

## **Andres Lipstok: Opportunities of the Estonian economy in global competition**

Opening address by Mr Andres Lipstok, Governor of the Bank of Estonia (Eesti Pank), at the Conference "Opportunities of the Estonian Economy in Global Competition", Tallinn, 23 May 2007.

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Excellencies, Ladies and Gentlemen!

### **Introduction**

It is a great honour to welcome you here in Tallinn.

Fifteen years ago Estonia regained its currency, the Estonian kroon. As we know, money has three key functions – it serves as a unit of account, store of value, and medium of exchange. The rise and fall of an economy depends on how well these three functions are fulfilled.

In smaller countries, such as Estonia, the meaning of money goes beyond that. Stable and credible currency becomes a national symbol of success. That is why the introduction of the Estonian kroon is the most important event for our people from the early nineties. The new constitution, the declaration of independence, free elections – all these political events were perhaps more significant. But our own currency was and still is very special for most people.

Our historical background might partly explain the “euro” scepticism of Estonians. The unfortunate truth is that joining the euro area is not very popular right now among Estonians. People understand the importance of it but hesitations still persist, price rise fears being the most common. Uncertainty is part of the cause as well: the exact date of the euro adoption is not known and there is no time to look deeper into the matter against the background of everyday life. Nevertheless, Estonians are one of the most pro-EU nations in the whole Union. More than 70 per cent of us hold positive or very positive views on the EU. However, the origins of euro scepticism and EU optimism are the same. The European Union and EU membership represent common European values, economic prosperity and security for our citizens. Our own currency stands for the same values: credibility, prosperity and economic security.

The Estonian kroon represents these values for a very specific reason. Namely, our currency has been pegged to the euro for already 15 years. I cannot resist joking that from the monetary policy perspective we are one of the oldest members of the euro area. A whole generation of Estonians has grown up without having to ask what the interest rate of Eesti Pank is. Instead, they know that the value of the kroon will not change and interest rate changes come from Europe. Most probably, what matters for Estonians is that while being part of Europe we still wish to retain something our own.

This is not the most convenient situation for Eesti Pank. On one hand, we should be proud of the trust we have earned at home. On the other hand, we know that joining the euro area is beneficial and necessary for the whole country. Not only because of the obligation arising from the Treaty of the European Union. Rather because euro area membership provides ultimate monetary and economic security for our nation that is already used to the “de facto membership”.

### **Competitiveness in today's world**

Ladies and Gentlemen let me now turn to the topic of today's conference: competitiveness in today's world. I would like to look at it from the perspective of a really small country.

As we all know, globalization has changed the understanding of success factors for countries. Old-style economic policies and market protection are of no use any more, since today whole factories and industries are moved within a short time. How can a small country survive in this world at all?

It is often said that real wages should be kept artificially low to attract investment and provide high returns on capital. I do not think this is the right way for a small country. We could never compete with major economies when it comes to mass production. Instead, we should make use of the fact that globalization creates also a huge spectrum of niche markets. Mass production cannot meet countless individual needs, as people all over the world demand more and more personalised products and services. This is the key to success for smaller economies.

The point of departure for a society to remain competitive is to get over the fear of globalization. The new world is after all an opportunity, not a cause for sorrow. Every small country should be able to seize the opportunity if policymakers get a few fundamental things right. I am now going to name four of these fundamentals.

#### **Four cornerstones of competitiveness**

The first, if not the most important, cornerstone of competitiveness is society's openness to new ideas, its willingness to communicate and ability to adapt. Of all factors that support economic growth, openness is universally considered the most important. Openness to ideas allows better understand and make use of the global marketplace.

Policy-makers can do a lot to promote openness. Efficient telecom infrastructure and Internet penetration serves as one way to do it. Market liberalization and competition are the keywords here. Another equally important factor is the country's ability to attract highly mobile professionals. Consequently, issues like security, quality of public and social services, language skills and clean environment are also becoming increasingly relevant in ensuring competitiveness.

The second and equally important factor in supporting innovative society is the spirit of entrepreneurship and culture of risk-taking. Openness makes the world and its ideas accessible to people. However, you need an entrepreneur to make use of these opportunities and ultimately bring benefits to the whole society. Today, competitiveness is directly and positively correlated to the ease of doing business.

There are several areas where policy developers can encourage risk-taking. For instance, better access to public services is one of the most instrumental ways to reduce red tape and increase the efficiency of business environment, either by means of the Internet or any other means. Flexible labour market structures and decentralised wage-setting are generally regarded as the prerequisite to support smaller enterprises, for these are often the engines of innovation in post-industrial economies.

Last but not least, we should not underestimate the role of policy-makers in developing education systems. Let me add a word on this last point. We are often told that Europe and Western countries in general need more engineers and mathematicians to restore their supposedly lost competitive edge. Engineers are definitely essential as creators yet the success of a company or a society requires more. To be truly competitive a firm also needs excellent management and marketing skills. In short, you need an entrepreneur. However, it is often overlooked when it comes to the educational reform in Europe. Young people should be taught the essentials of ethical entrepreneurship and finance from the very first grades onwards. When creating and producing something innovative you cannot just stop half way – you also have to sell it.

Thirdly, talking about competitiveness, we should not underestimate the role of universities and higher education either. Money is again an issue here. We should be much more open to finding additional sources of financing. As we know, in the United States the success of universities relies on relatively broad-based funding. We also know that European education systems are already facing tensions in light of the traditional role of a state. In my opinion, policy-makers should promote new and innovative ways of funding higher education which would be clearly beneficial for all parties. Private savings for financing higher education should increase considerably.

Finally, in addition to openness and the culture of risk-taking, a competitive society needs responsible macroeconomic and financial management. Indeed, stable money, low and predictable inflation, and fiscal responsibility are probably the most essential public goods governments and central banks can provide over a short term to support innovation. It is equally well known that market-based access to finance enables to quickly mobilise necessary funds for innovation. Single financial market supported by common infrastructure plays an essential role in increasing the competitiveness of the European Union.

Ladies and Gentlemen, let me once more welcome you to Tallinn. I wish you a successful and thought provoking conference.