Distinguished guests,
ladies and gentlemen,

Let me first welcome all of you to the East Capital Summit here in Tallinn. I understand that it is the 9th event of the kind, and the second here in Tallinn. Given that the scope of East Capital is by far wider than the Baltic region, I suppose that you have a good reason for revisiting Tallinn after only 3 years. This gives me the opportunity to compare the state of affairs between now and 2004, and to look ahead into the foreseeable future.

Looking back, in early 2004, Estonia was not yet a member of the EU. Those days we lived in the anticipation of upcoming EU enlargement; some trends we witness today, were visible already then. This holds for massive capital inflow, the early stage of the housing market boom and the rally on the credit market. However, not everything was perfectly foreseen – like very high growth rates of the economy and the impact of free movement of labor on our labor market.

As a somewhat expected surprise, joining the EU has served as a strong catalyst – or a positive shock – to our economy. It is hard to conceive 10% growth rates in the last years without EU membership. In this regard, I would like to stress that EU accession has had a major effect on the economy even without considering EU funds; joining the EU meant first and foremost the rise of expectations, higher credibility and abolishment of the last administrative barriers for trade and capital movement. However, in line with very fast economic growth some signs of overheating have emerged all over the Baltics. Latest assessments expect a soft landing for Estonia; last rating updates by S&P point to a stable rating outlook (rating A, outlook stable).

The biggest ‘unexpected surprise’ has been the rather strong impact of the free movement of labor. This became evident after the elimination of temporary restrictions on labor movement for new EU members; for us it concerned Finland in particular. It is well known that in today’s EU there are winners and losers on labor markets – like the UK and Ireland on the winners side, and poorer new member states on the other. Estonia has done relatively well in this respect, as labor outflow has remained relatively limited compared to some other new member states. It is believed that labor outflow is strongly correlated with income per capita; in this respect Estonia stands today at 60% of the EU average; this level may be the break-even point for the workers to start to repatriate; we have some evidence of this already.

Looking ahead, there are some keywords that may help us to cast some light upon the future: income convergence, joining the euro and productivity trends.

On convergence: in income terms we rank at 21st in the EU today; at the same time we have the 22nd position in world competitiveness standings released by IMD. These figures show the unused potential we still have. So it is reasonable to believe that Estonia will maintain strong growth for many years to come, assuming adequate economic policies. The main challenges today obviously lie in the labor market. The efficiency and flexibility of the labor market is crucial, both in terms of big the European labor market and the ageing population. The ageing population means that the labor supply is and will be a long-run problem, as it is elsewhere in Europe. Our fast economic growth now supports us as the incentives to work abroad diminish with growing income level.

On the euro, present high economic growth and rapid convergence means higher inflation than that in the euro area. Higher inflation is likely to keep us away from the euro area in this decade, but once we get over the positive economic shock partly caused by EU accession in 2004, the chances for meeting the Maastricht inflation criterion look fairly good.

And lastly, on productivity and competitiveness: along with the labor market, these are among the most crucial issues. On the exporting sector of our economy: in parallel with income growth we are losing one of our comparative advantages – cheap labor. This in turn means that we should concentrate on the education of a 'new wave' of more skilled workers and engineers. On the services sector: there are many fallacious myths about competition and globalization, one of those saying: 'All jobs in the economy compete globally'. This is obviously not the case for most services; so there is much room for improvement. This holds for both Estonia and the EU as a whole, if we look back to discussions around the EU services directive last year.

To conclude, I wish you a successful summit here in Tallinn and wise decisions in whichever sector of the economy it might be.