JOINING THE EUROZONE: A HELP OR A HINDRANCE ON ESTONIA?

By Sophie Greensite

In 2011, Estonia, a former member of the USSR, joined the Eurozone, the last formal step in their embracement of capitalism and relinquishing of their Soviet past (Central Intelligence Agency). Economic growth has been steadfast since the country was freed communism. Adopting the euro not only separates Estonia politically from Russia, but arguably more importantly, financially siphons it into European Union interests.

Before its economic success, Estonia didn't even have its own economic autonomy. As part of the Soviet Union, Estonia was stifled by economically stagnating socialist policies. After the dissolving of the Soviet Union, Estonia found economic prowess in manufacturing and trade (Central Intelligence Agency). Not only a decade later, Tallin, Estonia's capital, was intellectually up to speed with the western world and was at the forefront of technological innovation, with notably Skype being one of the biggest technological disruptions in the social networking and Internet space (NPR).

Predating the adoption of the euro, Estonia joined the European Union twenty years prior in 1991. The political reasons behind Estonia's membership in the EU and adoption of the euro are obvious: Defying their Soviet-occupied past, the Baltic states wished to be integrated into European identity, and distance themselves from Russia under the political safety net of EU support. Economically, the answer remains less clear. Joining a weak unstable stretched currency—one that had already wrecked Greece's economy—was it worth it? With the success of Estonia's economy in the 2000's and its swift recovery from the recession, it begs the question: does Estonia really need to be a part of the Eurozone? Could the stringent monetary policy of the European Central Bank hurt their economies in the long run?

The main benefit of the euro is security under the blanket of the European Union and increased desirability to foreign investors. Small countries need foreign capital to grow—take for example Estonia's booming technology industry, the birthplace of Skype (Fortune.com). However, joining the Eurozone means countries must forfeit the power of manipulating their own economies through their own unique monetary policy and exchange rate flexibilities.

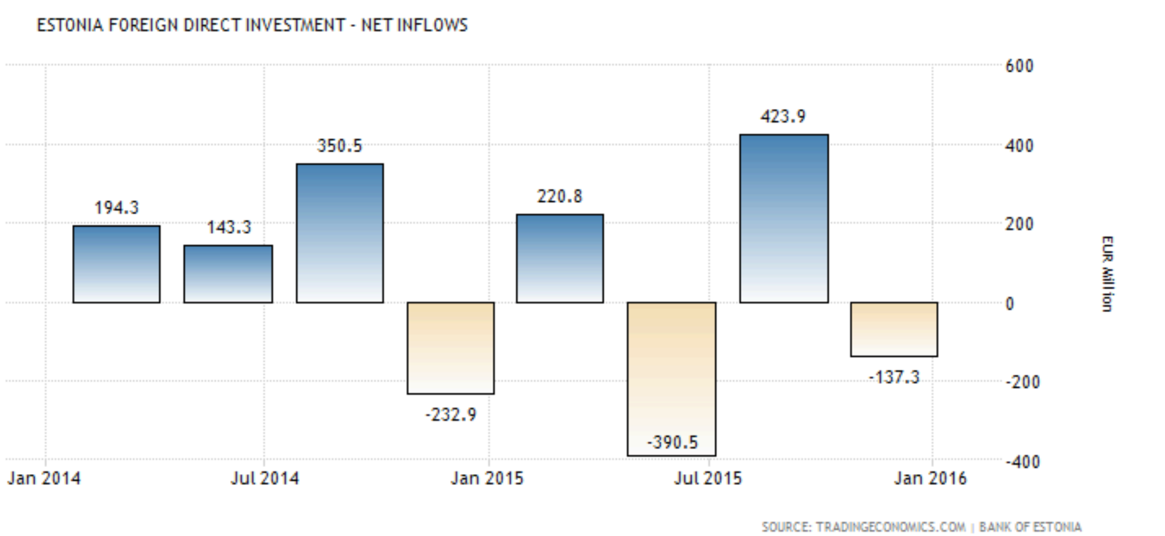
EVALUATING ESTONIA'S EURO SUCCESS: PRIMARY COMPARISONS

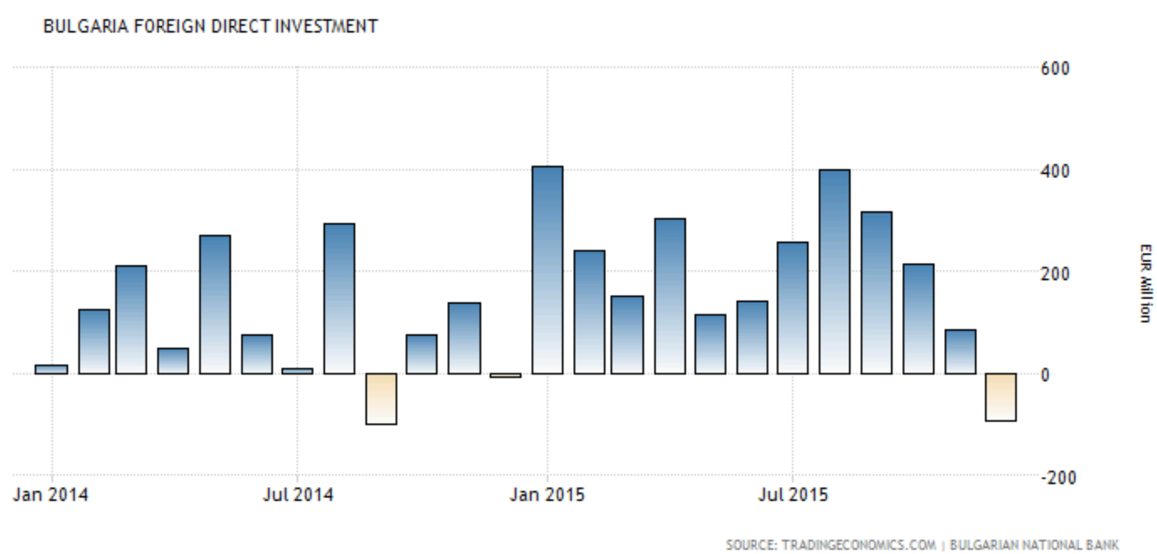
Foreign Direct Investment

In 2004, Estonia officially pegged themselves to the euro and began the process to switch over. The central rate of the Estonian kroon was set at 1 euro=15.6466 kroons (European Central Bank). This is favorable to foreign investment because it meant that the euro was fifteen times stronger than the kroon. Although this can make Estonians feel poor, in that now 15 of their kroons is just one euro, it is actually favorable for investment because it makes their goods and labor cheaper and more competitive on an international market.

A paramount benefit from joining the Eurozone is the enhanced feasibility of gaining foreign capital. An indicator of measuring this would be a comparison of Estonian FDI to the FDI of another Eastern European, previously Soviet-occupied country— for instance, Bulgaria.

As seen in the graph below, Estonia has been able to garner foreign investment as well as pay it back, divestment. According to Investopedia, divestment improves company value and obtains higher efficiency through selling back assets. The money from divestments is typically used to pay back debt, make capital expenditures, pay out dividends to shareholders, and fund working capital. Bulgaria, on the other hand, has seen a fair amount of investment, but with not as



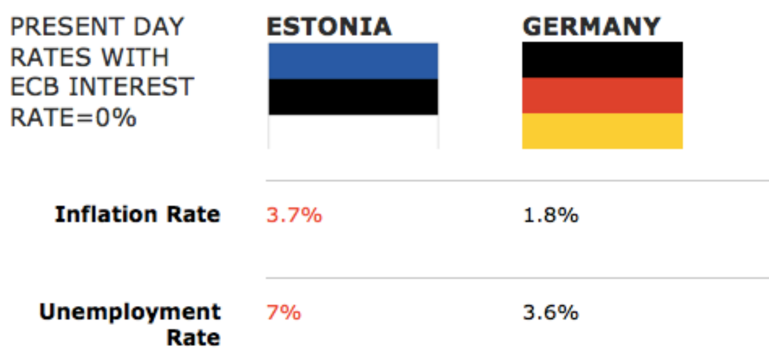


much divestment as Estonia—possibly signaling weaker fiscal policies in Bulgaria.

Labor Costs

The other important consideration is to compare salaries across countries in the Eurozone. Currently, the average monthly wage in Estonia is 1242 euros each month, while the average in Germany is 3745 euros per month. Given that labor is cheaper in Estonia compared to Germany, Estonia becomes an attractive investment as they are an export-oriented economy. The average monthly wage in Bulgaria is 1027 BGN per month, which is equivalent to roughly 525 euros per month. Bulgaria's monthly wages are more than half as much as Estonia's, however, Estonia has the advantage of being more accessible to foreign trade by being in the Eurozone.

Inflationary Considerations



The Eurozone's interest rate in the past few years has dropped from below one percent to zero percent ([European Central Bank]()). The effect this has on France and Germany is particularly different than the effect on the Baltic states. According to [Trading Economics](), Estonia's annual GDP growth is at 5.7%, with an inflation rate of 3.7% and an unemployment rate of 7%. [Germany](), on the other hand, the home of the European Central bank, has an annual GDP growth of 2.1% with 1.8% inflation rate and a 3.6% unemployment rate. Estonia's economy is heating up, with inflation and unemployment both considerably higher than Germany's. Estonia must keep an eye on their inflation rate, as a rate between one and two percent is considered normal and healthy. A higher interest rate, thus devaluating money, would cool off Estonia's economy and prevent further inflation. But with the case of the euro, this option is not possible.

ESTONIA'S CULTURE OF AUSTERE GRIT

Since there aren't individual monetary policies Estonia can impose under their Eurozone membership, the country must rely on fiscal policy to gain control over their economy. The Baltic states were notably quick and successful with climbing out of the 2008 recession—though it's important to note that none of them were in the Eurozone at that time (CNBC). This is because they implemented fiscal austerity measures that saved the country money. Estonia responded to the global crisis with austerity measures that warranted a steep upward recovery, surprising economists around the world. One might say the Baltic states are "tougher" or have more grit than countries that set out similar measures. For instance, Spain enacted "internal devaluation efforts" to cope with the recession, and did not see as drastic of a rise in real GDP than Estonia (Trading Economics).

Some contend that Estonia has the socio-cultural grit to survive potentially unfavorable ECB monetary policy. As Estonian Economics Analyst Peeter Koppel notes, "Western Europe has not really experienced a decrease in living standards since the Second World War. Historically, austerity is inevitable, but it's not part of the culture of Western Europe right now. This is what really differentiates us, that we were able to understand that" (CNBC).

Jaan Tallinn, one of Skype's founders, says that the end of Soviet occupation lead to a collective entrepreneurial spirit, along with an explosion of creativity, criminality and black markets in the Internet space. Tallinn remarks that by starting "a new country in the 1990s, you have the advantage of drafting new laws with the knowledge that the Internet is out there" (CS Monitor).