DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR ESTONIA

As approved by the Board of Directors on 28 June 2006

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ABBREVIATIONS AND CURRENCY EXCHANGE RATES

BAS	Business Advisory Services Programme
CAP	Common Agricultural Policy
CEB	Central Europe and the Baltics
CIS	Commonwealth of Independent States
EC	European Commission
ECB	European Central Bank
EEK	Estonian kroon
EIB	European Investment Bank
EMU	European Monetary Union
ERM II	Exchange Rate Mechanism II
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
FI	Financial Institutions
FSU	Former Soviet Union
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product
IAIS	International Association of Insurance Supervisors
IFC	International Finance Corporation
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
IPO	Initial Public Offering
IT	Information Technology
JASPERS	Joint Assistance in Supporting Projects in European Regions
JEREMIE	Joint European Resources for Micro-to-Medium Enterprises
MEI	Municipal and Environmental Infrastructure
MSME	Micro, Small and Medium-Sized Enterprise
NATO	North Atlantic Treaty Organisation
NBFI	Non-Bank Financial Institution
OECD	Organization for Economic Co-operation and Development
OSCE	Organization for Security and Co-operation in Europe
PPP	Public Private Partnership
SDR	Special Drawing Right
SME	Small and Medium-Sized Enterprise
TAM	Turnaround Management Programme
TC	Technical Cooperation
UNCITRAL	United Nations Commission on International Trade Law
USD	United States Dollar

EXCHANGE RATES

EUR 1.0	EEK 15.64
EUR 1.0	USD 1.26

EXECUTIVE SUMMARY

Estonia continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Over the last 15 years Estonia has made remarkable progress in transition and it is one of the most advanced countries among the new EU member states. Some 80 per cent of economic activity is in the private sector, and price and trade liberalisation, enterprise privatisation and effective financial sector reforms have taken place. There is an open foreign trade regime and there are no major constraints to foreign investment. This focused strategy reflects the achievements of Estonia and its advanced stage of transition.

GDP growth during 2005 exceeded expectations, largely due to strong internal demand and a better than expected external environment. The economy grew by 9.8 per cent during 2005, with a peak of 11.1 per cent in the fourth quarter. Main drivers included technology sector exports and strong domestic demand fuelled by investment activity. The fiscal position remained strong as Estonia recorded another surplus of the general government balance (estimated at 1.5 per cent of GDP) and one of the lowest public debt ratio in the EU (at around 5 per cent of GDP) in 2005. Although it remains high at over 10 per cent of GDP in 2005, the current account deficit is decreasing on the back of accelerating export growth. Above Maastricht-level inflation led the government to postpone the target date for European Monetary Union (EMU) membership from the initially scheduled January 2007 to January 2008. The banking system is prudently managed and financial deepening continues. Frequent government changes have so far had limited impact on economic policy-making given universally accepted objective of early adoption of Euro.

Since independence, Estonia has made significant progress in transition to a modern market economy and the country is now one of the most open and competitive economies in the world. The business environment is very dynamic and local banks and leasing companies are extending loans and leases to smaller companies, partially supported through credit lines from international financial institutions. Foreign ownership of the banking sector has led to the restructuring and recapitalization of the system, the introduction of a wider array of products and services and improved corporate governance and transparency.

While acknowledging the significant progress made in Estonia, a few transition challenges remain and this strategy aims to address those challenges in order to further increase the competitiveness of the Estonian economy. The priority transition challenges for Estonia are as follows:

Infrastructure, Environment and Energy

Energy efficiency is not yet fully compliant with all EU energy regulations and renewable energy in particular needs further regulatory strengthening. In the energy sector, unbundling of Eesti Energia remains a challenge and market-driven management of energy has not yet been fully developed. Furthermore, restructuring of the oil-shale based power plants continues to be a significant challenge, not least from an environmental perspective. In infrastructure, private sector involvement remains limited.

Enterprise Sector

In general industry, remaining challenges relate to further stimulating enterprise development in the poorer regions of the country. In the support of further SME growth, there is a need for a broader range of financial instruments, especially equity and mezzanine capital.

As at 31 May 2006, the Bank had signed a cumulative total of 48 direct and 24 regional projects for Estonia with a total project cost of €1,182 million, including Bank financing of €470 million, or 40 per cent. The private/state sector portfolio ratio stood at 100%.

While new projects in 2005 and early 2006 have been slow to materialise, the Bank can continue to play a role over the strategy period by focusing selectively on areas where it is additional and where it can address the remaining transition challenges, particularly in providing equity, mezzanine and cross-border financing, supporting the emerging renewable energy sector, promoting public private partnerships, and strengthening corporate governance and good business practice.

In addressing these transition challenges, the Bank's activities in Estonia will be based on the following operational objectives:

- Support the development of renewable energy projects;
- Support the expansion of local companies, particularly in cross-border projects by providing long term risk capital (equity, structured debt);
- Promote SME and municipal financing and energy efficiency through financial intermediaries as well as directly with a broader selection of financial instruments, enhanced with EU, or other, donor support; and
- Support complex transactions across sectors, including public private partnerships, which would benefit from the Bank's expertise in project structuring and mobilisation of co-financing.

In accordance with this strategy, the Bank will continue to ensure that all EBRD operations in Estonia meet sound banking principles, have transition impact, are additional and are subject to the Bank's Environmental Procedures incorporating, where appropriate, Environmental Action Plans.

1. THE BANK'S PORTFOLIO

1.1. Overview of Activities to Date

As at end of May 2006, the Bank's cumulative commitments in Estonia (including regional projects) had reached €470 million representing 1.5% of the Bank's net cumulative commitment volume. The Bank's financing had helped to mobilise a further €712 million of co-investment, representing a multiplier of 1.5.

The table below gives an overview of the Bank's current portfolio in Estonia by sector as at end of May 2006. Totalling €101 million, it represented 0.6% of the overall Bank portfolio. The private/state ratio and the non-sovereign/sovereign ratio stood at 100%.

Table 1: Current Portfolio by Industry (including regional projects) (as at 31 May 2006)

Sector	**No of Projects**	**EBRD finance** (€ million)	**Portfolio share** (%)
Industry and Commerce	**2.8**	**31.3**	**31%**
Agribusiness	0.5	6.1	
Property Tourism and Shipping	0.2	5.4	
Telecom Informatics & Media	0.1	0.3	
General Industry	2.0	19.5	
Financial Institutions	**3.9**	**25.2**	**25%**
Bank Equity	0.0	0.0	
Bank Lending	1.0	1.1	
Non Banking Financial Institutions	1.3	4.5	
Equity Funds	1.6	19.6	
Infrastructure	**1.6**	**44.3**	**44%**
Transport	0.0	0.0	
Municipal & Environment Infrastructure	1.6	44.3	
Energy Efficiency	0.0	0.0	
Power & Energy	0.0	0.0	
TOTAL	**8.3**	**100.8**	**100%**
of which debt	4.1	64.6	64%
of which equity	4.2	35.9	36%
of which guarantee	0.0	0.3	0%
of which private	8.3	100.8	100%
of which state	0.0	0.0	0%
of which direct	5.0	58.6	58%
of which regional	3.3	42.2	42%
of which non-sovereign	8.3	100.8	100%
of which sovereign	0.0	0.0	0%

The largest proportion of the portfolio (44 per cent) related to infrastructure, which comprised entirely of an exposure to Tallinn Water. A significant proportion of the portfolio (25 per cent) related to Financial Institutions, a reflection of the structure of the Estonian economy and the EBRD's significant role in supporting SMEs through credit lines and equity funds.

1.2 Implementation of Previous Country Strategy

The previous country strategy has been implemented in an increasingly competitive environment with term credit liquidity readily available from local banks and country risk improving with Estonia's accession to the EU. Financing SMEs through financial intermediaries, upgrading municipal infrastructure and supporting cross-border investments of Estonian companies have continued to be core areas for the Bank's activities in Estonia.

The 2004 country strategy outlined the following strategic priorities for the Bank in Estonia:

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

Enterprise sector: seek to support some of the larger industrial and service enterprises, particularly with a view to facilitating continued high inflows of non-privatisation related FDI and the expansion of Estonian enterprises to other countries of operation, increasing emphasis on equity instruments.

Financial sector: support SMEs (credit lines, leasing, equity) via local and regional financial institutions.

Implementing the previous country strategy, the Bank has signed four regional private equity fund projects, representing total commitments of approximately €10 million for Estonia during the strategy period.

In the **enterprise sector**, a few larger projects involving industrial and service enterprises have been analysed but following its mandate requirements the Bank has been unable to assist with financing of the projects. The construction of Estonian Cell greenfield pulp mill project, which was signed a few weeks before the start of the strategy period, was successfully implemented during the strategy period at a total cost of €153 million. Located in the north-eastern part of Estonia, the project also contributes to the regional development in the country.

The focus in enterprise as well as **infrastructure sectors** has also been on identifying large, complex projects requiring structuring assistance and co-financing from EU structural and cohesion funds. However, the process of defining investment priorities and preparing project proposals has been slower than expected. A number of infrastructure projects at both municipal and national levels were identified for the JASPERS initiative by local authorities in spring 2006, and the identified projects are at concept, early analysis or feasibility study stages. Whilst the Bank's support may be needed, eventual financing partners will only be decided at a later stage. Similarly, potential PPP structures have been developing slowly, but once they progress, the Bank could have much to offer in this field.

In the **energy sector** local commercial banks, EIB and NIB have been able to provide inexpensive financing for a variety of projects.

In the **financial sector**, SMEs have been supported through new regional equity funds. A few additional direct and regional fund projects, mainly in the form of mezzanine or equity capital investments, have been under development by the Bank for a targeted closing in late 2006 or 2007. Lack of sponsors with satisfactory track record and the advanced nature of financing products under discussion have delayed an earlier conclusion of these projects.

The previous strategy had identified need for supporting SMEs expanding cross-border into neighbouring countries. While these opportunities have been slower than expected to materialise, they have also tended to be too small for direct financing by the Bank. Smaller projects have therefore been financed more efficiently either from SME credit lines provided to local banks by the Bank, or as investments from existing pan-Baltic equity funds.

1.3 Transition Impact of the Bank's Portfolio and Lessons Learned

1.3.1 Relevance and Transition Impact of Previous Country Strategies

Infrastructure, Environment and Energy

The Bank's involvement in the **transport sector** has been through loans to Tallinn Airport. The last loan to the company, a refinancing transaction, was the first EBRD loan in Estonia to a state-owned enterprise without a guarantee or any other undertaking from the state.

Although the Bank has only had one new project in the **MEI sector** in Estonia over the last five years (Tallinn Water), the Bank's involvement continues to be an example of substantial impact in a reform-oriented country. The Bank has been co-operating with Tallinn Water for more than ten years, moving along all stages of reform in the water sector: starting from a sovereign guaranteed loan to the municipality, through a corporate loan, to the privatisation to a strategic investor and recent assistance in the IPO of Tallinn Water, achieving overall a *very significant* transition impact.

The Bank has currently no involvement in the **power sector**. Local energy utility company Eesti Energia has established itself as a strong corporate borrower (rated A1 by Moody's) and it has been able to borrow on international markets at very attractive terms, e.g. through a number of international long-term corporate bond issues.

Enterprise Sector

During 2000-2005, the Bank made two **agribusiness sector** investments in Estonia, both part of pan-Baltic transactions in retail business. The first project, Baltic Food Holding, financed an acquisition of new supermarkets and an upgrade of existing ones, but eventually ended up in bankruptcy. The second project, with Kesko, aimed at similar retail objectives and has been successful.

The Bank has played an important role in the restructuring of the **industrial sector**, achieving a *significant* transition impact since 2000. Imavere Sawmill (the largest and most modern sawmill in the Baltics) was granted three loans during 1997-2002, and Estonian Cell project (a greenfield pulp mill and the second largest FDI ever in Estonia) was financed with equity and subordinated loan in 2004.

The Bank's support in the development of SME financing in Estonia has been successful. In 2000, the three largest banks in Estonia (Hansabank, Eesti Ühispank and Sampo Bank) received SME credit lines of €10 million each. In addition, in 2003 Hansa Capital received €30 million of which €12 million was allocated to the development of leasing business in Estonia. Overall transition impact in the **MSME sector** in 2000-2005 was *significant.*

During 2000-2005 the Bank had no involvement in the **property and tourism sector** in Estonia, although Estonia has been a target country for a number of regional property funds (Heitman Central Europe Property Partners, Orco Aparthotels, and Europolis II).

Financial Sector

All EBRD projects in the **banking sector** excluding the MSME sector took place in the mid- and late-1990's when the Bank provided a range of financing to many local commercial banks. Gradually the market lived through the consolidation phase and is now dominated by two Swedish banks followed by two Finnish ones. However, after several years of stable market structure foreign credit institutions started to open branches in Estonia following the EU accession. Two years after EU membership started, there were 14 commercial banks operating in Estonia, compared to seven before 1 May 2004.

In the **non-bank financial institutions sector**, the EBRD invested in 2002 in LHV's pension fund management company to support pension reforms and stimulate local securities market. However, the client was small and recently merged with another pension fund managed by an insurance company. The pension investment market is strongly dominated by asset management companies, the two largest commercial banks having in total over 70% share of the pension fund market. The Bank has also been active in the leasing sector through its projects with Hansa Capital (across the Baltics) and Hansa Leasing Russia (cross-border leasing). Transition impact in the NBFI sector in 2000-2005 was *moderate*.

Private equity funds targeted the Baltics later than they did Central Europe. Since the late 1990's, the Bank has supported a number of regional private equity funds in the Baltics. As the vast majority of enterprises in Estonia are SMEs, the Bank's contribution as a core investor in private equity funds has enabled equity investments in a number of SMEs in Estonia. In the Baltics, the Bank has invested in seven equity funds which have in total invested in 70 companies. Of the investee companies, 32 are in Estonia. Transition impact in **private equity fund sector** during 2000-2005 was *very significant*.

Overall Assessment

The Bank's strategies for Estonia have addressed the evolving needs of the Estonian economy, which is characterised by high proportion of SMEs among corporate entities and by increasing interest of Estonian enterprises to invest abroad. At the same time, the economy can also be characterised by under-developed municipal infrastructure outside larger towns.

Since 2000, the Bank has invested €169 million in Estonia (including Estonian share of regional projects). Implementing the outlined strategies 35% of the total financings have been in the private enterprise sector, 43% in infrastructure and MEI, 11% in the financial sector and 11% in equity funds.

Policy Dialogue

In preparation of the amendment to the Energy Market Act in Estonia, the Bank has maintained policy dialogue with the authorities relating to the renewable energy legislation. The draft proposal is currently under consideration in the legislative process.

1.3.2 Selected Lessons Learned

The Bank's experience in Estonia in recent years has resulted in a variety of lessons learned, the most important of which are the following:

The Bank can contribute to higher *competition* in the market by unlocking access to private finance. In the area of *governance*, the Bank can use its leverage to push for standards in line with best practice by matching its operations to changing transition challenges, from privatisation to corporate governance reform and to consolidation.

Adequate *concession* arrangements must be in place for a full privatisation to be beneficial in the MEI sector. Prior to adequate legislation and regulation, privatisation through outsourcing of operations under well-defined service contracts may be a more conducive route than privatisation involving ownership of facilities. A close cooperation between end-users, procurement advisors and technical consultants is necessary for a successful implementation of MEI sector projects.

In the transport sector, it is essential that professional traffic studies be prepared or updated, including related assessments of competing modes, *regional impacts and inter-dependencies*.

In the enterprise sector, selection of the sponsor and provision of appropriate *sponsor guarantees* have enhanced the success of an operation. Further technological *skill transfer* can be achieved through a follow-on project supporting the purchase and installation of additional manufacturing facilities.

EBRD credit lines have been successful in expanding finance to the *SME sector*. In this context, the Bank should be proactive in assessing a client's training needs and in explaining the benefits to the client. Non-financial programmes, such as TAM and

BAS, have helped transfer management know-how and assisted the development and growth of SMEs.

The Bank has been active in the *leasing* sector, by financing operations targeting the domestic markets, regional Baltic markets as well as cross border leasing markets. The projects have been successful in providing asset-backed finance to SMEs.

1.4 Financial Performance of Existing Portfolio

During the last two years, the quality of the Estonian portfolio has remained stable on a good level. The overall portfolio risk category is 5.5, consisting of 5 direct and 20 regional operations, or sub-operations.

1.5 Mobilisation of Co-financing

Overall mobilisation ratio (total project cost/EBRD financing) is 2.5. Most notably, the Bank facilitated a €153 million financing to Estonian Cell green-field project by providing €19 million of equity and subordinated debt in 2004. The Bank's continuing support to the private equity industry focusing on SMEs is essential for raising second generation funds with majority private capital.

2. OPERATIONAL ENVIRONMENT

For the next two years covered by this strategy, the Bank is projected to be active in Estonia in accordance with the operation principles of transition impact, sound banking and additionality. This strategy will be implemented in accordance with the strategic outline for the years 2006–2010 agreed upon in Capital Resources Review 3 with respect to graduation.

2.1 General Reform Environment

Since independence, Estonia has made significant progress in the transition to a modern market economy. The structural reforms initiated in the 1990s have been successful and their implementation far reaching. The reform agenda in recent years focused on the adoption of the EU *acquis communautaire* and entry to the EU in May 2004. As a result, Estonia is now one of the world’s most open and competitive economies according to various surveys of the business environment. The Heritage Foundation ranked the country fourth in its 2005 Index of Economic Freedom. Transparency International records it as the least corrupt country in the region. The results from the 2005 EBRD/World Bank Business Environment and Enterprise Performance Survey also confirm Estonia’s progress.

However, certain transition challenges remain. They relate particularly to streamlining the bureaucracy and further stimulating enterprise development in the poorer regions of the country. Despite continuing improvements in the business environment, small businesses are still to a certain extent hindered by administrative inefficiencies and opaque licensing requirements. In general terms, according to the EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS), regulatory uncertainty, contract violations and anti-competitive practices remain important obstacles to firms’ operation and growth. The enforcement of intellectual property rights is uneven, although the government has initiated steps to improve the situation. In spite of recent improvements, the energy sector still needs reform, including the restructuring of Eesti Energia and the opening of the market. In addition, the sharp rise in domestic credit growth and the dependence on financing from external sources must be managed carefully.

2.1.1 Political Environment

Estonia continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Since independence, Estonia has been a constitutional parliamentary democracy based on the rule of law, with a 101-member single-chamber parliament (Riigikogu) elected directly by proportional representation. The Prime Minister is head of government, while the indirectly elected President serves as head of state, although most political power is vested in the Prime Minister. The government is nominated by the Prime Minister, appointed by the President and approved by Parliament. The government respects human rights, the judiciary is independent and civil society in Estonia is vibrant. Estonia acceded to both NATO and the EU in 2004.

The government of Juhan Parts resigned in March 2005, following a vote of confidence in the Minister for Justice, in which coalition parties voted against the government. A new, centrist government was formed in April 2005 under the leadership of Andrus Ansip of the Reform Party as Prime Minister and with the participation of the Centre Party and the People’s Union. The 2005 budget was approved by the new coalition government - the 11th since independence - with little disagreement. However, fiscal issues continued to divide the ruling coalition throughout 2005. Nevertheless, all three coalition parties fared well in the October 2005 municipal elections, which defused the growing expectations of government collapse. The main centre-right opposition party, Res Publica, and its smaller partner Pro Patria fared poorly at the municipal elections, and in late-April 2006 the two parties announced plans to merge into a single conservative party, ‘Party of Estonia’. The governing coalition is now widely expected to remain in office until parliamentary elections in 2007.

Estonia continues to have one of the least corrupt and most transparent political and business environments among the transition countries. Both anecdotal and empirical evidence, including the 2005 BEEPS, support the view that both petty and grand corruption are much less prevalent in Estonia than in virtually all other transition countries. The government has established detailed accounting and control mechanisms to ensure that Estonia’s EU structural funds are allocated and spent in a transparent manner. A small number of public procurement corruption cases have been reported at municipal levels, but the national government is actively engaged in promoting improvements to accounting and tendering procedures to ensure that municipal-level procurement practices comply with best practice.

Estonia’s accession to the EU on 1 May 2004 was expected to lead to an improvement in relations with Russia. However, despite the good marks given by the Council of Europe and the OSCE to Estonia for its policies towards its ethnic Russian and other non-Estonian minorities, Russia continues to maintain that Estonia is not doing enough to protect minority rights. In addition, Estonia and Russia do not yet have a formal border treaty, despite the fact that a treaty was initialed in 1999 and signed by the two countries' foreign ministers in May 2005.

2.1.2 Macroeconomic Conditions Relevant for Bank Operations

At 11.1 per cent in the fourth quarter and 9.8 per cent for the full year, GDP growth exceeded expectations in 2005, largely due to strong internal demand and a better than expected external environment. Supported by the recovery in Europe, real growth has been accelerating across the economy and involves practically all sectors but notably construction, financial intermediation, manufacturing and the hotel industry. GDP rose by 11.6 per cent year-on-year over the first quarter of 2006. Higher employment, real wage increases in line with productivity and rapid credit growth have all fuelled the growth of investment and private consumption without undermining the economy's competitiveness. Exports and investments remain the main drivers of the economy. Some sectors were above potential in 2005, particularly the housing market. Despite expanding construction of new residential space, the gap between demand and supply grew wide in 2005. Coupled with increasing borrowing and a limited supply of workers, this resulted in rapid price increases for most of last year. However, the beginning of 2006 has seen signs of a slowing trend. The speculative price increases observed last year have resulted in eroding consumption and some speculators - both foreign and locals - have started to sell. Real estate prices in the capital are now expected to stabilise, at least in some parts of the capital. Overall, the outlook for the economy for the next two years remains positive with GDP growth closer to potential (around 7 per cent).

The economic upturn resulted in job creation and declining unemployment. Labour market conditions continue to improve and the unemployment rate has been decreasing to 7.9 per cent in 2005, down from 9.7 the previous year. Employment increase was mostly driven by the service sector, notably tourism, transport, storage and communications, and the health care sector. Structural unemployment remains high, especially in the less developed regions of the country. Remaining structural reforms must address skills shortages and regional imbalances. The government has started to tackle such issues and recent improvements in the labour conditions are in part attributable to the active labour market policies recently introduced. Vocational education and training systems need updating in order to equip the workforce with skills relevant to the private sector needs. The availability of EU structural funds will allow Estonia to address this although a comprehensive strategy is still to be devised.

Annual average inflation has been accelerating in the past two years. Annual average consumer prices increased by 3.0 per cent in 2004, up from 1.3 per cent in 2003 and reached 4.1 per cent in 2005. This was driven mostly by supply side factors, notably oil and EU accession-related price increases. However, core inflation also accelerated, mostly through indirect effects of oil prices on transport prices. The outlook for inflation continues to be dependent on oil prices development and indirect effects are still expected to be present in the next few months. In addition, upward pressures may remain as local governments consider administered price increases (for water, sewage and garbage collection) and real convergence progresses. On the demand side, fast credit growth is adding to inflationary pressures. Such developments have led authorities to postpone the target date for European Monetary Union (EMU) membership initially scheduled for January 2007. Central Bank's optimistic scenario indicates the second quarter of 2007 as the earliest time for Estonia to fulfil the Maastricht inflation criterion. As a result, the government has decided to continue the necessary technical preparations in order to be ready for the adoption of the euro on 1 January 2008. Markets have not been perturbed by the one-year delay and confidence in the currency board remains strong, as indicated by decreasing short term interest rates differentials with the euro. Continued export growth suggests that the current EEK/euro parity is close to the equilibrium rate and that no major competitiveness concerns will emerge. Unless economic conditions change for the worse, this short-term delay will not have major consequences on the currency regime or the credibility of the government economic policy. Only an indefinite delay of EMU membership could lead to negative market reactions and interest rates unrest. When achieved, EMU membership will protect the country against external shocks.

Estonia has a strong record of fiscal balance and the budget has been in surplus for 5 years running. This resulted from the stabilisation of the deficits of local budgets over the years, the anchoring of the declining tax burden, and the ability to curb expenditures. On the back of strong economic growth and improved tax collection, the general government balance is estimated to be in surplus by 1.5 per cent of GDP in 2005. As in previous years, revenues turned out to be higher than budgeted, as a result of a higher than expected growth rate. While keeping the budget in surplus, the government decided to adopt a supplementary budget to increase spending by some 1 per cent of GDP, mostly for basic pensions and higher maternity benefits. The government continues to pursue a balanced budget, which makes for a procyclical stance given the current growth of the economy. However, the country frontloaded harsh economic measures at the beginning of the transition and further tightening now would lead to a polarisation of the society. To mitigate the risk of an untimely fiscal stimulus, the government has slowed the pace of the planned income tax reduction to 1 per cent per year from the current 2 per cent. The income tax will thus decline to 20 per cent by 2009. The long track record of fiscal surplus has led to the lowest public debt ratio in the region, at 4.5 per cent of GDP in 2005.

In line with the neoclassical paradigm of a small open economy, Estonia's current account deficit has diverged as the country integrated its goods and financial markets with the rest of the world over the past years. The peak was reached in 2004 when the deficit increased to close to 13 per cent of GDP. However, 2005 saw a reduction of the deficit to just over 10 per cent of GDP while a further reduction is expected in 2006. Such a performance resulted from an improved trade balance on the back of accelerating export growth. The high growth rate of foreign trade is related to some specific factors, such as the success of new plants in the electronic sector (exports growth above 30 per cent). In addition, high oil prices have made the export of oil-shale fuel competitive in international markets (export volumes more than doubled). Financing of the current account deficit includes traditional FDI inflows, banks borrowing from foreign parents and growing EU funding. After a lull in 2004, net FDI flows have resumed in 2005 at an unprecedented pace, mainly as a result of portfolio investments being converted into direct investments following the buyout of Hansabank's shares by its core investors. Nordic countries continue to provide the biggest source of FDI, with Sweden and Finland topping the list, followed by the US. Major investments outside the Tallinn area in recent years include Estonian Cell pulp mill in Lääne-Virumaa, and Sillamäe Port in Ida-Virumaa. Gross external debt remains high at over 80 per cent of GDP, although a large part of it is owed to the foreign parents of Estonian subsidiaries. Net external debt is comfortable at about 20 per cent of GDP.

The financial sector, one of the mainstays of the Estonian economy, is highly concentrated and profitable. Over 97 per cent of it is foreign-owned, mostly by Nordic banks which have significantly improved managerial and operational skills and raised the level of technological sophistication. Liquidity is good and the level of non-performing loans remains below 1 per cent of total loans. Financial supervision has undergone a thorough restructuring under the initiative of the Central Bank and the Ministry of Finance and in cooperation with Scandinavian supervisors. An independent Financial Supervision Authority was established in 2002. Estonian GAAP is in line with IFRS. IFRS has been permitted since 2003 and has been mandatory starting in 2005. As subsidiaries of Nordic groups, most banks have complied with IFRS or with Swedish or Finnish GAAP. Such features of the financial sector provide a mitigating factor to the risks coming from the high credit growth experienced in the last few years (see Section 2.2).

2.1.3 Transition Success and Transition Challenges

Estonia has made remarkable progress in transition in the last decade. In many areas of structural reforms the country took the lead among the transition economies. The transition indicator scores published in the *2005 Transition Report* indicate that Estonia is, on average, among the most advanced in transition in the new EU member states under the seven categories measured. In three categories – price liberalisation, trade and foreign exchange liberalisation and small-scale privatisation – Estonia has already achieved standards of a well functioning market economy.

Nevertheless, certain transition challenges remain. The 2005 Assessment of Transition Challenges (ATC) highlighted the following challenges for the country. Please refer to the ATC Snapshot table in Annex 5 for individual sector-by-sector ratings and to the table on Comparative Structural Change Indicators in Annex 6 for more detailed transition indicators.

Infrastructure, Environment and Energy

In the **power sector**, remaining transition challenges relate to the unbundling of Eesti Energia. The process started in April and July 2004 when Eesti Energia set up separate subsidiaries for the transmission network (OÜ Põhivõrk) and the distribution network (OÜ Jaotusvõrk) based on its existing business units. Although several options have been discussed since then, privatisation has been ruled out. The electricity market for companies that consume over 40 GWh has been open since 2003. Further liberalisation is expected from January 2009. After that, the market for smaller consumers will be liberalised step-by-step, with retail clients free to choose from 2016. Tariffs are sound and their structure is balanced. Since the adoption of the Electricity Market Act in 2003, Eesti Energia has started to separate its power generation and transmission tariffs and accounts. The regulator is subject to occasional interference.

Remaining transition challenges in the **MEI sector** are small. There has been a significant improvement in corporate governance following the concessioning of water services in Tallinn to International Water and United Utilities and an earlier state-guaranteed environmental loan channelled to 12 municipalities. There is substantial private sector participation in district heating. Tariffs allow for cost recovery and municipal utilities generally operate on commercial basis.

Remaining transition challenges in **energy efficiency** relate to the fact that the sector is not yet in compliance with all EU energy regulations and that the market-driven management of energy is still to be developed. In addition, renewable energy regulation needs to be further strengthened. Estonia has the second highest energy intensity in the region (in TPES/GDP (PPP) terms), although energy tariffs have been increased and the country has ratified the Kyoto protocol.

In the **telecommunications sector**, competition in the fixed line segment is proving more challenging than expected. The market was fully liberalised in January 2001 with the opening up of local, long distance and international markets and the removal of the fixed line monopoly. Estonia has also achieved significant progress in terms of implementation of its regulatory framework through a fully independent regulatory agency. Tariffs are cost-oriented though not fully rebalanced.

In **railways**, operating and policy setting functions have been separated. Operating companies have been privatised in vertically integrated feature. An independent regulator was established and infrastructure access is granted on a non-discriminatory basis. In **roads**, the Road Law and the Road Act were enacted in 1991 and 1999 respectively. The national road administration is only semi-independent.

Enterprise Sector

Estonia is regularly rated as one of the world's most open and competitive economies in various agencies' surveys of business environment. Remaining reform challenges in **general industry** relate to further stimulating enterprise development in the poorer regions of the country. Small businesses are still hindered by complex and changing tax requirements, administrative inefficiencies and opaque licensing requirements.

Estonia completed price and market liberalisation in the **agribusiness sector** early on in its transition, and is now integrating into the EU's CAP. A large share of land has been privatised – with almost 70% of land registered in cadastre. However, the land market continues to function poorly. The privatisation of agroprocessing and distribution/packaging services has been completed, but new owners still have to reduce costs, improve efficiency and upgrade hygiene standards in order to become internationally competitive. The low price of agricultural land and small farm size is still a major impediment to access to finance for farmers. Although the country has developed a modern banking system, the lending to agriculture is very limited.

In the **natural resources sector**, the most important domestic primary energy source is local oil-shale, although there is also peat and other biofuels (especially wood). The energy sector remains dominated by the vertically integrated 100% state-owned Eesti Energia, which controls generation, transmission, most of distribution and sales. The two largest oil-shale power plants owned by Eesti Energia at Narva produce more than 90% of electricity used in Estonia. As part of its final EU accession negotiations, Estonia won important concessions for its oil shale industry, relating to the creation of a minimum reserve of liquid fuel until the end of 2009, and a delay in the opening of the electricity market until the end of 2012. Meanwhile restructuring at the power plants is continuing while certain oil shale mines have been closed and their workers redeployed.

In the **property sector** the major issue is the size of the market which does not allow for a large expansion of new concepts. However, there is full tradability of land and the real estate sector is experiencing a fast pace of development, with significant segmentation and the introduction of new financing instruments.

Financial Sector

Remaining transition challenges in the **banking sector** are negligible as most has been achieved in recent years. The basic regulatory framework is in place and the number of banks is stable and a majority is foreign-owned. Regarding market institutions and policies, privatisation has been completed. Market-based conduct, approached through the domestic credit to private sector/GDP ratio, is high. The country has a banking system that can be properly used as a tool for development.

In the **non-bank financial sector**, securities markets legislation and regulation almost fully meet IOSCO standards. Insurance legislation and regulation meet IAIS standards. Stock market capitalisation is one of the highest among the transition countries but insurance penetration remains small. There are voluntary supplementary pension funds. Leasing and consumer finance markets are fully developed.

Although the **private equity fund sector** remains small, there has been renewed interest by private investors from Scandinavian countries who appear increasingly committed to private equity investments in the Baltic States. Increased business activity by equity funds, including the offer of a broader range of financial instruments, is needed to improve the visibility of the sector. If the locally based funds continue pursuing their SME orientation, including hands-on management, private equity funds have a good chance of becoming important providers of finance to local enterprises.

As for the **MSME sector**, the business environment is becoming more dynamic. According to the World Bank’s “Doing Business” report, starting a business is not excessively burdensome as it takes six different procedures and an average of 35 days at a cost equal to 6.2 per cent of gross national income (GNI) per capita, slightly lower than the OECD average (6.5 per cent). Domestic credit to the enterprise sector has increased significantly since the mid-1990s; although the stock of domestic credit to the enterprise sector remains still modest as a percentage of GDP (42.2% in 2004) as compared to other countries at similar stage of development. Still financing constraints have not emerged since cross-border parent-subsidiary financing is widely used. Loans and leases to MSMEs are available from commercial banks and leasing companies.

2.2 Access to Capital

Domestic Credit

Declining real interest rates, improved credit ratings and looser credit conditions in the Eurozone resulted in a fast growth of domestic credit over the last few years. Domestic credit has risen by 27 per cent on average per year since 2000 and has exceeded 70 per cent of GDP in 2005. High credit growth is expected to continue in 2006. Credit to the enterprise sector has also increased significantly, although it remains modest as a percentage of GDP relative to its peers in the region. While in line with Estonia's current phase of development, rapid credit growth may worsen inflationary pressures and exacerbate the expansion of the real estate sector. In addition, the country may be vulnerable to the risk of a sudden downturn in asset markets or a disruption to finance available from parent banks. However, the strengths of the financial sector mitigate some of these risks (see section 2.1.2).

Capital Market

There are virtually no restrictions on cash and capital flows to and from Estonia and both current and capital account transactions have been fully liberalised. Credit is allocated on market terms and foreign investors are able to obtain credit on the local market. The Security Market Law complies with EU requirements and enables EU securities brokerage firms to deal on the market without establishing a local subsidiary. Established in 1995, the Tallinn Stock Exchange is licensed and supervised by the Financial Supervisory Authority and it is part of OMX Exchanges which also operates exchanges in Copenhagen, Stockholm, Helsinki, Riga and Vilnius and offers access to 80% of all securities trading in the Nordic and Baltic marketplace. In addition, the Estonian Central Register of Securities (ECSD) administers the country's electronic central securities register and funded pension register, i.e. the second pillar of the pension system.

Foreign Direct Investment

Robust economic performance and a favourable business environment make Estonia an attractive destination for investment. While during the 1990s most of the FDI flows were related to the privatisation process, in more recent years there has been an increase in reinvested earnings and cross-border acquisitions. Following the EU membership, the share of green-field investments has also grown. By the end of 2005, the cumulative stock of FDI amounted to €10.37 billion. As of December 2005, investments in financial intermediation accounted for 47.4 per cent of total FDI, real estate for 15.6 per cent, manufacturing for 13.6 percent, and wholesale and retail trade for 7.9 percent of the total. Scandinavian countries continue to provide the biggest source of FDI. Sweden tops the list with 56.4 percent of the total, followed by Finland with 19.6 percent, the US with 3.2 percent and the Netherlands with 3.1 percent. Tallinn and its surrounding areas continue to receive most of the FDI flows, although other regions have also experienced increasing interest. Major investments outside Tallinn area in recent years include Estonian Cell pulp mill in Lääne-Virumaa, and Sillamäe Port in Ida-Virumaa.

2.3 Legal Environment

Estonia acceded to the European Union on 1 May 2004, following a referendum which both ratified the accession and approved necessary amendments to the Estonian constitution to permit this. Since then Estonia continues to develop its legal environment, notably in the streamlining and simplifying of judicial and administrative procedures, for example through the computerisation of its land registry and the removal of some burdensome corporate requirements. Of the concerns highlighted in the previous country strategy, the issue of corporate governance has in part been addressed through the adoption of a Corporate Governance Code but challenges remain in the area of secured transactions legislation.

Estonia is a parliamentary democracy where separation of powers and independence of the judiciary are recognised. It has continued to improve the efficiency of its courts system. Notably new Codes of Civil Procedure and Enforcement Procedure were enacted in June 2005 providing for a simpler and more effective process for civil debt recovery. It is considered to be performing well in the area of human rights and personal freedoms.

An overall assessment of commercial law reveals that Estonia has a legal system which is generally comparable to international standards. A more detailed assessment is included in Annex 10 which identifies weaknesses in particular in the area of secured transactions and the practical application of the insolvency regime, as well as noting the absence of both an overarching legislative framework and a policy framework for public private partnerships/concessions.

3. STRATEGIC ORIENTATIONS

3.1 The Bank's Priorities for Strategy Period

Given the success of the transition in Estonia to date, in response to the remaining transition challenges, and considering the Bank's ability to address them, the main focus of the Bank's activities during the strategy period will be the following:

- In the infrastructure sector the Bank will actively support energy efficiency projects, particularly development of renewable energy projects, and municipal infrastructure, particularly in regional cities and towns.

- In the enterprise sector the Bank will provide primarily equity investments and other intermediate capital to companies with projects requiring restructuring or corporate governance support, or cross-border investments.

- Where appropriate, the Bank will support the privatisation of remaining state-owned enterprises as well as the development of public private partnerships.

- The Bank will continue to work with selected financial intermediaries on providing equity, mezzanine and debt funding primarily to the SME sector.

3.2 Sectoral Challenges and Bank Objectives

In line with the transition challenges identified above and in Annex 5, the EBRD will focus on the following sectoral priorities.

3.2.1 Infrastructure, Environment and Energy

Transition Challenges

- Amendment to the Energy Market Act concerning renewable energy has not been introduced. Until legislation is in force, potential investors are subject to great uncertainty regarding viability of renewable energy projects. Estonia has undertaken to achieve 5.1% renewable energy share in total energy consumption by 2010.
- Unbundling of Eesti Energia is not completed and restructuring of the oil-shale based power plants remains a significant challenge.
- Further commercialisation or private sector participation when appropriate in municipal infrastructure is needed, particularly in regional cities and towns.

Operational Priorities

- Support the legislative process concerning renewable energy as well as finance projects in the sector, especially as an equity or mezzanine participant.
- Encourage and support commercialisation or private sector participation in the financing of municipal infrastructure: this could be achieved through public private partnerships, possibly complemented with the EU funding.

3.2.2 Enterprise Sector

Transition Challenges

- Increased business activity by equity funds, including offering of a broader range of financing instruments, is needed.
- Financial intermediation remains low, particularly to the SME sector. There is need for more equity and mezzanine capital to support continued economic growth, and the spectrum of financial market and capital market products is not fully developed.
- Expansion of private enterprises in less developed regions is important. The relative low wage advantage Estonia has been enjoying since the early 1990's is eroding and a number of industry sectors are being negatively affected.

Operational Priorities

- Provide equity or mezzanine investments to companies requiring restructuring or cross-border investments, and selectively commit capital to new equity and mezzanine funds, particularly those focusing on SMEs.

- Support knowledge-intensive and high technology enterprise innovation to sustain economic development to compensate for the eroding low wage advantage and to improve the competitiveness of the economy.
- Provide funding and subordinated finance to selected financial institutions to support corporate lending focusing on SME sector, also in the less developed regions, and encourage the development of local capital markets by promoting underdeveloped financial products, such as securitisation and high-yield bond financing.
- Selectively support privatisation of the remaining few state-owned enterprises.

4. CO-OPERATION WITH OTHER IFIs AND ORGANIZATIONS

- **European Union (EU) –** The EU committed a total of €680.33 million in Structural and Cohesion Funds for the period 2004-2006. Structural Funds amount to €371.3 million and are allocated to the following priority areas: social and economic infrastructure (€138.1 million); human resources development (€76.1 million); enterprise competitiveness (€73.2 million); rural development, agriculture and fisheries (€69.3 million); and technical assistance (€14.6 million). The total Cohesion Funds in the period 2004-2006 attributable to Estonia amount to €309.03 million to co-finance infrastructures in the environment and transport sectors. In recent years, EBRD cooperation with the EU included the EU/EBRD credit line to Sampo Bank in 2000, the EU/EBRD financing to Baltic SME Equity Fund in 2001 and the EU/EBRD financing to Hansa Capital in 2003. Cooperation with EU since last country strategy includes JASPERS and JEREMIE initiatives.

- **International Monetary Fund (IMF) –** Since joining the IMF in 1992, Estonia requested a total of three Stand-By Arrangements as a precautionary measure. The latest of these was approved in March 2000 for the amount of SDR 29 million. The agreement expired successfully in August 2001 with all performance criteria met. There are no further current or projected obligations to the IMF. In December 2003, the IMF sent a Technical Assistance mission to advise the authorities on medium-term budgeting. Since 2001 the Article IV consultations are held on the standard 12-month cycle. The last Article IV consultation was in October 2005. Estonia is also a subscriber to the Fund’s Special Data Dissemination Standard. No EBRD/IMF cooperation has taken place since last strategy.

- **World Bank –** Estonia joined the World Bank in 1992. Since then, World Bank commitments to the country have totalled USD 150.7 million for eight operations. Programmes focused on improving the environment, fostering private sector investment and growth, upgrading the efficiency of essential infrastructure, building human resources, and enhancing the country’s human development services. A USD 25 million loan for the partial upgrading of the highway between Tallinn and Tartu is ongoing. No EBRD/World Bank cooperation has taken place since last strategy.

- **International Finance Corporation (IFC) –** Estonia joined IFC in 1993. Since then, IFC has invested over USD 130 million in 18 projects in various sectors including textiles, pulp and paper, construction materials, electronics, tourism and transport. Following the country's accession to the EU, IFC will focus on the regions, sectors, and projects where private financing remains limited, emphasizing socially and environmentally sensitive sectors. No EBRD/IFC cooperation has taken place since last strategy.

- **European Investment Bank (EIB) –** Since 1992, the EIB has committed financing mainly to infrastructure projects (energy, roads, rail-corridors, airport, water systems) and to small and medium-sized enterprises (SMEs) through global loans to banking intermediaries. EIB's priorities in Estonia are to support projects that help integrate the economy into the EU Single Market and contribute to the application of European standards as developed in the *acquis communautaire*. The EBRD and the EIB collaborated on the reconstruction of the Tallinn Airport passenger terminal in 1999. Cooperation with EIB since last country strategy includes JASPERS and JEREMIE initiatives.

- **Nordic Investment Bank (NIB)** – Estonia became a member of the Nordic Investment Bank in January 2005. However, the NIB has been active in Estonia already since the country's independence through the Baltic Investment Programme (BIP), which supports SMEs in the private sector. Later, the NIB financed investment loans for major individual projects in energy efficiency, water utility and power generation sectors. No EBRD/NIB cooperation has taken place since last strategy.

- **Kreditanstalt für Wiederaufbau (KfW)** – KfW has provided financing to support the private enterprise sector through SME development. In addition, KfW has financed projects for improving energy efficiency through building rehabilitation. In 2005 KfW provided financing to all major banks in Estonia. Loans totalling €60 million and extended in co-operation with Council of Europe Development Bank were targeted to support small municipality development. No EBRD/KfW cooperation has taken place since last strategy.

- **Council of Europe Development Bank (CEB) –** Estonia became a member of Council of Europe Development Bank in April 1998. In 2005 CEB provided financing in co-operation with KfW to all major banks in Estonia to support small municipality development. Another area of focus for CEB is addressing social issues and problems in eastern part of Estonia. No EBRD/CEB cooperation has taken place since last strategy.

ANNEX 1: COMMITTED PROJECTS PER YEAR

Year	Operation Name	Regional/ Direct	Total Project Value	EBRD Finance	Debt	Equity
	Estonia Energy Sector Emergency Investment Project	Direct	26.5	24.7	24.7	0.0
1992	**1**		**26.5**	**24.7**	**24.7**	**0.0**
	Estline Marine Company Ltd	Direct	43.5	19.4	19.4	0.0
1993	**1**		**43.5**	**19.4**	**19.4**	**0.0**
	Tallinn Airport Rehabilitation Project	Direct	10.5	9.1	9.1	0.0
	Sampo Pank (formerly Optiva Pank) (credit line)	Direct	7.9	4.0	4.0	0.0
	Tallinn Water and Environment Project	Direct	74.6	22.7	22.7	0.0
	Hansapank (line of Credit)	Direct	17.2	2.6	2.6	0.0
	Estonian Investment Bank Capital Increase	Direct	4.5	1.5	0.0	1.5
	First NIS Regional Fund	Regional	0.5	0.3	0.0	0.3
1994	**6**		**115.2**	**40.2**	**38.4**	**1.8**
	Hansapank (formerly Eesti Hoiupank)	Direct	11.5	3.6	2.2	1.5
	Hansapank (formerly Eesti Hoiupank) (equity)	Direct	1.9	1.9	0.0	1.9
	Eesti Uhispank (Credit Line)	Direct	8.7	8.7	8.7	0.0
	Baltic Investment Fund	Regional	7.5	2.2	0.0	2.2
	Eurovision - Estonia	Direct	0.7	0.7	0.7	0.0
	Small Municipalities Environment Project	Direct	46.0	10.2	10.2	0.0
1995	**6**		**76.3**	**27.3**	**21.8**	**5.6**
	Hansapank (Credit Line)	Direct	0.3	0.3	0.3	0.0
	Hansapank Housing Loan	Direct	6.1	6.1	6.1	0.0
	Eesti Uhispank (credit line)	Direct	6.1	4.3	4.3	0.0
	Sampo Pank (Formerly Optiva Pank) (debt)	Direct	6.1	6.1	6.1	0.0
	New Europe Insurance Ventures	Regional	6.1	0.5	0.0	0.5
1996	**5**		**24.7**	**17.3**	**16.8**	**0.5**
	Hansapank (formerly Eesti Hoiupank) Housing Loan	Direct	7.7	7.7	7.7	0.0
	Sampo Pank (Formerly Optiva Pank) Subordinated Loan	Direct	2.0	2.0	2.0	0.0
	Eesti Uhispank (formerly Tallinna Pank - Subordinated loan)	Direct	2.6	2.6	2.6	0.0
	Eesti Maapank Equity Investment	Direct	1.5	1.5	0.0	1.5
	Hansapank - Subordinated Debt	Direct	7.7	7.7	7.7	0.0
	Eesti Uhispank - Housing Loan	Direct	6.1	6.1	6.1	0.0
	Hansapank (formerly Eesti Hoiupank) Sub Debt (equity)	Direct	25.5	25.5	12.8	12.7
	Baring Communications Equity	Regional	2.5	0.5	0.0	0.5
	Baltic Small Equity Fund	Regional	3.1	1.5	0.0	1.5
	Imavere Sawmill Expansion Project	Direct	16.8	7.1	7.1	0.0
1997	**10**		**75.5**	**62.2**	**46.0**	**16.2**
	Eesti Uhispank Increase to Subordinated Debt	Direct	5.1	5.1	5.1	0.0
	Hansapank Increase of the Subordinated Debt	Direct	7.7	7.7	7.7	0.0
	Eesti Uhispank DEM 40m Long Term Credit Line	Direct	20.5	16.6	16.6	0.0
	AS Norma	Direct	8.1	4.1	4.1	0.0
	Innova/98 LP	Regional	1.9	0.4	0.0	0.4
	Hansapank Convertable Sub Debt (equity)	Direct	10.2	10.2	5.1	5.1
	Hansapank Syndicated Loan	Direct	76.7	25.6	25.6	0.0
	Baltex 2000 / Qualitex	Direct	24.0	5.6	3.1	2.6
	Baltex 2000 / Qualitex (Phoenix Capital Rebooking)	Direct	1.8	1.8	1.8	0.0
	Baltex 2000 / Qualitex write-off	Direct	1.3	1.3	1.3	0.0
	IO Fund - Bunim-Welding	Direct	0.3	0.3	0.0	0.3
1998	**11**		**157.6**	**78.7**	**70.4**	**8.4**

Year	Operation Name	Regional/ Direct	Total Project Value	EBRD Finance	Debt	Equity
	Tallinn Airport Passenger Terminal Reconstruction	Direct	23.1	7.6	7.6	0.0
	PPF - Baltic - Tallegg	Direct	2.9	2.8	0.0	2.8
	Info. and Comm. Tech & Industrial Electronic Fund Ltd.	Regional	2.7	0.6	0.0	0.6
	Hansa Capital Syndicated Leasing Finance Facility (debt)	Direct	40.0	13.3	13.3	0.0
	Imavere Sawmill Expansion II	Direct	7.4	5.1	5.1	0.0
	Emerging Europe Capital Investors LDC	Regional	7.9	2.2	0.0	2.2
1999	**6**		**84.0**	**31.6**	**26.0**	**5.6**
	Baltic Food Holding	Direct	39.2	5.5	0.0	5.5
	Estonia: MSE Facility - Hansapank	Direct	17.9	5.0	5.0	0.0
	PPF - Baltic - MicroLink	Direct	1.9	1.8	0.0	1.8
	Estonia: MSE Facility - Eesti Uhispank (credit line)	Direct	11.0	3.0	3.0	0.0
	Baltic Investment Fund III	Regional	18.0	3.3	0.0	3.3
	EU/EBRD Phase II - Sampo Pank	Direct	8.0	8.0	8.0	0.0
2000	**6**		**96.0**	**26.6**	**16.0**	**10.6**
	DVI, Inc. (debt)	Regional	2.1	0.6	0.6	0.0
	EU/EBRD Phase I - Baltic SME Fund	Regional	5.5	1.0	0.0	1.0
	Fiesta	Regional	12.2	6.9	6.9	0.0
	Kesko Baltics	Regional	15.7	5.5	5.5	0.0
	Pleskodale	Regional	5.8	3.8	3.8	0.0
2001	**5**		**41.3**	**17.8**	**16.8**	**1.0**
	Imavere Sawmill III	Direct	12.3	7.0	7.0	0.0
	LHV Asset Management (equity)	Direct	2.8	1.1	0.0	1.1
	Tallinn Airport Loan	Direct	7.3	7.3	7.3	0.0
	Tallinn Water Privatisation Financing Project	Direct	172.8	55.0	55.0	0.0
	Askembla Growth Fund	Regional	14.5	5.0	0.0	5.0
	Heitman Central Europe Property Partners Fund II	Regional	3.6	1.1	0.0	1.1
2002	**6**		**213.3**	**76.5**	**69.3**	**7.2**
	ORCO APARTHOTELS	Regional	16.8	2.2	0.4	1.7
	EU/EBRD Extension 4 - Hansa Capital	Regional	10.2	5.1	5.1	0.0
	International Water United Utilities	Regional	30.7	11.2	0.0	11.2
2003	**3**		**57.7**	**18.5**	**5.5**	**12.9**
	Polish Enterprise Fund V	Regional	1.4	1.4	0.0	1.4
	Estonian Cell	Direct	153.0	19.0	14.0	5.0
	Europolis II	Regional	9.0	2.3	1.7	0.6
2004	**3**		**163.4**	**22.7**	**15.7**	**7.0**
	Emerging Europe Convergence Fund II	Regional	3.6	3.6	0.0	3.6
	Argus Capital Partners II	Regional	0.3	0.3	0.0	0.3
	SG AM Eastern Europe L.P.	Regional	3.3	3.3	0.0	3.3
2005	**3**		**7.2**	**7.2**	**0.0**	**7.2**
TOTAL	**72**		**1,182.1**	**470.4**	**386.5**	**83.9**

ANNEX 2: NET CUMULATIVE BUSINESS BY INDUSTRY

Sector Business Group (SIC)	Sector Team (SIC)	No. of Projects	Total Project Value	EBRD Finance	Debt	Equity	% Share of Commitments
Energy	Power and Energy	1.0	27	25	25	0	5%
Sub-total Energy		**1.0**	**27**	**25**	**25**	**0**	**5%**
Financial Institutions	Bank Equity	3.7	30	24	0	24	5%
	Bank Lending	18.4	251	149	149	0	32%
	Equity Funds	1.8	73	29	0	29	6%
	Non Bank Financial Institutions	2.4	61	21	19	2	4%
Sub-total Financial Institutions		**26.2**	**416**	**223**	**168**	**55**	**47%**
General Industry	General Industry	7.0	225	51	43	8	11%
Sub-total General Industry		**7.0**	**225**	**51**	**43**	**8**	**11%**
Infrastructure	Municipal & Env Inf	3.6	324	99	88	11	21%
	Transport	4.0	84	44	44	0	9%
Sub-total Infrastructure		**7.6**	**408**	**143**	**131**	**11**	**30%**
Specialised Industries	Agribusiness	2.2	75	22	16	5	5%
	Property and Tourism	0.2	30	6	2	3	1%
	Telecoms Informatics & Media	0.3	6	2	1	1	0%
Sub-total Specialised Industries		**2.6**	**110**	**29**	**19**	**10**	**6%**
ESTONIA TOTAL		**44.5**	**1,185**	**470**	**387**	**84**	**100%**

Direct	40.4	999	406	363	43
Regional	4.0	186	65	24	41

Non-Sovereign	39.5	1,004	396	312	84
Sovereign	5.0	181	75	75	0

PRIVATE	39.3	1,071	410	326	84
STATE	5.2	115	60	60	0

DEBT	35.1	890	386	386	0
EQUITY	9.3	291	84	0	84
GUARANTEE	0.0	4	0	0	0

ANNEX 3: SELECTED ECONOMIC INDICATORS

	2000	2001	2002	2003	2004	2005 Estimate	2006 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	7.9	6.5	7.2	6.7	7.8	9.8	8.5
Private consumption	8.6	6.2	10.3	5.7	4.4	9.2	na
Public consumption	1.1	1.8	5.9	5.8	9.1	7.5	na
Gross fixed capital formation	14.3	13.0	17.2	5.4	9.1	13.9	na
Exports of goods and services	28.3	-0.2	0.6	6.0	16.5	21.3	na
Imports of goods and services	28.3	2.1	5.4	9.0	14.7	17.4	na
Industrial gross output	13.9	7.6	14.5	7.9	8.5	11.6	na
Agricultural gross output	-0.8	-5.4	0.1	-1.5	-8.0	0.1	na
Employment			*(Percentage change)*				
Labour force (annual average)	0.4	-0.2	-1.2	1.2	-0.2	0.1	na
Employment (annual average)	-1.2	0.9	1.4	1.5	0.2	3.2	na
			(In per cent of labour force)				
Unemployment (annual average)	13.6	12.6	10.3	10.0	9.7	7.9	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	4.0	5.8	3.6	1.3	3.0	4.1	3.5
Consumer prices (end-year)	5.0	4.2	2.6	1.2	5.0	3.6	3.0
Producer prices (annual average)	4.9	4.4	0.4	0.2	2.9	2.1	na
Producer prices (end-year)	6.0	1.7	1.4	0.3	3.9	na	na
Gross average monthly earnings in economy (annual average)	10.6	12.1	11.6	9.4	8.4	6.8	na
Government sector			*(In per cent of GDP)*				
General government balance	-0.6	0.3	1.5	2.6	1.7	1.5	0.1
General government expenditure	36.2	34.7	35.5	35.6	37.1	40.5	na
General government debt	4.7	4.7	5.8	6.0	5.5	4.5	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	25.1	23.8	11.1	10.9	15.8	42.0	na
Domestic credit (end-year)	27.2	24.4	27.6	28.7	29.2	32.1	na
			(In per cent of GDP)				
Broad money (M2, end-year)	35.5	39.0	38.8	39.5	41.1	50.1	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Deposit rate (over 12 months)	6.8	4.5	3.7	2.4	2.1	3.0	na
Lending rate (over 12 months)	8.9	10.1	6.6	5.1	6.2	6.3	na
			(Kroons per US dollar)				
Exchange rate (end-year)	16.7	17.6	14.9	12.4	11.5	12.5	na
Exchange rate (annual average)	17.0	17.5	16.6	13.9	12.6	12.4	na
External sector			*(In millions of US dollars)*				
Current account	-294	-339	-716	-1,116	-1,432	-1,395	-1,390
Trade balance	-767	-788	-1,089	-1,553	-1,966	-1,826	-1,800
Merchandise exports	3,309	3,359	3,530	4,607	5,971	7,831	9,700
Merchandise imports	4,076	4,148	4,619	6,161	7,937	9,657	11,500
Foreign direct investment, net	324	343	153	763	781	2,250	540
Gross reserves, excluding gold (end-year)	921	820	1,000	1,373	1,790	2,407	na
External debt stock [1]	3,007	3,279	4,704	7,054	10,012	11,213	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	2.2	1.9	2.1	2.2	2.2	2.4	na
			(In per cent of exports of goods and services)				
Debt service	8.9	11.7	15.1	15.9	17.8	14.5	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	1.4	1.4	1.4	1.4	1.4	1.3	na
GDP (in billions of kroons)	93	104	117	127	141	165	185
GDP per capita (in US dollar)	3,989	4,371	5,172	6,775	8,314	9,897	na
Share of industry in gross value added (in per cent)	24.0	24.1	24.8	24.9	24.3	25.8	na
Share of agriculture in gross value added (in per cent)	5.1	4.7	4.4	3.9	3.5	3.5	na
Current account/GDP (in per cent)	-5.4	-5.7	-10.2	-12.1	-12.7	-10.5	-9.5
External debt - reserves (in US$ million)	2,086	2,458	3,703	5,680	8,222	8,806	na
External debt/GDP (in per cent)	54.9	54.9	66.8	76.8	89.1	84.1	na
External debt/exports of goods and services (in per cent)	62.6	65.5	89.7	103.1	113.8	102.1	na

[1] Data from the Bank of Estonia and include non-resident currency and deposits, liabilities to affiliated enterprises and liabilities to direct investors.

ANNEX 4: RATINGS FROM THE 2005 ASSESSMENT OF TRANSITION CHALLENGES

ESTONIA	Structure	Institutions	Conduct	Comments
Agribusiness	*Small*	*Small*	*Small*	Very open agricultural sector, but poorly functioning land market. Agroprocessors still need to improve efficiency and standards. Improvements to distribution and traceability are necessary. Small farm sizes and poor credit history limits finance to the sector.
Banking	*Negligible*	*Small*	*Small*	Regulatory framework in place. Number of banks is stable and over 90% of the sector foreign owned. Domestic credit to the private sector is high for regional standards, but lower than in western economies. Banking system that intermediates efficiently.
Energy Efficiency	*Medium*	*Medium*	*Small*	Lowest energy intensity in the region. Has ratified Kyoto Protocol, but the energy sector is not yet in compliance with all the EU energy regulations. Market driven management of energy is still to develop. Renewable regulation needs to be further strengthened.
General Industry	*Negligible*	*Negligible*	*Small*	Regularly rated as one of the world's most competitive economies. Remaining reform challenges relate to restructuring a few enterprises and stimulating enterprise development in the poorer regions of the country. Businesses are still hindered by changing tax requirements, administrative inefficiencies and opaque licensing requirements.
MEI	*Small*	*Small*	*Small*	Governance has improved significantly since the water services in Tallinn were concessioned to the private sector. There is substantial private sector participation in district heating. Tariffs allow for cost recovery and municipal utilities generally operate on commercial basis.
MSMEs	*Small*	*Small*	*Medium*	Starting a business is not excessively burdensome, but administrative barriers remain. A credit registry is in place. Domestic credit to the enterprise sector has increased significantly since the mid 1990s; however the stock of domestic credit to the enterprise sector remains still modest as a percentage of GDP.
Natural Resources	*Medium*	*Small*	*Small*	As part of its final EU accession negotiations, Estonia won important concessions for its oil shale-based electricity industry. Certain oil shale mines have been closed and their workers redeployed.
NBFIs	*Negligible*	*Small*	*Small*	Securities markets legislation and regulation almost fully meet IOSCO standards. Insurance legislation and regulation almost meet IAIS standards. Stock market capitalisation is one of the highest among the transition countries but insurance penetration remains low. There are voluntary supplementary pension funds. Leasing and consumer finance markets are fully developed.

Power	*Medium*	*Small*	*Small*	Unbundling of the vertically integrated Eesti Energia is progressing but privatisation of parts has been ruled out. Market liberalisation may occur in stages from 2006. Tariffs are sound and their structure is relatively balanced. The regulator is subject to occasional interference.
Private Equity Funds	*Medium*	*Small*	*Medium*	Although the private equity fund sector remains small, there has been a renewed interest by private investor from Scandinavia. Increased business activity by equity funds, including offering a broader range of financial instruments, is needed to improve the visibility of the sector.
Property + Tourism	*Small*	*Small*	*Negligible*	Full tradability of land. The real estate sector is developing fast, including new types property as well as financing instruments.
Telecoms	*Small*	*Small*	*Negligible*	Market was fully liberalised in January 2001 with the opening up of local, long distance and international markets and the removal of the fixed line monopoly. Competition in fixed line segment remains limited. Fully independent regulatory agency. Tariffs are cost oriented though not fully rebalanced.
Transport	*Small*	*Small*	*Small*	In railways, operating and policy setting functions have been separated. Operating companies have been privatised in vertically integrated feature. An independent regulator was established and infrastructure access is granted on a non-discriminatory basis. The national road administration is only semi-independent.

ANNEX 5: COMPARATIVE STRUCTURAL CHANGE INDICATORS

	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Slovakia	Slovenia
Liberalisation								
Share of administered prices in CPI (in per cent)	10.9	26.9	17°	14.3°	19.8	1.2°	19.9	16.7°
Number of goods with administered prices in EBRD-15 basket	1.0	3.0	2.0	2.0	1.0	0.0	2.0	1.0
Share of trade with non-transition countries (in per cent)	80.6*	72*	84*	65.5	63.6	81.7	66.1	77.7
Share of trade in GDP (in per cent)	125.4	125.8	113.9	82.3	93.7	69.8	138.6	100.2
Tariff revenues (in per cent of imports)	0.2°	0.1*	na	0.4°	0.5	1.5*	0.5*	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.0
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Privatisation								
Privatisation revenues (cumulative, in per cent of GDP)	21.9	7.5	31.1	5.3	13.4	14.5	35.0	4.7
Private sector share in GDP (in per cent)	80.0	80.0	80.0	70.0	75.0	75.0	80.0	65.0
Private sector share in employment (in per cent)	70*	na	na	76.0	na	72*	na	na
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	4.0	4.0	4.0	3.7	4.0	3.3	4.0	3.0
Enterprise and markets								
Budgetary subsidies and current transfers (in per cent of GDP)[1]	9.3	1.8	20.2	5.1	0.4	2.5	1.6	1.5*
Share of industry in total employment (in per cent)	29.7	25.2	33.3*	19.7	20.7*	22.3	29.2	36.3*
Change in labour productivity in industry (in per cent)	10.8	3.9*	7.6*	8.2	14.1*	11.9	2.9	8.8*
Investment/GDP (in per cent)	35.7	29.3	22.5	32.6	21.9*	22.0	na	25.3*
EBRD index of enterprise reform	3.3	3.7	3.7	3.0	3.0	3.7	3.7	3.0
EBRD index of competition policy	3.0	2.7	3.0	2.7	3.0	3.0	3.0	2.7
Infrastructure								
Fixed-line (mobile) penetration rate (per 100 inhabitants)	36.0 (96.5)*	33.9 (72.3)*	33.4 (78.3)	28.3 (52.9)*	25.3 (66.6)	31.9 (45.1)*	24.1 (68.4)*	40.7 (87.1)*
Internet penetration rate (per 10,000 inhabitants)	274.4*	498.9*	357.8*	178.8*	203.8*	203.8*	212.2*	214.8*
Railway labour productivity (1989=100)	69.9*	267.3*	133.9*	129.9*	67.8*	106*	60.5*	150.3*
Electricity tariffs, USc kWh (collection rate in per cent)	8.4 (na)*	6.5 (na)*	11.4 (99)*	7.1 (99)*	9.4 (90)*	9.8 (na)*	10.9 (na)*	na
GDP per unit of energy use (PPP in US dollars per kgoe)	3.2**	2.8**	4.7**	4.1**	3.7**	3.9**	3.1**	4.5**
EBRD index of infrastructure reform	3.3	3.3	3.7	3.0	2.7	3.3	3.0	3.0
Electric power	3.3	3.0	4.0	3.3	3.3	3.3	4.0	3.0
Railways	3.0	4.3	3.3	3.3	2.3	4.0	3.0	3.0
Roads	2.3	2.3	3.3	2.3	2.3	3.0	2.3	3.0
Telecommunications	4.3	4.0	4.0	3.0	3.3	4.0	3.3	3.0
Water and waste water	4.0	4.0	4.0	3.3	3.3	3.3	2.7	3.3
Financial sector								
Number of banks (foreign-owned)	35 (26)*	7 (4)*	39 (29)	23 (10)*	13 (7)*	58 (46)*	21 (16)*	22 (6)*
Asset share of state-owned banks (in per cent)	3*	0*	7.4*	4.1*	0*	25.7*	1.5*	12.8*
Non-performing loans (in per cent of total loans)[2]	5*	0.5*	3.8*	1.5*	2.6*	25.1*	9.1*	9.4*
Domestic credit to private sector (in per cent of GDP)	17.7*	33.7*	42.3*	38.8*	19.9*	17.8*	25*	43.2*
Stock market capitalisation (in per cent of GDP)	17.8*	41.5*	18.7*	9.6*	17.2*	17.3*	7.6*	17*
EBRD index of banking sector reform	4.0	4.0	4.0	3.7	3.7	3.7	3.7	3.3
EBRD index of reform of non-bank financial institutions	3.7	3.3	4.0	3.0	3.0	3.7	2.7	2.7

[1] Subsidies to enterprises and financial institutions, including the Czech Consolidation Agency.

EBRD rates as of mid 2005. Remaining data is for 2004, unless otherwise specified.
°Data for 2005
*Data for 2003.
**Data for 2001

ANNEX 6: POLITICAL AND SOCIAL ASSESSMENT

Political context

On regaining independence in 1991, Estonia established a multiparty, parliamentary democracy. In accordance with the 1992 constitution, the unicameral parliament (Riigikogu) has 101 deputies elected directly by proportional representation for a 4-year term, using a party list system with a minimal threshold of 5% of the national vote. The president, elected by parliament, is formally head of state, although most political power resides in the government. The government is nominated by the Prime Minister, approved by parliament and appointed by the President. Since independence, Estonia has held four parliamentary elections, all of which have been deemed free and fair by the international community.

Since 1991, Estonian voters have alternated in their support between conservative parties, in particular Mart Laar's Pro Patria Union, and centrist parties. Laar, who served as Prime Minister between 1992-1994 and again in 1999-2002, was forced to resign in 2002. Laar was replaced by Siim Kallas, the leader of the liberal Reform Party, who successfully steered Estonia through the final negotiations to join both NATO and the European Union.

A new political party, Res Publica, entered the political scene in advance of the March 2003 elections. Although Edgar Savisaar's left-leaning Centre Party—which had formed a coalition with the Reform Party following Laar's resignation in 2002—retained all 28 of their seats, their seat count was equalled by the newcomer Res Publica. Led by the former state auditor Juhan Parts, Res Publica ran in 2003 on a platform of 'honesty in public life' without much substantial policy commitment. After forming a coalition government with the Reform Party and the rurally oriented People's Union, Parts was appointed Prime Minister. The Parts government was in office when Estonia acceded to both the EU and NATO in 2004. The Parts government resigned in March 2005, after the Minister for Justice, a member of Res Publica, lost a vote of confidence in which the other two coalition parties voted against the government.

A new, centrist government—the 11th since Estonia's independence—was formed in April 2005 under the leadership of Andrus Ansip of the pro-business Reform Party. The three-party coalition, which has the minimal majority of 51 seats, also includes the larger left-leaning Centre Party and leftist-agrarian People's Union. The 2005 budget was approved by the new coalition government with little disagreement, although fiscal issues then divided the ruling coalition throughout the course of 2005. Nevertheless, all three coalition parties fared well in the October 2005 municipal elections, which defused the growing expectations of government collapse. The moderate nationalist, conservative parties, Res Publica and Pro Patria, both fared poorly at the municipal elections. In late-April 2006, the two parties announced plans to merge into a single opposition party, 'Party of Estonia'. The merger is scheduled for June 2006, following another round of local council elections.

International relations

The priorities of Estonia's international relations since independence have been integration into Western European institutions. Estonia achieved these objectives in 2004, joining NATO in April 2004 and the EU in May 2004, following a referendum in which 67% of the electorate backed EU membership. Although the rejection of the EU constitution by French and Dutch voters has tempered the pace of European integration, the Estonian populace remains firmly committed to deepening integration. During 2005, Estonia lobbied aggressively, with Poland and the other Baltic States, to retain the relatively high levels of structural funds agreed previously. Estonia has implemented effective fiscal and administrative measures to ensure full absorption of EU structural funds, alongside stringent control structures to police the transparent disbursement of those funds.

After many years of negotiations and standstill, the Estonian and Russian foreign ministers signed a border agreement between the two countries in May 2005. Whereas Estonia has ratified the agreements, Russia has not yet done so. The absence of a border treaty has not affected the European integration of Estonia, including Estonia's envisaged accession to the Schengen area in 2007. The border functions well.

Integrity issues

Estonia remains among the least corrupt transition countries. According to Transparency International's Corruption Perceptions Index (CPI), Estonia scored 6.4 out of 10 in 2005 (with 10 representing the lowest level of corruption). This marked yet another improvement on both Estonia's absolute score in 2004 (6.0), as well as Estonia's relative corruption ranking, moving from the 21st to the 17th percentile globally. Since the inception of the CPI, Estonia has consistently ranked among the least corrupt transition countries. The more detailed 2005 EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS) confirmed these findings on corruption, although it paints a more mixed picture of changes in the Estonian business environment in the period 2002-2005. While managers of Estonian firms report a reduction in most of the obstacles to their firms' operation and growth, they also report that organised crime, corruption and some forms of state regulation had become more problematic. These qualitative measures, however, might reflect changes in Estonian managers' expectations: on the BEEPS' quantitative measures, corruption in Estonia declined in all spheres of private-public interaction, and remains lower than in the other advanced transition countries.

Human trafficking is not a major problem in Estonia, although some cases were reported in 2005. According to a recent study by the International Organisation for Migration, fewer than 100 women and children were trafficked into, through, or from the country between 2001 and 2004. However, according to the US State Department's Bureau of Democracy, Human Rights and Labor, there were reports in 2005 that Estonia was a source, transit point, and destination for a small number of internationally and domestically trafficked women and children.[1] There were also reports that women and minors were trafficked from the country to Nordic countries and Western Europe for sexual exploitation. Although there is no specific law

[1] US Department of State, Bureau of Democracy, Human Rights and Labor, *Country Report on Human Rights Practices 2005 – Estonia* (released 8 March 2006). Available online at http://www.state.gov/g/drl/rls/hrrpt/2005/61646.htm.

criminalizing trafficking in Estonia, traffickers can be prosecuted under the law prohibiting enslavement and abduction. In February 2005 the government prosecuted its first anti-trafficking case under the enslavement statute, convicting four traffickers, and the Estonian police investigated an additional 10 trafficking-related cases during the year. The Estonian government actively participates in the anti-trafficking activities of the EU, the OSCE, CBSS, Nordic Council of Ministers, and the Council of Europe.

Social conditions

Population

According to estimates from the national statistics office, Estonia's population was 1.34 million at the beginning of 2006, representing a decrease of 14.2% from 1.57 million in 1989. The population decline is attributable to a combination of natural decrease—owing in part to the deterioration in living conditions in the early 1990s—and net migration outflows, primarily comprising ethnic Russians who emigrated in the early 1990s. The government has responded to the natural decrease in the population by encouraging larger families, including the introduction of earnings-linked child benefits targeted at young professionals. With increasing life expectancy, Estonia faces the same problem of an ageing workforce with which the rest of the member states of the European Union are struggling.

Minorities

Estonia's legal framework for the protection of minority rights is well developed. Estonia has ratified all key international human rights instruments, including the Framework Convention for the Protection of National Minorities. Moreover, in response to concerns expressed by the Council of Europe, OSCE and European Commission, in the late 1990s Estonia undertook a series of amendments to its citizenship legislation. In response to those measures the OSCE ended regular human rights monitoring reports for Estonia and closed its Tallinn office.

By January 2006, 9.4 percent of the resident population in Estonia remained 'resident aliens' without citizenship (down from 11 percent in 2005). It is important to note that a proportion of these 'resident aliens' have chosen not to pursue Estonian citizenship. The Estonian government remains committed to creating and ensuring possibilities for minority groups to receive education in their mother tongue and maintaining their culture, while supporting the integration of the country's non-Estonian minorities, including subsidising Estonian language training for all non-native speakers. The overwhelming majority of Estonia's resident alien population possess resident permits, have the right to vote in local (but not national) elections, and have access to social security.

Poverty

Income inequality in Estonia is among the highest in the transition countries: in 2003, Estonia's Gini coefficient of 37.20 was the third highest of the 26 transition countries included in the World Bank's *Human Development Report*. Globally Estonia ranked 61st of 126 countries included in the report. Despite Estonia's strong growth over recent years, poverty rates have remained significantly higher than the EU-15 average. In 2003, 18% of the Estonian population was classified (according to the European Union's Laeken indicators) as 'at risk of poverty'—defined as having an income of 60% or less of median equivalised income after social transfers—in comparison with an average of 15% in the EU-15 member countries. Furthermore, poverty in Estonia is concentrated in rural areas and is particularly acute among women at either end of the age range. While only 7% of Estonian men over the age of 65 were considered to be at risk of poverty, the equivalent figure for women aged 16-24 was 24%, while 22% of women over 65 were considered to be at risk. The growth of income inequality and the divide between the prosperous cities and the poorer countryside remains a concern, and the government is actively pursuing measures to stimulate real income growth in the countryside.

Education

Estonia has one of the highest levels of literacy in Europe: 99% of the adult population. Education is compulsory from the age of seven to 17, and more than 95% of primary school students advance to secondary education, where students have a choice of attending either vocational or comprehensive secondary schools. Since independence, Estonia's vocational education system has been restructured to more flexibly meet the needs of the labour market. Higher education is also increasingly popular in Estonia: the number of students enrolled in higher education courses has almost tripled since 1990, from 24,000 to 66,000 in 2004. Commercial considerations play a large role in Estonian students' choices of degree, with more than 20% studying for degrees in business and administration. The primary challenge for the Ministry of Education is the integration of Russian-language primary and secondary schools into the Estonian-language dominated state schooling system. By 2007, all primary and secondary school graduates will be required by law to be sufficiently fluent in Estonian to continue further studies in the language.

Health

Health indicators declined precipitously in the early 1990s, in the wake of Estonia's economic contraction. Life expectancy at birth fell sharply in the early 1990s, to a low of 60.5 years for men in 1994, but has since recovered. In 2004 life expectancy for women was 77.8 years, although for men it remains low by EU standards, at 66.3 years. Infant mortality reached a post-independence peak of 15.7 deaths per 1,000 live births in 1992, before declining to 6.4 in 2004, according to the national statistics office. Against the trend of Estonians' generally improving health, the number of newly diagnosed cases of HIV increased rapidly in the early 2000s, reaching a peak of 1,474 new cases in 2001, with intravenous drug use the primary route of transmission. The total number of officially diagnosed cases of HIV infection reached 5,063, or 377.8 per 100,000 inhabitants, by end-2005.[2] Although the infection rate has been halved since 2001, to 743 new cases in 2004, UNAIDS reports that Estonia had the highest HIV infection rate in the transition region in the early 2000s.[3] In response, the Estonian government has implemented an active HIV awareness programme to address the issue.

[2] NGO Aids Prevention Centre, 'Statistics,' available online at: http://www.aids.ee/main_eng.php?id=8.
[3] UNAIDS, *2004 Report on the Global Aids Epidemic*, available online at: http://www.unaids.org/bangkok2004/GAR2004_pdf/UNAIDSGlobalReport2004_en.pdf.

The health sector inherited from the Soviet Union was reorganised in 1992 and incorporated under the rubric of the Ministry of Social Affairs in 1993. The reforms included shifting health care provision to a state insurance system, administered by the Central Sickness Fund and 17 regional funds. The funding system was further centralised in 2001 with the establishment of the single Estonian Health Insurance Fund. However, Estonia's total expenditure on health—at 5.1% of GDP in 2002, according to the World Health Organisation (WHO)—remains very low by European and transition country standards (average health expenditure is 8.5% of GDP in the EU-15 and 7.2% of GDP across the WHO's European region, including the CIS). Partly as a result of this low expenditure, a major and mounting concern of the Estonian health authorities is the growing shortfall of qualified, Estonian-speaking doctors. With low levels of pay in Estonia and strong demand for qualified medical personnel elsewhere in Europe, Estonian doctors and nurses have been leaving the country in unsustainable numbers, particularly since Estonia's accession to the European Union in 2004.

Labour issues

Unemployment in Estonia reached its post-independence high of 13.6% (according to ILO methodology) in H2 2000. After 2000, the unemployment rate fell steadily to around 10% in Q4 2004, and then dropped rapidly during the course of 2005 to 7.5% at year-end. This sharp decline in the unemployment rate has been attributed primarily to the high demand for labour resulting from Estonia's rapid growth rate. However, the labour market continues to suffer from structural imbalances, with falling demand for unskilled labour and increasing demand for highly skilled labour and professionals, while concerns remain about the ability of the Estonian educational system to supply the labour market's demands. Employment in the agriculture and fishing sectors has declined from 18% of the workforce in 1992 to less than 6% in 2005, while employment in services has increased from 45% in 1992 to more than 60% in 2005. Employment in manufacturing has remained fairly constant, at around 24% of the workforce.

The basis of Estonian labour law, the Employment Contracts Act of 1992—as well as subsidiary legislation, such as the Collective Labour Dispute Resolution Act of 1993—provide the rights to workers to form and join trade unions and for unions to conduct their operations without interference from the government. However, trade unions in Estonia are relatively weak, with a membership of approximately 92,500, or 14.2% of the workforce, a significant decline from 37% of the workforce in 1994. In 2005, the Confederation of Estonian Trade Unions and the Estonian Journalists Union both reported anti-union activity among private sector employers and the media.

ANNEX 7: ENVIRONMENT

National Environmental Strategy

The Estonian National Environmental Strategy ("NES") was approved by Parliament in 1997. NES was influenced by EU accession needs and was aligned with the priorities specified in Estonia's Accession Partnership Agreement. NES defined 10 priority goals of environmental management and protection to be achieved by 2010, as follows:

1. Promote environmental awareness
2. Promote clean technology
3. Reduce energy sector pollution
4. Improve air quality
5. Waste – generate less, improve treatment
6. Clean-up past pollution
7. Improve groundwater protection & use
8. Protect surface waters & coastal seas
9. Preserve landscapes & biodiversity
10. Improve quality of built environment

In 2005 Estonia adopted the new Environmental Strategy covering the period until 2010.

Legislation and EU accession

Estonia essentially met the commitments and requirements arising from the accession negotiations and had implemented the *acquis* in most areas of environment policy on the date of its EU accession on 1 May 2004. Transitional periods were agreed for the following areas:

- Control of volatile organic compound (VOC) emissions
- Urban waste water treatment
- Quality of water intended for human consumption
- Landfill of waste
- Nitrate pollution from agricultural sources
- Protection of groundwater
- Discharge of dangerous substances into surface water

Amendments were also made to the annexes of both Birds Directive and Habitats Directive, in order to take into account special conditions of Estonia.

The compliance with the *acquis* will continue to require significant investments, but it also brings significant benefits for public health and environment. It has been estimated that the alignment of Estonian legislation on the *acquis* will have cost Estonia a total of EUR 2.21 billion by 2010.

National Sustainable Development Strategy

The Estonian National Sustainable Development Strategy "Sustainable Estonia 21" (“SE 21”) up to 2030 entered into force by the decision of the Estonian Parliament on 15 September 2005. Whilst the strategy acknowledges that environmental requirements will become increasingly stringent, it is a development programme covering all of societal life, not a strategy focusing on ecological issues only. It pursues a holistic approach to society and seeks to integrate and balance the success requirements arising from global competition with the principles of sustainable development and preservation of the identity and traditional values of Estonia. In addition to defining the development goals of society, the strategy lists the major assumptions about and factors that may affect Estonia’s development in the coming decades.

SE 21 establishes an overall framework for long-term sustainable and balanced development of the state and integrated development of the social, economic and environmental sphere. It specifies four development objectives for Estonia in its pursuit to catch up with the EU quality of life, as follows:

- Viability of the Estonian cultural space
- Growth of welfare
- Coherent society
- Ecological balance

The goal of ecological balance is broken down into three main components:

- Use of natural resources in ways and quantities that ensure ecological balance
- Reduction of pollution
- Preservation of biological diversity and natural areas

Movement towards knowledge-based society as an integral social system is considered to be an appropriate path to achieving these objectives. Knowledge-based society stands for a culture of operating and decision-making, where objectives that have been set and accepted jointly are achieved in the economy, social life, relations with nature and governing the state by relying, first and foremost, on knowledge, analysis and feedback.

Conclusion

Environmental legislation and Policy goals have been harmonised with those of European Union. The sustainable development (environmental, social and economic) objectives have been established and these are being integrated into other policies and programmes. Environmental priorities are being revised and a new National Environmental Strategy is being developed in line with the objectives of the National Sustainable Development Strategy. Significant additional investment from public and private sector is required to meet the sustainable development goals.

ANNEX 8: BILATERAL ASSISTANCE

Commitment Number	Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Sector	Linked to Inv.
BTAF-1992-11-01	Estonian Investment Bank - board representation	45,500	45,500	20/11/92	Closed	Finance, Business	Y
BTAF-1992-11-02	Preparation of investment and Business Advisory Services relating to SMEs	32,573	32,573	20/11/92	Closed	Manufacturing	Y
BTAF-1993-03-01	Baltic investment programme - feasibility preparation - training programme	184,900	184,900	20/03/93	Closed	Finance, Business	N
BTAF-1993-03-02	Assessment of SME support systems for management advice	44,018	44,018	20/03/93	Closed	Finance, Business	N
BTAF-1993-11-06	Establishment of Business Advisory Services	52,641	52,641	20/11/93	Closed	Manufacturing	Y
BTAF-1994-02-02	Estonian Savings Bank - due diligence	171,808	171,808	01/02/94	Closed	Finance, Business	Y
BTAF-1994-02-03	Privatisation programme - accountancy advice	426,063	426,063	01/02/94	Closed	Community/Social Services	Y
BTAF-1994-06-12	TurnAround Management Programme - Kalev Candy	49,730	49,730	15/06/94	Closed	Manufacturing	N
BTAF-1994-06-13	TurnAround Management Programme - Balti Manufaktuur	49,214	49,214	15/06/94	Closed	Manufacturing	N
BTAF-1994-06-15	Estonian Investment Bank - board representation	114,806	114,806	15/06/94	Closed	Finance, Business	Y
BTAF-1994-07-18	TurnAround Management Programme - NAKRO	28,467	28,467	15/07/94	Closed	Manufacturing	N
BTAF-1994-08-19	Feasibility study for establishment of an equity capital fund	44,788	44,788	20/08/94	Closed	Finance, Business	Y
BTAF-1994-11-26	TurnAround Management Programme - Dvigatel Cranes	50,000	50,000	20/11/94	Closed	Manufacturing	N
BTAF-1994-11-29	Post-privatisation Fund - investment preparation	53,128	53,128	20/11/94	Closed	Finance, Business	Y
BTAF-1994-12-30	TurnAround Management Programme - Tarmel	51,881	51,881	20/12/94	Closed	Community/Social Services	N
BTAF-1995-01-01	TurnAround Management Programme - Tarkon	49,953	49,953	01/01/95	Closed	Manufacturing	N
BTAF-1995-03-05	TurnAround Management Programme - Eesti Fosoriit	46,300	46,300	01/03/95	Closed	Community/Social Services	N
BTAF-1995-03-06	TurnAround Management Programme - Tartu Instrument	47,495	47,495	01/03/95	Closed	Manufacturing	N
BTAF-1995-04-09	TurnAround Management Programme - Standard Furniture Ltd	42,841	42,841	02/04/95	Closed	Manufacturing	N
BTAF-1995-04-15	Business Advisory Services - operating expenses for Tallinn	88,797	88,797	02/04/95	Closed	Manufacturing	N
BTAF-1995-05-18	TurnAround Management Programme - Sangar STC Ltd	49,710	49,710	04/05/95	Closed	Community/Social Services	N
BTAF-1995-06-21	Business Advisory Services - subsidies disbursement	1,094,054	1,094,054	20/06/95	Closed	Manufacturing	N
BTAF-1995-07-25	TurnAround Management Programme - Virko	43,482	43,482	20/07/95	Closed	Community/Social Services	N
BTAF-1995-07-26	TurnAround Management Programme - Zunda Furniture Factory	4,500	4,500	20/07/95	Closed	Manufacturing	N
BTAF-1995-09-30	Business Advisory Services - national fund director	44,862	44,862	20/09/95	Closed	Manufacturing	N
BTAF-1995-09-33	TurnAround Management Programme - Tallinn Meat Company	28,976	28,976	20/09/95	Closed	Manufacturing	N

Commitment Number	Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Sector	Linked to Inv.
BTAF-1995-10-37	Business Advisory Services - office lease for local Business Advisory Services office	113,605	113,605	10/10/95	Closed	Manufacturing	N
BTAF-1995-10-38	Business Advisory Services - purchase of furniture and equipment for Business Advisory Services Office in Tallinn	21,662	21,662	10/10/95	Closed	Manufacturing	N
BTAF-1995-11-41	TurnAround Management Programme - IPT	23,103	23,103	05/11/95	Closed	Community/Social Services	N
BTAF-1995-11-42	Business Advisory Services - project officer	26,518	26,518	05/11/95	Closed	Manufacturing	N
BTAF-1995-11-43	Business Advisory Services - administrative secretary	16,443	16,443	05/11/95	Closed	Manufacturing	N
BTAF-1995-12-45	TurnAround Management Programme - BaltPlast	32,727	32,727	01/12/95	Closed	Manufacturing	N
BTAF-1995-12-46	TurnAround Management Programme - AS Marlekor	24,642	24,642	01/12/95	Closed	Manufacturing	N
BTAF-1995-12-47	TurnAround Management Programme - Paide Piim	39,618	39,618	01/12/95	Closed	Manufacturing	N
BTAF-1996-05-05	TurnAround Management Programme - Dagomar	39,372	39,372	14/05/96	Closed	Manufacturing	N
BTAF-1996-05-06	TurnAround Management Programme - RAS Estel	50,000	50,000	14/05/96	Closed	Manufacturing	N
BTAF-1996-05-09	Baltic Post-privatisation Fund	406,999	406,999	22/05/96	Closed	Finance, Business	Y
BTAF-1996-08-12	TurnAround Management Programme - AS Flora Kommerts	46,324	46,324	05/08/96	Closed	Manufacturing	N
BTAF-1996-10-15	TurnAround Management Programme - United Dairies	40,358	40,358	10/10/96	Closed	Manufacturing	N
BTAF-1996-10-16	TurnAround Management Programme - AS Parnu EEK	38,423	38,423	10/10/96	Closed	Manufacturing	N
BTAF-1997-01-01	TurnAround Management Programme - Estiko Kommerts	44,015	44,015	01/01/97	Closed	Manufacturing	Y
BTAF-1997-03-06	Baltic Small Equity Fund - implementation / supervision	999,807	999,807	11/03/97	Closed	Finance, Business	Y
BTAF-1997-03-07	Baltics Small Equity Fund - preparation	42,157	42,157	11/03/97	Closed	Finance, Business	Y
BTAF-1997-03-08	Baltics Small Equity Fund - legal	136,770	136,770	11/03/97	Closed	Finance, Business	Y
BTAF-1997-04-09	Baltics Post-privatisation Fund - project initiation	49,500	49,500	10/04/97	Closed	Finance, Business	Y
BTAF-1997-07-12	TurnAround Management Programme - Estonian Railways	47,651	47,651	07/07/97	Closed	Manufacturing	N
BTAF-1997-10-15	TurnAround Management Programme - post-investment support - Imavere Saeveski	27,063	27,063	02/10/97	Closed	Manufacturing	N
BTAF-1997-10-19	Business Advisory Services - extension	2,400	2,400	21/10/97	Closed	Manufacturing	N
BTAF-1998-03-16	Business Advisory Services - National Fund Director	5,130	5,130	10/03/98	Closed	Manufacturing	N
BTAF-1998-03-17	Business Advisory Services - project officer	3,630	3,630	10/03/98	Closed	Manufacturing	N
BTAF-1998-03-18	Business Advisory Services - Assistant to National Fund Director	1,914	1,914	10/03/98	Closed	Manufacturing	N

Commitment Number	Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Sector	Linked to Inv.
BTAF-1998-06-20	Baltic Micro Business Advisory Services Programme - project officer	2,640	2,640	30/06/98	Closed	Manufacturing	N
BTAF-1998-07-23	Baltic Micro Business Advisory Services Programme - subsidy account	700,617	700,617	23/07/98	Closed	Manufacturing	N
BTAF-1998-07-25	Baltic Micro Business Advisory Services Programme - operating expenses	11,154	11,154	23/07/98	Closed	Manufacturing	N
BTAF-1998-11-29	Baltic Micro Business Advisory Services Programme - project officer	16,746	16,746	03/11/98	Closed	Manufacturing	N
BTAF-1998-12-31	TurnAround Management Programme - Kitman AS	59,740	59,740	02/12/98	Closed	Manufacturing	N
BTAF-1999-01-03	TurnAround Management Programme - Eesti Raudtee II	59,998	59,998	28/01/99	Closed	Manufacturing	N
BTAF-1999-02-05	TurnAround Management Programme - Media House	59,970	59,970	03/02/99	Closed	Manufacturing	N
BTAF-1999-08-14	TurnAround Management Programme (TAM) - Tallinn Airport II	45,906	45,906	04/08/99	Closed	Manufacturing	N
BTAF-1999-08-15	TunrAround Management Programme (TAM) - Sylvester AS II	59,598	59,598	20/08/99	Closed	Manufacturing	N
BTAF-1999-09-16	TurnAround Management Programme (TAM) - AS Osel Foods	36,020	36,020	21/09/99	Closed	Manufacturing	N
BTAF-1999-10-17	TurnAround Management Programme (TAM) - AS Saaremaa Liha-Ja Piimatoostys	59,965	59,965	08/10/99	Closed	Manufacturing	N
BTAF-1999-11-19	TurnAround Management Programme (TAM) - AS Repo Vabrikud	37,067	37,067	24/11/99	Closed	Manufacturing	N
BTAF-1999-12-23	Micro-BAS Programme - Project Officer	9,322	9,322	16/12/99	Closed	Manufacturing	N
BTAF-1999-12-24	Estonia: MSE Facility Project Implementation	1,027,620	938,256	21/12/99	Disbursing	Finance, Business	Y
BTAF-2000-02-02	Business Advisory Services (BAS) Programme - Subsidies	1,039,767	1,039,767	07/02/00	Closed	Manufacturing	N
BTAF-2000-03-06	TurnAround Management Programme (TAM) - AS Viisnurk	51,937	51,937	07/03/00	Closed	Manufacturing	N
BTAF-2000-05-09	Continuation TAM Programme in the Baltic States - AS Kuressaare Sanatorium	50,640	50,640	24/05/00	Closed	Manufacturing	N
BTAF-2000-07-19	TurnAround Management Programme (TAM) - Eesti Post II	50,024	50,024	28/07/00	Closed	Manufacturing	N
BTAF-2001-01-01	TurnAround Management Programme (TAM) - Tallinn Airport III	58,512	58,512	04/01/01	Closed	Manufacturing	N
BTAF-2001-01-02	TurnAround Management Programme in the Baltic States - Viru Kalatoosttuse OU	60,000	19,256	19/01/01	Committed	Manufacturing	N
BTAF-2001-02-05	TurnAround Management Programme (TAM) - AS Viljandi Aken Ja Uks	58,214	58,214	26/02/01	Closed	Manufacturing	N
BTAF-2001-10-11	TurnAround Management Programme (TAM) - Baltazar Trading Ltd	41,495	41,495	10/10/01	Closed	Manufacturing	N
BTAF-2005-12-01F	TAM - Majatootmise Ou	52,000	0	16/12/05	Committed	Manufacturing	N
CAN-1996-02-01	Tallinn Narva railway line capacity study	107,974	107,974	19/02/96	Closed	Manufacturing	Y
DEN-1992-03-03	Energy sector emergency assistance	91,473	91,473	01/03/92	Closed	Energy	Y
DEN-1993-11-04	Power engineering development advice	19,981	19,981	10/11/94	Closed	Energy	Y

Commitment Number	Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Sector	Linked to Inv.
DENT-2001-11-03PS	Tallinn Urban Transport	195,200	195,200	13/11/01	Closed	Transport, Storage	Y
EC-1992-10-44	Estonian Investment Bank - environmental adviser	29,783	29,783	20/10/92	Closed	Finance, Business	Y
EC-1992-12-58	Energy sector emergency investment programme - project management unit	359,834	359,834	20/12/92	Closed	Energy	Y
EC-1992-12-59	Energy sector emergency investment programme - energy emergency planning group	182,977	182,977	20/12/92	Closed	Energy	Y
EC-1992-12-60	Energy sector emergency investment programme - commercial accounting systems for main energy utilities	486,939	486,939	20/12/92	Closed	Energy	Y
EC-1992-12-61	Energy sector emergency investment programme - wood and peat conversion study	188,000	188,000	20/12/92	Closed	Energy	Y
EC-1992-12-62	Energy sector emergency investment programme - energy tariff formulation	287,916	287,916	20/12/92	Closed	Energy	Y
EC-1992-12-63	Energy sector emergency investment programme - energy conservation awareness campaign	189,000	189,000	20/12/92	Closed	Energy	Y
EC-1993-12-62	Baltic Post-privatisation Fund - legal advice	248,297	248,297	17/12/93	Closed	Finance, Business	Y
EC-1994-02-05	Privatisation programme	900,449	900,449	03/02/94	Closed	Community/Social Services	Y
EC-1994-03-10	Small municipalities environment	49,111	49,111	04/05/94	Closed	Local Authority Services	Y
EC-1994-09-30	Accounting systems - billing and revenue collection procedures for water utilities	386,910	386,910	23/08/94	Closed	Manufacturing	Y
ECP98-2000-12-78	BAS Programme in the Baltics	222,660	222,660	08/12/00	Closed	Manufacturing	N
FIN-1992-10-06	Baltic sea environment programme - municipal and waste water treatment feasibility study	158,332	158,332	23/10/92	Closed	Local Authority Services	Y
FIN-1993-11-09	Power engineering development advice	26,477	26,477	01/11/93	Closed	Energy	Y
FIN-1994-01-01	Energy sector development advice	92,431	92,431	11/01/94	Closed	Energy	Y
FIN-1994-11-03	Energy operations monitoring advisor	172,395	172,395	14/11/94	Closed	Energy	Y
FIN-1995-10-05	Development and implementation of Telecommunications Regulations	103,197	103,197	23/10/95	Closed	Telecommunications	N
JAP-1994-02-01	Muuga Port project	47,000	47,000	01/02/94	Closed	Transport, Storage	Y
JAP-1996-05-11	Telecommunications regulatory development	266,953	266,953	14/05/96	Closed	Telecommunications	Y
NOR-1991-04-01	Baltic Sea Environment Programme	137,152	137,152	01/04/91	Closed	Local Authority Services	Y
NOR-1991-08-02	Baltic Sea Environment Programme	42,954	42,954	01/08/91	Closed	Local Authority Services	Y
NOR-1991-08-03	Baltic Sea Environment Programme	36,995	36,995	01/08/91	Closed	Local Authority Services	Y
NOR-1992-03-04	Energy sector emergency assistance	335,437	335,437	01/03/92	Closed	Energy	Y
NOR-1992-10-06	Baltic Sea environment programme - small municipalities environment project	186,971	186,971	30/10/92	Closed	Local Authority Services	Y

Commitment Number	Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Sector	Linked to Inv.
NORG-1993-11-08	Power engineering development advice	25,000	25,000	01/11/93	Closed	Energy	Y
SWE-1992-04-05	Energy sector emergency assistance	87,892	87,892	01/04/92	Closed	Energy	Y
SWE-1992-06-06	Via Baltica transport feasibility study	40,565	40,565	04/06/92	Closed	Construction	Y
SWE-1992-09-09	Energy sector emergency investment programme - procurement advice	186,646	186,646	15/09/92	Closed	Energy	Y
SWE-1993-05-06	Estonian Investment Bank - training and institutional building	31,368	31,368	19/05/93	Closed	Finance, Business	Y
SWE-1993-11-11	Power engineering development advice	19,250	19,250	01/11/93	Closed	Energy	Y
SWE-1994-06-03	National privatisation programme - legal advice	121,275	121,275	22/06/94	Closed	Community/Social Services	Y
TAI-1991-10-05	National Minorities Conference	22,169	22,169	01/10/91	Closed	Community/Social Services	N
TAI-1992-06-37	Railway restructuring	111,078	111,078	01/06/92	Closed	Transport, Storage	Y
TAI-1992-07-42	Baltics privatisation workshop	23,525	23,525	01/07/92	Closed	Community/Social Services	N
TAI-1993-05-04	Energy sector emergency investment programme - equipment for project management units (tied portion)	31,746	31,746	01/05/93	Closed	Energy	Y
TAI-1993-11-15	Energy sector emergency investment programme - cofinancing and disbursement advisory services	30,000	30,000	01/11/93	Closed	Energy	Y
TAMEC-95-09-05	TurnAround Management Programme - advisory services contract - Tallinn Machine Building	48,829	48,829	01/09/95	Closed	Manufacturing	N
TAMEC-95-09-06	TurnAround Management Programme - advisory services contract - Aswega Enterprise	49,180	49,180	01/09/95	Closed	Manufacturing	N
TAMEC-95-09-07	TurnAround Management Programme - advisory services contract - Vaba Maa	49,743	49,743	01/09/95	Closed	Manufacturing	N
TAMEC-95-10-16	TurnAround Management Programme - advisory services contract - Klementi Trading Ltd	48,282	48,282	01/10/95	Closed	Manufacturing	N
TAMEC-95-11-24	TurnAround Management Programme - advisory services contract - Sangar	48,244	48,244	01/11/95	Closed	Manufacturing	N
TAMEC-96-01-07	TurnAround Management Programme - advisory services contract - AS Suva	48,581	48,581	01/01/96	Closed	Community/Social Services	N
TAMEC-96-01-08	TurnAround Management Programme - advisory services contract - Tallinn Pharmaceutical Plant Ltd	49,780	49,780	01/01/96	Closed	Community/Social Services	N
TAMEC-96-03-10	TurnAround Management Programme - Estonian airports	38,201	38,201	01/03/96	Closed	Manufacturing	N
TAMEC-96-04-19	TurnAround Management Programme - advisory services contract - RAS Kiviter	30,193	30,193	01/04/96	Closed	Manufacturing	N
TAMEC-96-04-23	TurnAround Management Programme - advisory services contract - ARE I	46,086	46,086	01/04/96	Closed	Community/Social Services	N
TAMEC-96-09-39	TurnAround Management Programme - advisory services contract - Hiis AS	27,942	27,942	01/09/96	Closed	Community/Social Services	N
TAMEC-96-10-40	TurnAround Management Programme - advisory services contract - Standard	35,613	35,613	01/10/96	Closed	Community/Social Services	N
TAMEC-96-10-41	TurnAround Management Programme - advisory services contract - Tarmel	38,108	38,108	01/10/96	Closed	Manufacturing	N

Commitment Number	Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Sector	Linked to Inv.
TAMEC-96-10-42	TurnAround Management Programme - AS Printarre Ltd	51,133	51,133	01/10/96	Closed	Manufacturing	N
TAMEC-96-10-43	TurnAround Management Programme - advisory services contract - Rakvere Meat Processing	48,741	48,741	01/10/96	Closed	Manufacturing	N
TAMEC-96-10-44	TurnAround Management Programme - advisory services contract - Estonian Airports	48,845	48,845	01/10/96	Closed	Manufacturing	N
TAMEC-96-11-47	TurnAround Management Programme - advisory services contract - Keila Terko	28,039	28,039	01/11/96	Closed	Community/Social Services	N
TAMEC-97-01-01	TurnAround Management Programme - advisory services contract - Baltic Ship Repairers	32,309	32,309	01/01/97	Closed	Community/Social Services	N
TAMEC-97-01-02	TurnAround Management Programme - advisory services contract - Rigas Miesnieks	49,695	49,695	01/01/97	Closed	Community/Social Services	N
TAMEC-97-01-03	TurnAround Management Programme - advisory services contract - Estonian Shipping Co. Ltd	21,711	21,711	01/01/97	Closed	Community/Social Services	N
TAMEC-97-01-04	TurnAround Management Programme - advisory services contract - Lembitu Ltd.	38,871	38,871	01/01/97	Closed	Community/Social Services	N
TAMEC-97-01-05	TurnAround Management Programme - advisory services contract - AS Norma	33,532	33,532	01/01/97	Closed	Community/Social Services	N
TAMEC-97-01-06	TurnAround Management Programme - advisory services contract - Tallinn District Heating	50,000	50,000	01/01/97	Closed	Community/Social Services	N
TAMEC-97-02-18	TurnAround Management Programme - advisory services contract - AGE-Com	49,759	49,759	01/02/97	Closed	Manufacturing	N
TAMEC-97-04-27	TurnAround Management Programme - Estiko training	39,056	39,056	01/04/97	Closed	Community/Social Services	N
TAMEC-97-05-31	TurnAround Management Programme - advisory services contract - Tallinn Pharmaceuticals	48,368	48,368	01/05/97	Closed	Manufacturing	N
TAMEC-97-06-34	TurnAround Management Programme - SE Esti Post	32,237	32,237	20/06/97	Closed	Community/Social Services	N
TAMEC-97-06-35	TurnAround Management Programme - Tartu Olletehas	35,501	35,501	20/06/97	Closed	Community/Social Services	N
TAMEC-97-07-38	TurnAround Management Programme - Aswega II	57,141	57,141	01/07/97	Closed	Manufacturing	N
TAMEC-97-08-44	TurnAround Management Programme - AS Norma	47,742	47,742	01/08/97	Closed	Community/Social Services	N
TAMEC-97-10-45	TurnAround Management Programme - Rakvere meat processing	13,814	13,814	01/10/97	Closed	Manufacturing	N
TAMEC-97-10-46	TurnAround Management Programme - Sylvester AS	67,137	67,137	01/10/97	Closed	Manufacturing	N
TAMEC-97-10-48	TurnAround Management Programme - Age-Com II	17,297	17,297	28/10/97	Closed	Manufacturing	N
TAMEC-98-02-04	TurnAround Management Programme - South-West Railways	20,711	20,711	10/02/98	Closed	Community/Social Services	N
TAMEC-98-02-05	TurnAround Management Programme - Eesti Spar	24,774	24,774	12/02/98	Closed	Manufacturing	N
TAMEC-98-03-06	TurnAround Management Programme - AS EMV	14,442	14,442	11/03/98	Closed	Community/Social Services	N
TAMEC-98-04-08	TurnAround Management Programme - Rakvere Lihakombinaat	43,992	43,992	02/04/98	Closed	Community/Social Services	N

Commitment Number	Commitment Name	Euro Committed	Euro Disbursed	Fund Approved Date	Commit. Stage Name	Sector	Linked to Inv.
TAMEC-98-04-10	TurnAround Management Programme - AS Norma	13,128	13,128	29/04/98	Closed	Community/Social Services	N
TAMEC-98-06-17	TurnAround Management Programme - Estiko Ltd	18,043	18,043	18/06/98	Closed	Community/Social Services	N
TAMEC-98-06-20	TurnAround Management Programme - Baltic Ship Repairers	41,409	41,409	18/06/98	Closed	Community/Social Services	N
TAMEC-98-06-21	TurnAround Management Programme - AS Flora Kommerts	17,070	17,070	19/06/98	Closed	Community/Social Services	N
TAMEC-98-06-22	TurnAround Management Programme - United Dairies Ltd	27,104	27,104	26/06/98	Closed	Community/Social Services	N
TAMEC-98-07-24	TurnAround Management Programme - Tallinn Airport	36,903	36,903	01/07/98	Closed	Community/Social Services	N
UK-1992-08-07	Energy sector emergency investment programme - financial planning	94,649	94,649	10/08/92	Closed	Energy	Y
UK-93-02-01PS	Baltic investment programme - project preparation and training	47,079	47,079	01/02/93	Closed	Finance, Business	Y
UKB-1995-02-02	Advisory services on framework for private pension funds	44,217	44,217	01/02/95	Closed	Finance, Business	N
UKE-1999-10-03	Estonian railways privatisation advisory services	148,026	148,026	29/10/99	Closed	Transport, Storage	Y
	Report Total Euro Amount:	**17,113,832**	**16,931,724**				
	No of Commitments:	**161**					

ANNEX 9: ASSESSMENT OF ESTONIA'S COMMERCIAL LAWS

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws "on the books" (also referred to as "extensiveness") and the actual implementation of laws (also referred to as "effectiveness"). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for Estonia, accompanied by critical comments of the Bank's legal experts who have conducted the assessments.

Capital Markets

The primary legislation governing the Estonian securities market includes the Securities Market Act (adopted in 2001 and last amended in October 2005), the Investment Funds Act (issued in 1997 and amended in October 2005), the Financial Supervision Authority Act (issued in 2001), the Guarantee Fund Act (issued in 2002 and last amended in October 2005) and the Estonian Central Register of Securities Act (issued in 2000 and last amended in March 2005).

Pursuant to the Financial Supervision Authority Act, a unified Estonia Financial Supervisory Authority (the "EFSA") was established in January 2002 as the single supervisory authority for the Estonian financial sector. The EFSA is an agency of the Bank of Estonia, with autonomous competence and a separate budget. It provides supervision over the securities and insurance markets and banking, while the Bank of Estonia is responsible for regulating the banking sector.

The Tallinn Stock Exchange (TSE) was established in 1995 and is the only regulated securities market in Estonia. It is part of OMX Exchanges, which also owns and operates securities exchanges in Copenhagen, Stockholm, Helsinki, Riga, and Vilnius. The number of securities accounts in the TSE increased by 30% in 2005 while the number of stock exchange transactions increased by 106%. The TSE's turnover reached EUR 1,941 million, representing an increase of 190% on 2004.

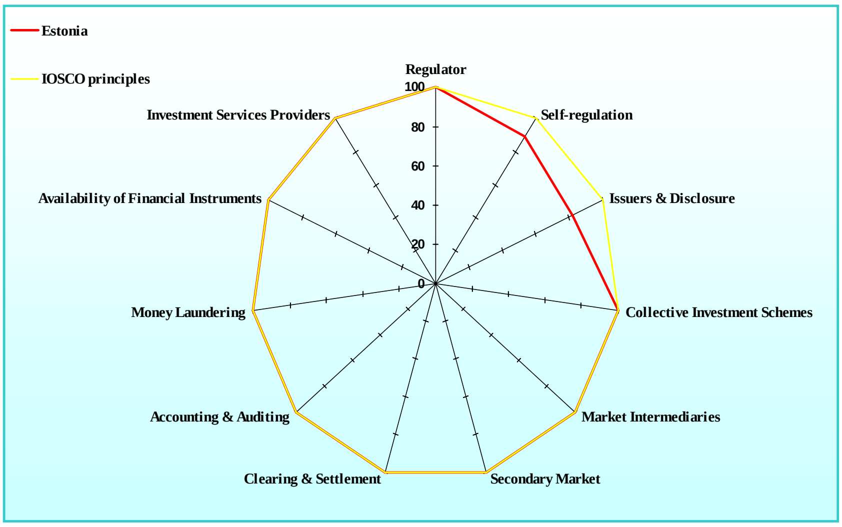
On 19 October 2005, the Parliament adopted the Act Amending the Securities Market Act, the Investment Funds Act, the Guarantee Fund Act and the Law of Property Act. The changes were to transpose the relevant *Acquis Communautaire* - especially the so-called Prospectus Directive - aiming to enable European companies to issue or list securities in the European Union on the basis of a single prospectus approved in the home EU member state.

The new Act provides new definitions in the Estonian legal system in line with EU law, although the main changes pertain to the requirements for the prospectus for a public offer of securities. The amendments also prescribe specific rights and duties of the EFSA exercise supervision over the operation of foreign issuers. The amendments entered into force on 15 November 2005, except for certain provisions that come into effect from 1 March 2006.

With reference to anti-money laundering, in September 2005, the Minister of Finance adopted a new Regulation requiring credit and financial institutions to adopt a code of conduct for internal audit rules. The Regulation, which was issued on the basis of the Money Laundering and Terrorist Financing Prevention Act, prescribes the procedure for identifying, verifying, preserving and updating relevant data and sets forth measures for preventing money laundering and terrorist financing and internal audit rules for monitoring compliance with the code.

Following accession to the EU in May 2004, in June 2004 Estonia joined the Exchange Rate Mechanism 2 (ERM II), the obligatory waiting room for the Euro Zone, while the scheduled date for joining the European currency is planned in 2008.

Quality of securities market legislation – Estonia (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO's *Objectives and Principles for Securities Regulations*. The fuller the 'web', the closer the relevant securities market legislation of the country approximates these principles.

Source: EBRD Securities Market Legislation Assessment 2004

According to the EBRD Securities Markets Legislation Assessment conducted in 2004, the country was found to be in "high compliance" with the Objectives and Principles of Securities Regulation published by the IOSCO (see above chart), showing only minor flaws in the "self-regulation" and "issuers and disclosure" sections.

The assessment was updated in 2005 and the results confirmed Estonia's "high compliance" rating, almost reaching the "very high compliance" category.

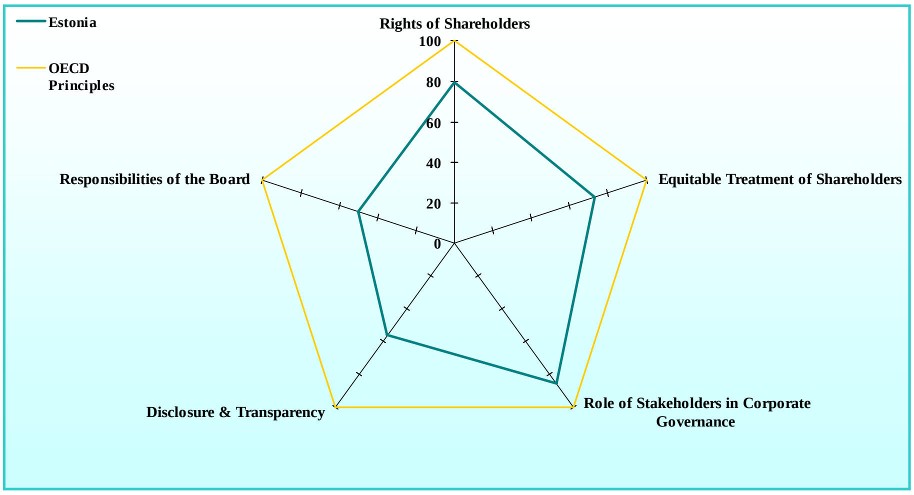
Company Law and Corporate Governance

The Commercial Code, issued in 1995 and last amended in October 2005 is the primary legislation concerning corporate governance. Pursuant to the provisions of the Commercial Code, the following types of company can be incorporated: general partnership; limited partnership; private limited company and public limited company. The latter two have their capital divided into shares.

Apart from the Commercial Code, it is worth mentioning the recently adopted Corporate Governance Code. On 1 January 2006 the "Corporate Governance Recommendations" entered into force and are intended to enhance corporate governance and transparency among listed companies. The Recommendations are enforced by regulations of the TSE and are based on the "comply or explain" principle.

The EBRD's 2004 Corporate Governance Sector Assessment, which assessed corporate governance related "laws on the books", rated Estonia as having achieved "medium compliance" when compared to the OECD Principles of Corporate Governance. As shown in the chart below some shortcomings were found in the "responsibilities of the board" and "disclosure and transparency" sections.

Quality of corporate governance legislation – Estonia (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles

Source: EBRD Corporate Governance Sector Assessment, 2004 assessment

On 12 October 2005, the Estonian Parliament passed a major amendment to the Commercial Code aimed at removing several flaws encountered in implementing the Code and at lifting excessively formal corporate requirements. Some parts of the Commercial Code have been clarified in the light of practice. Regulations concerning the rights and duties of companies' management bodies have also been improved. The amendments entered into force on 1 January 2006.

In 2005, the EBRD launched a survey for testing the effectiveness of corporate governance (how the law works in practice). A case study dealing with related-party transactions was designed. The case study investigated the position of a minority shareholder seeking to access corporate information in order to understand if a related-party transaction was indeed entered into by the company and on how it was possible to obtain compensation in case damage was suffered. Effectiveness of legislation was then measured according to four principal variables: complexity, speed, enforceability and institutional environment. The survey revealed that actions available to minority shareholders in JSCs – having less than 25% shareholding - are limited and in general not very effective. The survey found that minority shareholders can call a general meeting to request information from the management, but that they cannot adopt any decisions unless their action is backed by other shareholders representing the majority at the meeting. Also when considering redress, actions available to minority shareholders are limited, although much more effective. In this respect, procedures are deemed clear and enforceability is generally not considered a particular issue, although it might depend on the solvency of the debtor. Obtaining an executable judgement can take more than 24 months if the dispute goes before the Supreme Court and it is considered easy for the defendant to delay the proceedings. Finally the institutional environment is considered sound as courts are deemed impartial and generally experienced and competent in corporate law cases, corporate information is reliable and statutory auditors are deemed fairly independent from the controlling shareholder.

Concessions

Estonia does not have a general framework Concessions Act. Instead, the country takes a sector by sector approach to application of privatisation policy and use of concessions. In fact, no clear general policy framework for improving the legal environment and promoting PPP in the country could be found at governmental level.

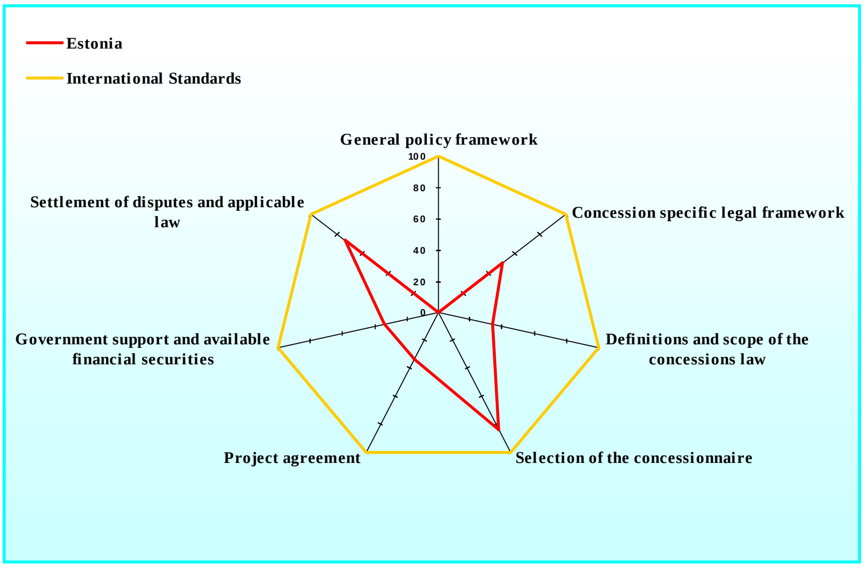
Several sector specific acts regulate the right of a private legal entity to utilise public assets in order to provide facilities or services to the public. Sector specific legislation does not refer directly to concessions, even if the regulation of certain activities (e.g. transport) allows concession-type arrangements. Concession-related issues are regulated by the Competition Act (and the Decree adopted on its basis) and the Public Procurement Act. More particularly, the former regulates the granting of "special or exclusive rights" and the latter regulates the granting of a "construction work concession" (and other contracts concluded by public authorities above certain thresholds). However, the application of one general law over the other is not simple to determine. General provisions on contractual arrangements which could be agreed in the context of a concession can also be found in the Law of Obligations Act.

The procedure to be followed is rather vague in the sector specific laws that refer to the general law (Competition Act or Public Procurement Act). According to the Railways Act, the Railway Administration may grant licences to perform certain activities/services in connection with the operation and/or maintenance of a railway system. The licences may be granted to private entities listed in the commercial register. A foreign company may only be awarded an operational licence if it operates through a branch listed in the commercial register.

The following types of licence exist: construction, management and the operation of railway infrastructure. Operating licences are issued for an unspecified term and are not transferable. They may be withdrawn under conditions stated in the Railways Act, but the licensee has to be given the opportunity to rectify the deficiencies that constitute the basis for a revocation. In order to obtain a license, the applicant has to fulfil a number of prerequisites stated in the Railways Act. A tendering procedure, or any other form of selection procedure, is not regulated in the Railways Act. However, this is counter-balanced by the clearly defined prerequisites that have to be met by the licensee thus ensuring a certain level of transparency.

The Water Supply and Sewage Act and the Water Act only provide for a framework for the privatisation of the water supply and sewage sector, and concessions are not awarded in these sectors.

Quality of concession legislation – Estonia (2005)



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.

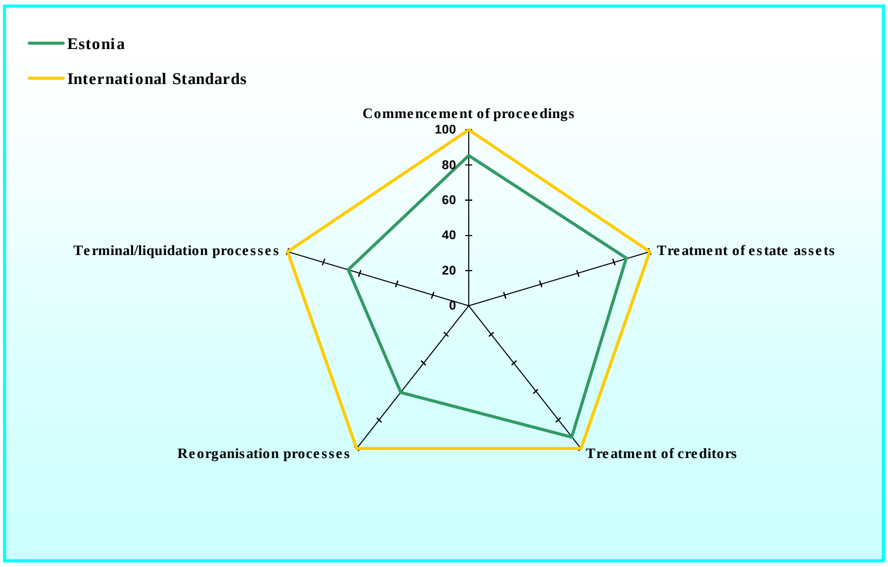
Source: EBRD Concessions Sector Assessment 2005

The recent EBRD Concession Laws Assessment assessing the legal framework governing concessions and PSP (laws on the books rather than how they work in practice), rated Estonian concession related laws as *generally conforming* with internationally accepted principles of concessions laws. In order to meet the requirements of a modern legal framework facilitating private sector participation, the Government may want to consider improving various PPP enabling provisions or, possibly, drafting a special law on this account. In particular, as can be seen from the diagram above, there is still much to be improved in terms of definitions and application of concessions, as well as in the area of project agreement and availability of mechanisms and rules governing security instruments and government support. One more dimension that will inevitably require the attention of the authorities is policy framework, the absence of which makes any law, even an ideal one, extremely difficult to implement.

Insolvency

Bankruptcy and insolvency in Estonia are governed by the Bankruptcy Act 2003 (as amended) (the "Insolvency Law"). This law scored "medium compliance" when compared with international standards in the EBRD's 2003-04 Sector Assessment Survey. The graph below displays the data collected in this project and shows level of compliance of the Insolvency Law with international standards in five core areas:

Compliance of the Estonia's Insolvency Law with International Standards
Quality of insolvency legislation – Estonia (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the international standards such as the World Bank's Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on "Legislative Guidelines for Insolvency Law", and others. The fuller the 'web', the more closely insolvency laws of the country approximate these standards.

Source: EBRD Insolvency Sector Assessment Project, 2003/4

As the above graph reveals, the law has some strengths in certain areas. Specifically, the law is very strong on the requirement of third parties to deliver assets of the insolvent estate to the insolvency administrator. This generally has the effect of enlarging the pool of assets divisible among creditors thereby increasing the level of recovery for creditors. The law also provides some of the most extensive and well-developed provisions for avoiding pre-bankruptcy transactions. Indeed, these provisions, often lacking in other insolvency laws in the region, could serve as a model for other countries.

As the above graph also indicates, however, there is much room for improvement in the Insolvency Law. Specifically, and most notably, there is an absence of modern rehabilitation provisions. The rehabilitation provisions that do exist in the Insolvency Law seem to ignore the commercial realities of restructuring (for example, they require that the rehabilitation plan provide for payment in full to creditors). Moreover, the Insolvency Law does not purport to deal with cases in which the assets in the insolvent estate are insufficient to pay the costs of liquidation. Finally, as with many other laws in the region, this law ignores the emergence of cross-border trade between Estonia and its neighbours and does not provide for how to address cross-border insolvencies.

It is important, however, to look beyond mere legislative provisions and to understand how the insolvency regime works in practice. The EBRD 2004 Legal Indicator Survey on Insolvency which examined the 'effectiveness' (or how the law works in practice) of insolvency regimes in both creditor-initiated insolvencies and debtor-initiated insolvencies revealed that the Estonian insolvency regime is much more 'creditor-friendly' at the expense of allowing debtors to restructure. Debtors are much more likely than creditors to find the system slow, expensive and unduly complex. All of these factors, together with the law's deficiencies, militate against the insolvency regime functioning properly as a 'stick' to induce debtors to act in good faith and as a 'carrot' to induce insolvency debtors, with businesses that are fundamentally viable, to try to promote the rescue of such businesses. In addition, there seem to be structural problems with the court system, in terms of predictability and competence, which will negatively affect both debtors and creditors.

These studies show that any attempts at reform in Estonia should be made in both the legislative and capacity-building spheres.

Secured Transactions

Secured Transactions in Estonia are governed by the Law on Property of 9 June 1993 and the Law on Commercial Pledge of 5 June 1996. On 15 January 2003, amendments to the Property Law were adopted, which created a new, advanced system to take security over rights (generally all intangible property). The law entered into force on 1 July 2003. Other, less substantial changes have since been made to both acts.

In order to take security over personal (movable) property, the three main legal instruments in Estonian law are:

1. (non-possessory) registered charges over assets whose title is already registered in a specific registry (i.e. vehicles, aircraft, boats, intellectual property rights, etc), as governed by the Property Law;
2. so-called commercial pledges, which encumber the whole of an enterprise, hence sometime referred to as enterprise charges, governed by the Commercial Pledge Law and Property Law; and
3. charges over rights (i.e. claims, accounts receivables, rights over real property, etc), governed by the new specific provisions of the Property Law.

This system is fairly strict in that it does not allow the parties to define the collateral as they wish. For instance, the commercial pledge could not cover only part of the enterprise: the object of a commercial pledge must be the “economic unit through which an undertaking operates". Moreover, commercial pledges (enterprise charges) can only be granted by enterprises which are registered in the commercial register.

A registered or commercial pledge requires the notarisation of the charge agreement, and the fees vary in proportion to the amount of the secured debt. Commercial pledges (enterprise charges) must be registered in the commercial pledge register, which is run by the Register Centre of the Ministry of Justice ("Kommertspandiregister").

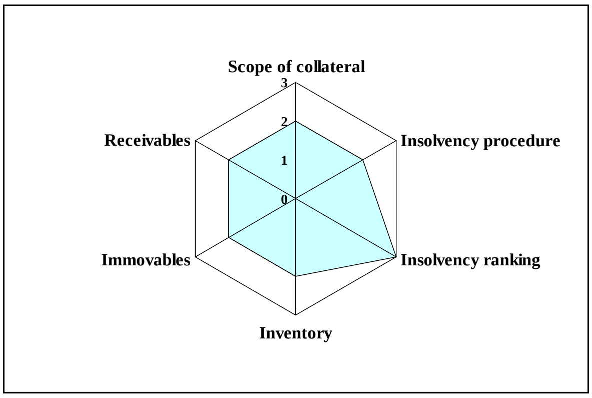
Mortgages are registered in the Registry of Real Property, except when the owner of the building does not own or have the ‘building title’ over the land beneath (in which case taking security over buildings will be created by way of a "pledge over movables"). There is a continuing process of registration of land in the Registry of Real Property. Mortgage registration takes place at the Real Estate Registry which is maintained at the local court.

The legal regime on charges over rights is comparable to conditional assignment: it requires that the sub-debtor be notified of the existence of the charge and the creditor can enforce the charge by receiving direct payment from the sub-debtor.

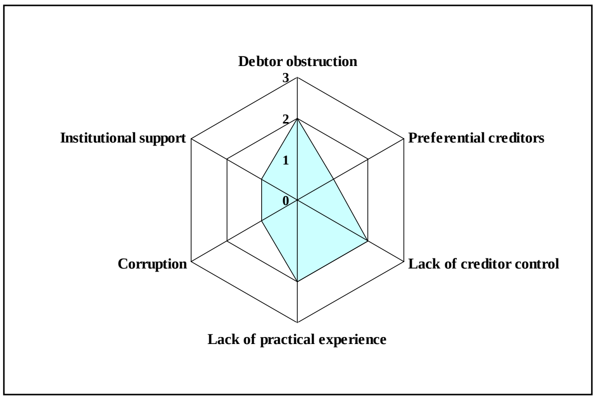
The Property Law provides for realisation of the charged assets through a sale by public auction but it also allows the parties to agree to a different method of sale. The creditor is liable for damages if he does not comply with the agreement for the method of sale. The Supreme Court held in 2002 that such an agreement of purchase and sale should be in accordance with fair practice. In a survey on enforcement of charges conducted by the EBRD in 2003 (see below), results for Estonia showed that the enforcement system works efficiently: secured creditors are able to realise the secured assets speedily at a good return. In contrast to what happens in neighbouring jurisdictions, secured creditors seem to prefer enforcing through courts rather than directly because of the lack of practice in out-of-court enforcement. Also, should the debtor be insolvent, the secured creditor priority ranking and procedure applicable would put him in a less favourable position.

Obstacles to charge enforcement process – Estonia (2003)

Scope



Process



Note: The fuller the web, the more serious the problems are in each of the respective categories. "Process" factors measure the impact that specific obstacles would have on the enforcement proceedings. "Scope" factors give an indication of how effective enforcement would be when conducted on various types of collateral and in the case of debtor insolvency.

Source: EBRD Legal Indicator Survey 2003

Generally, Estonia made a good attempt to reform secured transactions law in 1996 but it has not gone far enough and the scope and effects of the reform have proved to be too limited. The reform of charges over rights evidenced a pressure to offer more flexible solutions; however, a piecemeal approach is not desirable. Estonia could valuably consider a more integrated approach such as the one successfully adopted in both Latvia and Lithuania. The Bank has tried to encourage such reform, so far with no success.

Telecommunications

The telecommunications sector in Estonia is currently regulated by the Estonian National Communications Board (ENCB) and is governed by the framework imposed by the Electronic Communications Act of January 2005. ENCB carries out the policies set by the Ministry of Economic Affairs and Communications (the 'Ministry'). ENCB is a sector specific regulatory authority working under the administrative authority of the Ministry with responsibility for licensing, frequency allocation, type approval and elaboration of laws and standards concerning telecommunications. The Ministry is responsible for preparation of telecommunications policy, elaboration of draft laws, representation of Estonia in international bodies and intergovernmental organisations and handles the state budget in the field of telecommunications.

The Estonian market is one of the most developed in Eastern Europe. Following independence in 1989 the country moved quickly to open markets to competition. Estonia was the first central European nation to fully liberalise its market, in January 2001, with the opening up of local, long distance and international markets and the removal of the fixed line monopoly of Elion Enterprises Ltd (formerly Eesti Telefon, the incumbent operator). Estonia was one of the ten countries which joined the European Union (EU) in May 2004, and its telecommunications law has since been brought into line with the relevant EU directives.

While Estonia has achieved significant progress both in terms of liberalisation of the telecommunications market and implementation of its regulatory framework, it is notable that Elion continues to dominate the fixed-line market, accounting for approx. 80% of the fixed market measured in 2005. Number portability, introduced in January 2004, and reductions in interconnection charges during 2005 should enable alternative operators to achieve more of the dominant operator's fixed-line customers and its voice business. Elion has been partly privatised, with 47.91% owned by TeliaSonera, 27.23% by the state and 23.86% other private investors.

The mobile market in Estonia is home to vigorous competition with three network operators (EMT, Radiolinja and Tele2) competing for market share alongside two Mobile Virtual Network Operators (Bravocom and Diil). Official mobile figures currently report a penetration rate of in excess of 100%, placing Estonia alongside the more developed of European markets. All three incumbent mobile licensees have been awarded 3G licences, with EMT having launched commercial services late in 2005.

While virtually all relevant regulatory measures are in place the attention of the authorities must remain focussed on continuing enforcement of sector specific regulatory measures and broader competition rules to ensure a fully competitive and marketplace for telecommunications. While the progress within the Estonian market has been overwhelmingly positive, one notable element is lack of clarity with respect to the independence of the ENCB. Specifically, the ENCB appears to continue to operate under the administrative authority of the Ministry, with the 2005 Electronic Communications Act providing that the Ministry "exercises supervisory control over the [ENCB]". Such ambiguity could arguably be perceived as compromising to independence of the ENCB. While the European Commission noted this issue as far back as November 2003, the authorities have yet to address the matter.