

**DOCUMENT OF THE EUROPEAN BANK  
FOR RECONSTRUCTION AND DEVELOPMENT**

**STRATEGY FOR ESTONIA**

**REPORT ON THE INVITATION TO THE PUBLIC TO  
COMMENT**

## **Strategy for Estonia: Report on the invitation to the public to comment**

### **1. Invitation to the public to comment as part of the review process.**

In accordance with the EBRD Public Information Policy (PIP), an invitation to comment on the review of the Strategy for Estonia, along with a Management Note on the issues to be addressed in the strategy were posted on the Web page on 12 December 2005. The public was invited to submit comments, based on the Note and the previous strategy already on the Web site since 11 May 2004. The public was asked to submit comments no later than 10 February 2006 so that they could be taken into account in the review process.

No comments were received during the public comment period.

## 2. EBRD Management Note

### Invitation to comment on EBRD's Country Strategy Review for Estonia

The EBRD has started work on the revision of its Strategy for Estonia. Comments are invited to help the Bank in revising this strategy. Any comments should be submitted to the Bank no later than 10 February 2006 so that they can be taken into account. The current strategy - which has been available on the EBRD web site since 11 May 2004 - is attached as a basis on which to comment.

The first Article of the *Agreement Establishing the Bank* states that “the purpose of the Bank shall be to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics.”

In order to achieve these objectives, the Bank primarily provides finance for investment projects, with a special focus on the private sector, carefully selecting projects that promote transition, by:

- creating, expanding and improving markets;
- establishing and strengthening of institutions, laws and policies that support markets; and
- facilitating the adoption of market-oriented skills and sound business practices.

In addition, every Bank project is examined for its environmental impact and the EBRD lays special emphasis on projects that are oriented directly towards environmental improvements and energy efficiency.

At the time of the approval of the last strategy in 2004, the Bank noted that the Estonian economy had made remarkable progress in structural reforms in terms of price and trade liberalisation, enterprise privatisation and financial sector reforms and that Estonia had joined the EU and NATO earlier in 2004. The economy was growing at a robust pace and credibility in the fixed peg to the Euro remained strong. However, important challenges still remained, such as further restructuring of the energy sector, further commercialisation and liberalisation in the infrastructure sphere and the strengthening of domestic savings as well as increased financial intermediation. Moreover, Estonia was facing a number of important structural challenges at the time to progress in its transition to a market economy and to meet its long-term objective of successful integration into the EU and NATO.

Some of the transition challenges identified at the time included:

- keeping the external position sustainable will require tight fiscal policies, continued monitoring of potential vulnerabilities in the financial sector and ongoing progress with structural reforms;
- continuing to promote the development of a vibrant private sector, which would also address the high unemployment;
- with privatisation virtually complete, further improvement of the business environment for continued business creation, promoting further restructuring of large-scale

enterprises, and continuing to attract high inflows of FDI to enable further productivity increases;

- given the developed state of the banking sector, the main challenge of the financial sector concerned the development of non-bank financial institutions in order to increase financial intermediation.

The Bank's Strategy for Estonia was developed to help address a number of these challenges, and to support Estonia following its recent accession to the EU. The strategic priorities for the Bank in Estonia were therefore identified as:

### **Enterprise Sector**

Where possible, the Bank will seek to support some of the larger industrial and service enterprises, particularly with a view to facilitating continued high inflows of non-privatisation related FDI and the expansion plans of Estonian enterprise to other countries of operation. Increasing emphasis will be given to equity instruments.

### **Infrastructure and Environment**

The Bank will continue focusing on financing infrastructure investments and utilities at both the national and local levels (in particular in the electricity, utilities and transport sectors) without recourse to sovereign guarantees. Where possible, the Bank will promote transaction structures that involve, or can lead to, the participation of the private sector. The Bank will also aim to participate in the financing of projects that can improve cooperation and lead to the development of efficient markets (e.g. electricity sector) within the Baltic region and beyond. The Bank will explore the opportunities to work directly with the second tier municipalities to support the regional development.

### **Financial Sector**

Reflecting the advanced stage of development of the banking sector, the Bank will continue supporting SMEs (credit lines, leasing, equity) via local and regional financial institutions.

As at 31 October 2005, the Bank had signed a cumulative total of 44 direct and 22 regional projects for Estonia with a total project cost of €1,183 million, including Bank financing of €468 million, or 40 per cent. The private/state sector portfolio ratio stood at 93/7. The largest proportion of the portfolio (49 per cent) relates to infrastructure, which comprises almost entirely of an exposure to Tallinn Water (86 per cent of infrastructure portfolio). A significant proportion of the portfolio (24 per cent) relates to Financial Institutions, a reflection of the structure of the Estonian economy and the EBRD's significant role in supporting SMEs through credit lines and equity funds. During 2004-2005 one direct operation was signed in Estonia in the amount of €19 million. EBRD's investment in various regional funds has in the same period resulted in an allocation of €7.2 million.

Since the previous strategy, ongoing progress with structural reforms has assisted Estonia in its early years of membership of the EU and NATO. Since the last strategy, progress has continued on the reform front with e.g. Tallinn Water launching an Initial Public Offering and listing its shares on the Tallinn Exchange in May 2005.

The Bank now intends to develop a new Strategy for Estonia that will provide guidance for EBRD activities in Estonia, identifying the main challenges which the Bank should consider addressing. As such, the strategy cannot address all of the development issues a country faces and necessarily must be selective in identifying issues where the Bank has the experience and ability to play a constructive role.

Therefore to prepare the new Strategy for Estonia it would be useful for the Bank to receive comments on the business and economic environment as it relates to the Bank's operational priorities and activities in the following areas:

**1. Issues related to infrastructure needs and development**

This would include development needs in municipal and environmental infrastructure and transport sectors, with particular attention given to issues relating to restructuring, corporatisation, tariff reform, Public-Private Partnerships and environmental improvements.

**2. Issues related to power, energy utilities and energy efficiency**

This would include issues concerning (i) development needs in power, energy utilities and energy efficiency sectors, with particular attention given to restructuring, tariff reform, Public-Private Partnerships and environmental improvements; and (ii) development strategies and needs in the area of renewable energy, with particular attention to sector structuring, government policy and private investors, constructors and operators.

**3. Issues related to the environmental impact of EBRD activities**

This would include issues concerning environmental improvements and energy efficiency.

**4. Issues related to the investment climate and private sector development**

This would include issues concerning (i) the legal environment (the implementation and enforcement of laws); (ii) the regulatory environment for enterprises (such as issues related to establishing new businesses, taxation, trade protection, tariff and price-setting mechanisms, etc.); (iii) the functioning and efficiency of public administration; (iv) corporate governance and integrity; and (v) fraud and money laundering. We seek your views on how serious these issues are for businesses and how you think the EBRD could help to overcome them.

**5. Comments on the financial system**

This would include issues concerning (i) the level of intermediation of the banking sector; (ii) the development of non-banking financial sector (pension funds, insurance, leasing companies, other mortgage lenders); and (iii) the development of the capital markets.

## **6. Issues related to the social impact of EBRD investments**

This would include issues concerning (i) small and medium sized enterprises (SMEs) that enhance opportunities for entrepreneurship, innovation, job creation, regional development and social flexibility; and (ii) the effect of investments in infrastructure on issues such as social impact and affordability.

The Bank's policy dialogue is always closely co-ordinated with the IMF, the World Bank, other IFIs and the EU in order to ensure the coherent implementation of its strategy. Co-financing opportunities with commercial banks, other IFIs and EU programmes are always strongly sought, to address among other things the social or environmental components in the restructuring projects and to support municipal services projects.

The Bank will take into account all comments received. A summary of these, with staff responses, will be posted on the EBRD web site following the Board approval of the revised Strategy for Estonia. The Country Strategy is, however, a Bank document and the responsibility for its contents remains with the Bank.