WHAT ROLE HAS THE EU PLAYED IN SHAPING THE CONVERGENCE PROCESS IN THE CESEE REGION IN THE PAST 15 YEARS?

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First, one should stress that the EU influenced convergence long before accession took place, some 15 years ago. Primarily, this was reflected in what one could call the convergence of institutions, which then in turn supported also convergence in economic productivity and income levels. Some could perhaps argue that for Estonia, the most influential period in this regard was the second half of the 1990s and the first few years of this century, when a number of strategic choices were made.

The most important foundations of the EU in this regard – general adherence to free trade, assurance of the rule of law and implementation of competition legislation – were all major cornerstones for permanent change in business structures, as well as for the creation of a solid basis for increased investments, including FDI.

While EU accession was probably not the only player in town, its existence alone, accompanied later by the actual concrete process of accession, played a major role, not just in framing the steps of economic transition, but also in framing the relevant government organizations. It is important to recall that due to the specifics of the Soviet occupation, some Estonian government organizations were altogether lacking or at the very least needed to go through a major re-fit.

International cooperation, e.g. with the IMF or World Bank, and deepened exchanges with the Nordic countries helped to shape the build-up of organizational and professional know-how of various government bodies. The depth of interaction during the EU accession process was much stronger still, profoundly helping to put the necessary skills and efficiency of these bodies in place. I would argue that the accession negotiation phase was quite invaluable for Estonian statehood.

Then the EU accession shock occurred. Although accession was by no means a complete surprise and should have been factored-in by most market participants already for some time, its microeconomic and macroeconomic effects were larger and longer-lasting than forecast. Already during the pre-accession period, but more intensely thereafter, accession influenced the Estonian economy in complex ways through trade, labour market and capital channels.

It can be argued that, somewhat paradoxically, the pre-accession preparation phase did not necessarily help to avoid this accession shock. During the years of the accession negotiations and accession preparations, the pace of change had been fast. An enthusiastic rush of 'impatience' was therefore reflected in the mind-sets of many analysts' who expected everything to take effect immediately. There was a tendency around the time of accession to assume that the economic changes that were visible during the early months constituted the whole picture. This was definitely not true. Trade rules and other effects of practical integration still took some time to work themselves through. The same could be said of decisions on capital flows.

Therefore, as the first forecasts (and policy conclusions) following accession conveyed the message that in the economy 'there are changes, but they remain muted'. Early signs of a gearing-up in both foreign trade and more importantly, in the credit cycle, were overlooked.

Even if the economic effects of accession to the single market were relatively well understood and well anticipated, the effects coming from trade flows or from the integration of economic structures were surprisingly strong. By many accounts, these channels greatly supported the strategic integration of Estonia's real economy into the European economic sphere and the economic boost from lowering administrative barriers to trade was quite strong.

The channel of labour market integration, particularly with our northern neighbour Finland, took a bit longer to get off the ground, constrained for a while by a post-EU accession credit boom that boosted domestic economy wages. The extent of changes in this area therefore also remained underestimated for some time.

With the breakout of the financial crisis, however, this channel took off. The migration volumes were not as large as seen elsewhere in Europe, but the movement of labour was intensive enough to fundamentally change the functioning of the labour market, creating new pressures on migration-equilibrating wage level formation.

The question of how to treat this phenomenon in analysis and policy-making became a major intrigue in Estonia within the second stage of EU membership. Exactly how to assess the NAWRU remains a puzzle, while pressures to restructure the economy and to move away from low paid employment made progress in helping to stabilize migration flows. The dramatic increase in the potential mobility of labour resulting from accession, and the necessity to ensure the integration of societies, was perhaps the most important factor driving the further restructuring of the economy, which at the same time created new factions in the political landscape. Possibly, it had also a vital role to play in moving the economy towards higher value-added sectors such as the digital industries.

To evaluate how EU accession influenced financial integration is a bit trickier. True, legislative and regulatory best practices came from the EU. But international best practices might have also been acquired without EU Membership. The prospect, however, of access to the single market was a catalyst to integration, including by providing sufficient clarity for the integration of the Estonian banking sector into the Nordic banking system. This, at the time, helped to fuel the build-up of a credit boom in the post-accession period. Although a problem in itself, financial integration brought its own stabilizing forces. When the bubble burst, real estate market shocks were able to be absorbed and credibility restored by diversified financial groups.

And then there is the question of the euro. Euro area Membership was unequivocally one of the most important drivers of both the convergence process and further economic integration. While much attention in the usual "how-to-make-the-euro-stronger" discussions concentrates on macroeconomic elements, the effect of supportive microeconomic consequences of a single currency can be assessed as even more important. For example, the effects of more intensified price comparisons, the provision of a single accounting unit and also the boost to cross-border day-to-day investments have all been functioning well, as one would expect from a single currency area.

It should be noted that accession to the euro area materialized for Estonia in a rather delicate period of development. During the height of the global financial crisis, accession seemed rather unlikely to materialize any time soon and there was a fair amount of scepticism surrounding it. However, soon it was understood that the process could be both stabilizing and also mobilizing. It has therefore been also a personally quite satisfying experience to witness the very quick practical integration of the Estonian economy into the euro area, as well as faster-than-expected public acceptance of the euro as a single currency.

Then there is also the question of what difference, if any, EU membership has made relative to countries that remained outside the EU?

This is not an easy question to answer. There tends to be an inclination, and some rationale, to compare the economic and social outcomes of Soviet-bloc countries that have become EU members with those who have stayed outside. However, the causal link with EU accession is not always clear or justified. There are simply too many other potential factors at play, including the same reasons why EU accession itself was not in sight or did not materialize in those countries.

However, one can still safely speculate that at least the stabilization provided by some basic market economy institutions, and the push towards increased competition and market integration that EU accession provided played an important role in accelerating members' upward convergence relative to peers remaining outside the EU.

Probably many of the beneficial effects of EU accession, from the convergence point of view, remain hidden and the most important factors at play (e.g. market integration) are to some extent undervalued in society. And then there is a more general problem that things that function well are all too often taken for granted. Even political processes may start to overlook them and their benefits, particularly when important 'concrete milestones', like achieving euro membership, have already been achieved.