

DRAFT Estonia Country Strategy 2021-2026



European Bank
for Reconstruction and Development

PUBLIC



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		ETS	Emission Trading System	PR	Performance Requirement
		EU	European Union	PTI	Portfolio Transition Impact
		FDI	Foreign Direct Investment	R&D	Research and Development
		FI	Financial Institution	RE	Renewable Energy
		FI	Financial Institutions	RRF	Recovery and Resilience Facility
		GDP	Gross Domestic Product	RSF	Risk Sharing Facility
		GEFF	Green Economy Financing Facility	SME	Small and Medium sized enterprises
		GET	Green Economy Transition	SOE	State-owned Enterprise
		GHG	Greenhouse Gas	SPO	Secondary Public Offering
		GVC	Global Value Chains	TC	Technical Cooperation
		HR	Human Resources	TPES	Total Primary Energy Supply
		ICA	Industry, Commerce & Agribusiness	VC	Venture Capital
		ICT	Information and communications Technology	WDI	World Development Indicators
		IEA	International Energy Agency	WEF	World Economic Forum
		IFI	International Financial Institution		

Executive Summary



European Bank
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The Republic of Estonia's commitment to and application of principles set out in Article 1 of the Agreement Establishing the Bank has continued over the period since the adoption of the previous Country Strategy. The constitutional and legislative framework for a pluralistic parliamentary democracy is in place. The separation of powers and checks and balances in the political system, and guarantees for human rights and fundamental freedoms are largely in line with international and European standards. The media are pluralistic and competitive and civil society operates independently. Elections are conducted in a manner deemed by the OSCE to be free and in line with international standards. Estonia has been a member of the European Union since 2004.

Estonia has come a long way since declaring independence in the early 1990s and is widely considered as best in class of economic transition away from a planned towards a market-based economy. Similar to its regional peers, it has enjoyed strong income convergence, reaching 84% of EU GDP per capita in 2019, and strong economic ties with its Nordic and Baltic country neighbours. Nonetheless, a few pressing reform areas remain to fully leverage its green and innovative potential. Transition gaps remain particularly acute in the green space, where energy intensity remains exceedingly high even in comparison to other advanced economies. Likewise, despite its notable worldwide lead on e-government services, the full innovation potential of Estonia's private sector (particularly SMEs) remains somewhat under-tapped and integration into higher value-add global value chains is low.

The economy was significantly affected by the pandemic, thereby temporarily increasing EBRD's additionality to provide support for recovery during the strategy period. In light of a strong policy response and considerable EU funding expected under the RRF and MFF, the strategy will be reviewed as part of an extended Country Strategy Delivery Review in 2023, which will be informed by an analysis of market level additionality and will consider whether the objective of pursuing Covid-19 recovery has been completed. As a consequence of such review, and the country being on a sustained recovery path, the Bank's objectives in the remainder of the strategy period will be adjusted as needed to focus on core strategic sectors and products where the Bank's additionality and the transition gaps are evident and material. In line with EBRD's graduation policy, Estonia will indicate the country's intended path and plausible pace of graduation at the appropriate time.

EBRD is well positioned to help accelerate the country's green and just economy transition to meet its 2030 energy and climate targets and achieve its Nationally Determined Contributions, including through tapping into the country's offshore wind potential and more energy and resource efficient modes of economic activity. The Bank will equally continue to push the integration of the pan-Baltic capital market towards completion and continue serving as active investors in innovative debt and equity financing. In addition, and in line with the new Strategic and Capital Framework 2021-25, the Bank is well suited to explore opportunities to finance innovative scale-ups and digitalisation. The Bank will also support Estonia to deliver on its Technical Support Instrument programme in select areas, such as the pan-Baltic capital market. Throughout, the Bank will promote regional investment and transfer of regional knowledge in the three Baltic countries. The Bank's investment and policy activities will remain guided by the notion of additionality and focused delivery on the following strategic priorities in Estonia in 2021-2026:

- *Support Estonia's Green Economy Transition;*
- *Foster Estonia's Knowledge Economy through More Diversified Sources of Private Finance.*



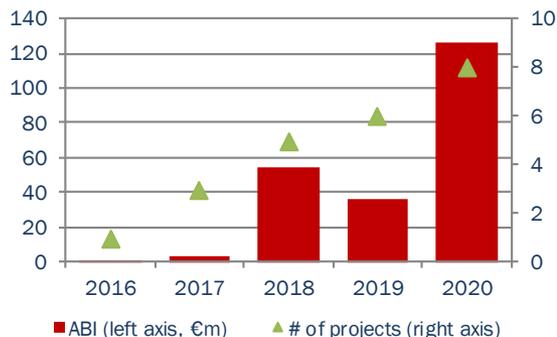
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Estonia – EBRD Snapshot

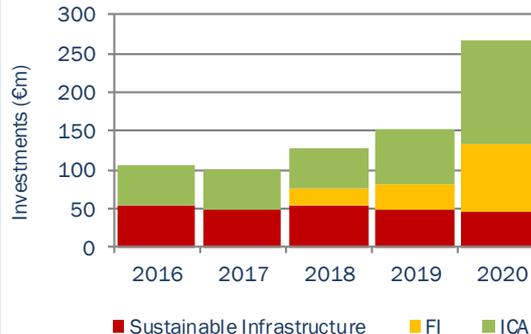
EBRD Investment Activities in Estonia (year-end 2020)

Portfolio	€266m	Active projects	32
Equity share	28%	Operating assets	€166m
Private Sector Share ¹	100%	Net cum. investment	€836m

ABI and Operations



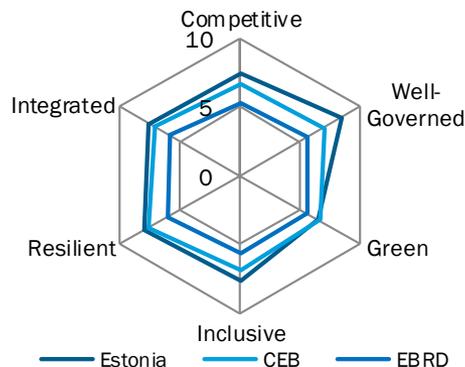
Portfolio Composition



Portfolio Dynamics



Transition Gaps²



Country Context Figures

	Country	Comparators
Population (million) ³ (2019)	1.327	Latvia (1.9), Lithuania (2.8)
GDP per capita (PPP, USD) ³ (2019)	38.915	Latvia (32,191), Lithuania (38,502)
Global Competitiveness Index (WEF) (2019) (out of 140 economies)	31	Latvia (41), Lithuania (39)
Unemployment (%; ILO est.) ⁴ (2019)	4.6	Latvia (6.5), Lithuania (6.5)
Youth unemployment (%; ILO est.) ⁴ (2019) share of youth not in employment, education or training (NEET)	6.9	Latvia (7.9), Lithuania (8.7)
Female labour force participation (%; ILO est.) ⁴ (2019)	57.6	Latvia (55.8), Lithuania (57.3)
Energy intensity (TPES/GDP) ⁵ (2018)	0.24	Latvia (0.16), Lithuania (0.17)
Emission intensity/GDP (kgCO ₂ /10'€) ⁵ (2018)	0.6	Latvia (0.2), Lithuania (0.2)

1 Cumulative Bank Investment: 5 year rolling basis on portfolio.

2 Cf. EBRD Transition Report 2020 3 World Bank WDI. 4 International Labour Organisation (estimates). 5 IEA's Energy Atlas.

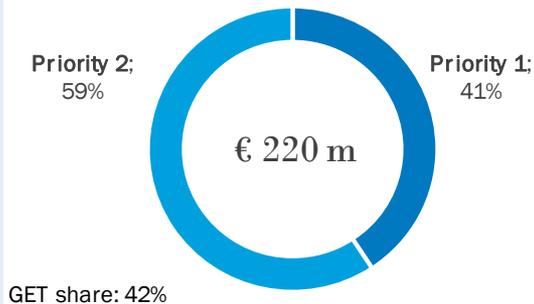


1. Implementation of Previous Strategy (2016-2020)

1.1. Key Transition Results Achieved during previous Country Strategy

Strategic Alignment 2016-2020

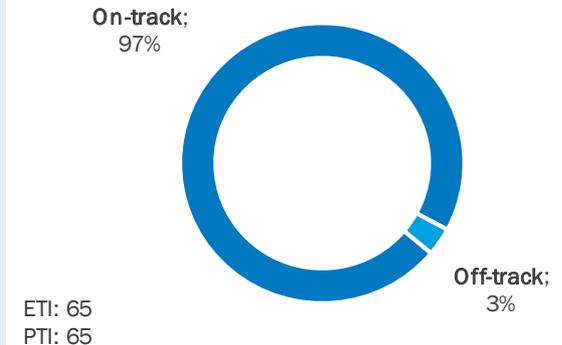
Annual Business Investment (ABI)



Technical Assistance and Investment Grants

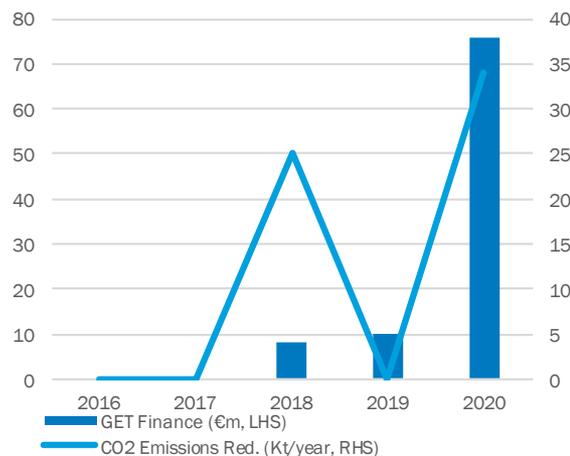


Transition Impact Performance*



Priority 1: Strengthening energy efficiency and enhancing the resource-efficient use of local energy sources

Green Economy Transition



Key Transition Results

- Supported private participation in new biomass CHP plants to generate 55,000 MWh of zero carbon electricity and save 113,850 tons CO2 per annum. Construction of Osula CHP completed in 2017, with good performance of generation company client, increasing gross revenues and stable profitability margins.
- Ongoing dialogue with the authorities and Eesti Energija (SOE) on the listing of its renewable energy subsidiary, Enerfit Green.
- Led and finalised the debt restructuring of the largest private oil shale processing company in the country, allowing it to maintain the commitment to its investment plans, albeit with delays, in order to enhance resource efficient use of local energy sources.
- Continued working with authorities, stake-holders and donors to facilitate investments in street lighting and the development of frameworks for EPCs.
- Invested in an innovative Baltic agribusiness company, with proceeds to be used in energy efficiency investments – specifically targeting reduction of fertilizers/chemicals and contributing to sustainable land use.
- Invested in the EfTEN Baltics Sustainable Property Fund, the first local property fund in the Baltics with a climate agenda and green objectives as an integral part of the business concept.

* Transition impact performance reflects how likely projects are to achieve the transition impact expected of them at signing. Calculated based on active mature (> 2 years) portfolio.

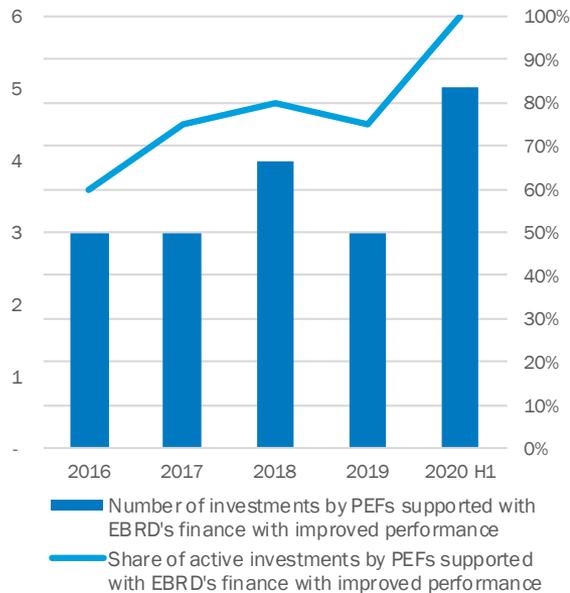


1. Implementation of Previous Strategy (2016-2020)

1.1. Key Transition Results Achieved during previous Country Strategy

Priority 2: Enhancing private sector competitiveness and innovation

EBRD supported PEF performance



Key Transition Results

- Invested in four equity funds, which target innovative and export oriented companies in their portfolios. This supports the emergence of a stronger, more sustainable private equity sector through the provision of equity and quasi-equity financing at all stages of company development.
- Contributed to the diversification of sources of finance, including private equity and venture capital, as three of the Bank's client funds (Livonia Partners Fund I, BPM Mezzanine Fund, 3TS CEE Fund III) invested in innovative companies: Ha Serv, MarkIT Holding, TourRadar respectively.
- Work under the Baltics Integrated Approach continued, leading to the establishment of the Baltic Venture Capital Association, laying the ground for training and capacity building events. Invested in 3 regional equity funds.
- Successfully completed TC project for the development of VC and PE ecosystem: Estonia's Venture Capital Association accepted recommended revisions to the draft Estonian collective investment vehicle law (IFA). Various proposed changes being adopted by the authorities as an outcome of extensive policy dialogue under the Baltics Integrated Approach. EBRD's work was recognised by VCA with joint launch event for the new IFA and investment regime.
- Secured SRSS funding for the development of capital markets, through extensive engagement with authorities and stakeholders. MoU signed in 2017 by the Finance Ministers of the Baltics supporting Pan-Baltic capital market development in areas such as covered bonds and SME financing.
- Continuously working on the development of the pan-Baltic capital market, including a number of debt transactions, e.g. Maxima, Lietuvos Energija and Luminor (as the client's first international bond issue) as well as equity (Port of Tallinn IPO).
- Committed to the first pan-Baltic Infrastructure fund.



1. Implementation of Previous Strategy (2016-2020)

1.2. Challenges to Implementation and Key Lessons

Context for Implementation

Since beginning of the last country strategy, Estonia has enjoyed strong and solid GDP growth and made further progress towards EU convergence. However, the Bank's delivery on the previous country strategy was challenged by the banking scandal that shook the Baltics, as well as by a pending change (now clarified) in the pension system whose impact on capital market development remains to be seen. Estonia entered the pandemic with strong economic fundamentals, including ample fiscal space thanks to its prudent fiscal management in previous years. The Bank has been active in Estonia since 1992, having invested €836m across a total of 97 projects, entirely in the private sector. Between 2016 and 2020, the Bank has focussed on areas where it remains additional, such as energy efficiency, developing a pan-Baltic capital market and improving the competitiveness of the private sector.

Implementation Challenges

- Limited progress on increasing wind energy power generation capacity as a result of permits being blocked by the Ministry of Defence (MOD) out of security concerns (i.e. radar-related impact of wind power).
- Universe (albeit small) of well-established, sophisticated and highly-liquid banks that can offer competitive pricing for mid-sized and larger corporates.
- Difficulties to finance more mature 'asset-light' companies a result of a lack of tailored EBRD-products.
- Limited supply of traded investible issues in Estonia.
- Uncertainty in banking sector created by the MONEYVAL / FATF process has deterred investor confidence and activities beyond just the banking sector.

Key Lessons & Way Forward

- Issue has been resolved (i.e. various areas released by MOD) and a rapid expansion of initially onshore and later offshore wind power capacity is expected for the next strategy period.
- Focus on financing gaps where total size of projects exceeds maximum ticket size of local banks.
- Under the umbrella of the SCF 2021-2025, explore opportunities within EBRD to further support innovative, high-growth companies, including in the digitalisation space.
- Continued engagement with the authorities and SOEs including the involvement in IPOs of SOEs.
- Continue to support development of pan-Baltic capital market to increase attractiveness of the Baltics as an investment destination.



2. Economic Context

2.1. Macroeconomic Context and Outlook for Strategy Period

Estonia - Main macroeconomic indicators

	2016	2017	2018	2019
GDP growth (% y-o-y)	3.2	5.5	4.4	5.0
CPI inflation (% avg.)	0.8	3.7	3.4	2.3
Government balance (% of GDP)	-0.4	-0.7	-0.5	0.1
Current account balance (% of GDP)	1.2	2.3	0.9	2.0
Net FDI (% of GDP)	-2.4	-3.9	-4.7	-3.5
External debt (% of GDP)	88.0	83.4	77.4	73.8
Gross reserves (% of GDP)	-	-	-	-
General government gross debt (% of GDP)	9.9	9.1	8.2	8.4
Unemployment (% , 15-64)	7.0	5.9	5.4	4.6
Nominal GDP (€bn)	21.9	23.9	25.9	28.1

Estonia's GDP per capita has further converged towards the EU average. In 2019, GDP per capita in PPS reached 84% of the EU average, widening the gap with the other CEB peers. This is a notable growth, as in 2009 it was at the CEB average (including Czech Republic) of about 65%.

Strong GDP growth has been driven by robust consumption and investment rates. GDP growth averaged 4.5% in the previous strategy period, on par with the growth recorded by Poland, as private consumption and investments had an average contribution of 2% and 1.9%, respectively. This has been supported by strong wage growth amid a tight labour market, which grew by an average 7.2% over the period.

In terms of sectors, ICT and trade had the largest contributions to value added. Reflecting robust GDP growth, the ICT sector has contributed by 3.8% to GVA since 2016 and increased its share to GVA to 8% in 2019. Despite a small decline in share compared to 2016 amid slower growth, manufacturing remains the largest sector in terms of value added (16%).

Estonia entered the Covid-19 crisis with ample fiscal space. In the first half of 2020, the economy was significantly affected by the pandemic, with GDP declining by 3.8% year-on-year. Good economic fundamentals, particularly the low public debt at 8.4% of GDP, have enabled a strong policy response to the crisis, reflected by a partial recovery in the third quarter to -1.9% year-on-year. Public debt is expected to increase in 2020 to about 18.7% of GDP.

Outlook remains uncertain in the short-term, but the economy is well-positioned for further convergence. The high uncertainty related to the evolution of the pandemic and speed of vaccination will likely affect economic recovery in 2021. The budget deficit in 2021 is expected to remain high as the government will stimulate the recovery, while the uptick in unemployment will drag down the recovery potential. In this sense, the national recovery and resilience plan will be key in unlocking additional EU resources to address existing transition gaps. In the medium term, the competitive and well-governed economy should support further growth.



2. Economic Context

2.2. Key Transition Challenges

Competitive (7.48/10)

- **Estonia is among the best performing EBRD countries in terms of regulatory framework and business climate**, outperforming most of the EBRD peers that are EU members.
- **SMEs are more productive than in the Baltic peers**, but the gap with the EU average is still significant. Digitalisation and more frontier innovation could provide an impetus to further move towards a knowledge-based economy. Private R&D spending remains well below EU average.
- The score on **economic complexity** is slightly **lower than regional CEB peers**, reflecting a less diversified and complex exports basket.
- **Estonia stands out in the EBRD Knowledge Economy Index**, thanks to the comparatively better performance in GVCs integration, an important channel of knowledge transfer.

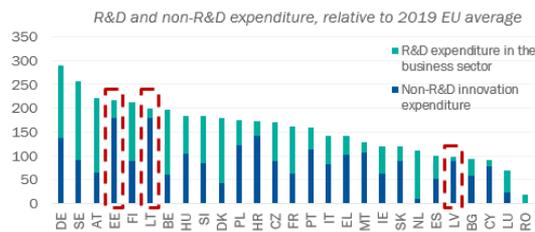
Well-governed (8.3/10)

- **On the corporate level**, Estonia is a leader among EBRD economies in the areas of transparency, disclosure, stakeholders and institutions. **On the national level**, Estonia is a leader on perception of corruption, judicial independence and e-governance participation, among other areas. **There is room for improvement** within the areas of rights of shareholders, enforcement of contracts, and political stability.
- **According to the Transparency International Corruption Perception Index, Estonia ranks 18th in the 2019 report.** The report points comprehensive legislative framework, independent institutions, and effective online tools as key to reducing petty corruption and making political party financing open and transparent. Regulating lobbying to reduce undue influence on policy-making is still an area for improvement.

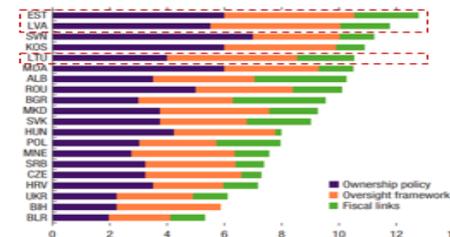
Green (6.45/10)

- **Green transition remains the most pressing issue**, given the need to shift from the oil shale sector. Just transition will thus be a key focus area going forward.
- **Landfilling of waste is significantly higher than regional peers are.** Landfilling accounted for 83% in Estonia, 64% in Latvia, and 19% in Lithuania in 2016.
- **Energy efficiency improvements have been driven by the residential sector** and should continue via building renovations. The share of this sector in total gain was equal to 59 per cent.
- **Estonia met the renewable energy target in final energy consumption by 2020, but reaching 2030 targets will require significant and continued investment in the RE sector from both the private and public sector.** Moreover, the share of renewable energy in transport sector remains lower than the EU average.

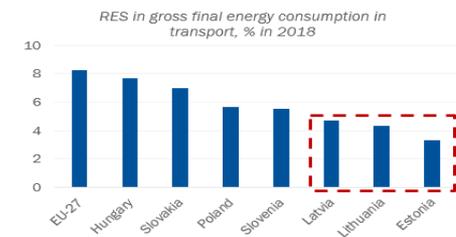
R&D remains low despite high levels of innovation expenditure



Governance of SOEs in the Baltic states is among the best in CEB region



Share of RES in transport lags behind regional peers





2. Economic Context

2.2. Key Transition Challenges

Inclusive (7.61/10)

- The three Baltic countries rank in the top of the inclusive ranking for all EBRD countries of operations. Estonia has the highest rankings of the three, followed by Latvia and then Lithuania.
- Age-based poverty, the gender pay gap and ensuring enough high-skills supply are the key issues in inclusion.
- The labour force participation for women is close to 56% across all three states and lower than the participation of men: Estonia: women 57.10%, men 71.0%, Latvia: women: 55.72%, men: 68.38%, Lithuania: 56.53%, men: 67.74%.
- Quality of education in Estonia is among the highest in EBRD countries. Both Estonia and Latvia score high in harmonized test scores (541.98 and 530.42 respectively) where 625 represents advanced attainment and 300 represents minimum attainment.

Resilient (7.47/10)

- Baltics' banking sector is highly concentrated and majority owned by Nordic banking groups, with a number of only four key banks in each of the three countries.
- Asset quality is high and continues to improve. In the Baltic States, Non-Performing Loans (NPLs) have declined steadily since 2010. They recorded 0.36 per cent in Estonia, 5 per cent in Latvia and 1.16 per cent in Lithuania in 2019.
- The capital markets remain shallow compared to EU. Against this background, the creation of a pan-Baltic integrated market is at the core of the capital markets development strategy in the region.
- The three Baltic States' electricity grid still operates synchronously with the Russian and Belarusian systems. By 2025, the synchronisation with the continental European network is expected to be completed.

Integrated (7.57/10)

- Thanks to the European Union membership, the country is part of 44 regional trade agreements (EBRD countries average: 19), but also have a high number of non-tariff measures originating from EU or domestic regulations (Latvia: 2031, Lithuania: 1989, Estonia: 197, EBRD countries average: 900).
- Estonia is part of 84 bilateral investment treaties with investment provisions, which is the lowest number among the CEB countries'. Latvia is part of 98, and Lithuania of 109, which is close to the OECD comparator countries' average of 115.
- In all three Baltic countries, the capital account openness is very high, Estonia and Latvia are ranked at the top, Lithuania slightly lower.
- In relation to the assessment of the international logistic performance, Estonia performs better than its Baltic peers, but still below the average of the OECD comparator countries.

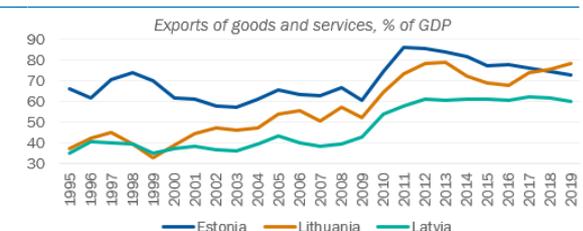
Estonia is still at the top of gender pay gaps in the EU



The Baltics' stock market size combined is small compared to regional peers



Exports growth slowed down after 2015





3. Government Priorities and Stakeholder Engagement

3.1. Government Reform Priorities

Current focus on short-term crisis response measures to provide liquidity to the economy, particularly SMEs, and protection of the labour market through revenue support to vulnerable workers and individuals.

Environment – decreased waste disposal to landfills by 30%; development of diverse and sustainable production technologies based on different sources of energy; slowdown and stabilisation of energy consumption; and integration of an environmentally sustainable public transport system.

Energy - commitment under the Paris Agreement, to achieve an 80% reduction in GHG emissions by 2050 and 13% reduction by 2030; to reach 42% share of renewable energy in total final consumption by 2030, to reduce primary energy consumption to 14%, and ensure energy security by reducing the dependency on imported energy.

Innovation – support towards the sustainable development of a more knowledge-intensive economy through internationally competitive and visible research and innovation.

Labour market – increased productivity per employed person to reach 80% of the EU average; and raised employment rate in the age group 20–64 to 76%, including through: support policy to promote enterprise development, and a transition to a market-based support system, e.g. through financial instruments and venture capital solutions.

Regional development – increased focus on the developmental needs of all of Estonia's regions and investing more than previously in the improvement of work availability and services in areas that have been adversely affected by urbanization by emphasizing the strengths and unique aspects of each region.

Demographics – in recognition of an increasing need for employees to maintain economic growth: alignment of training and education with the needs of the modern labour market; active labour market policy; raising skills of employees; increasing healthy life years by improving health-related behaviours and reducing the number of accidents, and expanding healthcare infrastructure.

Pension reforms – a bill on reforming the second pillar of the Estonian pension system has become law on 1 January 2021, this will make the second pillar voluntary and allow savers to withdraw their funds from autumn 2021.

Anti-money laundering – continued measures to fight against money laundering and terrorist financing, including through a strengthened Money Laundering and Terrorist Financing Prevention Act and establishment of dedicated government committees and supervisory organisations.

3.2. EBRD Reform Areas Broadly Agreed with Authorities

- The Bank will provide support for private sector recovery from the pandemic through investments and policy advisory.
- Transition gaps are present in green, competitiveness and resilience, accordingly the Bank will support Estonia's green and digital transition.
- The Bank will support Estonia's achievement of its NDC targets through green investments in the private sector, including financing renewable energy generation, and energy and resource efficiency improvements.
- The Bank will support the growth and digitalisation of corporates, through debt, equity and risk-sharing products, as well as continued participation in investment funds.
- Continued capital market development is a shared priority. EBRD will continue to cooperate with the Bank of Estonia and support and invest in innovative and green financial instruments.

3.3. Key Messages from Civil Society to EBRD

- Civil society organisations endorsed the Bank's Estonia strategy priority regarding the Green Economy Transition (GET). In particular, EBRD support is needed in the areas of circular economy, recycling and waste management, in which Estonian CSOs are actively campaigning.
- CSOs moreover urged the EBRD not to invest in fossil fuel projects, in companies with a large carbon footprint, and to be careful of investments in biomass which is a sensitive sector in Estonia.
- Civil society representatives welcomed the EBRD's Estonia strategy focus on promoting the knowledge economy and digitalization, including through investments in Research and Development (R&D). They also pointed out that governance and transparency should be improved, including lobby transparency.



4. Defining Estonia Country Strategy Priorities

What needs to change? (Country Diagnostic)

Can it be changed? (Political Economy)

What can the Bank do? (Bank's additionality)

- Most carbon intense economy in the CEB region (oil shale sector).
- Energy intensity remains high compared to OECD and EBRD COO average, esp. in residential and transport sectors.
- Landfilling accounts for 84% of waste (higher than regional peers).
- Waste generation pc higher than EU.

- Ambitious National Energy and Climate Plan (NECP) with high RE 2030 target
- Rising carbon prices are accelerating shift to RE (domestic oil shale-based electricity priced out of market).
- Launch of the Just Transition Platform.
- Estonia's long-term building renovation strategy with the goal to decarbonize its buildings sector by 2050.
- Commitment to carbon neutrality by 2050 and EU-wide targets for 2030 important driver and commitment for dev't of RE, incl. rapid expansion of wind power capacity.

- Expertise and track record in supporting rollout of RE anchored in GET 2.1 support for developing auction systems.
- Experience in supporting energy efficiency upgrades in residential housing stock (e.g. Lithuania).
- Dedicated EBRD team to support the Just Transition Plan.

- Scarce opportunities for institutional investors / limited investible issues.
- Limited availability of alternative sources of finance.
- Despite a favourable environment for SME development, SME productivity lagging EU average (at least 30% lower).
- SMEs in need of digitalisation.
- Weaker performance on economic complexity than regional CEB.
- Integration into GVCs lagging behind Central European peers.

- Clarity on pension fund reform will attract more institutional investors.
- EC's Action Plan on Building a Capital Markets Union / Technical Support Instrument programme serving as external anchor.
- Digitalisation high priority for the EU (under Recovery and Resilience Fund).

- Strong track record in capital markets development, incl. capacity-building and serving as active investor for IPOs and bond issues.
- In-house expertise for accommodating launch of new instruments and SME listings.
- Experience and dedicated programs to support equity/quasi-equity risk-taking.

Strategic Priority (2021-2026)

What We Want to see (Key Objectives)

Support Estonia's Green Economy Transition

- Improved energy and resource efficiency
- Reduced GHG emission, increased renewable energy

Foster Estonia's Knowledge Economy through More Diversified Sources of Private Finance

- Improved access to finance for innovation and digitalisation
- Deepened and diversified debt and equity capital markets



5. Activities and Results Framework

Priority 1: Support Estonia's Green Economy Transition

Key Objectives	Activities	Tracking Indicators (Outcomes)
Improved energy and resource efficiency	<ul style="list-style-type: none"> Support Estonia's achievement of its NDCs through Green Economy Transition investments in the private sector, such as energy efficiency improvements or green technologies and practices. Support development of the circular economy through financing of recycling and waste management and technologies to reduce material demand. 	<ul style="list-style-type: none"> Total primary energy saved (GJ/years) Materials, solid waste reduced or recycled (tonnes/yr)
Reduced GHG emission, increased renewable energy	<ul style="list-style-type: none"> Support renewable energy through financing and policy engagement incl. auction system for offshore wind. Finance development of sustainable and green transport & infrastructure solutions including through InvestEU (e.g. electric mobility, intermodal terminals). Explore options to support the role of the private sector in Just Transition in north-eastern Estonia. 	<ul style="list-style-type: none"> Total CO2e emissions reduced (tonnes/year) Policy framework for introduction of offshore wind energy in Estonia





5. Activities and Results Framework

Priority 2: Foster Estonia's Knowledge Economy through More Diversified Sources of Private Finance

Key Objectives	Activities	Tracking Indicators (Outcomes)
COVID-19 recovery (2021-2023)	<ul style="list-style-type: none"> Deploy equity, debt and risk sharing products focused on Covid-19 recovery to Build Back Better, focusing on areas of additionality. 	<ul style="list-style-type: none"> New instruments introduced or existing ones tailored to support resilience and Covid-19 recovery
Improved access to finance for innovation and digitalisation	<ul style="list-style-type: none"> Continue participation as active investor in VC/equity/property funds. Support growth of corporates including their expansion abroad, inclusion and gender equal opportunities and explore opportunities to finance innovative scale-ups (including fintechs and the IT sector). Invest in private infrastructure that supports innovation (incl. 5G), inclusion and green digitalisation. 	<ul style="list-style-type: none"> Total number of innovative companies supported
Deepened and diversified debt and equity capital markets	<ul style="list-style-type: none"> Continue policy engagement to develop the pan-Baltic capital market through leveraging Technical Support Instrument funds (e.g. sustainable capital market, single index classification). Grow investor and issuer base through financing and introduction of new and green instruments (e.g. commercial paper, sustainability-linked bonds). Explore further opportunities to support and invest in IPOs, incl. SOEs (e.g. energy sector). 	<ul style="list-style-type: none"> Pan-Baltic covered bond framework adopted and implemented, number of Pan-Baltic capital market instruments launched Volume of capital market transactions facilitated





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6. Mapping of International Partners Complementarity in EBRD Business Areas

EBRD BUSINESS AREAS																
		Sectors										Cross-cutting Themes				
		Industry, Commerce & Agribusiness					Sustainable Infrastructure		Financial Institutions			Strategic Initiatives				
Previous strategy period indicative annual investment/ Grants, €m (2016-2019 average unless otherwise specified)		2020	Agribusiness	ICT	Manufacturing & Services	Natural resources	Property & Tourism	Energy	Infrastructure	Banking	Non-bank Financial Institutions	Green Economy	Inclusion and Gender	Local Currency and Capital Markets	Small Business	
EU (ESI Funds)*	637	NA	€P	€	€		€P		€P			€P	€P		€P	
EIB	199	280	€	€	€		€	€	€	€		€	€		€	
NIB	31	815					€		€				€		€	
EIF **	26	477	€	€	€										€	
CEB ***	6	200											€			
EBRD	24	126	€	€	€		€	€		€	€	€		€		

€ Area of significant investments

P Area of significant policy dialogue

● Focus mostly on private sector

○ Focus mostly on public sector

Potential Areas of cooperation for the next Country Strategy Period

Green:
Co-operate with the Ministry of Economy on the policy framework for renewable energy; work with the authorities and the EU on Just Transition in north east Estonia. Coordinated Green Economy investments with the EIB – given its strengthened focus on climate and environmental sustainability, and with the EIF – as it is expanding to themed fund products.

Competitive:
Leverage Just Transition Mechanism funds to finance growth sectors in the economy. Finance corporates in coordination with other IFIs (NIB, EIB).

Resilient:
Build on the Technical Support Instrument funded policy work, and the close collaboration with the Central Bank, Ministry of Finance, and the NIB in capital market development, incl. the introduction of new instruments (e.g. Commercial Paper). Align COVID response measures with other locally active IFIs.

Note: IFI activity mapping based on publicly available information. Significant IFI investment defined as projects exceeding 5% of annual investment and signed from 2016.

* Based on the EU contributions to the Estonia Country Budget for 2014 – 2020.

European Investment Fund, including EIF Baltic Innovation Fund 2 and EFSISME Guarantee Window. * Council of Europe Development Bank



7. Implementation Risks

Risks to the Strategy Implementation	Probability	Effect	Environmental and Social Implications
<ul style="list-style-type: none"> Adverse impact of COVID-19 on the domestic capacity to introduce innovative products and progress with greening transition. 			<p>Assessment and Management of E&S Impacts: Ensure that direct, indirect, cumulative and transboundary E&S impacts of projects and associated facilities are appropriately assessed and mitigated in accordance with EBRD PRs. Consider environmental and social capacity building to ensure adoption of good international practice. Support clients to strengthen E&S management capacity and disclose information.</p>
<ul style="list-style-type: none"> Preponderance of grant and soft loans could limit the ability to leverage debt finance. 			<p>Labour and Working Conditions: Ensure that clients' HR policies and labour practices comply with EBRD requirements, particularly in respect to labour terms and conditions; contractor management; potential discrimination in the workplace, promotion of equal opportunities and managing impacts of large scale retrenchment and preventing potential discrimination towards minority and other vulnerable groups.</p> <p>Resource Efficiency and Pollution Prevention and Control: Support capacity building initiatives in relevant sectors; ensuring that alternatives are considered to identify investments that support compliance with EU standards and EU Best Available Techniques (BAT), transition to a low carbon and resource efficient economy, strengthen resilience to climate change and promote circular economy. Support clients to comply with relevant EU Directives and improve the efficiency of industry-specific processes in line with EU Best Available Techniques.</p> <p>Health and Safety: Improve occupational and community health and safety with specific focus on activities which are associated with common accidents reported on Bank's projects. Additional emphasis and TC support will be placed on road safety by requiring road safety audits, capacity building and raising awareness within communities at risk.</p> <p>Land Acquisition, Involuntary Resettlement and Economic Displacement: Ensure that any projects requiring acquisition of land comply with compensation and livelihood restoration requirements of the Bank, with particular attention on informal land users and vulnerable groups.</p> <p>Biodiversity Conservation and Sustainable Management of Living Natural Resources: Support capacity building initiatives for robust biodiversity assessments and mitigation approaches that will ensure that species and habitats of conservation importance are protected where projects could encroach upon nature protected areas, sensitive flora, fauna, ecosystem services and/or legally protected and internationally recognised areas of biodiversity value.</p> <p>Cultural Heritage: Work with clients to ensure appropriate assessment processes to identify and consult with key stakeholders to protect cultural heritage.</p> <p>Financial Intermediaries: Ensure that FI partners have adequate E&S capacity and risk management procedures in place.</p> <p>Stakeholder engagement: Support clients in developing and implementing stakeholder engagement plans and ensure transparent participatory consultation is carried out as part of local permitting and ESIA's.</p>

High Medium Low



8. Donor Co-Financing Assessment

8.1. Needs Assessment for the New Country Strategy Period

Some funding will be needed to achieve the strategic objectives of the Country Strategy, including for:

- Policy dialogue activities, including potential engagements in further capital market development and integration, as well as in renewable energy (e.g. regulatory support for auctions).
- Project preparation and implementation support for investments in energy efficiency and other green initiatives.
- Guarantees offered under the InvestEU programme to facilitate new investment opportunities.

8.2. Potential Sources of Donor Funds

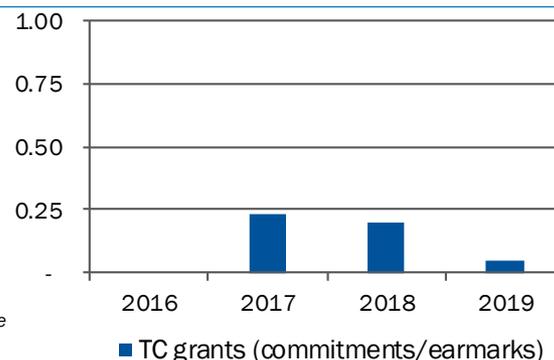
- As an advanced transition country, **Estonia** is expected to provide its own financing to help support investments and policy engagement, both in Estonia as well as in other countries of operation.
- The **EU** is an important source of funding in Estonia, most notably via monies allocated through **European Structural and Investment Funds, the Recovery and Resilience Framework, and the Just Transition Mechanism**. These could include opportunities for:
 - Blended finance, including through the use of guarantees, under the proposed **InvestEU** programme;
 - Co-financing in the context of the **Recovery and Resilience Facility**;
 - Funding for engagements promoting structural reforms, including capital markets development, under the proposed **Technical Support Instrument**;
 - Funding for initiatives promoting research and innovation under the proposal for **Horizon Europe**;
 - Access to TC funds from the EU's sectoral programmes, including in support of investments backed up by **InvestEU** guarantees.
- Limited resources may also be available from the **Shareholder Special Fund (SSF)**.

Selected Affordability Indicators

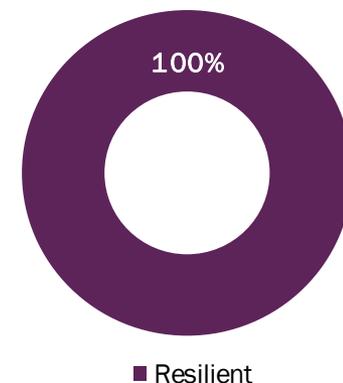
	EBRD regional percentile rank ¹	
GDP per capita (PPP, current. \$) ²	38,811	92 nd
ODA Country ³	No	N/A

1. Simple percentile rank reported as the share of EBRD economies that are represented below Estonia.
2. Source: WDI (2019 or most recent year)
3. Source: OECD (2018)
4. 2016-2019 TC data is based on earmarks at the project level.
5. Based on the primary Transition Quality of TC grants earmarked in 2018 and 2019.

Donor finance during last strategy (€m)⁴



Use of grants in 2018-2019⁵



Annexes



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Annex 1 – Political Assessment in the Context of Article 1



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The Republic of Estonia's commitment to and application of principles set out in Article 1 of the Agreement Establishing the Bank has continued over the period since the adoption of the previous Country Strategy. The constitutional and legislative framework for a pluralistic parliamentary democracy is in place. The separation of powers and checks and balances in the political system, and guarantees for human rights and fundamental freedoms are largely in line with international and European standards. The media are pluralistic and competitive and civil society operates independently. Elections are conducted in a manner deemed by the OSCE to be free and in line with international standards. Estonia has been a member of the European Union since 2004.

In the period since the adoption of the previous Strategy, Estonia has made further progress in all areas of democratic reform, building on the sustained efforts towards consolidating a multiparty democracy. Some challenges remain, however, in the areas related to the integration of the Russian-speaking minority.

Free Elections and Representative Government

Estonia is a parliamentary republic, with the legislative power lying with the 101-seat unicameral parliament, which approves the prime minister nominated by the president. The legislative and constitutional framework provides for a clear separation of powers and checks and balances of executive, legislative and judiciary. Key political decisions are made by elected officials, who have the power to govern effectively and are free of undemocratic constraints.

The legal framework for elections provides a solid basis for the conduct of democratic elections, as assessed by the OSCE Office for Democratic Institutions and Human Rights (OSCE/ODIHR). Generally, elections are competitive and voters are provided with a diverse choice of political alternatives. Campaigns are conducted in an environment characterised by respect for the freedom of expression, association and assembly. The situation regarding remaining divisions along ethnic and linguistic lines has improved in the period since the last Strategy, as the leader of a party

mainly representing the sizeable Russian-speaking minority became Prime Minister of Estonia for the first time since the restoration of independence in 1991. However, the participation of national minorities in the electoral process could still be improved, as noted by the ODIHR, whose recommendations in this area have not yet been fully addressed.

The last general election took place in March 2019. The election administration enjoyed full trust by election stakeholders. Voters were able to use a broad range of tools to exercise their right to vote, including electronic voting. The OSCE/ODIHR offered some recommendations related to the inclusivity of the electoral process including facilitating participation of persons with disabilities and further facilitating participation of persons belonging to national minorities. Additional recommendations were made including adjusting legal redress mechanisms and streamlining provisions on nominations to election committees.¹

Civil Society, Media and Participation

The Constitution guarantees the freedom for civil society organisations (CSOs) to operate independently. There are multiple channels for civic and political participation. Civil society is active, independent and exerts influence on public policy, although funding for CSOs is a challenge. The law allows Estonian citizens to form political parties, which is implemented in practice. Opposition parties are able to campaign freely and to oppose government initiatives. Political parties across the spectrum increasingly include candidates belonging to ethnic minorities in their party candidate lists for elections. “Persons of undetermined citizenship” have the right to vote in local elections, while they are excluded from voting and standing as candidates in parliamentary elections and do not have the right to join political parties.

The Constitution guarantees freedom of expression and the right to information. The media environment is pluralistic and represents a wide array of political opinions. It includes public and private broadcasters. Media ownership is generally transparent.

Annex 1 – Political Assessment in the Context of Article 1



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Rule of Law and Access to Justice

The Constitution guarantees all citizens equality before the law, the right to a fair trial and freedom from arbitrary arrest or detention. Legal and institutional safeguards for the supremacy of the law and the independence of the judiciary are in place, and adhered to in practice. The judiciary provides an effective check on executive and legislative powers.

Transparency International's 2020 Corruption Perceptions Index ranks Estonia 17 out of 180 countries assessed,² which makes Estonia the best-ranked EBRD Country of Operations. Estonia's legal and institutional framework provides a sound basis for preventing and fighting corruption and has been further strengthened since the last Strategy. The latest Council of Europe Group of States against Corruption (GRECO) report highlighted areas for improvement to enhance preventative efforts in particular focusing on senior government officials and law enforcement personnel. The GRECO highlights the absence of a code of conduct to cover all relevant government actors and the need to further increase integrity procedures among law enforcement structures.³

Civil and Political Rights

The fundamental freedoms of speech, information, religion, conscience, movement, association, assembly and private property are fully guaranteed by the Estonian Constitution and upheld in practice.

The report by the Commissioner of Human Rights of the Council of Europe, following her visit to Estonia in June 2018, focused on three areas: gender equality and women's rights; the human rights of older persons; and improving national human rights structures in protecting the rights of citizens.⁴

Estonia provides for Gender Equality by law and effective institutions to implement corresponding policies are in place. However, Estonia has the highest gender pay gap in the EU (22.7%)⁵ with the EU average being 14.8% in 2018.

Disparity among ethnic groups remains an issue in Estonia. Estonia has a sizeable Russian-speaking minority (30%) and a significant group of residents with "undetermined citizenship" (around 6%). Representation of national minorities in the public sector remains low and regions with significant Russian-speaking populations tend to be characterised by lower labour participation rates, labour productivity and competitiveness, which can be attributed, inter alia, to language and other skills issues. Estonia's legal framework allows for full and equal electoral participation of national minority representative who hold citizenship.⁶

Constitutional guarantees against harassment, intimidation and torture are in place and upheld in practice.

² Transparency International (2020): *Corruption Perceptions Index 2020*

³ GRECO (2018): *Fifth Evaluation Round Evaluation Report pp. 4-6 and pp. 57-58.*

⁴ CoE (2018): *Report of the Commissioner for Human Rights of the Council of Europe, following her visit to Estonia 11-15 June 2018.*

⁵ Eurostat: *Gender pay gap: How much less do women earn than men?* 6 March 2020.

⁶ OSCE/ODIHR: *Estonia Parliamentary Elections 3 March 2019 ODIHR Election Expert Team Final Report 27 June 2019 pp. 9-10 and European Commission data 2020.*