STRATEGY FOR ESTONIA

As approved by the Board of Directors at its meeting on 10 February 2016
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EXECUTIVE SUMMARY

The Republic of Estonia is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with Article 1 of the Agreement Establishing the Bank.

Estonia is an advanced transition country with strong trade links to Scandinavia and Russia that has experienced a steady recovery since the deep recession of 2007-10. In 2011 Estonia became the first EU member to accede to the euro area since the financial crisis, and output is expected to regain its pre-crisis peak in 2016. Recent years have seen rapid progress in further liberalisation of the energy sector and strengthening of the innovation environment, and market regulation remains supportive of continued convergence.

Estonia’s EU funds absorption rate has been the highest in the EU and over the coming seven years the country stands to benefit from the €4.5 billion allocated to it through the European Structural and Investment Funds (ESIF) for the 2014-2020 budgetary period. However, as the country approaches certain income thresholds, the allocation after 2020 will be markedly lower, with EU structural funds increasingly shifting from traditional grant-based instruments towards commercially-based financial mechanisms that leverage private funds. In this context, the Bank’s support in establishing the institutions and governance for attracting and sustaining private investor participation in publicly led projects will be crucial to sustain growth.

Estonia faces longer-term challenges, such as a shrinking workforce from emigration, low activity rates and acute skills shortages, which are severely affecting the labour market and discouraging investment. Amid the abundant liquidity in the banking sector, the Estonian capital market remains relatively undeveloped and the market has failed to elicit sufficient foreign investor interest. While the country boasts a world-renowned innovative start-up sector, broader performance in innovation and productivity growth has not been adequate to address these longer-term challenges.

In designing its support and related instruments, the Bank will tailor them to the advanced stage of transition of Estonia. As Estonia’s transition has become more advanced, the Bank has accordingly narrowed the scope of its activities as a consequence of the fewer market segments in which Bank activities can satisfy its operating principles (transition impact, sound banking and additionality).

Estonia reaffirms its commitment to the principle of graduation. Although there has been significant progress in its transition to a sustainable market economy, some gaps remain and new challenges have arisen related to uncertainties in the broader geopolitical and investment environment. Estonia will continue to keep the question of graduation under review and will indicate its graduation intention at the appropriate time.

To help Estonia address these key challenges, the Bank will pursue the following focused strategic orientations in the new Strategy period:

- **Strengthening energy efficiency and enhancing the resource-efficient use of local energy sources:** In order to help ameliorate Estonia’s energy intensity, which remains the second highest in the EU, the Bank will seek to facilitate investments in energy efficiency as well as support investments in domestic energy resources (both
traditional and renewable) to boost the enhanced, resource-efficient generation of local energy.

- **Enhancing private sector competitiveness through innovation.** Estonia still remains below the EU average in innovation performance and funding for innovative enterprises is hampered by the underdeveloped and fragmented private equity and venture capital industries. New investment in high-value added sectors is needed to enhance production capacity, and demonstrate to other businesses how upgraded capital and technologies will sustain growth. The Bank will seek to finance export-oriented companies and innovative producers of higher value-added goods and will support, directly and indirectly (including through private equity funds), measures to increase the availability of financing for growing companies and cross-border expansion.
1 OVERVIEW OF THE BANK’S ACTIVITIES

1.1 The Bank’s current portfolio

Private sector portfolio ratio: 100 per cent, as of 31 December 2015.

<table>
<thead>
<tr>
<th>Sector Group</th>
<th>Sector Team</th>
<th>Portfolio no of operations</th>
<th>Portfolio (€m)</th>
<th>% Portfolio</th>
<th>Op Assets</th>
<th>% Op Assets</th>
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<tr>
<td>Energy</td>
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<td>Infrastructure</td>
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<td>Summary</td>
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</table>

Source: EBRD Business Performance Navigator

1.2 Implementation of the previous strategic directions

Over the present country strategy period, the Bank’s main priorities in Estonia have been to: (1) support investments in energy efficiency and renewable energy; (2) support development of SMEs and help enterprises improve their competitiveness; and (3) support cross-border investments by Estonian companies.

In making investments against these strategic priorities, the Bank has been highly selective in its approach, bearing in mind the need for high transition impact and additionality, in this advanced country. Hence, over this period, the Bank signed 9 new transactions, totalling just over €100 million. All but two projects have been regional in focus, with five investments in private equity funds, three in the energy sector financing investments in Estonia and Latvia, and one in natural resources. Notably, the Bank has:

- Launched the Integrated Approach for the Further Development of the Venture Capital and Private Equity (VC/PE) Ecosystem in the Baltic States (the “Baltics IA”) which aims to facilitate emergence of a strong, more sustainable VC/PE sector in all three countries, with equity and quasi-equity/mezzanine financing available at all growth stages of companies. The Baltics IA pairs investments into VC/PE funds with targeted policy dialogue addressing barriers to further development of the VC/PE industry.
As part of the Baltics IA, invested in three Baltics dedicated private equity funds, managed by local teams and focused on SMEs. One was a mezzanine fund, with the Bank’s support further developing the market for this still rare instrument in Estonia. Another, Baltcap II, follows a buy-and-build strategy, incorporating cross-border activity, which will help integrate investments across all three Baltic States. And in June 2015 the Bank signed a €17 million investment in Livonia Partners Fund I. The Fund will have a generalist sector strategy and will provide growth and acquisition capital to companies in the Baltics. For the moment, no investments have been yet made in Estonia from the above mentioned funds.

In addition, the Bank maintained a close dialogue with relevant stakeholders, including participation in three Baltic-wide capacity building events for existing and aspiring Baltic fund managers covering, among other topics, regulatory and legislative aspects affecting the VC/PE sector.

Provided a loan of €35 million to Viru Keemia Grupp (VKG) supporting energy efficiency investments and lowering of CO₂ emissions by over 126,000 tons per annum at their facilities, where various petrochemical products from locally mined oil shale are produced.

Continued to support Graanulininvest, an Estonian wood pellet producer, through a loan of €24 million (in 2013) to finance part of the construction cost of two new biomass combined-heat-and-power plants (CHPs) located in Latvia, which are expected to generate an expected savings of 100 kt CO₂ per year. A further loan of €42 million to finance two CHPs in Estonia was signed in July 2015. Both investments will increase the share of privately-owned electricity generation, help the company generate zero-carbon renewable electricity in a more energy efficient manner, and lead to combined CO₂ savings of over 124,000 tons per annum.

1.3 Key lessons

Notwithstanding the advanced stage of transition in Estonia, the country’s financial sector offers few alternatives to traditional bank lending, and the Bank, working with stakeholders ranging from investors to other IFIs and regulators, will continue to play an important role in increasing the availability of equity in the economy. A key element of the Bank’s integrated approach will be investments in regional PE/VC funds, building on those noted above.

The Bank’s involvement in PE/VC markets has helped mitigate the perceived risks of investing in a first time team and in a volatile region. EBRD participation has helped build institutional capacity in the industry by supporting both first time and successor funds, which can demonstrate strong management team potential, and attract outside institutional investors and government agencies to invest in private equity in the region. However, the sector remains at a nascent stage of development and the number of investments into Baltic companies is low. Continued EBRD support thus remains vital for the development of the asset class in Estonia and the Baltics as a whole, especially at a time when institutional investors are concerned with the stability of the region. This is all the more important given the modest level of EBRD financing to date of innovative, export-oriented companies; notwithstanding success stories such as Graanulinvest, small transaction size and the availability of competitive financing from local banks present in all three Baltic states has limited Bank investments. This may change as Estonia further emerges from the 2007-2010 financial crisis.
Energy security is also gaining in importance, particularly as geo-political uncertainty persists. The Bank can play a role in regional integration, while supporting local energy generation using local sources of energy, as well as facilitate financing structures that increase private sector involvement in energy generation.

2 OPERATIONAL ENVIRONMENT

2.1 Political context

The current coalition government was established on 9 April 2015 following parliamentary elections on 1 March. The coalition is led by the centre-right Reform Party, which won the general election for the third consecutive time. It comprises the centre-left Social Democratic Party and the centre-right Pro Patria & Res Publica, both having been in and out of the previous ruling coalitions since 2007. Although disagreements occasionally emerge between coalition partners due to programmatic differences, the three-party alliance commands a comfortable majority in parliament providing for the government’s stability and its ability to ensure the adoption of necessary legislation. The new governing coalition has embraced a more socially oriented programme while maintaining fiscal restraint.

The anti-immigration Conservative People’s Party as well as another newly established liberal Free Party have entered the parliament for the first time. The Centre Party is the second largest and the main opposition force. It draws support mainly from Estonia’s sizeable Russian-speaking minority, whose integration remains an issue.

In view of the changed regional geopolitical context, national defence and security have become a key priority shared by the vast majority of the country’s political forces.

2.2 Macroeconomic context

A Eurozone country since 2011, Estonia is a small and highly open economy, with strong trade links to Scandinavia and Russia. As the other Baltic economies, Estonia experienced strong loan-financed growth in the years following EU accession, as external and financial sector vulnerabilities gradually worsened. The deep recession of 2007-10 then forced internal and external adjustment and GDP contracted by a cumulative 20 per cent. Since then, Estonia has experienced a steady recovery, and output is expected to transcend the pre-crisis peak in 2016, according to EBRD’s forecasts.

Following rapid growth of 2.9 per cent in 2014, GDP rose by only 1.2 per cent in 2015, primarily due to weak exports. However, relatively strong domestic consumption was continuously supported by strong wage growth, higher pensions and historically low inflation rates. Domestic trade services and manufacturing were key sectors contributing to growth, whereas value added in the construction and transport sectors substantially decreased, in part due to the Russian embargo on food products from the EU.

Investment activity has fallen since the last quarter of 2013. This reflects the rapid running down of the EU structural funds under the previous budgetary framework which came to an end in 2013. New disbursements of EU funds for the 2014-20 programming period should revive public investment gradually over the course of 2016. Private investment growth has also been weak, as geopolitical tensions dampened domestic sentiment.
In 2015, exports volumes dropped sharply, as the key export markets of Finland and Russia contracted (between them accounting for more than a quarter of exports). Exports to Russia dropped by 35 per cent in 2015. Despite the rapid increase in wage costs, and a slight erosion in competitiveness (evident in the more rapid increase in unit labour costs over the past five years), Estonia’s position in export markets does not seem under threat as market shares seem to have further expanded. Outward FDI flows decreased to about 3 per cent of GDP, from 6 per cent of GDP in 2014, to a large extent driven by the extensive lending by direct investment companies based in Estonia to parent enterprises abroad.

Following a 0.5 per cent increase in average consumer prices in 2014, inflation fell to only 0.1 per cent in 2015, which is in line with a sharp reduction in inflation across the Eurozone. Price deflation could be a risk for Estonia, given the relatively high levels of corporate and household debt. However, alongside other euro area countries Estonia stands to benefit from the euro depreciation, and related quantitative easing by the European Central Bank (ECB).

Estonia continues to show the lowest public debt in the EU, at only 10.4 per cent of GDP in 2014. After registering small deficits in 2012 and 2013, in 2014 the government registered a surplus of 0.8 per cent of GDP. This was due to higher tax revenues, a postponement of public investments and lower than anticipated social transfers. Recently launched income tax cuts and higher family benefits worsened the fiscal position to a minor deficit of 0.3 per cent in 2015, according to the European Commission’s 2016 winter forecast.

2.3 Structural reform context

Estonia is a highly advanced transition country with the EBRD’s transition gap assessments in 2014 showing the highest average score of any country of operation. Recent years have seen some progress in areas that remain problematic. For example, there has been further liberalisation of the energy sector, including through competition and common pricing mechanisms for electricity suppliers. Also innovation policy has been further strengthened. Market regulation is therefore on the whole supportive of continued convergence. Labour productivity has grown by 6.4 per cent since 2010, although at only 70 per cent of the EU average, there is substantial potential for further convergence.

A key structural challenge lies in the labour market. The labour force has been shrinking since 2006, and is expected to contract by a further 27 per cent by 2050. Emigration and declining population figures have tangibly impacted the labour market, including in terms of skills shortages. In addition, real wages have been rising rapidly since November 2011, outpacing registered growth in labour productivity. In 2015, an annual real wage increase of above 5 per cent was registered against the background of persistent mismatches between the skills base in the labour force and the more advanced skills demanded in industry, a rising number of job vacancies and hikes in the minimum wage. The modest unemployment rate of 6.5 per cent as of November 2015 hides a low activity rate, and a high structural unemployment rate.

In terms of innovation intensity, Estonia is above all other EU countries of operation (and hence of any other transition country). Product innovation and the digital economy are encouraged through various policy initiatives, particularly in the public sector (e-government, public health system). That said, the country remains below the EU average, and the
performance is weak in particular with regard to private investment in R&D, which fell again in the past three years, and collaboration between research institutes and industry.

The government has taken steps to increase the effectiveness of public innovation support. The *Entrepreneurship Growth Strategy for 2014-2020* was approved in late 2013 and focuses on areas where cooperation between businesses and researchers, whether domestic or foreign, has greatest potential. The areas with the biggest growth potential are information and communication technology, health technology and services, and more effective use of resources.

The burden from licensing remains low overall. However, some barriers remain in the regulation of professions, in particular in services, and liberalisation could strengthen productivity growth. Similarly, a recent Organisation for Economic Co-operation and Development (OECD) assessment found Estonia’s corporate bankruptcy law below best practice, as procedures are long, excessively costly for entrepreneurs and the recovery of creditor claims remains poor.

A further challenge remains in Estonia’s high energy intensity, which is about three times that of the EU-28 average. Excessive energy intensity in buildings, heating systems and transport, effectively contributes to high greenhouse gas emissions, the highest of any OECD country in terms of GDP. As a result, it is uncertain whether Estonia can meet the ambitious climate and energy targets it has set for 2020.

### 2.4 Access to finance

*Private sources of capital*

The Estonian banking sector, which is dominated by subsidiaries and branches of large Nordic financial institutions, is liquid and well capitalised. Corporate funding is dominated by bank loans.

Given its restrictive fiscal policies, Estonia lacks a government bond market and the commercial bond market is poorly developed. At the moment, Estonia has no outstanding government bonds. The government last accessed the debt markets in 2002 and for the time being does not plan to issue further bonds. The lowest debt level in the EU, at 10.6 per cent of GDP in 2014, and practically balanced fiscal budgets since 2011 are the key strengths that explain Estonia’s sovereign rating, at AA-/A-1+ with stable outlook.

The greatest difficulty that Estonian companies face in accessing capital market financing is the size of the individual companies and the overall size of the Estonian market. The local stock exchange in Tallinn (NASDAQ Tallinn) is part of the Nasdaq Baltic Market, and 100 per cent owned by NASDAQ. Even though listed companies have – through the NASDAQ Baltics trading platform – exposure to the global universe of investors, overall liquidity remains significantly low and the market has failed to elicit sufficient foreign investor interest. Stock Exchange turnover experienced a sharp decline in 2014, from €135 million to €99 million. As of December 2014, the main investors in the stock market are located in Estonia (59.8 per cent), followed by Luxembourg (11.1 per cent), the Cayman Islands (6.8 per cent), Netherlands (5.4 per cent) and Finland (2.9 per cent). The securities market is dominated by corporate investors accounting for around 90 per cent of trading volume. In 2014, only 6 per cent of pension funds money was invested inside Estonia. The vast majority of assets under management by pension funds were invested outside Estonia, thus not
providing much long term capital to the domestic capital market. The total assets of second pillar funds were €2.4 billion as of June 2015 (over 11 per cent of GDP), having grown more than 40 per cent in two years.

Estonia’s economy continues to experience deleveraging by foreign bank creditors. As of Q1 2015 foreign banks had reduced their exposure by almost 2 per cent of Estonian GDP. This is roughly in line with the broader average for the CESEE region (excluding the CIS), and considerably slower than what has been observed in the other Baltic economies, underlining that in the aftermath of the crisis funding ratios in the financial system were less stressed in Estonia.

In contrast to the other two Baltic states, corporate credit resumed growth soon after the crisis in 2012. The pace of expansion remains in the low single digits, and overall credit depth is modest, at only about 34 per cent of GDP. Credit outstanding at long maturities continues to contract. In terms of consumer financing, alternatives to traditional bank financing are developing, though their role as yet remains more limited. Bondora, an Estonian peer-to-peer lending platform for private individuals, is one example.

The Estonian venture capital and private equity sector has €367 million assets under management. In 2014, €48.2 million were invested in 60 companies, of which 28 were new investments (see below).

Foreign direct investment (FDI) has traditionally accounted for a significant share of capital formation in Estonia. As elsewhere in the region, flows are diminished compared to pre-crisis levels, though also less concentrated in non-tradeable sectors such as real estate. In 2014 FDI inflows rose to about 6 per cent of GDP, though this was primarily from reinvested earnings by existing FDI investors. As FDI remains concentrated in technology-intensive sectors, and in a small number of affiliates, a downswing in these sectors, or changing perceptions of geopolitical risk could have a significant impact on funding flows.

Multilateral and bilateral development bank finance and EU Funds
During the 2007-2013 EU budgetary period, Estonia was eligible for up to €3.4 billion in EU structural funds. Estonia’s absorption rate has been the highest in the EU, standing at 94.9 per cent at the end of March 2015. During the budgetary period that just began (2014-2020), €4.5 billion will be available through the European Structural and Investment Funds (ESIF), of which approximately 19 per cent is envisaged for research and innovation, 14 per cent for transport and energy networks, 12 per cent for education, 11 per cent for employment and the labour market, 12 per cent for social inclusion, and the remainder allocated to SME competitiveness (9 per cent), the low carbon economy (9 per cent), the environment and resource efficiency (7 per cent), as well as to public administration, ICT and climate change risk and prevention.

Like other EU countries, Estonia will establish so-called Financial Instruments that will be endowed with EU funds but seek to leverage private funding to extend repayable instruments, including equity and loan guarantees, to beneficiaries. Estonia stands to surpass the 75 per cent threshold of national income relative to the EU average in the coming years. At that point it will become ineligible for large parts of EU structural and investment funds. The public-private funding mechanisms established in the form of the EU Financial Instruments could therefore be especially relevant in fostering private investment.
Estonia also benefited from the European Fund for Strategic Investments (‘EFSI’, also known as the “Juncker Plan”), which became operational in late-2015. Unlike several other EU countries, as of July 2015 the government had not made any national co-financing available. In late 2014, Estonia submitted 32 projects to the Special Task Force on Investment in the EU for potential EFSI funding. Projects submitted were in the areas of transport, energy, knowledge and the digital economy, social infrastructure and resources and the environment, and underlined a potential funding gap of up to €12.3 billion.

In addition, several other institutions have been active in the country, largely in the energy infrastructure and transport sectors:

- From late 2012 to the end of May 2015 the European Investment Bank (EIB) signed three loans totalling €298.8 million in Estonia. A loan of €66.8 million was signed with the City of Tallinn for the development of urban infrastructure and another loan of €32 million for Elering to finance the construction of an emergency power plant. The third operation was a €200 million facility for the Government to support investments in research, innovation, sustainable transport infrastructure and SME development.

- Since early 2013 the European Investment Fund (EIF) has committed €35 million via the Baltic Innovation Fund, €20 million for BaltCap Private Equity Fund II and €15 million for BPM Mezzanine Fund. Both funds invest across all three Baltic states. EIF has also signed a €40 million guarantee facility with LHV Pank to finance innovative companies in Estonia.

- The Nordic Investment Bank (NIB) has signed four loans in Estonia since late 2012 totalling €76 million. One loan of €25 million was for the Port of Tallinn to finance the purchase of an icebreaker. NIB also financed the construction of Estlink-2 connecting Estonia and Finland with a loan of €10 million. An additional loan of €20 million was signed for Tallinn Water and another €21 million loan for Tartu University Hospital to finance the construction of a new medical campus.

- Since end of 2012 the Council of Europe Development Bank (CEB) has not signed any loans in Estonia.

2.5 Business environment and legal context

Business environment

Estonia’s business environment continues to be the most attractive in the Central Europe and Baltics region, according to the World Bank’s 2016 Doing Business report, which ranks the country 16th globally. The latest report acknowledges progress made in starting a business indicator, with only about one day necessary to open a new company, as opposed to the OECD average of more than 8 days. Costs relating to opening a business are also only one-half of the OECD average. The country also remains the regional leader in regards to trading across borders and registering property. Nevertheless, improvements in indicators such as securing electricity and protecting minority investors would be desirable.

The OECD assessment of product market regulation confirms the overall competition-friendly business environment, and ranks the country as slightly less restrictive than the OECD average. Nevertheless, it flags a number of barriers in professional services, and in services trade within Estonia and with foreign partners. The OECD has for a number of years flagged weaknesses in insolvency laws, and in out-of-court restructuring.
The World Economic Forum’s *World Competitiveness Report 2015-2016* highlights a number of additional obstacles. Tax rates, an inadequately educated workforce, excessive government bureaucracy and insufficient capacity to innovate were assessed as the most problematic business obstacles.

In the 2012-13 EBRD/World Bank Business Environment and Enterprise Performance Survey (BEEPS V), the top three business environment obstacles identified by Estonian firms were competitors’ practices in the informal sector; electricity issues; and workforce skills. Tax administration was also one of the top concerns in the country. On average, the number of inspections by, or meetings with, tax officials increased from 2 to 2.8 – above the regional average of 2.2 and second only to Croatia in the region.

**Legal context**

The Bank’s assessment of laws in the region where the EBRD operates shows that Estonian commercial laws are among the most advanced. They have been regularly amended and European directives have also been regularly implemented.

The laws regulating the Estonian capital market and its operations are reasonably modern. If the capital market remains illiquid, it is due to the lack of demand and supply, and not to the legal framework. Adopting some regulation applicable to the issuance of covered bonds should nevertheless be considered. Secured transactions are another area which would benefit from some reform and in particular security over movable assets. Unless granted on the whole of an enterprise (which conditions are strict and burdensome), security over identified movable assets requires a transfer of possession of the collateralised property. This does not match the needs of modern business and might restrict access to credit in Estonia.

Estonian corporate governance rules have been amended in order to comply with the *acquis communautaire* and now guarantee good standards. Although insolvency legislation is of a high quality, improvement of the reorganisation proceedings and in particular of the information available and amount payable to creditors would be beneficial. The court system functions well, is generally independent from political influence and deals efficiently with commercial cases ensuring judicial efficiency. Alternative dispute resolution methods are available and related legislation has transposed the European Directive on mediation. Except for arbitration, other alternative dispute resolution methods such as mediation and conciliation have not gained much traction.

Estonia has transposed the Third Energy Package, ratified the Kyoto Protocol and achieved its obligation to reduce emissions by 8 per cent compared to 1990. Improving energy efficiency by tackling inefficient consumption of energy resulting from depreciated assets from Soviet times should be considered in residential and public buildings.

Annex 4 offers more detailed analysis on the legal context for investments in Estonia.

### 2.6 Social context

According to the UNDP 2014 Human Development Index (HDI)¹, Estonia is ranked 30th out of 188 countries, which is above the regional average for Europe and Central Asia and

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¹ According to the HDI, countries fall into four broad human development categories: Very High Human Development, High Human Development, Medium Human Development and Low Human Development.
SEMED countries. The HDI is comprised of three dimensions: health, education and decent standard of living.

Life expectancy at birth was 76.8 years on average in 2014 which is slightly lower than the EU average of 80.6 years. According to Eurostat, 23.5 per cent of the population (mainly children) was at risk of poverty and social exclusion in 2014, above the EU average and a slight increase from 21.7 per cent in 2010. Inequality is relatively high in Estonia with a Gini index value of 32.7 compared to the regional average of 30.6 per cent.

Although the educational attainment of young people is high and the tertiary education attainment rate above the EU average (33.7 per cent compared to 26 per cent), well-educated Estonians have tended to migrate to countries with better career opportunities. In addition, there is a clear shortage of students in technology and science subjects (with 13.2 per 1000 youth aged 20-29 in 2012 according to Eurostat), which has contributed to the skills mismatches. The participation rate in vocational educational and training (VET) remains relatively low at 37 per cent compared with the EU average. A reform of curricula in the VET education system is ongoing.

In the EBRD region, Estonia is considered a country with relatively low gender discrimination. In terms of economic opportunities, according to the 2012 Women’s Economic Opportunity Index of the Economist Intelligence Unit (which ranks 128 countries on their ability to support the economic advancement of women), Estonia is ranked 29th globally and 7th in the EBRD region. According to the 2012 BEEPS survey, 30.4 per cent of the 360 surveyed firms in Estonia had a female owner, performing better than other countries in Central Europe and the Baltics. However, Estonia has one of the highest gender pay gaps among EU countries at 30 per cent and access to childcare remains limited.

Regional differences in Estonia are significant. Rural areas suffer from outward migration to urban areas of Tallinn and Tartu. This is most pronounced in northeast Estonia, a region that was industrialised after World War II with a focus on heavy industries, and in south Estonia. At the local government level, support for entrepreneurship is limited and varies across the region. Skill and location mismatches have led to long durations of unemployment. Long-term unemployment, defined as people seeking work for more than 12 months, has remained high, particularly in the northeast, and constituted nearly one-half of the total unemployed in 2014. Regional gaps also exist in relation to access to infrastructure and services, particularly in relation to central heating and quality drinking water and waste water systems, where network coverage is substantially lower and connections are of poorer quality than in urban areas.

2.7 Energy efficiency and climate change context

Among EU Member States, Estonia is relatively high on energy intensity with the use of energy per unit of GDP three times higher than the EU-28 level (0.35 kg oil eq/USD of GDP vs 0.11, IEA 2012) as well as carbon intensive, with CO₂ emissions per unit of GDP about four times higher than the EU-28 average (1.03 kgCO₂/USD of GDP vs 0.24, IEA 2012). Although Estonia's import dependency is one of the lowest in the EU, its energy mix is also one of the least diversified, and it remains isolated from the rest of the EU. While Estonia has made progress over the last decades, there is considerable scope for further energy efficiency and renewable energy investments across all sectors in the economy. The need for a more rational use of energy as well as resources (water and waste) is also important across sectors.
In addition, more support is needed for regional interconnections, new power generation and re-powering capacities with private investors and further reinforcement of transmission and distribution grids, particularly to handle production from renewable sources. Smart grid and smart metering could be further enhanced and more investments linked to the introduction of new technologies and improving energy efficiency are needed as well as the development of a functional ESCO market. Under EU Directive 2012/27/EU, three per cent of central government owned buildings must be refurbished each year, and the private sector can contribute towards this target with finance and expertise through ESCO projects and energy performance contracting. Private ESCOs could invest in street lighting projects as well as refurbish and upgrade municipal buildings. The ESCO concept is also applicable to private sector energy efficiency investments, e.g. commercial and residential buildings. EBRD policy dialogue and finance can provide substantial support for gradual transition to low carbon buildings in compliance with the provisions of the EU Energy Performance of Buildings Directive, as well as low carbon public service provision.

Annex 4 offers additional information on the legal context and policy dialogue that can be pursued in Estonia.

3 STRATEGIC ORIENTATIONS

3.1 Strategic Directions

Estonia has steadily recovered from the deep recession of 2007-10, and output should soon regain its pre-crisis peak. Against the backdrop of traditionally cautious fiscal and prudential policies, its vulnerabilities have been contained, and its 2011 accession to the euro area was the first by any EU member since the EU-wide financial crisis struck.

However, as with many other countries in the region, the longer-term challenges of a shrinking workforce, low activity rates, and acute skills shortages are starting to show tangible effects in reduced foreign investment. While the country boasts a world-renowned innovative start-up sector, its broader innovation performance and productivity growth have not been adequate to redress these longer term challenges. In addition, Estonia’s energy intensity remains the second highest in the EU, and there is considerable scope for improving energy efficiency across multiple sectors.

Estonia will benefit from a substantial allocation of European Structural and Investment Funds (ESIF) over the coming five years. The allocation after 2020 will be markedly lower, and the authorities are concerned that private finance is not well established to substitute for this fall in public funds. EU structural funds will increasingly shift from the traditional grant-based instruments towards commercially-based financial instruments that leverage private funds. Establishing the institutions and governance for attracting and sustaining private investor participation in publicly led projects will be crucial to sustain growth.

To help Estonia address these challenges, the Bank will focus on the following orientations in the new strategy period:

- **Strengthening energy efficiency and enhancing the resource-efficient use of local energy sources.** The Bank will seek to facilitate investments in energy efficiency as well as support investments in domestic energy resources (both traditional and
renewable) to boost the enhanced, resource-efficient generation of local energy. As Estonia shows the second-highest energy intensity in the EU, this agenda is essential to both overall objectives in energy efficiency and security, as well as in terms of private sector competitiveness.

- **Enhancing private sector competitiveness through innovation.** New investment in high-value added sectors is needed to enhance production capacity, and demonstrate to other businesses how upgraded capital and technologies will sustain growth. While there is a well-known start up sector, overall productivity growth has faltered recently, and innovation performance needs to be strengthened to sustain export market share. A better environment for risk capital could underpin private sector investment in this regard. The Bank will seek to finance export-oriented companies and innovative producers of higher value-added goods and will support, directly and indirectly (including through private equity funds) measures to increase the availability of financing for growing companies and cross-border expansion. The Bank will aim to synchronise these activities with the Government’s enterprise and innovation policies.

In designing its support and related instruments, the Bank will tailor them to the advanced stage of transition of Estonia. As Estonia’s transition has become more advanced, the Bank has accordingly narrowed the scope of its activities as a consequence of the fewer market segments in which Bank activities can satisfy its operating principles (transition impact, sound banking and additionality). This is also intended to enable the Bank to gather further experience and develop its knowledge in its advanced markets that it could share in other parts of the EBRD region.

Likewise, during the strategy period, Estonia’s donor activities will continue to strengthen private sector development in the EBRD region and the authorities will seek opportunities to share their experience and expertise gained during Estonia’s transition with other countries in the EBRD region.

Reaffirming the principle of graduation and consistent with the Medium-Term Directions for the Bank (BDS14-098 (F)), the Bank considers that the main instrument for decision-making on graduation is the respective country strategies, jointly agreed by the Bank and country authorities. Estonia reaffirms its commitment to the principle of graduation. Although there has been significant progress in its transition to a sustainable market economy, some gaps remain and new challenges have arisen related to uncertainties in the broader geopolitical and investment environment. Estonia will continue to keep the question of graduation under review and will indicate its graduation intention at the appropriate time.

### 3.2 Key challenges and Bank activities

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

**Transition challenges**

- Estonia’s energy intensity remains the second highest in the EU, with a gross inland energy consumption to GDP ratio significantly above that of regional peers Latvia, Lithuania and Poland. Substantial energy efficiency investments have been made in public buildings, as well as measures to reduce energy consumption in housing and
central heating systems, although there are still a number of areas where further investments are necessary. Energy efficiency in industrial and residential buildings should be improved, as well as in the transport sector, where clean technologies are poorly developed when compared with other EU countries.

- In contrast to the other two Baltic states, Estonia exhibits a very low overall dependence on external energy imports. The share of imported energy in total domestic energy consumption is only 12 per cent, far below the EU average of 53 per cent in 2013. However, the country relies almost completely on solid fuels (such as oil shale) in its energy mix that represent the most polluting source of energy in terms of greenhouse gas emissions. Oil shale is an important source of energy in Estonia, and represents more than 60 per cent of the energy mix in the country, but is energy intensive. Additional investment in alternative fuel energy generation, including renewables, would balance the energy intensity of the country.

- Natural gas, one of the main alternative energy sources to solid fuels, is primarily supplied through the gas supply network, historically part of the Soviet gas supply system. Estonia has cross-border connections with Russia and Latvia, and this year also began to import gas from Lithuania’s LNG terminal, with the latter providing about 20 per cent of Estonia’s total foreign energy supply. A pipeline between Estonia and Finland that is currently under construction and the associated LNG terminals in the two countries could further improve security of supply and facilitate competition in the wholesale market. Increased sources may lead to a higher share of gas consumption in Estonia’s overall energy mix, which could help reduce the country’s carbon intensity should it displace more polluting fuels.

- The pan-Baltic pipeline grid should be further strengthened, in particular through usage of underground gas storage facilities.

Operational Response

- The Bank will seek to support local generation of electricity, primarily by supporting investments in renewable energy generation based on local energy sources such as biomass, waste, biogas and wind. Increased private sector participation will be sought. Support for other low greenhouse gas (GHG) emission power generation, e.g., gas-fired power plants, will also be pursued.

- Energy efficiency investments will be financed in the corporate sector, and the use of ESCOs and Energy Performance Contracts (EPCs) to facilitate energy efficiency investments in other areas, such as residential and public sector buildings, will be supported.

- Investments that seek to improve efficiency in refining oil shale into cleaner fuel and facilitate extraction of valuable residuals, thereby increasing the value added of this natural resource, will be pursued.

Policy dialogue and Technical Assistance

The Bank’s policy dialogue will focus on the following areas:

- Improving the predictability and transparency of the regulatory framework for renewable energy, which will increase the use and resource efficiency of local energy sources, such as biomass and wind;

- Increasing the involvement of the private sector in providing energy saving services by further improving the legal structure for EPCs and technical assistance to
facilitate the use of ESCOs (such as contract templates and support in project identification and preparation) and implement the EPC financing structure; and

- Promoting the use of Financial Instruments, in conjunction with EU structural funds, to support the financial structuring of projects in the energy and resource efficiency sectors.
### Results Framework for Theme 1: Strengthening energy efficiency and enhancing the resource-efficient use of local energy sources

<table>
<thead>
<tr>
<th>CHALLENGES</th>
<th>OBJECTIVES</th>
<th>ACTIVITIES</th>
<th>TRACKING INDICATORS</th>
</tr>
</thead>
</table>
| 1.1        | Estonia remains dependent on energy-intensive solid fuels | Diversify Estonia’s energy mix by increasing electricity generation from local, renewable resources | • Direct/indirect financing to generating companies (“gencos”) using local, renewable energy sources  
• Policy dialogue to improve the regulatory framework for renewable energy, which will increase the use and resource efficiency of local energy sources, such as biomass and wind | • Number of investments in gencos utilising local, renewable energy sources, and evidence of improved financial and operational performance (TIMS/TCRF) *(Baseline – established at projects’ approval)*  
• Evidence of successful strengthening of regulatory framework for renewable energy *(Baseline – N/A)* |
| 1.2        | Estonia’s energy intensity remains the second highest in the EU | Improve energy efficiency | • Finance energy efficiency investments, including in the corporate sector and for residential and public sector buildings, and through support for EPC framework to improve access to finance for ESCOs  
• Policy dialogue, including technical assistance, to facilitate development of regulatory structure for EPCs | • Volume of energy savings achieved through Bank investments based on EBRD methodology in toe/year *(Baseline – 0)*  
• CO₂ emissions reduction as a result of the Bank’s operations in tCO₂e/yr *(Baseline – 0)*  
• Number of energy efficiency investments successfully implemented or financed *(Baseline – 0)*  
• Evidence of successful strengthening of regulatory framework for EPCs *(Baseline – N/A)* |

**Context indicator:** Δ in Estonia’s energy intensity *(Source: Eurostat (Baseline (2013) – 512.7 kg oil equivalent/€1000))
**Theme 2: Enhancing private sector competitiveness through innovation**

**Transition challenges**

- Estonia’s labour productivity remains relatively low, at about 70 per cent of the EU-28 average. Since the trough of the financial crisis in 2010, Estonia has achieved modest productivity growth of 6.4 per cent cumulatively, while increases in wage costs have contributed to a slight erosion in competitiveness (evident in unit labour costs, which have risen over 16 per cent over the same period, the highest such increase in the EU). Estonia is a highly open economy and its share of world market exports has edged up slightly, underlining continued improvements in product quality.

- Capital formation, the key prerequisite to sustaining productivity growth, has been weak over the past three years, and high value added sectors such as manufacturing and information technology have declined since 2013. More recently, the transition to a new framework of EU funds has weakened public investment, while private capital spending has been dampened due to external political risks.

- Estonia remains below the EU average in innovation performance, according to a widely-followed EU rating. Most recently, weaknesses have been detected in the number of innovative SMEs, firms’ non-R&D innovation expenditures, and linkages between research institutions and industry. Business investment in new technologies, including research and development, is relatively low and volatile given its concentration in a few sectors.

- The policy framework for research and development has improved, as the various parts of the government are now more closely coordinated. Weaknesses remain in the framework for commercialisation of research, and in cooperation between research centres and business.

- Credit to the corporate sector has been growing at a modest pace since 2012, and well-established SMEs confront few supply-side constraints in the predominantly foreign-owned banking system. By contrast, the market infrastructure and market depth of private equity and venture capital remain underdeveloped compared to other emerging markets at a similar stage of development. Networks between such funds on the one hand and entrepreneurs and research centres on the other are insufficiently developed across the Baltic countries and elsewhere in the region.

**Operational response**

- The Bank will continue its work under the Baltics IA and invest in regional private equity and venture capital funds targeting the Baltics, including Estonia, thereby supporting further development of local capital markets and improving the availability of various types of equity investment into expanding SMEs. The Bank will also seek ways to support development of financing mechanisms like crowd-funding and peer-to-peer financing.

- The Bank will prioritise financing export-oriented companies and innovative producers of higher value added goods. Resource efficiency and in particular energy efficiency investments by corporates will be targeted in order to improve their competitiveness.

- To bolster FDI into Estonia, the Bank will support foreign companies’ investments, and the associated knowledge transfer, adoption of best business practices and/or improvement of corporate governance standards.
• The Bank will seek to deepen its engagement in Estonia’s knowledge economy by financing investments in innovation, research and development and adoption of modern technology in knowledge-intensive industries and by investment and aggregation (consolidation) in related ICT infrastructure.

• Mindful of proper risk-sharing between the public and private sectors, the Bank will work with the authorities, as appropriate, to promote and finance PPP structures to improve energy efficiency and, as opportunities arise, transport infrastructure.

• Cross-border investments by Estonian companies into other EBRD countries of operation where the Bank’s local presence and involvement can facilitate investment will be supported.

Policy dialogue and TC

• The Bank will continue working under the Baltics IA together with market participants and authorities aiming to further improve the legal and regulatory environment enabling PE/VC to grow further in Estonia. This will involve also some technical assistance for capacity building, early stage development support, creating and enhancing networks, and increasing the availability of information on VC/PE funds.

• The Bank will closely co-operate with the authorities through advisory to develop and structure PPP projects, coupled where possible with finance.
## Results Framework for Theme 2: Enhancing private sector competitiveness and innovation

<table>
<thead>
<tr>
<th>CHALLENGES</th>
<th>OBJECTIVES</th>
<th>ACTIVITIES</th>
<th>TRACKING INDICATORS</th>
</tr>
</thead>
</table>
| 2.1 Funding environment for innovative enterprises remains limited         | **Strengthen private sector competitiveness through investment in innovative and export-oriented companies** | • Debt and equity investments in support of export-oriented and innovative producers of higher value-added goods, including, as applicable, those further developing adoption of modern technologies and/or Estonia’s knowledge economy | • Evidence of successful operation of export-oriented and innovative companies supported directly or indirectly by the Bank (qualitative account) *(Baseline – N/A)*  
• Evidence of development of innovation or adoption of modern technology by local companies as a result of the Bank’s investments (qualitative account) *(Baseline – N/A)* |
| 2.2 Risk-oriented private equity and venture capital remain underdeveloped and fragmented | **Diversify sources of finance, including private equity and venture capital, as alternatives to the banking sector** | • Under the Baltics IA, investments in regional PE and VC funds targeting the Baltics, supported by policy dialogue and technical assistance to improve the legal and regulatory environment | • Evidence of availability of innovative financing (e.g., number of PE and VC funds financed) and number of innovative companies financed by client funds *(Baseline – 0)*  
• Evidence of improvement in the regulatory environment as a result of the Bank’s policy dialogue (qualitative account) *(Baseline – N/A)* |

**Context indicator:** Δ in Sub-indicator on Innovation systems from Adjusted Knowledge Economy Index *(Baseline (2013) – 7.25)*
3.3 Potential Risks to Country Strategy implementation

The EBRD’s ability to deliver on its strategy in Estonia will be influenced by a number of factors outside the Bank’s control. Where feasible, the Bank will work to address and mitigate these risks through proactive and sustained engagement with clients, the authorities and other stakeholders.

i. Continued sluggish growth in Western Europe

The rest of the EU is an important market for Estonian exports. As a result, any negative impact on the EU economy would be reflected in the local economy through a smaller contribution to gross domestic product from exports.

ii. Continued geopolitical tensions surrounding Russia/Ukraine

Russia is an important export market and also a significant source of business for the Estonian transit-related transport sector. A changed geo-political situation arising from the Ukrainian conflict could trigger a deterioration of market confidence and economic outlook in major trading partners. Perceived increased risks might also deter foreign investors, although the EBRD’s presence and support may mitigate this to some extent.

iii. Low investment in the corporate sector

For the Bank to be able to implement an important part of its strategy, the corporate sector in Estonia needs to invest. The uncertain geo-political situation could lower investments in Estonia and, more likely, cross-border investments by Estonian companies, thereby reducing the number of opportunities for the Bank.

3.4 Environmental and Social Implications of Bank Proposed Activities

Estonia is one of the most sparsely populated countries in Europe and forests cover over one half of the country. Eighteen percent of the land territory is a nature reserve. Estonia’s National Strategy on Sustainable Development defines the framework for sustainability in development and the main goals are the viability of the Estonian cultural space, the growth of welfare, a coherent society and ecological balance. As a European Union member, Estonia has adopted environmental and social legislation that is harmonised with the EU acquis and is aligned with the EBRD’s Environmental and Social Policy.

Estonia has made substantial progress in advancing its sustainability agenda. For example, the emissions from oil-shale burning power plants have decreased by 80 per cent since 1980. Similarly, waste recovery has constantly increased. In 2013, more than a half of generated waste was recovered, as compared to only 13 per cent in 2000. This increase was mainly caused by a rapid rise in recovery of oil-shale excavation waste due to its use in road construction. In recent years, there has also been a noticeable increase in the incineration of municipal waste with more than half of generated municipal waste being incinerated in 2013.

Challenges remain, however, especially in the area of energy performance. Estonia is a country with a large energy consumption; the main reason is the low efficiency of energy production from oil shale (in Estonia, the efficiency of the production of electricity from oil shale is about 30 per cent). While Estonia is one of the smallest greenhouse gas emitters in the EU in absolute terms (0.4 per cent of the total greenhouse gas emissions), it ranks second
in per capita emissions. Diversifying energy sources (including increasing the share of renewable energy), decreasing the energy consumption of all sectors and increasing energy efficiency are all measures which can decrease greenhouse gas emissions and improve energy performance.

The Bank’s focus on supporting investments to improve private sector competitiveness as well as strengthen energy security and energy efficiency present opportunities to improve environmental and social performance (including the promotion of gender equality), and reduce greenhouse gas emissions. Transport infrastructure and renewable energy projects require the EBRD to apply a precautionary approach due to the potential adverse impacts on biodiversity and sensitive habitats, including Natura 2000 sites. The Bank’s Environmental and Social Policy and Performance Requirements will apply to all projects in Estonia.

3.5 EBRD co-operations with Multilateral Development Banks (MDBs) and the EU

- The EBRD will continue to work closely and actively co-ordinate its efforts with the EIB, EIF and NIB to enhance the leverage of its investment financing, especially to increase private sector participation in energy.
- The Bank will continue to engage in policy dialogue with the Estonian authorities to support private investors’ involvement in public investment schemes, in particular regarding the use of Financial Instruments in conjunction with EU Structural and Investment Funds.
- In cooperating with the EIB, investments under the Juncker Plan may hold particular potential to leverage the Bank’s expertise in certain sectors.
ANNEX 1 – POLITICAL ASSESSMENT

The Republic of Estonia is committed to and applying the principles of multiparty democracy, pluralism and market economics in accordance with Article 1 of the Agreement Establishing the Bank.

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 became a member of the European Union in 2004 and joined the Eurozone in 2011.

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 since the restoration of independence in 1991. Some challenges remain, however, in the areas related to the integration of the Russian-speaking minority.

Free Elections and Representative Government
The legal framework for elections, which has been further amended since the last Strategy, 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, despite remaining divisions along ethnic and linguistic lines. The last general election took place in March 2015. The election administration enjoyed widespread 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 internet voting, political party and campaign finance, as well as the participation of ethnic minorities.2

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.

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, including a party mainly representing the sizeable Russian-speaking minority, 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.3

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.

**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 2015 Corruption Perceptions Index ranks Estonia 23rd out of 168 countries assessed (an improvement from rank 28 in 2013)\(^4\), 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. In its latest EU-wide Anti-Corruption Report, the European Commission highlighted the low perception levels of corruption in Estonia.\(^5\) The Council of Europe’s Group of States against Corruption (GRECO) recommended measures to further improve corruption prevention in respect of members of parliament, while noting that the authorities initiated an ambitious reform process in this area.\(^6\)

**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 last United Nations Universal Periodic Review (UPR) for Estonia was conducted in 2011. The largest share of recommendations to address remaining weaknesses concerned international instruments (24.41 per cent of all recommendations), followed by women’s rights (21.26 per cent) and the rights of the child (14.17 per cent).

Estonia provides for Gender Equality by law and effective institutions to implement corresponding policies are in place. However, while the labour force participation rate is the highest in the region, on average women earn less, with a gender pay gap of 30 per cent.\(^7\) The share of female Members of Parliament increased from around 20 per cent in 2011 to approximately 24 per cent in the current parliament.

Estonia has a sizeable Russian-speaking minority, whose integration requires further effort. In its 2014 report on Estonia, the UN Committee on the Elimination of Racial Discrimination (CERD) noted remaining challenges due to a number (around six per cent of the population) of “persons with undetermined citizenship”.\(^8\) At the same time, CERD commended Estonia for amending the Citizenship Act in order to facilitate the naturalisation of “persons of undetermined citizenship”, and the OSCE/ODIHR encouraged the authorities to ensure the implementation of its provisions.\(^9\)

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

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\(^7\) European Commission (2014): Tackling the gender pay gap in the European Union, p. 11

\(^8\) CERD (2014): Concluding observations on the combined tenth and eleventh periodic reports of Estonia, p.2&4

### ANNEX 2 – SELECTED ECONOMIC INDICATORS

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015 (projection)</th>
<th>2016 (forecast)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Output and expenditure</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>2.5</td>
<td>7.6</td>
<td>5.2</td>
<td>1.6</td>
<td>2.9</td>
<td>1.2</td>
<td>2.8</td>
</tr>
<tr>
<td>Private consumption</td>
<td>-1.6</td>
<td>3.7</td>
<td>4.4</td>
<td>3.8</td>
<td>3.5</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Public consumption</td>
<td>-0.4</td>
<td>1.3</td>
<td>3.6</td>
<td>1.5</td>
<td>3.0</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>-2.6</td>
<td>32.7</td>
<td>10.9</td>
<td>2.3</td>
<td>-2.8</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Exports of goods and services</td>
<td>24.0</td>
<td>24.2</td>
<td>6.2</td>
<td>4.7</td>
<td>1.8</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Imports of goods and services</td>
<td>21.2</td>
<td>27.2</td>
<td>11.7</td>
<td>4.5</td>
<td>1.4</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Industrial gross output, excl. construction</td>
<td>22.9</td>
<td>19.7</td>
<td>1.5</td>
<td>4.2</td>
<td>2.4</td>
<td>-2.4</td>
<td>na</td>
</tr>
<tr>
<td><strong>Labour Market (not including workers abroad)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross average monthly earnings in economy (annual average)</td>
<td>0.9</td>
<td>5.4</td>
<td>5.9</td>
<td>7.8</td>
<td>5.6</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Real LCU wage growth</td>
<td>-1.8</td>
<td>0.3</td>
<td>1.6</td>
<td>4.4</td>
<td>5.1</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Unemployment rate (annual average)</td>
<td>16.7</td>
<td>12.3</td>
<td>10.0</td>
<td>8.6</td>
<td>7.4</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td><strong>Prices</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer prices (annual average)</td>
<td>2.7</td>
<td>5.1</td>
<td>4.2</td>
<td>3.2</td>
<td>0.5</td>
<td>0.1</td>
<td>na</td>
</tr>
<tr>
<td>Consumer prices (end-year)</td>
<td>5.4</td>
<td>4.1</td>
<td>3.6</td>
<td>2.0</td>
<td>0.1</td>
<td>-0.2</td>
<td>na</td>
</tr>
<tr>
<td><strong>Fiscal Indicators</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General government balance</td>
<td>0.2</td>
<td>1.2</td>
<td>-0.3</td>
<td>-0.1</td>
<td>0.7</td>
<td>0.3</td>
<td>na</td>
</tr>
<tr>
<td>General government revenues</td>
<td>40.7</td>
<td>38.6</td>
<td>38.8</td>
<td>38.1</td>
<td>38.7</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>General government expenditure</td>
<td>40.5</td>
<td>37.4</td>
<td>39.1</td>
<td>38.3</td>
<td>38.0</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>General government debt</td>
<td>6.6</td>
<td>5.9</td>
<td>9.5</td>
<td>9.9</td>
<td>10.4</td>
<td>10.1</td>
<td>na</td>
</tr>
<tr>
<td><strong>Monetary and financial sectors</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Eurozone broad money (M2, end-year)</td>
<td>2.1</td>
<td>2.0</td>
<td>4.4</td>
<td>2.4</td>
<td>3.5</td>
<td>5.3</td>
<td>na</td>
</tr>
<tr>
<td>Credit to the private sector (end-year)</td>
<td>-4.6</td>
<td>-5.1</td>
<td>0.3</td>
<td>0.8</td>
<td>3.3</td>
<td>4.9</td>
<td>na</td>
</tr>
<tr>
<td>Non-performing loans ratio (end-year)</td>
<td>6.1</td>
<td>4.5</td>
<td>3.0</td>
<td>1.7</td>
<td>1.5</td>
<td>1.0</td>
<td>na</td>
</tr>
<tr>
<td><strong>Interest and exchange rates</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ECB deposit facility rate</td>
<td>0.25</td>
<td>0.25</td>
<td>0.00</td>
<td>0.00</td>
<td>-0.20</td>
<td>-0.30</td>
<td>na</td>
</tr>
<tr>
<td>ECB main refinancing operations rate</td>
<td>1.00</td>
<td>1.00</td>
<td>0.75</td>
<td>0.25</td>
<td>0.05</td>
<td>0.05</td>
<td>na</td>
</tr>
<tr>
<td>ECB marginal lending facility</td>
<td>1.75</td>
<td>1.75</td>
<td>1.50</td>
<td>0.75</td>
<td>0.30</td>
<td>0.30</td>
<td>na</td>
</tr>
<tr>
<td><strong>External sector</strong></td>
<td>(in per cent of GDP)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current account</td>
<td>1.8</td>
<td>1.3</td>
<td>-2.4</td>
<td>-0.1</td>
<td>1.0</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Trade balance</td>
<td>-2.8</td>
<td>-2.1</td>
<td>-6.6</td>
<td>-4.7</td>
<td>-5.0</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Export of goods</td>
<td>50.9</td>
<td>63.3</td>
<td>63.0</td>
<td>60.8</td>
<td>58.4</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Import of goods</td>
<td>53.6</td>
<td>65.4</td>
<td>69.6</td>
<td>65.9</td>
<td>63.6</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Foreign direct investment, inward</td>
<td>13.2</td>
<td>5.0</td>
<td>7.7</td>
<td>3.5</td>
<td>5.9</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Gross external debt stock</td>
<td>112.1</td>
<td>101.9</td>
<td>101.9</td>
<td>93.5</td>
<td>96.8</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td><strong>Memorandum items</strong></td>
<td>(Denominations as indicated)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Population (end-year, thousand)</td>
<td>1,329.7</td>
<td>1,325.2</td>
<td>1,320.2</td>
<td>1,315.8</td>
<td>1,313.3</td>
<td>1,311.8</td>
<td>na</td>
</tr>
<tr>
<td>GDP (in billions of Euro)</td>
<td>14.7</td>
<td>16.7</td>
<td>18.0</td>
<td>19.0</td>
<td>20.0</td>
<td>20.2</td>
<td>na</td>
</tr>
<tr>
<td>GDP per capita (in Euro)</td>
<td>11,069.4</td>
<td>12,577.3</td>
<td>13,639.1</td>
<td>14,451.0</td>
<td>15,200.7</td>
<td>15,400.79</td>
<td>na</td>
</tr>
<tr>
<td>Share of industry, incl. constr., in GDP (in per cent)</td>
<td>24.5</td>
<td>25.5</td>
<td>25.2</td>
<td>25.4</td>
<td>24.5</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Share of agriculture in GDP (in per cent)</td>
<td>2.8</td>
<td>3.5</td>
<td>3.6</td>
<td>3.1</td>
<td>3.2</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Inward FDI (in million of Euro)</td>
<td>1,935.6</td>
<td>817.8</td>
<td>1,393.8</td>
<td>664.3</td>
<td>1,172.1</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>External debt/exports of goods and services (per cent)</td>
<td>150.6</td>
<td>107.9</td>
<td>118.3</td>
<td>112.8</td>
<td>114.8</td>
<td>na</td>
<td>na</td>
</tr>
</tbody>
</table>
## ANNEX 3 – ASSESSMENT OF TRANSITION CHALLENGES (2014)

<table>
<thead>
<tr>
<th>Market Structure:</th>
<th>Market Institutions:</th>
<th>Key challenges:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CORPORATES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Agribusiness</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small</td>
<td>Medium</td>
<td>• Further enhancing productivity of farming and processing activities.</td>
</tr>
<tr>
<td><strong>Manufacturing and Services</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Negligible</td>
<td>Negligible</td>
<td>• Very little challenge remains in the sector given its business environment that is considered to be one of the best in the world; however, more attention could be paid to regional disparities in terms of human resources endowment to facilitate the expansion of private enterprises in less developed regions.</td>
</tr>
<tr>
<td><strong>Real estate</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Negligible</td>
<td>Negligible</td>
<td>• The sector is already well developed with no significant remaining transition challenges.</td>
</tr>
<tr>
<td><strong>ICT</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small</td>
<td>Negligible</td>
<td>• Further increasing competition in the wireline segment.</td>
</tr>
<tr>
<td><strong>ENERGY</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Natural Resources</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small</td>
<td>Negligible</td>
<td>• Enhancing competition in the wholesale and retail gas markets.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Completing the unbundling process approved by the Estonian Parliament.</td>
</tr>
<tr>
<td><strong>Sustainable Energy</strong></td>
<td>Medium</td>
<td>Reduced energy intensity of the economy especially in the power sector.</td>
</tr>
<tr>
<td></td>
<td>Medium</td>
<td>• Supporting policies to lower CO2 emissions.</td>
</tr>
<tr>
<td><strong>Power</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Negligible</td>
<td>Negligible</td>
<td>• Increasing cross border trade.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Increasing private sector competition in power generation.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Reducing carbon intensity/emissions.</td>
</tr>
<tr>
<td><strong>INFRASTRUCTURE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Water and wastewater</strong></td>
<td>Negligible</td>
<td>Full removal of cross-subsidies between consumer groups.</td>
</tr>
<tr>
<td></td>
<td>Small</td>
<td>• Ensuring adequate water and sewage systems throughout the country that meet appropriate environmental standards.</td>
</tr>
<tr>
<td><strong>Urban Transport</strong></td>
<td>Medium</td>
<td>Increased private sector participation in transport services.</td>
</tr>
<tr>
<td></td>
<td>Medium</td>
<td>• Development of parking infrastructure in other cities besides Tallinn, possibly on a PPP basis.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Improvement in financial sustainability.</td>
</tr>
<tr>
<td><strong>Roads</strong></td>
<td></td>
<td>Completion of the privatisation process for road</td>
</tr>
<tr>
<td>Market Structure:</td>
<td>Market Institutions:</td>
<td>Key challenges:</td>
</tr>
<tr>
<td>------------------</td>
<td>---------------------</td>
<td>----------------</td>
</tr>
</tbody>
</table>
|                  |                     | maintenance companies.  
|                  |                     | • Further improvements and introduction of performance based contracts for all maintenance contracts.  
|                  |                     | • Development of PPP projects in line with international best practice.  

**Railways**

Small  Negligible  • The re-privatisation (or other forms of private sector participation) of railway service.  
• Possibly full separation of freight and infrastructure.

**FINANCIAL INSTITUTIONS**

**Banking**

Small  Small  • Developing and facilitating growth of new innovative products (eg, products related to Carbon Finance and Energy Efficiency).  

**Insurance and other financial services**

Small  Small  • Developing and facilitating growth of new innovative insurance products.  

**Micro, Small and Medium-sized enterprises**

Small  Small  • Improving access to finance by start-ups, innovative and high growth companies to equity capital.  
• Enhancing the coverage of credit information services.  
• Increasing the availability of training and consultation services for micro, small and medium enterprises (MSMEs).  

**Private equity**

Medium  Medium  • Broadening companies’ access to PE and VC financing through facilitating the launch of new institutional quality (Baltic-focused) PE and VC funds;  
• Facilitating development of the VC-related ecosystem in the country (e.g., through facilitating improved effectiveness of business accelerators).  

**Capital Markets**

Medium  Small  • Facilitating increase in liquidity in local capital markets, including by developing local institutional and private investor base.
ECONOMIC INCLUSION GAP RATINGS

<table>
<thead>
<tr>
<th>Inclusion gap dimension</th>
<th>Inclusion gap</th>
<th>Key challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Youth</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| Opportunities for Youth | Medium        | ▪ Creating high value added jobs with sound career progression to offer young people local opportunities and ensure an adequate labour force, possibly through enhanced R&D initiatives.  
▪ Improving work-based learning opportunities for young people with the focus to increase the number of apprenticeships to ensure a competitive and qualified workforce. Improving the collaboration between private sector employers and education providers will ensure adequate skills matching and progress routes for young people from education and training into employment. |
| Quality of Education    | Medium        | ▪ Strengthening the private sector engagement with education authorities to improve the quality of Technical and Vocational Education and Training (TVET), to ensure that the skillset of young labour force entrants meets the demand of the local labour market. |
| Gender                  |               |                |
| Labour Practices        | Large         | ▪ Incentivising clients to improve HR policies with regards to equal opportunity practices, including equal pay practices and access to child care to improve women’s economic opportunities. |
| Employment and Firm ownership | Medium | ▪ Improving women’s enrolment and graduate rate for STEM (science, technology, engineering and manufacturing) educational programmes, through targeted outreach programmes, improved career guidance and partnerships with private sector clients.  
▪ Improving the access to female leadership programmes to improve women’s progress routes into management positions. |

10 The EBRD Economic Inclusion gaps rate the institutions, markets and education systems across all of EBRD’s countries of operation in terms of their capacity to extend economic opportunity to individuals regardless of their gender, age or place of birth. These gaps measure differences in opportunities – between 15 to 24-year-olds and older workers, and between women and men – rather than opportunity levels. Gaps are reported in this Country Strategy where there exists an Inclusion Gap above Small. These gaps are consistent with the EBRD 2014 Inclusion Gap update.
| Access to Finance | Medium | - Identifying underlying market failures and support the Banking sector in the development of new products or service offers for women-led SMEs, including but not limited to business support and know-how for women entrepreneurs and SMEs. |
| Regions | | |
| Access to Services | Medium | - Improving access to employment and entrepreneurial opportunities, with a specific focus on regions outside the urban areas of Tallin and Tartu.  
- Improving regional infrastructures, particularly access water management and central heating in North-East Estonia.  
- Participating in policy dialogue, supporting the Ministry of Social Affairs Development Plan for Social Protection, Inclusion and Equal Opportunities 2016-23 to guarantee access to services (education and employment) at local level. |
ANNEX 4 – LEGAL TRANSITION

Introduction

This annex offers critical analysis on selected legal topics relevant to the Bank’s investment strategy in Estonia during the forthcoming period. It is based on the assessments of commercial laws conducted by the EBRD’s Legal Transition Programme.

1. Energy sector

Energy/Renewable energy

Estonia is among the countries least dependent on energy imports in the EU. Its energy requirements are met primarily out of oil shale and, increasingly, renewable energy sources (RES). At the same time, according to the most recent Business Environment and Enterprise Performance Survey (BEEPS), electricity supply is seen as the second biggest concern by Estonian companies. Efforts are being made to enhance Estonia’s energy independence and security, including strengthening interconnectedness with neighbouring countries and regional energy linkages. The launch of an additional power connection with Finland (EstLink2) in 2014 is one example, aimed at increasing the flow of electricity between the Baltic and Nordic countries. Connectivity of the Estonian gas market to the rest of the EU remains an issue.

Estonia has transposed the EU Third Energy Package into its national legislation. The Electricity Market Act, as amended, and the Natural Gas Act, as amended, are the primary laws governing the electricity and gas markets, respectively. The National Development Plan of the Energy Sector until 2020 defines the government’s policy objectives in the energy sector, including diversification of the energy portfolio and stimulation of more environmentally sound energy production.

The main sources of renewable energy are wind and biomass, with biogas and hydropower also providing a small amount of electricity. These have helped Estonia to become one of only three EU states (alongside Bulgaria and Sweden) to have already met its 2020 target of 25 per cent RES in total energy consumption, with its 2011 share already having reached 25.5 per cent.11 RES in transport remains largely non-existent.

A feed-in premium is the key RES support mechanism, along with investment support available for certain types of RES technologies. RES producers are not given priority access to the grid but rather are subject to the general principles of connection based on principles of non-discrimination. Specifically, the grid operator is obliged to develop the grid within its area of service to be able to connect further electricity plants to the grid and on request, to connect plants within its area of responsibility if they meet the technical requirements. Certification programs and requirements for RES installers are in place. At the same time, there are no nationwide regulations or minimum standards to promote RES in the buildings or transports sectors.

Estonia ratified the Kyoto Protocol in 2002 and for 2008-2012, has achieved its obligation to reduce emissions by 8%, compared to 1990.

11 http://ec.europa.eu/eurostat/documents/2995521/6734513/8-10032015-AP-EN.pdf/3a8c018d-3d9f-4f1d-95ad-832ed3a20a6b

PUBLIC

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While the RES market has been rapidly developing, the government is reported to be in the process of reforming the system in response to the growing market. At the end of 2014 the European Commission approved reform of the RES support scheme under State aid; however draft legislation was postponed until after the general election in 2015. The new subsidies are expected to fix support for existing generators using a type of one-way contract-for-difference (CfD), rather than a fixed top up on the market price, and not be paid out on generation during periods of negative prices. The government may consider adopting certification and licensing rules for RES generation plants and associated transmission and distribution network infrastructure, in order to enhance the RES generation capacity.

The National Development Plan of the Energy Sector until 2030 is currently under development and is aimed at setting up broader and long-term goals for the energy sector development. The government acknowledges the needs to promote RES in buildings, including by developing legislation establishing the minimum level of energy use from RES for new and existing public sector buildings that undergo large-scale renovation, identification of sample low-energy buildings, preparing forecasts and capacity building activities for the building sector specialists. Legislative amendments regarding the promotion of RES in transport are also being considered.

Energy efficiency

The energy intensity of the Estonian economy remains relatively high, with the energy efficiency (EE) of production among the lowest in the region and CO2 emissions per capita among the highest. High energy intensity mostly owes to the production of oil shale energy as well as inefficient consumption of energy, which results from depreciated infrastructure dating back to the Soviet period (such as apartment buildings and district heating networks). The residential sector is the largest energy end-user in the country.

The foundations of the policy framework in the EE sector are set out in the National Development Plan of the Energy Sector until 2020 which covers the broader energy sector. The government’s primary objective in the EE sector is to maintain by 2020 final energy consumption at the 2010 level, which is estimated to provide 13.1 per cent savings if the objective is met. The second National Energy Efficiency Action Plan (“NEEAP”) was prepared in 2014 and reports on measures undertaken or to be undertaken according to Directive 2012/27/EU on Energy Efficiency (the “EED”). The government intends to put in place an EE obligation scheme, with alternative measures including energy and CO2 taxes and funding schemes, e.g. for upgrading street lighting and reconstruction of apartment blocks.

The Electricity Market Act and the Natural Gas Act lay down the grounds for metering and requirements for electricity bills. It is envisaged that legislation that will transpose the EED will provide specific rules for the energy audits and their use in specific sectors. The government is focused on improving EE in buildings, having taken measures to promote and facilitate efficient use of energy by domestic customers. These include support schemes for the reconstruction of apartment buildings, the primary objective of which is to enhance EE in buildings, introduction of a tax exemption for interest on loans for home renovation, as well as promotional events, including information campaigns on the benefits of EE improvements and a national energy savings week. Regulation is in place setting forth the requirements for the energy performance of buildings. The government is also keen on developing the ESCO market, although currently only a few companies provide energy services.
The government signalled its intention to transpose the requirements of the EED through adoption of new, horizontal energy management regulation (tentatively, the “Organisation of Energy Management Act”). It is expected that the act will reflect the measures identified in the NEEAP through legally binding forms. The government is also preparing a buildings renovation strategy, in order to report on meeting the relevant obligations under the EU acquis. The government might also need to strengthen incentives to invest in EE of buildings and encouraging ESCO participation through appropriate financial instruments.

2. Capital markets

The basic legal act regulating capital markets activities in Estonia is the Securities Market Act (Väärtpaberituru seadus) of 17 October 2001, as subsequently amended. It sets up the regulatory framework for the operation of the Estonian Securities Market, inter alia governing the provision of investment services, the regulated market and stock exchange, initial public offering of securities and settlement of securities transactions. Other relevant legislation includes: the Investment Fund Act (2004), which stipulates requirements for collective investment schemes; the Financial Supervision Authority Act (2002, consolidated text of 2011), which provides the legal basis for Financial Supervision Authority activities; the Money Laundering and Terrorism Financing Prevention Act (passed on 19 December 2007, entered into force in July 2011), which establishes measures preventing money laundering and terrorism financing; and the Credit Institutions Act of 09 February 1999, as amended, which regulates activities of banks and other financial institutions. In addition, due to Estonia’s accession to the Eurozone, the Act on the Adoption of the Euro was passed on 22 of April 2010. The majority of the aforementioned legal acts implement relevant EU directives.

The securities market regulator is the Financial Supervision Authority, which supervises securities market operations, investment firms, credit institutions, collective investment schemes activities, insurance and pension funds. The Financial Supervision Authority has the authority to issue advisory guidelines to securities markets legislation in order to provide guidance to subjects of financial supervision. The Tallinn Stock Exchange is the only regulated securities market in Estonia. It is part of the NASDAQ Baltic Market, a cross-Baltic stock exchange maintained by NASDAQ.

All Estonian public limited company securities are registered in the Estonian Central Security Depository. Transactions with securities can be made using over-the-counter systems or the regulated market. The regulated market operates in the context of the NASDAQ Baltic Market which coordinates the trading process and imposes regulations. Investors can enjoy simplified access and minimised investment barriers when operating on Estonian market.

Despite these developments, Estonian capital markets remain rather nascent and illiquid. This is not due to the legal framework but rather to the limited demand and supply side. On the legal side, the enforceability of netting for derivatives transactions has not been tested, and there is no ISDA (International Swaps and Derivatives Association) legal opinion on the issue. Also, it may be advisable to develop the legal basis for the issuance of covered bonds. Covered bonds are popular in neighbouring Scandinavia, where they have been used for a long time. Estonia could benefit from bonds which would be issued by local banks with a specific home loan portfolio as a security and which would be considered bankruptcy-remote of the respective bank. In other words, bonds would not be issued by separate legal bodies – the so-called mortgage banks, such as in Denmark – but by local commercial banks. Finally,
some legislative fine tuning could be introduced in order to foster development of private equity and venture capital.