | 5.00 | 8.95 | 79 |
| 3. | Solyanka soup | 1.92 | 2.50 | 30 |
| 4. | Fresh tomato, 1 kg | 1.50 | 2.00 | 33 |
| 5. | Fresh cucumber, 1 kg | 2.27 | 2.99 | 32 |
| 6. | Carrots, 1 kg | 0.26 | 0.38 | 46 |
| 7. | White head cabbage, 1 kg | 0.46 | 0.65 | 41 |
| 8. | Bananas, 1 kg | 1.25 | 1.69 | 35 |
| 9. | Pasta | 0.95 | 1.25 | 32 |
| 10. | Potato (unwashed), 1 kg | 0.33 | 0.60 | 82 |
| 11. | Vegetable oil (from rapeseed), 1 litre | 1.91 | 2.59 | 36 |
| 12. | Sugar, 1 kg | 1.02 | 1.19 | 17 |
| 13. | Light beer, 4.5% | 2.24 | 2.50 | 12 |
| 14. | Palmolive soap | 0.30 | 0.44 | 47 |
| 15. | Haircut (ladies) | 8.50 | 12.20 | 44 |

Source: Pealinn 2011: 4–6

It is also interesting to read the information of the Consumer Protection Board that businesses have continued to adjust their prices after transition to euro by making them more attractive for marketing. For instance, in January 2011, a little more than 10% of

prices ended in 9 but in March 2011 there were already more than 20% of such prices. (Eesti toiduainetööstus ... 2011) Also these adjustments have led to a certain increase in prices.

The food basket, services and several other prices and the price dynamics will gradually shape the attitude of the population towards euro in Estonia. Concerning the attitude towards euro, it is, for instance, generally known that Germans are not enthusiastic about euro, as the German mark they had earlier was a stable and strong currency. It had been ensured by (Kaupmees 2010):

- the general knowledge that one has to work hard and diligently to achieve success
- discipline and order in everything, including in one's work
- extensive saving and economizing
- high level of engineering
- high economic productivity (achieved through all the above-mentioned factors).

Probably many countries, surely also Estonia need to follow the example of Germany in many issues. Also, for instance, Swedes regard Germany a good example to follow in many respects (Ibid). Returning once more to German economy, the economic growth forecasts for Germany have been optimistic. For instance, in November 2010 the economic growth forecast for 2010 in the European Union was 1.8% and in Germany 3.7% and for 2011 the respective forecasts were 1.7% and 2.2% (Tageschau 2010). Germany has also been regarded as so-to-say the main engine of the European Union for exiting the economic crisis (Ibid). For instance, in November 2010 the consumer price index increased by 1.5% in Germany, above all due to the price increases of food products and motor fuel (Regional 2010). At the same time the price comparisons show that the price increases of goods and services in Estonia are almost double of the average increases in the EU (Pao 2011: 8). But when we compare the prices of February 2011 with those in February 2010, the change in the consumer price index in Estonia was 5.7% (Enim ... 2011). Considering the economic situation in Germany and the situation of the euro zone, it is evident that euro can be stabilised above all with the leadership and economy of Germany.

Unlike in Estonia, the prevalent basic position of economics in Germany (similar to other countries with a high level of development) has been that the increase in labour productivity has to exceed the increase in average salaries. And this principle has also been followed. According to Statistics Estonia, the Estonian economy and the Government of the Republic of Estonia are not particularly interested in these indicators, or, in other words – there is no demand. Thus the increase in average salary has been generally faster than the increase in labour productivity in Estonia during the last twenty years after regaining independence, and non-observance of that ratio has not been talked about or pointed out for years (particularly in the years of high economic growth). The Estonia media sometimes pointed it out only in the conditions of the economic crisis. The actions of the government in Estonia quite often reminds us of the times of the Soviet Union when suitable economic indicators were carefully selected to characterise the development of the country above all from positive aspects.

For conclusion

The rapid economic growth of Estonia has been supported in earlier years by the creation of many new private companies (above all micro businesses and small businesses); active investment activities (incl. involvement of foreign investors); expansion of economic contacts; carrying out several reforms (educational reform, land reform, agricultural reform, health care reform and several others). Also joining the European Union and the NATO membership have considerably contributed to the development of Esto-

nia. Also several wrong or half-hearted decisions were made which besides all other negative consequences often created a situation where the increase in productivity remained low in Estonia.

The economic crisis had an extensive impact on Estonia: decrease in exports, demand and production; redundancy of labour; reduction of salaries; bankruptcies of companies; dramatic increase in the number of unemployed people; increase in unemployment; increase in regional imbalance and many other phenomena. The problems were evident most of all outside larger cities, particularly in the Estonian rural areas. Exiting the economic crisis largely also depends on the success of other EU countries and countries of the world in overcoming difficulties.

Adoption of euro in Estonia from 1 January 2011 (which is often officially regarded as an important objective for the achievement of recovery and growth of the economy) is an instrument of monetary policy but the actual impact of using it will become evident only in a few years or even later. Fulfilment of the criteria for the adoption of euro, the related budget cuts, operation in the situation of the economic crisis, incl. decrease in the number of jobs and several other activities have taken the Estonian economy to a difficult situation. The economic crisis and the objective of adoption of euro have been like a double burden on the Estonian society and economy (above all the years 2009–2010).

The extremely high unemployment rate, which has, however, had a decreasing trend in the second half of 2010 (with the increasing trend of the economic growth at the same time) in comparison with 2008 and the earlier years, will, however, surely remain high for a long time (not all unemployed people are either interested in getting a job again or able to learn and acquire retraining; employers have no clear idea about the labour they need; employers do not have a clear interest in incurring the expenses of retraining and further training themselves (although there are often also no possibilities for that); employers and owners have also relatively little interest in making investments (outdated equipment).

The issue is – was the adoption of euro at such a price as in Estonia (high unemployment rate, extremely low quality of life of many people and their families, including children; many other social problems) a timely step to ensure long-term stable development of the small country. Or were the interests of party politics in the foreground rather than the well-being of the population and achievement of balanced economic development?

Further necessary but surely interrelated activities: reduction of the number of the unemployed – creation of new jobs and businesses (there is, however, a lack of qualified and required labour at places); economic restructuring (above all through orientation to more science-intensive activities); achievement of a considerably higher growth of productivity, and several others. Development of national production activities and industry is necessary, not relying on subcontracts and foreign investments. It is very important to complete the administrative and territorial reform soon (it has continued for more than ten years already) and to achieve balanced regional development in Estonia. It would also be necessary to complete the land reform to enable private owners (not only agricultural producers) to occupy themselves just with the cultivation and management of land. Also a tax reform would be required in order to achieve social justice. The educational system needs improvement and development in order to ensure quality.

Literature

1. Amin, S., Arrighi, G., Frank, A. G., Wallerstein, I. *Dynamics of global crisis*. London, Basingstoke: Macmillan, 1982
2. Berton, P. *The Great Depression, 1929-1939*. Toronto: McClelland & Stewart, 1990.
3. Eesti majandusnäitajad aastate lõikes. Eesti Pank. [http://www.eestipank.info/dynamic/itp2/itpreport_2a.jsp?reference=503&className...]. 19.03.2010.
4. Eesti toiduainetööstus teenis mullu IV kvartalis läbi aegade suurima kasumi. [<http://www.e24.ee/?id=415384>]. 08.04.2011.
5. Enim nõutud statistika. Põhinäitajad. Statistikaamet. [<http://www.stat.ee/pohinaitajad>] 11.01.2010 (a)
6. Enim nõutud statistika. Põhinäitajad. Statistikaamet. [<http://www.stat.ee/pohinaitajad>] 17.03.2010 (b)
7. Enim nõutud statistika. Eesti Statistika. Statistikaamet. [<http://www.stat.ee/pohinaitajad>]. 24.03.2011.
8. Kaupmees, Anu (Rootsi raadio reporter). Intervjuu Vikerraadio saates "Uudis-pluss" (ERR). 29. november 2010 (kell 15.30).
9. Klein, D. *Krisen des Kapitalismus – Strategien und Tendenzen*. Berlin: Dietz, 1987
10. Krugman, P. R., Obstfeld, M. *Internationale Wirtschaft: Theorie und Politik der Außenwirtschaft*. 7. Auflage. München: Pearson, 2006, 874 S.
11. Pao, Adele. Eesti hinnatõus ületab ligi kaks korda Euroopa Liidu keskmist. Postimees, 8.märts 2011, lk. 8.
12. Pealinn. 14.veebruar 2011, lk. 4-6.
13. Potisepp, Priit (Statistikaameti peadirektor). Autori telefoniintervjuu, Tallinn, 28. veebruar 2010
14. Regional, NDR, 09. detsember 2010 (kell 19.30)
15. Registreeritud töötus 1993-2011. Peamised statistilised näitajad. Eesti Töötukassa. [<http://www.tootukassa.ee/index.php?id=13524>]. 15.04.2011
16. 2009. a. teise lisaelarve seadus (Riigikogu poolt heaks kiidetud). Rahandusministeerium [<http://www.fin.ee/index.php?id=80384>] 08.01.2010
17. Sisemajanduse koguprodukt ja kogurahvatulu. Eesti Statistika. Statistikaamet. [<http://www.pub.stat.ee/px-web.2001/Dialog/Saveshow.asp>]. 24.03.2011.
18. Sundkulutuste osatähtsus leibkonna eelarves on suurenenud. Eesti Statistika. Statistikaamet. [<http://www.stat.ee/49507>]. 08.04.2011.
19. Tageschau, Das Erste (ARD). 29. november 2010 (kell 20.00).
20. Toidukaupade jaehindade muutused veebruaris. Eesti Konjunkturiinstituut. EKI uudised ja pressiteated. 28.02.2011. [<http://www.ki.ee>]. 28.03.2011.
21. Varga, E. *Die Krise des Kapitalismus und Ihre politischen Folgen*. Frankfurt am Main: Europäische Verlagsanstalt, 1974.