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on Estonia's Application

for Membership of the European Union

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A. INTRODUCTION

a) Preface

The Application for Membership

Estonia presented its application for membership of the European Union on 24 November 1995, and the Council of Ministers decided on 4 December 1995 to implement the procedure laid down in Article 0 of the Treaty, which provides for consultation of the Commission.

That is the framework in which the Commission submits the present Opinion, responding to the request of the European Council in Madrid in December 1995 to present the Opinion as soon as possible after the conclusion of the Intergovernmental Conference, which commenced in March 1996 and concluded in June 1997.

The Context of the Opinion

The Estonian application for membership is being examined at the same time as applications from nine other associated countries. Estonia's accession is to be seen as part of an historic process, in which the countries of Central and Eastern Europe overcome the division of the continent which has lasted for more than 40 years, and join the area of peace, stability and prosperity created by the Union.

The European Council in Copenhagen in June 1993 concluded that:

"The associated countries in Central and Eastern Europe that so desire shall become members of the Union. Accession will take place as soon as a country is able to assume the obligations of membership by satisfying the economic and political conditions. Membership requires:

- that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;

- the existence of a functioning market economy, as well as the capacity to cope with competitive pressure and market forces within the Union;

- the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.

The Union's capacity to absorb new members, while maintaining the momentum of European integration, is also an important consideration in the general interest of both the Union and the candidate countries".

This declaration spelled out the political and economic criteria for examining the accession requests of the associated countries of Central and Eastern Europe.

The European Council in Madrid in December 1995 referred to the need, in the context of the pre-accession strategy, "to create the conditions for the gradual, harmonious integration of the applicant countries, particularly through:

- the development of the market economy,

- the adjustment of their administrative structure,

- the creation of a stable economic and monetary environment".

In its Opinion, the Commission analyses the Estonian application on its merits, but according to the same criteria as the other applications, on which it is delivering Opinions at the same time. This way of proceeding respects the wish, expressed by the European Council in Madrid, to ensure that the applicant countries are treated on an equal basis.

In addition to the individual Opinions the Commission is presenting separately to the Council, in the framework of its communication "Agenda 2000", a general assessment of the accession requests, and its recommendations concerning the strategy for successful enlargement of the Union. At the same time, it is presenting an evaluation of the impact of enlargement on the Union's policies.

The Contents of the Opinion

The structure of the Opinion takes account of the conclusions of the European Council in Copenhagen. It:

- describes the relations up to now between Estonia and the Union, particularly in the framework of the association agreement;

- analyses the situation in respect of the political conditions mentioned by the European Council (democracy, rule of law, human rights, protection of minorities);

- assesses Estonia's situation and prospects in respect of the economic conditions mentioned by the European Council (market economy, capacity to cope with competitive pressure);

- addresses the question of Estonia's capacity to adopt the obligations of membership, that is the *acquis* of the Union as expressed in the Treaty, the secondary legislation, and the policies of the Union;

- makes finally a general evaluation of Estonia's situation and prospects in respect of the conditions for membership of the Union, and a recommendation concerning accession negotiations.

In assessing Estonia in respect of the economic criteria and its capacity to assume the *acquis*, the Commission has included a prospective assessment; it has attempted to evaluate the progress which can reasonably be expected on the part of Estonia in the coming years, before accession, taking account of the fact that the *acquis* itself will continue to develop. For this purpose, and without prejudging the actual date of accession, the Opinion is based on a medium-term time horizon of approximately five years.

During the preparation of the Opinion, the Commission has obtained a wealth of information on Estonia's situation from the Estonian authorities, and has utilised many other sources of information, including the member states and numerous international organisations.

b) Relations Between the European Union and Estonia

Historical and Geopolitical Context

Estonia shares its eastern border with Russia and its southern border with Latvia. It has an area of 45,000 km^2 and a population of 1.5 million. Across the Finnish Gulf and the Baltic Sea Estonia has had historically close links to Finland and Sweden.

From the early 13th century Estonia experienced seven centuries of foreign rule, by Denmark, the German Teutonic Knights, Poland, Sweden and from 1710 Russia. The 19th century brought an era of national awakening and development of civic society. Estonia declared its independence on 24 February 1918, and successfully defended it against Soviet forces. On 2 February 1920 the Estonian-Russian Peace Treaty was signed in Tartu.

The Republic of Estonia became a member of the League of Nations in 1921. The Estonian Constitution established Estonia as a democratic parliamentary republic, where supreme legislative power was exercised through the 100-member Parliament, the Riigikogu. During the 1930s an authoritarian regime was established which led to the adoption of a new Constitution in 1937. Estonian society and economy as well as the national culture developed rapidly. The economy was comprehensively reorganised and reoriented towards the United Kingdom, Germany and the Nordic countries. Estonia was annexed by the Soviet Union in June 1940, then occupied by Germany in 1941-44.

After the war Soviet rule was re-established, though not recognised by most Western States. It was accompanied by mass deportations and settlement of Russians. In March 1991 a referendum gave clear support to restoration of Estonia as an independent republic. Independence was declared in August 1991. The last Russian military forces withdrew from Estonia in August 1994.

After the re-establishment of independence a further referendum in June 1992 gave support to a new constitution, and the first parliamentary elections were held in

September 1992. Since then, despite frequent changes of government coalition, there has been consensus on development of a liberal market economy.

Estonia's Position Concerning the European Union

Since restoring independence in 1991, Estonia has actively pursued a policy aimed at strengthening political, economic and social ties with the European Union and anchoring its security and stability in trans-Atlantic security structures. Estonia applied for EU membership on 28 November 1995.

The strong determination of Estonia to achieve European integration and accession to the EU was underlined by President Meri , in his speech at the French Institute of Foreign Relations on 13 February 1997:

"Once the European Union has set the applicants for membership a definite threshold, it is in the interest of Estonia like any other European country to meet those criteria in all respects. We do not need concessions, which would dilute the essence of the Union and make it similar to many impotent world organisations. Estonia, even though she has a taste of blood in her mouth, already meets a lot of legislative and economic requirements set by the European Union. According to an EBRD assessment Estonia is one of the fastest and most successful reformers among the post-communist states.....And it is not only economic criteria I am talking about. In the year 1997 we can again enjoy a sweet privilege in Estonia that we were deprived of for such a long time: we live in an open society where there is constitutionally guaranteed freedom, where the military are strictly under civilian control and where a viable non-governmental sector prospers. Democracy functions in Estonia."

Contractual Relations

Diplomatic relations between the European Communities and Estonia were established on 27 August 1991. A Trade and Co-operation Agreement was signed on 11 May 1992 and entered into force in 1993. At present, the basis of the contractual relationship between the EU and Estonia is the Free Trade Agreement which was signed on 18 July 1994 and entered into force on 1 January 1995. This preferential agreement abolishes duties and quantitative restrictions between Estonia and the European Community, with the exception of Estonian exports into the EU of some specified products (agricultural products and fisheries) for which preferential treatment is granted. The Free Trade Agreement further comprises provisions concerning payments, competition and other economic provisions, including approximation of legislation.

A Europe Agreement between the European Communities and Estonia was signed on 12 June 1995. Estonia ratified the Agreement on 1 August 1995. It will enter into force on completion of ratification by all EU Member States.

Once it enters into force, the Europe Agreement will be the legal basis for relations between Estonia and the Union. Its aim is to provide a framework for political dialogue, promote the expansion of trade and economic relations between the parties, provide a basis for Community technical and financial assistance, and an appropriate framework to support Estonia's gradual integration into the Union. The institutional framework of the Europe Agreement provides a mechanism for implementation, management and monitoring of all areas of relations. Sub-committees examine questions at a technical level. The Association Committee, at senior official level, provides for in-depth discussion of matters and often solutions to problems arising under the Europe Agreement. The Association Council, at Ministerial level, examines the overall status of and perspectives for relations and provides the opportunity to review Estonia's progress on preparation for accession.

The Pre-Accession Strategy

Implementation of the Free Trade Agreement and the White Paper

The Free Trade Agreement is fully functioning, according to the agreed timetable. A new Protocol entered into force on 1 April 1997 allowing for Pan-European cumulation of rules of origin. Implementing rules on undertakings and state aid have been prepared and agreed. In order to make the necessary adaptations following the enlargement of the Union in 1995 as well as the conclusion of the Uruguay Round, autonomous measures were adopted by the Community for agricultural products, processed agricultural products and fishery products. An additional Protocol has been prepared to incorporate these measures in the Agreement. Other main issues discussed in the context of the Free Trade Agreement are: approximation of legislation and pre-accession strategy, macro-economic issues, customs cooperation, certification and standardisation issues and trade issues. No serious issues of conflicting views have occurred.

The Commission's White Paper of 1995 on the Internal Market set out the legislation which the candidate countries would need to transpose and implement in order to apply the *acquis*, and identified elements essential to the implementation of the single market (known as Stage I measures) which would need priority attention. In response to the White Paper the Government drew up in June 1996 an Activity Plan for Joining the European Union. This document includes a detailed list of all legislative initiatives necessary for the implementation of the *acquis*. For each legal act, the Plan states the main responsible ministry, the state of the existing legislation as well as tentative deadlines for the approximation work. The Government Activity Plan currently includes all Stage I measures, and the incorporation of Stage II measures is being established.

Comprehensive measures in anticipation of membership have been taken, and administrative structures have been established to ensure coordination of integration policy. A Ministerial Commission, chaired by the Prime Minister, formulates the general policy and submits proposals for the government. It is supported by a Council of Senior Civil Servants and an Office of European Integration, which reports directly to the Prime Minister. A European Affairs Committee has been established in the Parliament.

The EC/Estonia Free Trade Agreement functions well. No disagreements over implementation have arisen. Its functioning already takes Estonia some of the way towards the enhanced level of cooperation with the EU which will be required when the Europe Agreement comes into force.

Structured Dialogue

Estonia has participated in the Structured Dialogue since the Cannes European Council in June 1995.

Phare

Technical and financial assistance from the EU to Estonia commenced under the 1991 Tacis programme and has since 1992 been extended through the Phare programme. During the period 1992-1997, Phare provided over 152 MECU to Estonia. The allocation in 1997 is 32 MECU (excluding Cross Border).

The main targets have been establishment of the legal and institutional framework, strategy formulation in key areas of the reform programme and support for export promotion, infrastructure development as well as restructuring and privatisation and third pillar issues.

Phare has had a particular impact on privatisation of enterprises and land, as well reform of the tax administration and customs.

Participation in Community Programmes

Estonia will become eligible to participate in Community programmes from the entry into force of the Europe Agreement. It has already applied to participate in: Socrates, Leonardo, SAVE II, LIFE, Raphael, Kaleidoscope, MEDIA II and Ariane. It has earmarked budgetary funds to cover its financial obligations.

Trade Relations

Since 1991 the trade pattern of Estonia has swiftly changed from an almost exclusive orientation towards the CIS to a strong integration with the EU. Following the accession of Finland, Sweden and Austria as well as the entry into force of the Free Trade Agreement between the Community and Estonia, 54% of Estonia's exports were directed to the EU in 1995, while 66% of Estonia's imports originated in the EU.

Estonia's most important trading partners within the EU are Finland (29.2% of imports and 18.4% of exports), Germany and Sweden . Estonia's imports from the EU consist mainly of machinery and electrical equipment, agricultural products and textiles . Estonia's main exports into the EU are wood products and textiles.

Estonia has a growing trade with other candidate countries, mainly Latvia. A Free Trade Agreement with Latvia and Lithuania covers trade in all goods including, from

1 January 1997, also agricultural products. Estonia aims at membership of the Central European Free Trade Association (CEFTA).

General Evaluation

Relations with the EU have developed well since Estonia regained its independence. There have been no disagreements over implementation of the Free Trade Agreement and free trade has virtually been achieved. Cooperation will be further enhanced when the Europe Agreement with Estonia enters into force.

B. CRITERIA FOR MEMBERSHIP

1. Political Criteria

The European Council in Copenhagen decided on a number of "political" criteria for accession to be met by the candidate countries in Central and Eastern Europe. These countries must have achieved "stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities".

In carrying out the assessment required in this connection, the European Commission has drawn on a number of sources of information: answers given by the Estonian authorities to the questionnaire sent to them by Commission staff in April 1996, bilateral follow-up meetings, reports from Member States' embassies and the Commission's delegation, assessments by international organisations (including the Council of Europe and the OSCE (Organisation for Security and Cooperation in Europe), reports produced by non-governmental organisations, etc.

The following assessment involves a systematic examination of the main ways in which the public authorities in each of the candidate countries are organised and operate, and the steps they have taken to protect fundamental rights. It does not confine itself to a formal description but seeks to assess the extent to which democracy and the rule of law actually operate.

This assessment relates to the situation in June 1997. It does not examine in detail any changes which have taken place in the past or which may come about in the future, though it generally takes account of any stated intention to reform a particular sector. The situation of the government is mentioned here only in passing: it will be examined in greater depth in chapter 4.

1.1 Democracy and the Rule of Law

Under the new Constitution adopted by referendum in June 1992, Estonia is a parliamentary democracy. The institutions function correctly, the various powers being mindful of the limits of their competence and willing to cooperate with each other.

<u>Parliament and Legislative Powers: Structure</u>

The Parliament - the Riigikogu - is unicameral and comprises 101 members elected for four years according to a proportional representation system (a minimum score of 5% is needed to qualify for seats). No provisions exist for any specific representation of the minorities, though six members of the party representing the Russian-speaking minority have held seats in Parliament since 1995.

The President of the Republic can dissolve Parliament in three circumstances, namely if a government bill is thrown out by the Riigikogu, if the latter defeats the Prime

Minister or the Government, and if it fails to adopt the budget within two months of the start of the budget year.

Members of Parliament enjoy the conventional immunities. The opposition's role in the institutions and its participation in its workings are recognised in Estonia, in particular when parliamentary committees of enquiry are set up. Four such committees are currently active, two of them dealing with corruption and monitoring the secret services. These committees comprise an equal number of government and opposition members. Three of the committees are chaired by opposition MPs.

A genuine multi-party system exists in Estonia (seven electoral coalitions and nine political parties fielded candidates at the last elections in 1995). While establishing parties may be easy, it should be noted that non-citizens cannot become members of them. Political parties receive funds from the State budget on the basis of their representation in Parliament. Each parliamentary group is allocated offices and staff free of charge.

Parliament exercises the legislative power and shares the right of initiative with the President of the Republic (only as regards amendments to the Constitution) and the Government. The President of the Republic can ask the Riigikogu for a second reading. If Parliament votes the same way as before, the President can refer the matter to the National Court. The President has done so six times and been vindicated on five of these occasions. Some matters are the exclusive domain of the regulatory power and Parliament has no right to delegate its legislative power to the Government, even on a temporary basis.

Parliament can decide to organise referendums on any subject it deems fit.

Functioning of Parliament

The elections in September 1992 and March 1995 were free and fair, resulting, in the latter case, in a change of government (see annex for the results of the last elections in March 1995).

Parliament functions satisfactorily, its prerogatives are respected, and the opposition plays a full part in its work.

The Executive: Structure

The President of the Republic is elected by a two-thirds majority of Parliament for a four-year term. If he/she cannot command that majority in the first two ballots, a third ballot takes place, with the representatives of the local authorities (273 persons) voting along with the members of the Riigikogu. The President has the standard duties of head of State.

The Prime Minister is appointed by the President but must receive Parliament's endorsement before he/she can form a government, which must not comprise more than 14 ministers. At the Prime Minister's request, the President has the power to dismiss ministers (under Articles 78 and 90 of the Constitution), who are also individually accountable to Parliament.

Administratively, the country is divided into 15 districts ("maakond") headed by Governors appointed for five-year terms by the government. Governors have the task of coordinating the work of the various government departments in the districts and overseeing that of the local authorities. The Governors' work is financed directly by the State budget.

Estonia has only one level of local authority, the municipality (of which there are 254, comprising 45 cities/towns and 209 rural municipalities), responsible for administering the main public services locally. Their governing bodies are elected directly by universal suffrage every three years. Local authorities have budget autonomy and tax-raising powers. Their work is overseen by both the governors and the "Chancellor of the Law".

Estonia introduced a civil service code which guarantees government officials' employment in January 1996. The public's right to information on the administration's decisions is guaranteed by Article 44 of the Constitution, which gives citizens access to the administration's documents, except those of the secret services.

The army, secret services and police are under the control of the civil authorities, as demonstrated by the President's dismissal of the Commander-in-Chief of the armed forces in late 1995.

Functioning of the Executive

The central institutions of the State function correctly.

Local authorities in Estonia enjoy a large measure of autonomy.

Estonia's public service has a shortage of qualified personnel, in particular in the legal field, and suffers from competition from the better-paid private sector.

The police's effectiveness has sometimes been called into question given the rise in organised crime and in the fight against corruption. Major efforts are currently being made to reorganise and modernise the force.

The secret services fall under the control of a parliamentary committee of enquiry.

The Judiciary: Structure

The independence of Estonia's judiciary system is guaranteed. Judges are appointed for life by the President of the Republic on a proposal from the National Court and can only be dismissed if they are found guilty of a crime. Subject to the approval of the President of the Republic, the National Court is competent to hear complaints against magistrates of lower courts while Parliament hears complaints against judges of the National Court on referral by the "Chancellor of the Law".

The department of public prosecutions continues to fall under the authority of the Minister of Justice under the 1993 Law.

Administrative acts are scrutinised by the "Chancellor of the Law", who is elected by Parliament for seven years on a proposal from the President of the Republic. The "Chancellor of the Law" checks the constitutional conformity of government measures and local authority acts and can intervene where he deems they are unconstitutional. Where the authority refuses to amend them, he can refer the matter to the National Court.

Estonia has no ombudsman. A government bill introducing one is currently being considered.

Vetting for constitutionality is the task of the National Court, Estonia's supreme judicial authority, which hears appeals against the judgments of the lower courts and acts as Constitutional Court. Its President is elected by Parliament on a proposal from the President of the Republic. Its members are appointed by the President of the National Court himself. Matters can be brought before it by the President of the Republic, the "Chancellor of the Law" or private citizens. The National Court scrutinises laws for conformity with the Constitution and treaties.

Functioning of the Judiciary

The major difficulties facing the justice system relate to uncertainty regarding the law applying in many areas of legislation and the inexperience of the magistracy (90% to 95% of judges have been replaced since independence).
In Estonia's institutions the National Court plays an important role in upholding democracy and the rule of law. Petitions addressed to it are rising in number, even though most of them are groundless.

1.2 Human Rights and the Protection of Minorities

Estonia has set in place a number of regulations to ensure observance of human rights and the rights of minorities. Various international conventions are also applicable, above all the European Convention on Human Rights and its main additional protocols. In accordance with Article F of the TEU, this collection of texts forms part of the *acquis*: any country wishing to join the Union must have ratified them.

Estonia, which has been a member of the Council of Europe since May 1993, ratified the European Convention on Human Rights and most of its additional protocols (with the exception of Protocol 6 on the death penalty) in April 1996. It has also granted private individuals the right to appeal to the European Court of Human Rights if they consider that their rights under that Convention have been violated.

Among other international conventions protecting human rights and minorities, Estonia has ratified the Convention against the use of torture and the framework convention on minorities. It has not signed the European Social Charter. It has ratified

the main conventions on human rights concluded under the aegis of the United Nations.
Under Article 123 of the Constitution, properly ratified treaties take precedence over national law.

Civil and Political Rights

Access to the judicial system is to a large extent guaranteed in Estonia. Although the Criminal Code provides for legal aid, it is not always available in practice.

Capital punishment has not been abolished in Estonia, where the last execution was carried out in September 1991. The President of the Republic has declared a moratorium on the application of the death penalty and the Minister of Justice has undertaken to abolish it before 1 February 1998. In November 1996, the Estonian Government also adopted a new draft penal code, since presented to the Riigikogu, that makes no provision for the death penalty.

Protection against arbitrary arrest appears to be guaranteed in so far as police custody is limited to 48 hours, after which any further detention must be decided by a court.

All citizens over 18 years old can vote in national elections. However, local elections are open to all persons legally resident in Estonia though only Estonian citizens can stand as candidates.

Freedom of association is guaranteed, as demonstrated by the large number of associations (4 000 associations and 200 foundations existing currently). While non-citizens may not join political parties, they are free to belong to associations.

Freedom of assembly is also guaranteed.

Freedom of expression is shown by a free and vigorous press (cf. the role played by the press in denouncing illegal telephone-tapping, which led to the fall of the Government in October 1995). Pluralism in the audio-visual media is ensured by the existence, alongside the public radio station and the public television channel, of 29 private radio stations and five private TV channels (two national and three local). A Radio and TV Broadcasting Council runs the public channels and appoints their managers.

The right to property is enshrined in the Constitution (Article 32) and former owners have received compensation for property expropriated under the Communist regime, although some complaints have been filed on the level of compensation granted. The courts also closely respect the right to property, as is shown for example by the decision of the National Court in 1995 to condemn the Government's nationalisation of property formerly held by the Soviet authorities, which they considered should be returned to the original owners.

Respect for privacy is guaranteed by the requirement for a warrant to be issued by a public prosecutor or a judge before any search can be made.

In February 1997 Estonia ratified the Geneva Convention on refugees and Parliament adopted a law implementing the Convention in the country. This major step forward puts an end to the previous situation in which asylum seekers were treated as illegal immigrants and frequently detained under harsh conditions.

Some cases of ill-treatment, suffered in particular by prisoners remanded in custody, have been recorded. Estonia has undertaken a modernisation programme, which is coming up against the relatively meagre financial resources available.

Economic, Social and Cultural Rights

Article 28 of the Constitution recognises the right to a minimum income and social security.

Trade union freedoms are guaranteed without restriction in Estonia, where two national federations unite most union members. Almost 30% of workers are members of a trade union.

The right to strike is recognised by Article 29 of the Constitution, but is prohibited in the civil service (State and local authorities), the armed forces, the justice system, the emergency services and in the private sector when negotiations are under way on a collective agreement or its validity.

Freedom of education and religion are guaranteed in Estonia.

Minority Rights and the Protection of Minorities

When it comes to assessing the situation of minorities in Estonia, a distinction should accordingly be made between rights and protection attendant on membership of an ethnic and cultural community irrespective of the nationality held, and differences in personal status deriving from the fact of not holding Estonian citizenship. In this respect, the definition of the concept of minority adopted by Estonia in its declaration when depositing the act of ratification of the Council of Europe's framework convention on minorities is not relevant and the situation of non-citizens also needs to be taken into consideration in this assessment.

Around 35% of the population of Estonia consists of minorities, including non-citizens, made up of 28% Russians, 2.7% Ukrainians and 1.5% Belorussians. The minorities live mainly in Tallinn and the north-eastern quarter of the country (Narva-Sillamae region), where they may account for up to 95% of the total population (Narva). Of that 35%, a group of 23% (numbering around 335 000, mainly of Russian origin) are not Estonian citizens, 8% having chosen Russian nationality and 13% former Soviet citizens now without any nationality. The Soviet Union's post-1945 policy of encouraging the settlement of Russian speakers in Estonia is largely responsible for the present situation (88.2% Estonians and 8.2% Russians in the 1934 census, compared with 74.6% Estonians and 20.1% Russians in 1959, and 64.7% Estonians and 27.9% Russians in 1979).

Under the Law of April 1995, applicants for Estonian nationality must sit an examination to test their command of the Estonian language and their knowledge of the country's history and institutions.

Since 1992, approximately 90 000 applicants have acquired Estonian nationality. Under the new naturalisation procedure introduced by the Law of April 1995, the number of naturalisations per year has fallen (around 7 000 should be naturalised in 1997 according to the Estonian authorities' forecasts). The number of candidates also seems relatively low. At this rate, a large percentage of Estonia's population will continue to remain foreign or stateless for a long time.

This situation can be explained by several factors. The examination system has often been held responsible, its difficulty being blamed for the small number of applicants. The cost of enrolling for the examination is also relatively high. In addition, the rule whereby candidates must wait one year after submitting their applications for naturalisation until they can sit the test is an obstacle which is perhaps no longer entirely justifiable given the small number of applications currently in the pipeline. Not having Estonian nationality may also have been seen as an advantage in certain cases (no liability for compulsory military service in Estonia), which may help to explain the small number of applications.

The Estonian authorities have introduced some improvements. New rules applying since 1 January 1997 have made it easier to pass. At all events, the success rate recorded (between 80 and 90%) seems satisfactory. Since 1995 too, the written examination in Estonian has been waived for elderly persons and they no longer sit the oral test.

The main weakness in the present system lies in the inadequate resources available for Russian speakers to learn Estonian in order to sit the naturalisation test. In areas where Russian speakers are in the majority, the number of teachers of Estonian is very low and the cost of enrolling for courses is high. Much effort is still required in this area if the rate of naturalisations is to be kept up in the future. Since 1996 the PHARE programme has provided support for measures undertaken by the Estonian Government (a programme costing ECU 1.4 million was launched in December 1996).

The Estonian authorities should consider means to enable stateless children born in Estonia to be naturalised more easily, particularly with a view to the impending entry into effect of the European Convention on nationality agreed within the Council of Europe.

The 1993 Law lays down clear rules on the status of "non-citizens". "Foreigners' passports" are being issued and should resolve some practical difficulties, in particular as regards freedom of movement.

The Estonian authorities have systematically issued temporary residence permits (valid for five years) to all foreigners, including residents in Estonia prior to

1 July 1990. Issue of permanent residence permits would have had a much more positive impact and would have carried more practical benefits, such as the right to invite family members or friends to Estonia. However, the Estonian authorities have undertaken to renew such permits automatically on expiry and the Government has tabled an amendment in Parliament to the law on foreigners so some can be given permanent residence permits as from 1998.

Foreigners are subject to some restrictions: Estonian citizenship is necessary to sit on the boards of some companies or to belong to a political party. While only Estonians can be civil servants under the Law of January 1995, transitional provisions have been adopted to allow non-nationals to keep their posts while applications for naturalisation are in progress (e.g. in the police force). Lastly, non-citizens do have the right to vote in local elections, a right enjoyed in few countries in Europe today and which effectively contributes towards the integration of non-citizens and the protection of their rights.

On the whole, the rights of the Russian-speaking minority (both with Estonian nationality and without) are observed and safeguarded. Furthermore, no major problems affect relations between Estonians and the Russian minority.

There are no rules granting minorities special representation in Parliament. However, six members belonging to the party representing the interests of the Russian-speaking minority sit in the Riigikogu. Similarly, under the voting rights granted to foreigners in local elections, the Russian minority has representatives on the elected councils of the towns where it makes up a sizeable percentage of the population (e.g. 16 of the 64 town councillors in Tallinn). In July 1993, a round table bringing together representatives of all the minorities was set up to consider matters affecting them. The Law of October 1993 authorises minorities to set up autonomous institutions to preserve their culture and traditions. The present Estonian Government has also appointed a Minister for inter-ethnic relations.

National languages can also be used in the courts and in dealings with the administration in districts where the minority represents a majority of the local population. The Russian minority also has a large number of media using its national language as a vehicle (three dailies and two weeklies in Tallinn, three radio networks, including a public one, and many Russian-language broadcasts on State and private TV channels).

In the field of education, Estonia offers teaching in Russian at all levels funded by the State. This system, planned only up to the year 2000, should be maintained without time limit in the future. The shortage of teachers of Estonian, in particular in areas where Russian speakers are numerous, remains crucial and is likely to obstruct the present plans of the Ministry of Education to increase the number of courses taught in Estonian in schools for the minorities. The Government is currently considering a programme under which schoolchildren in schools where teaching is in Russian can be helped to reach the level of skill in Estonian required for entry to public tertiary education.

1.3 General Evaluation

Estonia's political institutions function properly and in conditions of stability. They respect the limits on their competencies and cooperate with each other. Elections in 1992 and 1995 were free and fair, and in the latter case led to an alternation of power. The Opposition plays a normal part in the operation of the institutions. Efforts to improve the operation of the judicial system and to intensify the fight against corruption need to be sustained.

There are no major problems over respect for fundamental rights. But Estonia needs to take measures to accelerate naturalisation procedures to enable the Russian-speaking non-citizens to become better integrated into Estonian society.

Estonia presents the characteristics of a democracy, with stable institutions guaranteeing the rule of law and human rights.

2. Economic Criteria

In examining the economic situation and prospects of Estonia, the Commission's approach is guided in particular by the conclusions of the European Council in Copenhagen in June 1993, which stated that membership of the Union requires "the existence of a functioning market economy, as well as the capacity to cope with competitive pressure and market forces within the Union".

This part of the Opinion therefore gives a concise survey of the economic situation and background, followed by a review of Estonia's progress in key areas of economic transformation (liberalisation of the price and trade system, stabilisation of the economy, structural change, reform of the financial sector) as well as its economic and social development. It concludes with a general evaluation of Estonia in relation to the criteria mentioned by the European Council and a review of prospects and priorities for further reform.

2.1 The Economic Situation

Background

Estonia, with a population of 1.5 million, had in 1995 a gross domestic product (GDP) of about 6 billion ECU (expressed in purchasing power parity); the size of its population was 0.4 percent of that of the Union, while the size of its economy was only 0.1 percent. GDP per head was about 23 percent of the EU average in purchasing power terms. Average monthly wages at the end of 1995 were estimated at 179 ECU.

Estonia has been an observer to the GATT since June 1992 and requested accession in March 1994. Its application to become a member of the WTO is currently being examined.

Progress in Economic Transformation

In the inter-war period, Estonia was an independent state, and highly integrated in the world economy. In 1940, the country was forcibly annexed by the Soviet Union and subsequently central planning was introduced. Over fifty years of Soviet rule destroyed Estonia's economic integrity. The resulting structure of the economy was based on the inflow of labour, mainly from Russia, and on strong trade and production links with the USSR. It changed the country from an agricultural economy into one dominated by heavy industry. A relatively well-developed infrastructure, combined with a skilled labour force, prompted the establishment of relatively sophisticated industries, making Estonia one of the most advanced Republics of the USSR.

Pressure for economic and political independence was always present in Estonia. It gained momentum in the 1980s and contributed to the approval of a law on economic autonomy by the Supreme Soviet of the USSR in 1989. The law paved the way for economic reforms in various areas, including price and wage determination, fiscal policy and the financial sector. The economic transformation reached a critical stage with the currency reform and the introduction of a national currency in June 1992. Despite repeated changes in government, the basic course of reform has remained unchanged so far. It is based on a liberal economic policy, fostering competition and openness of the economy, with a minimal degree of state intervention. The country has seen rapid progress in domestic economic liberalisation, privatisation and the introduction of a liberal external payments regime for both current and capital transactions

As in other Soviet republics, state and, to a lesser extent, collective ownership were the dominant forms of ownership in Estonia. Private entrepreneurship was practically non-existent. After independence in 1991, the private sector has developed very rapidly. Almost all small and large enterprises have been privatised and the government has embarked upon an ambitious scheme for selling the remaining state assets. The share of the private sector in GDP was estimated at 70% in mid-1996.

Foreign Direct Investment

Foreign direct investment has been particularly strong, with amounts per capita over the period 1989-1996 accumulating to 366 ECU (source: EBRD). However, the performance of 1996 was far less satisfactory. Foreign direct investment decreased to only 55 million ECU compared to 156 million ECU in 1995, and from 5.6% of GDP in 1995 to 1.6% in 1996. There are two main reasons explaining this fall: a change in the official classification which tightened the conditions for defining FDI and the slow-down of the privatisation process. Inflows of portfolio investment and foreign bonds issues by banks went up in 1996. Also, Estonian FDI abroad sharply increased last year, in particular in the other Baltic countries and in Russia.

Economic Structure

Agriculture has traditionally been one of the most important sectors of the Estonian economy. Today it accounts for 8% of the total Gross Value Added (GVA) and employs 7% of the labour force. The food processing industry contributes about one third of gross industrial output. Fishery is the third largest food processing industry. In a bold move, trade tariffs were abolished completely at the outset of the transition process - a radical application of the general principle of free trade to agricultural policy.

The restitution of property rights on land has produced a number of relatively unprofitable private farms, with an average area of about 23 hectares in 1996. The average size of farms has been falling in recent years. In fact, despite some mergers which have followed the initial restitution, it will take years to restore efficient and competitive private farming.

The **industrial** sector grew rapidly during the Soviet era. In 1991, it accounted for about 40% of GDP and over 30% of employment. The transformation from an overly energy-intensive production structure, which heavily relied on CMEA markets, to a pattern which is more in line with the country's natural endowments and comparative advantage is still under way. Industrial production is estimated to have contracted by more than 60% between 1992 and 1994, due to the disruption of traditional trade links, the terms-of-trade shocks, and the imposition of trade barriers by Russia. As a result, the share of industry in GVA has declined to 23% in 1995. Industry's share of employment (excluding mining, energy and construction) stood at 22.5% in 1996.

The **services** sector has been expanding at a very rapid pace and accounts for about two-thirds of the total gross value added. Wholesale and retail trade, tourist services, transport and communications are the most dynamic activities. Tourism in particular has become very important for Estonia. In 1996 alone, 2.5 million tourists visited the country, 67% of whom where Finnish. Most of the tourists come for a one-day visit. Tourism receipts are extremely important for the balance of payments: in 1995, the surplus on travel services represented 70% of the surplus of services and 39% of the trade deficit. For the three first quarters of 1996, the figures were 75% and 41% respectively.

Main indicators of economic structure
(all data for 1996 unless otherwise indicated)

Population	*million*	1.5
GDP per head	*PPS-ECU (1995)*	3900
as % of EU-15 average	*per cent (1995)*	23
Share of agriculture in:		
gross value added	*per cent (1995)*	8
employment	*per cent (1995)*	7
Gross foreign debt/GDP	*per cent*	6
Exports of goods & services/GDP	*per cent*	73
Stock of foreign direct investment*	*billion ECU*	0.6
	ECU per head	366

** FDI stock converted at end-1996 exchange rate of 1ECU=$1.25299*

Source: Commission services, national sources, EBRD

The share of small and medium-sized enterprises has increased rapidly, especially in the export sector. Because of problems with the registration of enterprises, all companies will have to renew their entries on September 1, 1997. More than half of the entries in the old register, which will be replaced by the Trade Register, concerned shell companies that were no longer operating. The new requirements are expected to bring about a rise in the number of limited liability companies and a decline in the number of share companies.

Liberalisation

Price Regime

Price liberalisation started in 1989 and was almost completed in 1992. Remaining price controls affect land and forestry, oil shale, medicines and public services. The prices of a limited number of services (e.g., rents and public transport) are controlled at the municipal level. Administrative price regulations apply to companies with monopoly power in such areas as the supply of energy, water and sewerage services. Together these goods and services still make up some 25% of the basket on which the consumer price index is calculated. Administrative decisions, such as the lifting of price controls on alcoholic beverages in December 1995, can therefore have a sizeable impact on month-to-month inflation rates.

Trade Regime

Estonia proceeded to dismantle the very restrictive trade regime inherited from the Soviet Union immediately after independence. The country has today one of the most liberal trade regimes in the world. Import duties apply only to furs, and excise taxes are levied only on cars, motorcycles, cycles and recreational boats. However, introduction of protection on a limited number of agricultural products is currently under consideration. This should not be considered as a change in the liberal orientation of trade policy but rather as a response to the very specific problems of the agricultural sector.

Quantitative restrictions have been completely abolished, as have import subsidies. Export licenses are not restrictive, but serve only for statistical purposes. Export tariffs have been removed completely, with the exception of those on items of cultural value. There are no export subsidies, and the few remaining export quotas were eliminated at the end of 1994.

Estonia has had observer status in the WTO (and before that in GATT) since June 1992. A working group to prepare for full membership has started its activity in March 1994. A free trade agreement between Estonia and the EU has been in force since January 1, 1995. Estonia has reached free trade agreements with the EFTA countries, and has applied for membership to the Central European Free Trade Agreement (CEFTA). It also has a number of other bilateral agreements. Since 1 April 1996, a free trade agreement with its Baltic neighbours, Latvia and Lithuania, is in force. On 1 January 1997, this agreement was extended to trade in agricultural products. The objective is to establish a full customs union at a later stage.

Foreign Exchange Regime

Since Estonia introduced a currency board (cf. below) in 1992, its national currency, the kroon, has been fully convertible for current account transactions.

This was formalised in 1994, when Estonia accepted the obligations of the IMF's Article VIII. The central bank guarantees conversion of kroon bank notes and reserve deposits into DM, and vice versa, at a rate of 8 Estonian kroons for one DM. Transactions in 13 other foreign currencies are supported. Individuals may open currency accounts in domestic banks or abroad. By contract, most repayments on loans from domestic banks are denominated in DM. The Law on the Security of the Estonian kroon stipulates that Eesti Pank (the central bank) has no right to devalue the currency. Such a decision can only be taken by parliament, which is meant to reinforce the credibility of the exchange rate.

Stabilisation of the Economy

Domestic

After the sharp contraction of output which followed independence, economic recovery started in the second half of 1993. Estonia has experienced fairly fast growth thereafter, reaching 4.3% in real terms in 1995. Preliminary figures for 1996 indicate that real growth should have been of the same magnitude. However, a comprehensive assessment of the economic performance of the country in the recent past is made particularly difficult by the infancy of the statistical apparatus.

Since 1992, Estonia's economic policy has been remarkably consistent. To a large extent, this reflects the consensus among policy-makers on the basic features of a strategy aimed at modernisation and integration in the European and world economy. Also, it reflects the disciplines imposed by the currency board system. Indeed, the currency board, introduced in June 1992, limits the scope for the authorities to intervene in economic policy. Under this system the authorities voluntarily give up discretionary control of the money supply, the exchange rate is pegged, and the increase in base money needs to be fully matched by an increase in foreign exchange reserves. Moreover, in the currency board system as it has been adopted in Estonia, neither local authorities nor the central government can borrow from the central bank. Central bank lending to commercial banks is restricted to well-defined emergency situations.

Main economic trends		1994	1995	1996
Real GDP growth rate	*per cent*	-1.8	4.3	4.0
Inflation rate				
Annual average	*per cent*	47.7	29.0	23.1
December on December	*per cent*	41.7	28.9	14.8
Unemployment rate, end-year	*per cent (ILO definition)*	7.6	NA	10.2*
General government budget balance	*per cent of GDP*	1.3	-0.8	-1.6
Current account balance	*per cent of GDP*	-7.1	-5.1	-10.2
Debt/export ratio	*per cent*	9.1	10.3	8.8
Foreign direct investment inflow	*per cent of GDP*	9.2	5.6	1.6

* *Fourth quarter*

Source: Commission services, national sources, EBRD

The currency board has worked well in ensuring exchange rate stability and in reducing inflation. It has also contributed to fiscal discipline. Inflation came down rapidly after the introduction of the currency board system. After a lull in 1995 and in the early months of 1996, which can be explained by deregulation and increases in indirect taxation, consumer price inflation resumed its downward path and has been falling rapidly since the end of 1996, reaching 9.1% on a year-on-year basis in March 1997. Export prices have also risen moderately.

Registered unemployment is quite low and rather stable. The number of unemployed job-seekers that were registered at employment offices in February 1997 amounted to 4.4% of the labour force. The number of people entitled to receive unemployment benefits is much smaller. The labour force has been contracting, due to the emigration of part of the Russian population and the reduction in the participation rates. However, when using the ILO definition, unemployment is much higher, and reached 11.6% at the end of the first quarter of 1997.

<u>External</u>

The external sector is characterised by an increasing trade deficit, which in 1996 exceeded 24% of GDP - a truly extraordinary figure (change in statistical methodology in 1996 is partly responsible for a worsening in the overall balance). The bulk of exports concern processed goods, and a very significant shift has taken place from foodstuffs to electronics and computer equipment. One third of exports is directly linked to imports, either in the form of processing or in the form of transit trade. A strong surplus on the services balance has so far mitigated the negative effect of the trade deficit on the current account - which has nevertheless been in deficit since 1994. The surplus on services is largely, and increasingly, due to the spending of Finnish tourists.

Foreign currency reserves increased considerably since the introduction of the currency board. The basis was formed by the restitution of historical gold reserves by Western central banks in 1991. At present levels, however, the reserves cover less than three months of imports.

Estonia had no legacy of foreign debt from the former Soviet Union. At the end of 1996 the stock of external debt amounted to about 239 million ECU, approximately 6.4% of GDP. The debt-to-exports ratio remained almost constant at a low level, as did the debt-to-debt-service ratio.

Structural Change

Foreign Trade

Dependence on the former Soviet market has been dramatically reduced, and trade has been progressively reoriented to western markets. EU countries now account for more than two thirds of Estonian trade. Finland has replaced Russia as the main trade partner, Russia remains a major importer of Estonian goods, although Russia has increased tariffs. A large part of the exports concerns processed goods. In 1996, the continuing appreciation of the local currency against other European currencies has led to a small reorientation of trade towards other transition countries and non-European regions. For example, exports to transition countries in eastern and central Europe increased from 14% to 15.6% of total exports and the share of Asia in the Estonian trade also rose significantly.

However, the export base is rather limited: the share of re-exports in Estonia's exports is high (33.7% in 1996 and 45.9% in the first quarter of 1997). This reflects Estonia's position as a transit centre and also as a favourable processing base (essentially for the textile industry) because of its low labour costs. Wood and wood products, processed food products and textile products constituted more than 40% of all exports in 1996.

A large inflow of foreign direct investment and other capital has kept the overall balance of payments in surplus up to now.

Labour Market

Employment has declined steadily since 1992, with major job losses concentrated in industry and agriculture. However, a sharp reduction in the size of the labour force (due to emigration by the Russian part of the population), emigration of Estonian workers (mostly to Finland), and reduced participation ratios have contributed to limit the impact on unemployment. The unemployment rate is estimated to be close to 5%, but this does not include the part of the labour force that is seeking work because it is only employed on a short-term basis. In the context of a recent survey, and using the ILO methodology, unemployment was estimated to represent 11.6% of the total labour force in the first quarter of 1997.

Employers contribute 33% of wages and salaries towards social security. Employers are not allowed to pay wages under the minimum level applying to full-time government employees. The minimum hourly wage is 4 kroon and the minimum monthly wage is 680 kroon (45 ECU).

Public Finances

The centrepiece of the budgeting process in Estonia is the concept of balanced budget at the level of the central government. So far this principle has been respected.

The tax structure has undergone several modifications. VAT was first introduced in 1992. Rates were modified in 1994, and VAT now is levied at 18%. Personal and corporate income tax are levied at a flat 26% rate. A minimum tax-free allowance is granted for personal income tax. The overall tax burden is estimated at 34-36% of GDP. The share of taxes in the total wage bill is estimated to have been 41% in the fourth quarter of 1995, of which 60% concerns social security contributions.

Substantial decentralisation has been introduced after independence. One-third of general government expenditure is spent by local authorities. In fact, under the pressure of heavy spending by local authorities, the general government deficit in 1996 increased to an estimated 1. 6% of GDP, a departure over the previous years' balanced budgets.

Enterprise Sector: Privatisation and Enterprise Restructuring

Privatisation has advanced fast, and by the end of 1996 practically all large enterprises had been sold, with the exception of those in the transport, telecommunication and energy sectors. The privatisation process is handled by the Privatisation Agency and is based on the privatisation law passed in 1993. Although the law provided for various forms of sales of assets, privatisation has been carried out mostly through bids with preliminary negotiations, open to foreign bidders. This strategy has favoured strategic investors over management and employees, and it has helped to make Estonia very attractive to foreign direct investment.

Small-scale privatisation was almost completed by the end of 1995. It has been regulated by a law, passed in 1991 and amended in 1992, which allowed for employee buy-outs and auctions. Privatisation vouchers have been issued to the public. They can be used for the privatisation of housing and land, and for the purchase of shares. Only limited trading of vouchers is allowed. Housing privatisation was launched at the end of 1993. Most housing was expected to be privatised against privatisation vouchers, but due to uncertainties over ownership titles caused by the restitution process it has proceeded rather slowly. The government is also committed to compensate, by restitution or with vouchers, all owners of property in Estonia prior to 1940.

Future privatisation plans focus on utilities, including firms in the energy sector, the part of the Estonian telecommunications company which has not yet been privatised, railways and ports. The state has the intention to divest firms where it still maintains minority stakes, such as Estonian Tobacco, Estonian Gas, and others. Restructuring of privatised enterprises has been left to investors, mostly through business plans submitted at the time of bidding.

Bankruptcy legislation was passed in 1992 and a large number of bankruptcy procedures has been initiated, especially concerning agricultural co-operatives.

Financial Sector

A two-tier banking system, separating central bank functions from commercial banking activities, was formally established in 1989, but became fully operational only in 1992. The nature and extent of the central bank's activity are determined by the monetary reform of 1992 which established a currency board and confined its role to supervision and prudential regulation. The central bank is completely independent from the government, although it is accountable to parliament. Lending to the government is prohibited by law.

Under the currency board arrangement there is no room for discretionary monetary policy. The central bank has neither monetary targets, nor credit restrictions for banks, nor discount rates.

Estonia's financial system is dominated by the banking sector while the capital market and non-bank financial institutions are much less developed. The financial sector has already gone through a process of rationalisation. The banking crisis of 1992, which was followed by several bank failures in the period up to 1994, prompted the reorganisation of the sector. This has been followed by a phase of consolidation, in which the involvement of the state in the banking sector has been greatly reduced. At present, the sector comprises 13 domestic banks, 1 branch of a foreign bank and 5 foreign banks' representative offices, but the number of banks should decline further in the coming months as the industry continues its consolidation; in fact, a new merger between two banks was approved in April 1997.

Central bank supervision and prudential regulation have been reinforced. All banks meet at present the capital adequacy standard. The Bank of Estonia continues to gradually increase the minimum capital requirement for banks (which will reach 75 million kroons at the end of 1997) in an effort to force a consolidation of the banking system. A draft law on deposit insurance is being prepared.

The total assets of the banking sector amounted to 22 billion kroons at the end of 1996. The share of non-performing loans in banks balance sheets dropped considerably as asset quality and risk management improved. The improvement in asset quality was more pronounced in banks with state participation than in the private banks. At the end of March 1996 private companies made up 68 per cent of the banking system loans. Although the segment of individual borrowers is starting to increase, private companies remain the key borrowers. There was a lengthening of the average maturity of bank loans to 2.7 years at the end of 1995. This trend accelerated in 1996 and early 1997 as banks were able to obtain longer-term resources, notably in foreign currencies. Loans to state enterprises have been reduced from almost 30% of total outstanding loans in 1993 to less than 4% in 1996. The modernisation and sophistication of the banking sector is progressing continuously: 20-year housing loans have been introduced recently while the number of credit cards has expanded strongly.

State ownership in the sector has declined considerably throughout the restructuring process of the Estonian banking sector in the 1990s. At present the state has some shareholdings in 2 credit institutions.. The government intends to end its involvement in banks in the coming years. Branches of foreign banks can be opened and operated under the same conditions that are stipulated for domestic banks. At the end of 1995 direct foreign ownership was 29.2 per cent and other foreign ownership 5.7 per cent.

The capital market and non-bank financial institutions are less developed compared to the banking sector. The privatisation of state-owned companies contributed to the emergence and development of the securities market. The Tallinn Securities Exchange started its operations on 31 May 1996, providing substantial improvements in the organisation of the secondary market. The first public issue of shares was carried out in 1991. The capitalisation of the stock market represented about 12% of GDP at the end of 1996. However, despite recent progress (a number of corporate and municipal entities have raised funds on the international capital markets), it remains difficult for local companies to get access to long-term finance which is needed for long-term investment. As the government budget has been in balance for the last three years, there are no outstanding treasury bills. The main instrument actively traded on the money market is the Bank of Estonia certificate of deposit whose issuance started in 1993.

Economic and Social Development

Social Indicators

Life expectancy rates have recovered from the initial worsening after 1989. Although they remain considerably higher than in the EU, infant mortality rates are no longer going up. The population has been declining since 1991. This is mostly due to the emigration of part of the Russian-speaking minority, which in 1991 represented about 30% of the total population, but also to a negative natural increase. The low unemployment benefits provide little incentive to register as unemployed. A recent household survey suggest that 10% of the labour force could be searching for a job. An increase in the retirement age by five years, to be introduced over a ten-year period, has been agreed to counteract the decline in the labour force. In 1995, the retirement age was 56 for women and 61 for men.

Education is fairly good. Almost 80% of the working population has higher secondary education or more. Enrolment rates are comparable to those of most European countries. Ten per cent of the total number of pupils today is in university. Quality is high in specific areas, such as mathematics and science.

Regional and Sectoral Differences

Business activity is liveliest in Tallinn and the north-western part of Estonia and most depressed in the north- and south-eastern corners of the country. Employment in north-eastern Estonia used to be heavily dependent on energy generation, heavy industry and the Soviet military-industrial complex. Unemployment in this region has risen sharply, probably to more than 15% of the labour force after the closure of the factories involved. Unemployment in the south-eastern region is also probably higher than 15%, but there it is due to the decline in agricultural production, which is the main activity in southern Estonia.

Small businesses flourish in the north-western part of the country, including a wide area around Tallinn, and in the transit area to Russia. As a result of the disappearance of heavy industry, long-term unemployment is high in both south-east and north-east Estonia. South-eastern households have the lowest income.

Six major regional programs were approved by the government in 1995, modelled in part on the regional objectives of the EU. One program is aimed in particular at the integration of the Russian speaking population in East-Virumaa, the most north-eastern region. A secondary objective of the same program is to ensure the efficient use of natural resources (oil shale).

2.2 The Economy in the Perspective of Membership

Introduction

The European Council in Copenhagen in 1993 defined the conditions that the associated countries in central and eastern Europe need to satisfy for accession. The economic criteria are:

- the existence of a functioning market economy;
- the capacity to cope with competitive pressure and market forces within the Union.

These criteria are linked. Firstly, a functioning market economy will be better able to cope with competitive pressure. Secondly, in the context of membership of the Union, the functioning market is the internal market. Without integration into the internal market, EU membership would lose its economic meaning, both for Estonia and for its partners.

The adoption of the *acquis,* and in particular the internal market *acquis*, is therefore essential for a candidate country, which must commit itself permanently to the economic obligations of membership. This irreversible commitment is needed to provide the certainty that every part of the enlarged EU market will continue to operate by common rules.

The capacity to take on the *acquis* has several dimensions. On the one hand, Estonia needs to be capable of taking on the economic obligations of membership, in such a way that the single market functions smoothly and fairly. On the other hand, Estonia's capacity to benefit fully from the competitive pressures of the internal market requires that the underlying economic environment be favourable, and that the Estonian economy have flexibility and a sufficient level of human and physical capital, especially infrastructure. In their absence, competitive pressures are likely to be considered too intense by some sections of society, and there will be a call for protective measures, which, if implemented, would undermine the single market.

The capacity and determination of a candidate country to adopt and implement the *acquis* will be crucial, since the costs and benefits of doing so may be unevenly spread across time, industries and social groups. The existence of a broad based consensus about the nature of the changes to economic policy which membership of the Union requires, and a sustained record of implementation of economic reforms in the face of interest group pressure reduce the risk that a country will be unable to maintain its commitment to the economic obligations of membership.

At the level of the public authorities, Membership of the Union requires the administrative and legal capacity to transpose and implement the wide range of technical legislation needed to remove obstacles to freedom of movement within the Union and so ensure the working of the single market. These aspects are examined in later chapters. At the level of individual firms, the impact on their competitiveness of adopting the *acquis* depends on their capacity to adapt to the new economic environment.

The Existence of a Functioning Market Economy

The existence of a market economy requires that equilibrium between supply and demand is established by the free interplay of market forces. A market economy is functioning when the legal system, including the regulation of property rights, is in place and can be enforced. The performance of a market economy is facilitated and improved by macroeconomic stability and a degree of consensus about the essentials of economic policy. A well-developed financial sector and an absence of significant barriers to market entry and exit help to improve the efficiency with which an economy works.

Estonia can be regarded as a functioning market economy. The good macroeconomic performance observed over the past few years is the result of rapid progress in economic liberalisation and privatisation. A new and rigorous policy framework has been enshrined in law, and any loopholes tend to be closed off rather quickly. The currency board system and the generally prudent stance on fiscal policy, have helped to maintain internal equilibrium and to attract large capital inflows.

Price setting has been liberalised to a large extent, in labour and capital markets as well as in output markets. The imposition of hard budget constraints, by cutting subsidies and putting a stop to easy credits to enterprises, and the rapid privatisation have strengthened the role of market forces in investment and production decisions. The liberal trade policy, openness to foreign investment as well as the emergence of a strong banking sector ensure that market signals and hard budget constraints are transmitted fairly rapidly unto the economy.

The consensus on the basic features of the economic strategy, the consistency in policy-making despite repeated changes in government as well as the strengthening of the economic links with current EU member States have all contributed to a favourable environment for investment and economic activity. While the growing external imbalances are a serious cause for concern and need to be addressed in order to maintain the credibility of the currency board system, macroeconomic stability has strengthened the market mechanisms. Good progress in the future implementation of the EC-Estonia Free Trade Agreement should also help to complete the functioning of the market economy.

The Estonian legal system has its roots in the period of pre-war independence. It is similar to German law, in particular where private law is concerned. In restoring and renewing the legal system, the laws enacted in EU Member States have served as examples.

The prospect of EU integration has acted as a major impetus for gearing up the process of administrative reform. The process is guided and co-ordinated by government commissions at the level of ministers and top civil servants. It is recognised that a large group of middle and lower ranking civil servants involved in the implementation of the new laws and procedures will need more training to adapt to the requirements of a more market-oriented public administration. The authorities are also planning to significantly increase spending linked to transposition of EU legislation and modernisation of Estonia's public administration. The government is also keenly aware that the fiscal restraints on the central government will need to be extended to the local authorities. Commitment to reform and modernisation of the economy is not disputed among Estonia's political forces.

The Capacity to Cope with Competitive Pressure and Market Forces

It is difficult, some years ahead of prospective membership, and before Estonia has adopted and implemented the larger part of Community law, to form a definitive judgement of the country's ability to fulfil this criterion. Nevertheless, it is possible to identify a number of features of Estonia's development which provide some indication of its probable capacity to cope with competitive pressure and market forces within the Union.

This requires a stable macroeconomic framework within which individual economic agents can make decisions in a climate of a reasonable degree of predictability. There must be a sufficient amount of human and physical capital including infrastructure to provide the background so that individual firms have the ability to adapt to face increased competitive pressures in the single market. Firms need to invest to improve their efficiency, so that they can both compete at home and take advantage of economies of scale which flow from access to the single market. This capacity to adapt will be greater, the more firms have access to investment finance, the better the quality of their workforce, and the more successful they are at innovation.

Moreover, an economy will be better able to take on the obligations of membership the higher the degree of economic integration it achieves with the Union ahead of accession. The more integrated a country already is with the Union, the less the further restructuring implied by membership. The level of economic integration is related to both the range and volume of goods traded with member states. Direct benefits from access to the single market may also be greater in sectors where there are a sizable proportion of small firms, since these are relatively more affected by impediments to trade.

Estonia has made great progress to improve the capacity of the economy to cope with competition and market forces within an enlarged Union. The rapid and successful transition of the Estonian economy thus far is not merely a result of making the right policy choices, and of following with resolve a clear medium-term strategy of structural reforms. Estonia has always benefited from its location between eastern and western Europe. The allocation of capital and labour was less distorted than in other states of the former Soviet Union. This has allowed exports of processed goods and of the light manufacturing industries to expand rapidly, without the need to renew the capital stock completely. The switch of exports markets from the East to the West has been facilitated by the initial setting of the exchange rate and the maintenance of a favourable edge in terms of unit labour costs. The prices of traded goods have risen much less than the prices in the sheltered sector of the economy.

Estonia has a number of comparative advantages which should help the country compete in the context of the Single Market. Light industries such as clothing, textiles, wood and electrical construction are already expanding strongly, although the restructuring of some of these sectors is far from being completed. The wood industry in particular appears to be well placed to perform strongly in the Single Market: wood is abundant (almost 48% of Estonia's territory is covered with forests), FDI from Nordic countries is helping modernise the production base, skilled labour is abundant and wages are still relatively low. Exports of wood and furniture have been buoyant and the country had a substantial trade surplus in these categories in 1996. The rapid modernisation of this sector is an encouraging sign of Estonia's capacity to face the competitive pressures of the single market.

Transport, travel and financial services represent other promising and relatively strong sectors of the economy, which would perform well in the context of the single market. The emergence of a healthy banking and financial services sector, as well as its gradual consolidation and expansion in neighbouring countries, is a positive indication of the capacity of Estonian managers to adapt to new circumstances and take advantage of market opportunities. The modernisation of the transport infrastructures, with the help of multilateral lenders, should help Estonia develop its activities as a transport hub and goods processing centre.

The degree of trade integration and the nature of trade with the Union suggests that Estonia is well placed to cope with competitive pressures within the single market. In 1996, the EU was the largest trading partner of Estonia in 1996, accounting for 65% of imports and 51% of exports. Moreover, despite the importance in value of exports of wood, furniture and textiles, exports have become less concentrated and intra-industry trade is increasing. For example, compared to the same period of 1995, EU imports of machinery and electrical apparels have grown faster in the first six months of 1996 than EU exports of the same products. During the same period, wood products and textiles have remained constant as the percentage of EU imports from Estonia. Estonia industry has succeeded in exporting other goods to the West (including electronic products) because of improvements in quality standards and close business relationships with western companies. Another positive indication is the growth of Estonian exports on the competitive and dynamic markets of Asia, although these exports still represent very small quantities.

However, the export base remains limited, and can be easily eroded if inflation continues to be higher than in the countries which are the main importers of Estonian goods. With the complete liberalisation of external trade, and the firm commitment of the government to a fixed exchange rate, it would be difficult for Estonian exporters to adjust to a fall in foreign demand. The external position of Estonia therefore has to be regarded as rather vulnerable. It is clear that any increase in real wages exceeding or preceding labour productivity improvements in the open sector of the economy would risk to jeopardise the export position.

The continuation of foreign direct investment is crucial to the Estonian economy, both as a means to finance the current account deficit under the currency board system and as a means to renew the existing capital stock and diversify the industrial base. Roughly one third of all Estonian firms is relying on foreign capital. The share of foreign capital in these firms is 65%, on average, and most of them are engaged in export activities. Despite the fall of 1996, there are good reasons to believe that the inflow of capital will increase again in 1997 and 1998. The entry of foreign banks on the Estonian financial market is cautiously encouraged and the Estonian banks are gradually extending their range of services.

Prospects and Priorities

The Estonian authorities are guided by some clear principles and a strong commitment to integration in the European and World economy. The strengthening of the private sector, in particular by the emergence of small and medium-sized enterprises, is the main priority. As announced in early February 1997, the authorities intend to complete the privatisation of the industrial sector and to start with the privatisation of large infrastructure companies. Privatisation proceeds are primarily used to set up property reform, housing and environment funds. The rigorous monetary and fiscal framework will be maintained and its legal basis will be solidified. Other priorities of the government are the development of the financial sector and of anti-monopoly safeguards and the promotion of investment and exports.

Estonia has reached the stage where mainly land and infrastructure enterprises are left to be privatised, but these last privatisation's are far from being unproblematic. Progress in land reform has been slow and this has been an obstacle to the privatisation of residential property, agricultural land and undeveloped land which otherwise would be available for greenfield investment. It has been legally possible for anyone to purchase land since 1991, but in practice very little of the total land available has been privatised. The government has had great difficulty in reconciling the rights of the original owners with the interests of prospective investors. The programme of property restitution has been unexpectedly lengthy and slow. Although the validity of claims for the large majority of properties has been resolved, property which has actually been returned to legitimate owners, or vouchers issued as compensation, covers only a very small part of the total. Fortunately, this is no longer holding up the privatisation of existing enterprises, since the practice has been to lease the land to the buyer of the physical capital pending the settlement of any disputes. Nevertheless, it is far from clear how these disputes will be resolved in the end.

Privatisation of public utilities is complicated because of their size and their essentially monopolistic character. The government is now focusing on energy providers, to be followed by railways, ports and telecommunication companies. The first step is to split the state enterprises into companies that are ready to face competition, and activities which should remain in state hands. The next step is to put an effective regulatory framework in place for establishing prices. This is a particular problem in the area of energy pricing, complicated by the necessity, for environmental reasons, to switch from oil shale to natural gas and other domestically unavailable sources of energy.

Although the whole process is not likely to be completed before the end of this century, implementation has started with the 1997 privatisation programme. According to the government's plan, the Estonian Railways will be divided into four subsidiaries by September 1997, which will then be privatised separately. Other monopolies and infrastructures companies put up for sale in 1997 include Estonian Energy, Tallinn Port and Estonian Oil Shale Mining company. However, the privatisation of infrastructure enterprises may take even longer than that of energy companies, since it is unclear which parts should remain in state hands.

A problem of a different nature is the autonomy of local authorities. They are relatively free to spend their share of general government revenue, which is largely collected at the level of the state. Up to 1996 local governments were allowed to borrow abroad, whereas the central government was not. This loophole in the law has been plugged, but this may lead to higher claims by local authorities on general government revenue.

The main risk on the macroeconomic side is that at some point in time it may become difficult to finance the rising current account deficit. Indeed, in 1996, the trade balance showed a rising deficit, which surpassed the level of 20% of GDP. Because the nominal exchange rate vis-à-vis the D-mark is kept unchanged, as long as inflation in Estonia exceeds that in Germany, export price competitiveness is continuously eroded on the markets with currencies linked to the DM. Data on the evolution of the real effective exchange rate of the kroon since July 1992 show a gradual but clear appreciation of the kroon. This is the result of two opposite trends: a sharp real appreciation vis-à-vis Western trading partners (although, more recently, the real exchange rate has depreciated against the dollar), partially offset by a depreciation vis-à-vis the other Baltic republics and former Soviet partners. To the extent that Estonia wants to reorient its trade to the West, this may increasingly become a problem, as demonstrated by the evolution of the structure of trade in 1996, when the share of the EU in total trade stagnated. The export base is rather limited, and a relatively large part consists of processed goods.

A deficit which is rapidly increasing should not necessarily be cause for concern, especially as long as it reflects mainly investment activity and is not accompanied by significantly higher inflation. In the case of Estonia, however, the widening trade deficit is caused by a deceleration in export growth, accompanied by an increase in imports involving a shift towards a greater proportion of consumer goods. While the deficit was largely financed up to 1996 by the inflow of foreign direct investment, this was not the case in 1996. Moreover, a large part of the deficit was financed by Finnish tourists spending and by what could be interpreted as speculative capital flows, attracted by high interest rates on kroon deposits. A sharp fall of tourism receipts as well as a turnaround of international investors' positive views on Estonia's economic and political stability would put a severe constraint on the overall balance of payments and represent a source of weakness for the economy. On the other hand, Estonian residents have heavily invested in government bonds of other Nordic and Baltic countries.

Serious problems are present also in the farming sector, where output has been declining steadily since independence. Rural interest groups blame excessive laissez-faire policies for high unemployment and falling living standards in the countryside. While it is true that domestic agriculture has faced very stiff competition from external producers, it is important that if tariffs are introduced they do not delay the necessary modernisation of the sector. In fact, there is a need for sustained investment in agriculture and food-processing industries. Moreover, land reform is still far from completed, and the land ownership question remains open. This has adversely affected investment in the farm sector.

2.3 General Evaluation

Estonia can be regarded as a functioning market economy. It has radically liberalised foreign trade and privatised the public sector. Prices have been liberalised to a very large extent. The currency board system and the prudent fiscal stance have helped to reduce inflation. The legislative framework is largely in place. However, land reform has been slow, and reform of the pension system has not yet started.

Estonia should be able to make the progress necessary to cope with competitive pressures and market forces within the Union in the medium term, provided in particular that the export base is broadened. The setting of a low exchange rate and low unit labour costs have facilitated the switch to light manufacturing industry as a source of foreign reserves. The banking sector is healthy and expanding strongly. Estonia has been a major recipient of foreign direct investment, although the inflow has decreased recently. However, the export base is rather narrow, and the need to finance the rising trade and current account deficits is a matter of concern.

3. Ability to Assume the Obligations of Membership

The European Council in Copenhagen included among the criteria for accession "the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union".

In applying for membership on the basis of the Treaty, Estonia has accepted without reserve the basic aims of the Union, including its policies and instruments. This chapter examines Estonia's capacity to assume the obligations of membership - that is, the legal and institutional framework, known as the *acquis*, by means of which the Union puts into effect its objectives.

With the development of the Union, the *acquis* has become progressively more onerous, and presents a greater challenge for future accessions than was the case in the past. The ability of Estonia to implement the *acquis* will be central to its capacity to function successfully within the Union.

The following sections examine, for each main field of the Union's activity, the current and prospective situation of Estonia. The starting-point of the description and analysis is a brief summary of the *acquis*, with a mention of the provisions of the Europe Agreement and the White Paper, where they are relevant. Finally, for each field of activity there is a brief assessment of Estonia's ability to assume the obligations of membership on a medium-term horizon.

3.1 Internal Market Without Frontiers

Article 7a of the Treaty defines the Union's internal market as an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured. This internal market, central to the integration process, is based on an open-market economy in which competition and economic and social cohesion must play a full part.

Effective implementation of the liberties enshrined in the Treaty requires not only compliance with such important principles as, for example, non-discrimination or mutual recognition of national regulations - as clarified by Court of Justice rulings - but also concomitant, effective application of a series of common specific provisions. These are designed, in particular, to provide safety, public health, environmental and consumer protection, public confidence in the services sector, appropriately qualified persons to practise certain specialist occupations and, where necessary, introduction or coordination of regulatory and monitoring mechanisms; all systematic checks and inspections necessary to ensure correct application of the rules are carried out on the market, not at frontier crossings.

It is important to incorporate Community legislation into national legislation effectively, but even more important to implement it properly in the field, via the appropriate administrative and judicial structures set up in the Member States and respected by companies. This is an essential precondition for creating the mutual trust indispensable for smooth operation of the internal market.

This chapter must be read in conjunction with, inter alia, the chapters on social policy, the environment, consumer protection and sectoral policies.

The Four Freedoms

A step-by-step approach is being taken to absorption of the *acquis* by the applicant countries:

- The Association Agreement between the Community, its Member States and Estonia was signed in June 1995 and is being ratified. With regard to the four freedoms and approximation of legislation, the Agreement provides, in particular, for immediate or gradual application of a number of obligations, some of them reciprocal, covering, in particular, freedom of establishment, national treatment, free trade, intellectual property and public procurement.

- The Commission's 1995 White Paper (COM(95) 163 final), guidelines intended to help the applicant countries prepare for integration into the internal market, gives a closer definition of the legislation concerned. It identifies the "key measures" with a direct effect on the free movement of goods, services, capital and persons and outlines the conditions necessary in order to operate the legislation, including the legal and organizational structures. Twenty-three areas of Community activity are examined, dividing the measures into two stages, in order of priority, to provide a work programme for the pre-accession phase. The Technical Assistance and Information Exchange Office (TAIEX) was set up with the objective of providing complementary and focused technical assistance in the areas of legislation covered in the White Paper. A legislative database has recently been established by the Office.

- The applicant countries will have to transpose and implement all the *acquis*. The "Action plan for the single market" submitted to the Amsterdam European Council gives details of the priority measures necessary to make the single market work better among the fifteen current Member States in preparation for introduction of the single currency. This will inevitably entail development of the *acquis*.

General Framework

Whatever their field of activity, undertakings must be able to operate on the basis of common rules. These are important since they shape the general framework within which economies operate and, hence, the general conditions of competition. They include the rules on competition (on undertakings and State aid) and tax measures discussed elsewhere in this opinion, the opening-up of public works, supply and service contracts, harmonisation of the rules on intellectual property (including the European patent), harmonisation of the rules on company law and accountancy, protection of personal data, transfer of proceedings and recognition of judgments (Article 220 EC Conventions).

Descriptive Summary

The Public Procurement Office under the Ministry of Economic Affairs is in charge of managing and supervising the various aspects of public procurement policy, although its enforcement powers are rather limited. The Law on Public Procurement came into force on 1 January 1997.

The Estonian legislation for intellectual and industrial property is only to some extent in accordance with Community requirements. The Estonian Patent Law is based on the requirements of the Munich convention. Estonia is also preparing for accession to the WTO/TRIPS Agreement (Trade Related Aspects of International Property Rights) during 1997.

Company law is governed by the Commercial Code, which has undergone substantial reform. A number of different kinds of enterprise are recognised by law, including private and public limited companies. These form by far the majority of the approximately 50.000 enterprises actually registered in Estonia. Generally speaking there are no regulations dependent upon a company's size apart from certain provisions relating to corporate governance. Public limited companies may issue shares and there are measures to protect the interests of shareholders. Minimum capital requirements are laid down by law. There is a basic level of protection for creditors. Companies are required to publicise nationally any major decisions affecting them. A Commercial Register is maintained which records the key information about each company. The Register is open to the public.

The Law on Accounting (1995) provides the basic framework for the annual accounts of companies, including standards, guidelines and recommendations. An Estonian Accounting Board has been set up. Auditors are authorised by the Estonian Auditing Board. Estonian Regulations on Auditing were issued in September 1994.

The Personal Data Protection Act entered into force in July 1996. A time limit of one year was given by the law to administrations and undertakings to bring processing of personal data into conformity with the Act. This law establishes the institutional framework for the protection of personal data, including an independent supervisory authority.

Current and Prospective Assessment

Legislation on Public Procurement complies to some extent with the acquis. However, in some important fields it does not fulfil the Community requirements. This is the case, for instance, as regards the utilities sector, the remedies system or the Stage II measures of the Commission White Paper for the Single Market. The Law provides for domestic preference clauses which will need to be abolished once the Europe Agreement enters into force. It is clear that further amendments to the legislation are needed, but the work is progressing well.

A considerable amount of legislative work is still needed in the field of intellectual and industrial property in order to ensure full compliance with the Community acquis. Drafts of Copyright Law and Trademark Laws are foreseen by the Estonian authorities for 1997 in order to comply with the *acquis*. According to Estonian authorities Patent Law is compatible with the Munich convention. Legislation is foreseen for 1998 and 1999 for the protection of semi-conductors and border enforcement.

Effective implementation and enforcement will remain a significant concern in the medium term due to the lack of experience of the authorities involved and to the current weakness of internal control and border enforcement mechanisms.

According to the information on company law provided by Estonia, the Commercial Code already reflects the provisions of the Second, Third and Eleventh Directives and most of the First and the Twelfth Directive. It is understood that efforts are currently being made to bring the Commercial Code completely in line with the First Directive.

Concerning Accounting the 1995 law is largely in line with the 4th Directive. The Estonian Accounting Board will issue a guideline on consolidation based on international standards as well as on the 7th Directive. A number of further standards are under preparation. A law on auditing is under preparation, which will be designed to transpose the 8th Directive. Certain transitional problems are in evidence relating to the implementation in practice of the new rules, including a shortage of qualified accountant and auditors and major efforts will be required if they are to be solved in the medium term.

The law on the protection of personal data has clearly been inspired by the EC framework Directive. However, it will need improvement to be fully in line with the Directive. The Commission has no information concerning the implementation of the law, in particular as far as the establishment of the independent supervisory authority is concerned. Accession to Council of Europe Convention n° 108 for the protection of personal data is not planned in the near future.

Conclusion

The process of approximation in the field of public procurement needs to be strengthened. Further amendments will be needed to meet all the requirements of the Public Procurement Directive. A considerable amount of legislative work will still be necessary in the fields of intellectual and industrial property.

As far as company law is concerned, there would not appear to be any major problem with Estonia's implementing the *acquis*, although there is as yet no clear timetable for the adoption of the remaining measures required to bring their legislation fully into line.

In accounting, actions to achieve full conformity with the *acquis* are programmed in Estonia and seem realisable in accordance with the programme foreseen. In auditing, the information provided does not provide a sufficient basis on which to make a detailed assessment of conformity with the *acquis* or Estonia's prospects of achieving this in the medium term.

Estonia has made progress in the field of data protection. The implementation of the 1996 law will provide Estonia with useful experience, but further efforts are required to bring the law fully in line with the EC framework Directive.

Free Movement of Goods

Free movement of goods can be achieved only by removing measures which restrict trade – not only customs duties and quantitative restrictions but all measures with equivalent, i.e. protectionist, effect, irrespective of whether or not they are specifically aimed at domestic or imported products. Where technical standards are not harmonised, the free movement of goods must be ensured by applying the principle of mutual recognition of national rules and accepting the rule that national specifications should be no more stringent than is required to achieve their legitimate objectives. This rule was established in the *Cassis de Dijon* judgment.

For the purpose of harmonisation, the European Community has developed the "New Approach" which introduces an approach carefully balanced between government and private autonomous bodies and in which Community legislation and European standards play a distinct complementary role. Thus, instead of imposing technical solutions, Community legislation is limited to establishing the essential requirements which products must meet. Products manufactured in accordance with European standards are presumed to meet such essential requirements, but European standards are not the only way to prove such conformity. The "New Approach" works in conjunction with the "Global Approach" on product certification which governs the apposition of the "CE Mark" on the product. For other products such as pharmaceuticals, chemicals, motor vehicles, and food products, Community directives follow the traditional regulatory pattern of providing fully detailed rules.

The free movement of goods also dictates that a number of Community harmonisation measures be transposed into national law. Implementation of health and safety harmonisation rules is particularly important and requires the establishment of appropriate mechanisms and organisations, both for businesses and the authorities.

Two of the "horizontal" directives essential to smooth running of the single market are the Directive on general product safety and the Directive on liability for defective products. The regulations concerning general product safety are covered in the section on consumer protection (see section 3.6).

The rules on agricultural products (compliance with veterinary and plant-health standards) are explained in detail in the section on agriculture (see section 3.4).

Descriptive Summary

The liberal trade policy of Estonia, in general, means that very few restrictions are imposed on the free movement of goods. No legislation on trade barriers or quantitative restrictions is in force. No significant problems are foreseen concerning the implementation of the Articles 8-35 of the Europe Agreement.

Except for some energy prices (electricity, gas, petrol), prices are freely determined in the market. Licenses are needed for importation of alcohol, tobacco, cars, pharmaceuticals, arms, precious metals, and metals. The principal objective of this system is the protection of the consumer. The system does not differentiate on the basis of the origin of the products and does not impose any quantitative restrictions.

In the fields of standardisation, conformity assessment and metrology a series of legislative measures were adopted since 1993 to improve compatibility with the EU system. A law on standardisation drawing the line between technical regulations and voluntary standards was enacted by the end of 1996. Estonia has affiliate membership of the European Centre for Standardization (CEN) and the European Centre for Electromechanical Standardization (CENELEC) and will apply for European Telecommunication Standardisation Institute (ETSI) membership in 1997.

Current and Prospective Assessment

The implementation of free trade in goods between Estonia and the EU is already advanced. The licensing system will need to be reviewed and, if necessary, adjusted. The implementation of a new system, in conformity with WTO (World Trade Organization) rules, is foreseen during 1997.

According to the Estonian work programme for the approximation of technical legislation; 1977 should be an important year for the alignment on White Paper priority measures. However, little evidence is available of substantial legislative work going on with respect to such priority measures, nor have indications been given on approximation plans for the rest of White Paper measures. A number of New Approach directives are planned for adoption by the end of 1997, and so is basic legislation on foodstuffs and chemicals. Legislative alignment on pharmaceuticals seems to proceed rather speedily, while in the automotive sector a type-approval based on the EU system will become operational in 1997 following Estonia's signature of the UN-ECE Agreement two years ago. It needs to be borne in mind, in any case, that secondary legislation is often necessary in order to implement the general legislative framework.

In the field of certification, Estonia is in principle ready to accept EC marking without submitting products imported from the EU to additional conformity assessment procedures.

It is not easy to assess the state of Estonia's legislation on product liability. Draft legislation is under consideration but no timetable is available and Estonia has indicated a need for technical assistance.

In the areas subject to national rules and not covered by Community harmonisation, there is too little information available to assess whether Community legal principles on the free movement of goods are properly applied in Estonia. The reporting procedures which form part of the internal-market machinery are not yet operational and so cannot be used in the pre-accession period. The most important instruments in this connection are: Directive 83/189, requiring governments to report draft national technical standards and regulations; Decision 3052/95 on measures derogating from the principle of the free movement of goods; procedures by which complaints can be submitted to the Commission; and Article 177 of the Treaty, enabling Member States to ask for preliminary rulings from the Court of Justice. It is also hard to assess whether Estonia complies with the principle of mutual recognition; more information is required on its national rules, and on administrative practices, which can have an effect on product marketing.

Conclusion

The free movement of goods will not represent a serious obstacle to Estonia's accession provided that the on-going law reform is continued and enforced, in particular as regards standardisation and conformity assessment. The degree to which Estonia will have a good record of legislative alignment by the end of the pre-accession period is difficult to assess for the time being. Despite laudable approximation efforts in the fields of standardisation and conformity assessment, some doubts remain as to a substantial and speedy process of legislative alignment in a number of technical fields.

The Estonian authorities will also have to ensure that in fields not covered by harmonisation at Community level their national legislation is not likely to hinder trade, in particular by checking whether the law in force is commensurate with the goals sought.

Free Movement of Capital

The Europe Agreement establishes the principle of the free movement of capital between Estonia and the EU. This, as far as the obligations of Estonia are concerned, applies from the entry into force of the Europe Agreement as regards direct and portfolio investment, commercial credits and financial loans made by companies already established in Estonia and as regards branches and agencies of Community companies (as well as the self-employed), gradually during the transitional period.

The White Paper highlights the link between the free movement of capital and the free movement of financial services. It suggests a sequence of capital movements liberalisation, starting from medium and long term capital movements and those linked to commercial operations, to short term capital.

Descriptive Summary

Since the 1992 monetary reform, Estonia has pursued a liberal policy as regards foreign exchange controls. Convertibility for current payments was introduced simultaneously with the monetary reform. Estonia accepted formally the provisions of Article VIII of the Articles of Agreement on 15 August 1994. Most capital movements were liberalised in 1992. All foreign exchange controls were abolished in 1994, as confidence to monetary policy increased. At present, there are no foreign exchange controls in Estonia and payments between Estonian and foreign entities as well as currency conversions can be effected free of any restrictions.

Investments in real estate by non-residents is the only capital transaction for which restrictions still apply. As a general rule, land and real estate can be acquired by non-residents under license of the county-governor. In special cases (islands, border zones) acquisition of land by non-residents and foreign legal persons is not permitted.

Since 1993 foreign direct investment has had an important role in the development of the economy and the modernisation of enterprises. The volume of FDI made up to 9.8 % of GDP in 1993 and 9.3 % in 1994 . The total amount of FDI reached approximately 600 MECU for the period 1990-1996. The share of FDI from EU countries in total was 65.7 % in 1994 and 75.8 % in 1995. Industry trade and transport were the sectors which attracted most FDI capital.

In regard to the physical cross-border transfer of means of payments measures were taken in order to prevent money-laundering.

Current and Prospective Assessment

The degree of capital liberalisation already introduced by Estonia goes beyond the obligations undertaken under the Europe Agreement. Estonia should have no difficulties in removing the residual restrictions, concerning acquisition of real estate by non-residents and assume the Community acquis in the area of capital movement in the next few years.

Conclusion

The field of free movement of capital does not present any major obstacles for accession in the medium term.

Free Movement of Services

The basis of the free movement of services is the prohibition of discrimination, in particular on grounds of nationality, and rules on the alignment of divergent national legislation. These rules often concern both the right of establishment, which comes under the heading of the free movement of persons, and the freedom to provide services. Their implementation implies the establishment of administrative structures (banking control boards, audio-visual control authorities, regulatory bodies) and greater cooperation between Member States in the area of enforcement (mutual recognition arrangements).

A substantial amount of the legislation applicable to the free movement of services relates to financial services. It also concerns the problems relating to the opening-up of national markets in the sectors traditionally dominated by monopolies, e.g. telecommunications and, to a certain extent, energy and transport. These subjects will be dealt with in the sections of the Opinion specifically referring to them.

Descriptive Summary

Estonia's Banking sector experienced a crisis rather early on in the transition process (1992-3). The Law on Credit Institutions came into effect in 1995 and was drafted on the basis of the EC's Banking Directive. Banking supervision is being taken care of by a department of the main Bank of Estonia. which is also responsible for the prevention of money laundering.

The market is fairly concentrated but market penetration is fairly low

Privatisation of commercial banks has been quick. It is planned to fully end State ownership in banks in the coming years.

The Estonian Securities market is relatively new. The Securities Market Act dates from 1993. The first public issue of shares was carried out in 1991 while the first government bonds were issued in 1993. In 1994, the Estonian Central Register of Securities was established and supervisory activities over the securities market were launched. The Tallinn Stock Exchange began its activities operations in May 1996 and disposes of an electronic trading system.

All members of the Exchange must be legal persons registered in Estonia, having been granted a securities intermediary licence by the Ministry of Finance, and holding Tallinn Stock Exchange shares at the minimum equivalent of 400000 EEK (26000 ECU).

The insurance sector is regulated by the Insurance Act of 1992 which was drafted on the basis of EU insurance legislation. However, it complies only to a certain degree with the acquis. The insurance sector is monitored by the Insurance Supervisory Authority which was set up in 1993 under the responsibility of the Ministry of Finance.

Current and Prospective Assessment

The First Banking Directive, the Own Funds Directive and the Solvency Directive are mostly incorporated into Estonian banking law. However, there are certain key aspects which do not yet fulfil EU requirements. The Second Banking Directive, The Annual Accounts and Consolidated Accounts Directive and the Large Exposures Directive have also been partially implemented. There is no specified timetable for full implementation of the Capital Adequacy Directive.

There is currently no legislation in force for bank deposit guarantee schemes. However, a draft law has been submitted to Parliament and its adoption is expected for October 1997. The Government will present to Parliament in September a new law on credit institutions, which will deal with all the Stages I and II directives, including money laundering with the exception of the Capital Adequacy Directive. Adoption is expected at the end of this year.

The Estonian legislation for Securities only to a limited degree covers the Community acquis, with specific provisions for the acquisition or disposal of majority shareholding in listed companies, insider dealing, and public offers of transferable securities missing.

Also a licence regime and state supervision with regard to investment services other than securities trading on the stock exchange is not available. Stage II measures of the White Paper so far have not been implemented yet in this field. As regards enforcement, the Securities Inspectorate must be strengthened considerably in terms of staff and other resources. A draft Securities Market Act is under preparation for submission to the Parliament before the end of 1997. In this connection fulfilment of Stage I measures is foreseen for the public issue of securities, the legal status of the stock exchange and insider training.

A revision of the existing Insurance Act is currently under preparation with a view to increasing the minimum capital requirements and completing the privatisation. An insurance supervision system responding to a free market system still needs to developed.

Conclusion

Although the Estonian Banking system is based on a free market policy, apparently stable and well supervised, in the context of EU accession there are still some elements which either do not fully correspond to EU requirements or will need rather significant amendment for full harmonisation.

In the field of Securities, the ongoing reform of legislation needs to be intensified in order to fulfil EU requirements in the mid-term perspective. Special attention must be given to the strengthening of the regulatory bodies.

On the assumption of an intensification of the current legal reform work it is not expected that the insurance sector will present major problems for accession.

The financial services sector in Estonia is rather well developed. However, the approximation process seems to be rather slow, both on the point of view of the enactment of the appropriate regulations and of their actual implementation which makes it difficult to integrate the EU financial market within reasonable delay. The field of free movement of services is not expected to present any major obstacles to accession in the medium-term.

Free Movement of Persons

The free movement of persons encompasses two concepts with different logical implications in the Treaty. On the one hand, Article 7a in Part One of the Treaty on 'Principles' mentions the concept in connection with the establishment of the internal market and implies that persons are not to be subject to controls when crossing the internal frontiers between the Member States. On the other hand, Article 8a in Part Two of the Treaty on 'Citizenship of the Union' gives every citizen of the Union the individual right to move and reside freely within the territory of the Member States, subject to certain conditions. The abolition of frontier checks must apply to all persons, whatever their nationality, if Article 7a is not to be meaningless. While the rights deriving from Article 8a apply in all Member States, those stemming from Article 7a have not yet been fully applied throughout the Union.

(a) *Free Movement of Union Citizens, Freedom of Establishment and Mutual Recognition of Diplomas and Qualifications*

The Europe Agreement provides for the non-discriminatory treatment of workers that are legally employed (as well as their families). It covers the possibility of cumulating or transferring social security rights, and encourages Member States to conclude bilateral agreements with Estonia on access to labour markets. From 1999, the Association Council will examine further ways of improving the movement of workers.

The White Paper considers the legislative requirements in order to achieve a harmonious development of the labour market, whilst simultaneously preventing distortions of competition.

The free movement of workers is one of the fundamental freedoms enshrined in the Treaty; freedom to practise certain professions (e.g. in the legal and health fields) may, however, be subject to certain conditions, such as qualifications. Depending on the case, these may be dealt with through coordination or by applying the principle of mutual recognition. Freedom of establishment is also guaranteed under the Treaty and covers the economic activity of self-employed natural persons and companies.

The free choice of place of residence may thus be subject to minimum conditions as to resources and health insurance where the person does not exercise a profession in the country concerned.

Descriptive Summary

Nationals of third countries can move to Estonia for residence or employment purposes. For residence purposes, they can obtain residence permits for personal reasons or for family reunification. Third country nationals who enter, stay and work in Estonia illegally, without a valid visa, residence permit or combined residence-working permit, as well as their employers, may be prosecuted according to the Code of Administrative Offences.

The existing legislation concerning the education and training of dentists, doctors, veterinary surgeons, architects, midwives and nurses, only to a limited extent take into account the Community requirements regarding mutual recognition of professional qualifications. Furthermore, enforcement structures are still mainly to be set up.

Current and Prospective Assessment

Estonian legislation will need to be prepared for the equal treatment of EU citizens with nationals working in Estonia.

In order to fulfil the Community requirements regarding mutual recognition of professional qualifications, a general Law on Professions is being prepared. Finalisation of a draft is foreseen for the end of 1997. The curricula for dentists, pharmacists, midwives and nurses are being reviewed and reformed in the light of the Community requirements. The existing legislation only to some degree conforms with the *acquis* and a sustained and intensive continuation of the current reforms will be needed to take up the *acquis* in the medium term. The time schedules for possible reforms of specific educational structures must, however, be carefully considered as such reforms, by their nature, will take several years to implement.

Conclusion

The *acquis* for free movement of persons does not in general present major problems in terms of accession in the medium term. As regards mutual recognition of professional qualifications, the preparation of the necessary legislative and enforcement measures will need to be intensified in order for it to be in place in the mid-term perspective.

(b) Abolition of Checks on Persons at Internal Frontiers

The free movement of persons within the meaning of Article 7a of the EC Treaty, i.e. the abolition of checks on all persons, whatever their nationality, at the internal frontiers has not yet been fully implemented in the Union. Doing away with checks on persons is conditional on the introduction of a large number of accompanying measures, some of which have yet to be approved and implemented by the Member States (see separate section on Justice and Home Affairs). However, that objective has been achieved by a limited number of Member States in accordance with the Schengen Convention (seven Member States already apply it and another six are working towards implementation).

The draft Treaty aims to make that objective easier to achieve within the Union by including a new chapter on an area of freedom, security and justice and incorporating the Schengen *acquis* into the Union.

Estonia has stated its desire and readiness to fulfil the provisions of the Schengen Agreement. It has begun preparations to this end and has sought assistance in this connection from Member States, notably in regard to the strengthening of border controls.

General Evaluation

1. Estonia's progress in the implementation of legislation relating to the White Paper is summarised at annex. According to that table, Estonia considers that by 30 June 1997 it will have adopted national implementing legislation for 283 of the 899 directives and regulations in the White Paper. That figure covers provisions for which Estonia considers it will have adopted implementing legislation or which it will have checked for compatibility with Community rules and does not prejudge actual

compatibility as such, on which the Commission is not able at this stage to state an opinion.

2. Estonia has made significant progress with the alignment of its legislation with Community rules in most of the areas covered by this chapter. Legislation has been adopted in full or in part to implement most of the measures according to the Estonian authorities' assessment, though the Commission cannot at this stage express a position on its total compatibility with Community law. However, considerable efforts are still necessary to achieve full conformity with the *acquis*, in particular in the areas of public procurement, intellectual and industrial property and financial services.

The Estonian authorities are well aware of these requirements, and amendments to the legislation or new texts are under preparation. Most of them should be adopted in the next two years.

3. Despite the progress already achieved in the field of legislation, serious doubts should be raised about the capacity of the Estonian administration to implement this legal framework. For the time being, the Estonian administration still shows significant weaknesses. However, these can be considered transitional given the relatively high potential of the presently understaffed public administration.

As things currently stand, the Commission cannot yet express an opinion on the capacity of companies, particularly small and medium-sized businesses, to implement the *acquis*.

4. Leaving aside certain specific aspects relating to agriculture, checks at the internal frontiers of the Union can only be abolished once sufficient legislative harmonisation has been achieved. This calls for mutual confidence, based in particular on sound administration (e.g. the importance of safety checks on some products at the place of departure). As far as goods are concerned, the completion of the internal market on 1 January 1993 was only achieved by doing away with all the formalities and checks performed by the Member States at the internal borders of the Union. In particular these checks covered technical points (product safety), veterinary, animal-health and plant-health matters, economic and commercial matters (e.g. prevention of counterfeiting of goods), security (weapons, etc.) and environmental aspects (waste, etc.). In most cases, the abolition of checks was only made possible by the adoption and application of Community measures harmonising the rules on movement and placement on the market (particularly as regards product safety) and, where applicable, by shifting the place where controls and formalities are conducted to within the Member States or their markets (in particular as regards VAT and excise duties, veterinary and plant-health checks, and the collection of statistics). A section of Estonia's present borders will become the Union's external frontier and this means border checks will need to be stepped up (see separate section on Customs).

In view of the overall assessment that can be made of progress achieved to date and the rate at which work is advancing in the various areas concerned, it is difficult at present to put a time-scale on Estonia's ability to take over and implement all the instruments required to abolish internal border checks and to transfer those checks to the Union's external frontier.

5. Estonia has already adopted significant elements of the *acquis* relating to the single market. However, the Commission is not yet able to take a position on every measure whose transposition has been reported by Estonia. Further progress will be needed with regard notably to public procurement, intellectual and industrial property and the financial services sector. In most areas, enforcement needs to be strengthened. A particular effort will be necessary with regard to the strengthening of the administration. In the medium term, provided current efforts are stepped up, Estonia should have adopted and implemented most of the single market legislation and made the necessary progress on the mechanisms of enforcement, in order to be able to participate fully in the internal market.

Competition

European Community competition policy derives from Art. 3 (g) of the Treaty providing that the Community shall have a system ensuring that competition in the internal market is not distorted. The main areas of application are anti-trust and state aid.

The Europe Agreement provides for a competition regime to be applied in trade relations between the Community and Estonia based on the criteria of Articles 85 and 86 of the EC Treaty (agreements between undertakings/abuses of dominant position) and in Article 92 (State aid) and for implementing rules in these fields to be adopted within three years of the entry into force of the Agreement.

Furthermore, it provides that Estonia will make its legislation compatible with that of the Community in the field of competition.

The White Paper refers to the progressive application of the above provisions and those of the Merger Regulation (Regulation. (EEC) No 4064/89) and of Articles. 37 and 90 (Monopolies and Special Rights).

Descriptive Summary

The Estonian Competition Act came into force on 1 January 1994 and safeguards the principles of a free market. It only contains very rudimentary provisions on restrictive agreements and abuse of dominance, and does not contain any provisions for merger control or provisions for granting block exemptions. Procedural aspects also need to be reviewed.

The Competition Board was established in 1993 under the Ministry of Finance to supervise the implementation of the Competition Act and the Act of Prices. The field of state aid is monitored by the Budget Department of the Ministry of Finance in cooperation with the Competition Board.

In order to be in line with the current and foreseeable situation regarding sectors subject to the monopolies, Estonia has apparently started its policy of liberalising and opening up to competition certain sectors such as telecommunications and postal services.

The state aid inventory is not complete and some way from the methodology used by the Commission in its aid survey.

Current and Prospective Assessment

The main weaknesses of the existing Competition Act will be removed with the adoption in 1997 of the new Competition Act.

In various commercial sectors, systems of exclusive rights have been established and will have to be progressively adjusted or abolished before accession. This, for instance, is the case in telecommunication services, and air, railway and maritime transport. Existing state monopolies would need to be discontinued before accession in such areas as oil shale, electricity supply, and export of scrap metals.

A substantial effort must be made to establish a state aid inventory in accordance with Community practice. The compatibility of the existing "Fund for state export aid" and "Export credit fund" is very doubtful. Other aid measures constitute operating aids which are only allowed under very strict conditions. Due to the lack of transparency, it is unclear whether the conditions for the granting of operating aid are complied with.

In addition to the adoption of legislation sufficiently approximate to that of the EC,credible enforcement of competition law requires the establishment of well functioning anti-trust and state aid monitoring authorities. It requires moreover that the judicial system, the public administration and the relevant economic operators have a sufficient understanding of competition law and policy.

Conclusion

With the forthcoming adoption of the new draft Competition Act the progress in approximation of legislation in the field of anti-trust is significant. Subject to the introduction in the new draft text Competition Act of some amendments, the degree of approximation in the state aid area would also be satisfactory.

As regards enforcement the Estonian Competition Board seems to be working rather well and seems to be capable of enforcing the new Competition law when adopted.

However, considerable efforts will be necessary to fulfil the requirements as regards state aid monitoring in the medium term, in particular in respect of transparency. Close cooperation with the Commission in this field will be necessary.

It appears, moreover, that in certain exclusive and special rights exist which are not compatible with the Community *acquis*. These problems should be addressed in the near future.

3.2 Innovation

Information Society

Present Situation

The economic and social effects made possible by the combination of information technology and telecommunications are great. In Estonia these possibilities were neglected before 1990 although education generally was not. Today the education sector has taken a leading role in promoting the Information Society. Trade data for the information technology (IT) sector are lacking but the number of PCs per 100 inhabitants (5.5 in 1995) is high in relation to GDP per capita. The existence of host computers on the Internet, as a relative measure of development towards the information society (IS), suggests that Estonia exceeds the achievement today of five EU countries. Perhaps taking a lead from the experience in Finland which one of the EU's leading countries in this respect, the Government of Estonia has been active in cooperating with EU initiatives and in promoting the use of Information and Communication Technologies (ICTs) and particularly in the education sector.

Conclusion

Because of the positive approach to telecommunications liberalisation combined with the excellence of efforts at national level in the national education sector, Estonia can expect to realise the potentialities of the Information Society earlier than the average CEEC and no later than many EU member states.

Education, Training and Youth

Articles 126 and 127 of the EC Treaty provide that the Community shall contribute to the development of quality education and implement a vocational training policy aimed at promoting the European dimension in education and at enhancing industrial adaptation and the responsiveness of the labour market through vocational training policies.

The Europe Agreement provides for co-operation in raising the level of education and professional qualifications. The White Paper includes no measures in this field.

Descriptive Summary

Estonia's educational spending amounts to 5.7 % of GDP. Education takes 17.0 % of the state budget.

There are 240,000 pupils, 27,000 students and 19,000 teachers in Estonia.

Estonia has six state universities, one private university, and 20 higher vocational education institutions (12 of which are private).

Estonia is currently undertaking reforms at all levels of the systems of education and training in order to further adapt the country to the needs of a democratic society based on a market economy. This is necessary, not only to achieve progress in regard to key economic factors (such as productivity and the quality of production, competitiveness on the international markets, development of the private sector, labour mobility, and unemployment), but also to ensure the democratic functions of society.

No nationally agreed comprehensive vocational training policy exist at the moment but vocational training importance is increasing in national policy.

A vocational education and training department was established by the restructuring of the Ministry of Education which took place at the beginning of 1996.

The Tempus programme has contributed to the achievement of the goals of higher education reform and created the basis for cooperation with the EU higher education institutions.

About 14,2 % of the total population of Estonia is aged between 15 and 25. The law on youth is currently being developed, which aims to improve conditions for young people, stimulate active participation in the process of democratisation of civil society, and to provide the conditions for voluntary service activities for young people. Some Estonian youth organisations have been participating in European youth activities since 1995, as a first step towards participation of Estonia to this programme.

Current and Prospective Assessment

In order, to achieve a comprehensive upgrading of the education and training systems, considerable investments in curriculum-reform, teacher training, text books, equipment and buildings will be needed. Due to the financial constraints, this process is likely to take a number of years to achieve.

Despite achievements, reforms are still at the very beginning and there remains much to do before the vocational system can be considered in accordance with EU and Member States requirements.

Estonia's participation in Community programmes will have positive effects on the people concerned and represent a good preparation for integration in Community programmes.

Conclusion

In the perspective of accession, no major problems should be expected in these fields.

<u>Research and Technological Development</u>

Research and Technological Development (RTD) activities at Community level, as provided for by the Treaty and in the Framework Programme, aim at improving the competitiveness of European industry, the quality of life, as well as supporting sustainable development, environmental protection, and other common policies.

The Europe Agreement will provide for co-operation in these areas, notably through participation in the Framework Programme. The White Paper includes no direct measures in this field.

Descriptive Summary

The Estonian Research and Development Council is the main Estonian institution responsible for implementing science and technology policy, managing strategic government programmes and planning, co-ordinating and financing all state funded activities. Competitive mechanisms for research funding have been introduced. The current science expenditures represents 0.7% of GDP in 1994.

In addition to the universities, Estonia has 32 state research institutions. The research is mostly state-funded, and concerns both basic and applied research (figures for basic research fell below 50% of the budget in 1995).

Estonia's long term priorities are:
- to bring financing up to the average European Union level,
- to orient priorities towards those of the Community.

In the short term, Estonia is aiming to:
- ensure that the state budget allocations for research are kept at the level of 2 % of expenditures,
- substantially increase state budget expenditure on technological innovation, predominantly via the Innovation Foundation under the Ministry of Economic Affairs.

Regular cooperation with the European Community started in 1992 with the 3rd Research and Technology Development Framework Programme. So far, cooperation was mainly concentrated on COPERNICUS (Specific Programme for Cooperation with CECs and NIS) and remains rather low for participation in the 4th Framework Programme. Estonia is a member of COST (European cooperation in the field of scientific and technical research).

Since 1992, the statistics in this field are compatible with OECD standards.

Current and Prospective Assessment

Important changes and improvements have already taken place in this sector. A big effort has been made in the improvement of the internal structure, liberalisation, financial support. Human resources and potential remain strong despite the cutbacks.

Nevertheless, it is necessary to improve the level of innovativeness in the economy generally and in industry and to reinforce the links of research institutes with industry and small and medium enterprises.

Estonia is prepared to play an active role in the European research and technological development and allocate the funds to this activity. It has declared its intention to be fully associated to the 5th Framework Programme.

Conclusion

In the perspective of accession no major problems are expected in this field. Accession would be of mutual benefit.

Telecommunications

The objectives of EC telecommunications policy are the elimination of obstacles to the effective operation of the Single Market in telecommunications equipment, services and networks, the opening of foreign markets to EU companies and the achievement of universally available modern services for EU residents and businesses. These are achieved through harmonisation of the standards and conditions for service offerings the liberalisation of the markets for terminals, services and networks and the adoption of necessary regulatory instruments. The Directives and policies needed to achieve this have now been established, but the liberalisation of public voice telephony and operation of related infrastructure will be deferred for a year or two after 1998 in certain member states.

The Europe Agreement provides for cooperation aimed at enhancing standards and practices towards EC levels in telecommunication and postal policies, standardisation, regulatory approaches and the modernisation of infrastructure. The White Paper focuses on the approximation of regulation, networks and services, followed by further steps ensuring gradual sector liberalisation.

Descriptive Summary

Until 1991, the national communications networks were part of the Soviet networks so that, for instance, all international lines were routed via Russia. The Estonian network was entirely automatic, but consisted largely of electrical engineering equipment. Since regaining independence, the development of telecommunications in Estonia has been characterised by a general growth in capacity and an improvement of quality. The telephone penetration rate was expanded to 30 per 100 by the end of 1996 although the waiting list remains large.

A telecommunications law was enacted in 1991 which provides the basis for a policy of liberalisation and licensing. A concession agreement was negotiated with foreign investors in the national operating company. The concession gives the company, which is 49% foreign owned, a monopoly of switched telephone until the end of the year 2000.

Current and Prospective Assessment

Degree of Liberalisation

The Government has adopted a pro-competitive policy for the telecommunications sector in 1992 and partially privatised the state-owned operating company Eesti Telecom (ET). This joint venture, consisting of ET (51%), Telecom Finland (24.5%) and Telia (24.5%) a monopoly for long distance and international voice telephony until the year 2001 and also has a licensed mobile telephone network using the pan-European standard (GSM).

Tariff rebalancing has begun and although the country already has a relatively high penetration of lines, universal service, as required by the *acquis*, remains to be achieved. Although other infrastructures (CATV, internal road, rail electricity) are allowed to compete with the public network, no application for a licence has so far been made. Thus there is no competition in this area. The local market is already open to new entrant operators but there is only one small company operating. There are 10 mobile operators, (1 analogue, 1 using NMT 450, 4 using GSM and 4 using DCS 1800) and also 5 operators offering paging services. Satellite communication services and value added services can be offered without licence as long as no connection to the public network is needed.

Approximation to EC Law

The regulatory authority (the Inspectorate of Telecommunications) is functioning within a ministry where the responsible minister also exercises ownership rights over the principal operator. About half of EU law has been transcribed into Estonian law. A new communications law is planned for the end of 1997 which will allow a more effective separation of the regulatory and policy body from any operating company and will enable the Government to administer a pro-competitive policy successfully law. The Government plans to comply with the *acquis* by the year 2000. On the basis of progress to date, Estonia has the administrative capacity as long as it continues to use technical assistance programmes to meet its objectives.

Infrastructure

The principal policy objective of the Government has been to boost investment in the expansion and modernisation of the public telecommunications networks and to improve the quality of services available

Like the two other Baltic States, the Estonian telecommunications network was an extension of the USSR network. The original network equipment was obsolete and modernisation was necessary. Between 1991 and 1996 the telephone network grew from 22.1 to 30.0 lines per 100 inhabitants (compared to an average of 43.9 lines / 100 inhabitants in Greece, Portugal and Ireland). Modernisation is under way and at the end of 1995, 20% of the network was digitised (compared to a current average of 62.4% for Greece, Portugal and Ireland). The objective is to reach 48% by 2000 and to cut waiting times to a few weeks.

The number of cellular users at the end of 1996 was about 4.1 per 100 inhabitants which is well above the average for CEECs. Growth in mobiles is very fast since the new operators commenced operations during 1995. There is competition in both data services and satellite services. There were 22 cable TV subscriptions per 100 households in 1995.

Competitiveness of the Sector

With 10 employees / 1000 lines in 1995, the productivity of the public network operator is low compared to an average for Greece, Portugal and Ireland of 6.2 employees/1000 lines but high relative to other applicant countries (12.1). Although the GDP/capita is sixth among the applicant countries the ratio in terms of purchasing power is second. The current revenue per line, perhaps just sufficient to maintain the service, has to be significantly increased to allow for the required investment.

The current waiting time for a new connection is about three years and at today's rate of network expansion it will take a few more years before even basic telephone service will be universally available.

Conclusion

Estonia has moved quickly to liberalise the telecommunications field and has a good chance of complying with the acquis communautaire in the medium term provided that the current efforts to transpose laws are continued and measures to liberalise are reinforced. Greater competitiveness of the public operator must be achieved if the sector is to attract investment and face up to competition.

Audio-visual

The audio-visual *acquis* aims, in the context of the Internal Market, for the provision and free movement of audio-visual services within the EU as well as the promotion of the European programme industry. The Television Without Frontiers Directive, which is applicable to all broadcasters regardless of the modes of transmission (terrestrial, satellite, cable) or their private or public nature, contains this *acquis*, setting down basic rules concerning transfrontier broadcasting. The main points are: to ensure the free movement of television broadcasts throughout member states; to promote the production and distribution of European audio-visual works (by laying down a minimum proportion of broadcasting time for European works and those by independent producers); to set basic standards in the field of television advertising; to provide for the protection of minors and to allow for the right of reply.

The Europe Agreement provides for co-operation in the promotion and modernisation of the audio-visual industry, and the harmonisation of regulatory aspects of audio-visual policy.

The Television Without Frontiers Directives is a Stage I measure in the White Paper.

Descriptive Summary

The legal framework for the audio-visual sector is determined by the 1994 Law on Broadcasting.

There are currently two national television broadcasters and three local television stations. Private broadcasters need a licence to operate, issued by the Ministry of Culture.

Current and Prospective Assessment

The audio-visual sector in Estonia is attempting to re-establish itself after major upheavals in recent years, and is characterised by rapid growth and constant change. Its ability properly to adhere to the *acquis* presupposes an upgrading of the capacity of the programme-making industry to meet the important challenges of an adapted regulatory framework.

Analysis of the existing legislation reveals a number of deficiencies, including questions of freedom of reception, promotion of European works, advertising rules and the protection of minors. Legislation is being prepared to amend the Broadcasting Law. The draft represents useful progress toward alignment with the *acquis*.

Conclusion

Provided that the necessary legislative measures are pursued with sufficient urgency and that they are accompanied by the necessary structural adaptations of the industry, Estonia should be able to meet EU requirements in the medium term.

3.3. Economic and Fiscal Affairs

Economic and Monetary Union

By the time of Estonia's accession, the third stage of EMU will have commenced. This will mark important changes for all Member states, including those that do not participate in the euro area. All Member states, including the new ones, will participate fully in the economic and monetary union. Their economic policies will be a matter of common concern and they will be involved in the coordination of economic policies (national convergence programmes, broad economic guidelines, multilateral surveillance, excessive deficit procedure). They will be required to respect the stability and growth pact, to renounce any direct central bank financing of the public sector deficit and privileged access of public authorities to financial institutions, and to have completed the liberalisation of capital movements.

Accession means closer monetary and exchange rate co-operation with the European Union. This will require strengthening structural reforms in the area of monetary and exchange rate policies. Member states not participating in the euro area will be able to conduct an autonomous monetary policy and participate in the European System of Central Banks (ESCB) on a restricted basis. Their central banks have to be independent and have price stability as primary objective. Monetary policy has to be conducted with market-based instruments and has to be "efficient" in transmitting its impulses to the real economy. Therefore, reforms need to be pursued to tackle factors that hinder the efficiency of monetary policy, such as the lack of competition in the banking sector, the lack of development of financial markets and the problem of "bad loans" in the banking sector. Finally all Member states shall treat their exchange rate policy as a matter of common interest and be in a position to stabilise their exchange rates in a mechanism yet to be decided.

As membership of the European Union implies acceptance of the goal of EMU, the convergence criteria will have to be fulfilled by Estonia, although not necessarily on accession. While the fulfilment of the convergence criteria is not a precondition for EU membership, they remain key points of reference for stability oriented macroeconomic policies, and must in time be fulfilled by new member states on a permanent basis. Hence the successful conclusion of systematic transformation and market oriented structural reforms is essential. Estonia's economic situation and progress has already been analysed in preceding chapters of this Opinion.

Current and Prospective Assessment

The Estonian Central Bank enjoys a high degree of independence. Its Governor is appointed with the participation of the Central Bank Board and the government is excluded from the appointment procedure. In addition, the Central Bank is independent from the government in conducting its monetary policy. The formal objective of the Bank is the stability of the national currency and the Law on the Central Bank is already compatible with the Treaty provisions of explicit full prohibition of central bank budget deficit financing. In practice, since 1992 Estonia has operated under a currency board. Under the currency board arrangement, the central bank has a very limited scope for discretionary monetary policy and budget deficit financing.

Monetary policy in Estonia has been successful in bringing inflation down to single digit levels. It has been strictly followed the rules of the currency board. Open market operations (using Central Bank bills) have not been used for monetary policy purposes but rather to encourage the development of a secondary market and the deepening of the interbank market. Similarly, reserve requirements are not used as monetary policy instruments but with the aim to assist the banks in case of liquidity shortages. The degree of privatisation of the banking sector is relatively high and further bank privatisation is envisaged for the future. The competition in the sector is satisfactory and the bankruptcy laws play the role of enforcing a hard budget constraint on financial firms. Concluding, the Estonian banking system is certainly one of the more developed and sounder of the area, and bad loans in the sector have almost completely disappeared.

The exchange rate is fixed (against the DM) as the rules of the currency board prescribe. There have been no major tensions on the foreign exchange market to date.

Conclusion

It is premature to judge whether Estonia will be in a position, by the time of its accession, to participate in the euro area; that will depend on the success of its structural transformation permitting to attain and to adhere permanently to the convergence criteria, which are not however a condition of accession.

Estonia's participation in the third stage of EMU as a non-participant in the euro area should pose few problems in the medium term. Its central bank legislation is already fully compatible with EC rules in terms of explicit prohibition of budget deficit financing. The successful implementation of the currency board to date and the relative development of the banking sector are encouraging indicators of the ability of Estonia to complete the restructuring of its financial sector in the next few years.

Taxation

The *acquis* in the area of direct taxation mainly concerns some aspects of corporation taxes and capital duty. The four freedoms of the EC Treaty have a wider impact on national tax systems.

The indirect taxation *acquis* consists primarily of harmonised legislation in the field of Value Added Tax and excise duties. This includes the application of a non-cumulative general tax on consumption (VAT) which is levied on all stages of production and distribution of goods and services. This implies an equal tax treatment of domestic and non-domestic (import) transactions. The VAT *acquis* also contains transitional arrangements for the taxation of transactions within the European Union between taxable persons. In the field of excise duties the *acquis* contains harmonised tax structures and minimum rates of duty together with common rules on the holding and movement of harmonised excisable goods (including the use of fiscal warehouses). As a result of the introduction of the Single Market, all fiscal controls at the Community's internal frontiers were abolished in January 1993.

The mutual assistance between Member State tax authorities is an important feature of administrative cooperation in the Internal Market; the respective Directive covers both direct and indirect taxation.

The Europe Agreement contains provisions on approximation of legislation in the area of indirect taxation.

The White Paper contains as Stage I measures those which make up the main requirements of the indirect taxation *acquis* (essentially, those measures applied in the Community up to 1993), and as Stage II measures those which are in addition necessary to implement the full indirect taxation *acquis*.

Descriptive Summary

Direct Taxation

The two company taxation Directives and the Arbitration Convention provide for a mechanism which applies on the basis of reciprocity. Respective provisions can therefore by definition not be expected to exist before accession.

Indirect Taxation

The overall contribution of VAT and excise duty revenue to the Estonian state budget was about 42% and 11% respectively in 1995. This is expected to continue on an upward trend.

Value Added Tax

The current Estonian VAT system was introduced in January 1991 with major revisions entering into force in January 1994. Estonia applies a single VAT rate of 18% which is applicable to all taxable transactions, including imported goods. In contrast, "imported" services are not liable to any VAT. In addition to the standard VAT rate Estonia applies zero-rating to a limited ranges of supplies.

Certain activities are exempt from VAT without the right to claim the input credit on such supplies. These exemptions relate mainly to activities in the public interest, financial and insurance services, property and lotteries and similar games. Taxable persons are in principle entitled to deduct VAT incurred on their purchases for business purposes of goods and services. However, the Estonian VAT Act does not contain any provisions enabling tax to be refunded to taxable persons not established within the country.

Excise

The current system of excise duty in Estonia was introduced in 1995. Excise duties are applicable to mineral oils, alcohol and alcoholic beverages and manufactured tobacco. For each product category, the duty is specific in nature.

Mutual Assistance

The tax administration has not yet had to develop its capacity for mutual assistance with the tax authorities of Member States, since mutual assistance is a feature which would only become applicable on accession.

Current and Prospective Assessment

Value Added Tax

The current VAT system in Estonia has been based on the main principles of the VAT legislation of the Community and thus represents a starting point in its future alignment on the Community VAT *acquis*. However, it is characterised by being very general and inconsistent in its application.

In order to register for VAT in Estonia the entrepreneur must be listed in the Business Code which requires the establishment of a branch in the country. This means that foreign entrepreneurs (without a branch in the country) cannot be registered for VAT purposes in Estonia. Estonia's approach regarding exempt transactions deviates from that of the Community both in terms of scope and substance. Since Estonia does not operate any arrangements for the refund of VAT to non-registered foreign taxable persons, VAT represents an increased cost to such traders.

Estonia's membership of the European Union would require substantial adjustment to bring the VAT legislation into line with the requirements of the Community *acquis*, both in respect to the general provisions of the Community VAT legislation and as regards the system of taxation necessary in a Community with no internal frontier controls.

The Estonian national strategy plan for implementing the recommendations of the White Paper regarding VAT does not provide a clear and detailed timetable for future adjustments. In the short term it is planned to concentrate on changing zero-rates to exemptions without the option for credit of the input VAT. The medium term objectives envisage the full alignment of the Estonian VAT system on that of the Community by 1 January 2000.

Excise

There exists no effective excise suspension system where goods can move between authorised tax warehouses without payment of duty.

In order to ensure a correct application of the Community excise legislation it is essential that Estonia sets up a warehousing system based on the Community model as soon as possible.

The Estonian national strategy plan for implementing the provisions of the White Paper does not provide a clear and detailed timetable for future adjustments of the Estonian excise legislation. A short term objective consists of enhancing controls at local level. The long term objective is the approximation of the scope and rates of duty towards the Community legislation. However no full harmonisation of the legislation is planned.

Mutual Assistance

There would also be a need, on accession, to implement the appropriate arrangements for administrative cooperation and mutual assistance between Member States. These requirements are essential for the functioning of the Internal Market.

Conclusion

The *acquis* in respect of direct taxation should present no significant difficulties.

As regards indirect taxation, although a start has been made a considerable effort will be required if Estonia is to comply with the *acquis* concerning VAT and excise duties in the medium term.

It should be possible to start participating in mutual assistance as the tax administration develops its expertise in this respect.

Statistics

The main principles of the Community *acquis* relate to the impartiality, reliability, transparency, confidentiality (of individual information) and dissemination of official statistics. In addition there exists an important body of principles and practices concerning the use of European and international classifications, systems of national accounts, business registers, and various categories of statistics.

The Europe Agreement provides for co-operation to develop effective and reliable statistics, in harmony with international standards and classifications.

The White Paper includes no provisions in this field.

Descriptive Summary

The State Statistical Office (SSO), under the Ministry of Finance, is the central body charged with producing and disseminating official statistics in Estonia.

The legal basis for Estonian official statistics consists of the 1990 Statistics Act. A new Statistics Act, which takes EU and other international statistical standards into account, was approved by the Government in December 1996 and is now in the Parliament.

Current and Prospective Assessment

Estonian official statistics meet basic Community requirements. Important progress is still required.

There are deficiencies in sectors such as business statistics, the establishment of a business register, short-term economic indicators, and input/output statistics. The reorganisation of agricultural statistics is still a major task.

Conclusion

Estonia will require a sustained effort if it is to comply with EU requirements for official statistics in the medium term.

3.4 Sectoral Policies

Industry

EU industrial policy seeks to enhance competitiveness, thus achieving rising living standards and high rates of employment. It aims at speeding up adjustment to structural change, encouraging an environment favourable to initiative, to the development of undertakings throughout the Community, and to industrial co-operation, and fostering better exploitation of the industrial potential of policies of innovation, research and technological development. EU industrial policy is horizontal by nature. Sectoral communications aim at transposing horizontal concepts into specific sectors. EU industrial policy results from an articulation of instruments from a number of Community policies; it includes both instruments related to the operation of markets (product specification and market access, trade policy, state aids and competitions policy) and measures related to industry's capacity to adapt to change (stable macro-economic environment, technology, training, etc.).

In order to cope with competitive pressure and market forces within the Union, the industry of applicant countries needs to have achieved a certain level of competitiveness by the time of accession. The applicant countries need to be seen as pursuing policies aimed at open and competitive markets along the lines set out in Article 130 ("Industry") of the Treaty. Co-operation between the EC and the candidate countries in the fields of industrial co-operation, investment, industrial standardisation and conformity assessment as provided for in the Europe Agreement is also an important indicator of development in the right direction.

Descriptive Summary

Industrial output of Estonia stood at around 0.8 bn Ecu in 1995, or less than a third of the industrial output of Luxembourg and it has a 23% share in GDP. Industry accounts for 185 thousand jobs (28% of total employment). The food processing industry (20% of the industrial work force), light industry (19%), engineering and metal processing (19%), engineering and metal processing (19%) and wood processing industry (11%) are the main employers. The total number of industrial enterprises is estimated at around 4600, nearly all are SMEs.

Estonia's economic structure to a large extent has overcome the inefficient system of inter-regional labour division under Soviet occupation regardless of its natural resources and limited national market. Yet with the beginning of the transition in Estonia radical changes took place in its industry. The recovery in GDP growth since 1994 can be primarily attributed to an expansion in industrial production, a sizeable increase in the number of new private businesses and a rise in foreign direct investment (FDI). In 1990 heavy industry accounted for half of industrial production and it is currently being forced to improve product quality and production technology. A special feature of recovery of the Estonian industry is its strong involvement in outward processing trade (OPT, covering 12% of all imports), practised mostly in the textile industry with Finland and Sweden. While EU companies want to benefit from the low labour costs in Estonia, Russia has its semi-finished products processed in Estonia because of its higher production quality. The ongoing process of modernisation of the Estonian economy is reflected in the high share of machinery and technical equipment in imports. Conversely the composition of exports increasingly reflects the country's current comparative advantages in low value added sectors, such as wood processing, the paper industry, textiles and food stuffs. Estonia has been very successful at reorienting its exports to western markets.

Estonian Industry, main production sectors in 1995

Sector	% share industrial employment	% share industrial output[1]
Food Industry	15	40
Textile and Clothing	14	11
Forest Industry and furniture	11	15
Mechanical and electrical engineering	12	11
Chemical Industry and pharmaceuticals	7	12
Transport Equipment	3	5
Other non-metallic mineral products	3	6
Construction	20	n.a.
Total	100	100
pm: Share industry (excl. construction) in total GDP	*23*	

The **food industry** is the most important sector in Estonian industry. Production capacity was designed to meet the requirements of Estonia and many parts of the FSU. Market collapse led to sharp output reductions. Despite the recession, however, the food industry managed to retain its leading position in Estonian industry. Reorientation of the industry toward EU markets proved difficult because of trade restrictions and quality and hygiene requirements. An important part of Estonia's food exports still go to Russia in spite of the high import tariffs imposed by Russia on Estonian products. The food industry is the favourite target of foreign investors, which has led to restructuring and an improvement of the technological level of manufacture. There are also steps taken on the legislative side to improve quality and meet EU requirements. It is possible that the sector will be sufficiently advanced at the time of accession. The long term outlook for especially fish products, manufacture of beverages and dairy products is relatively good.

The **textiles and clothing** industry is the second most important sector in the Estonian industry and is dominated by a small number of large, privatised companies. Low labour costs and low capital investment needs have made it Estonia's most important sector for subcontracting and outward processing trade. However, Estonian companies have started to reduce the number of subcontracts and to concentrate on the export of own collections. With labour costs expected to rise in the future, there will be further adjustment needs.

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The **wood industry** is also a major branch of industry and, given that a large part of Estonia's territory is forest, the industry has the domestic resources for its development. The mechanical forest industry, especially furniture, has strong competitive advantages due to inexpensive wood, a very skilled low-cost labour force and a low capital investment need due to the high share of manual work. Furniture accounts for more than half of total output in the forest sector, which has strong trade links with the EU. This sector should develop well and accession should not pose a problem. The chemical forest industry will have to compete on both domestic and export markets with technologically more advanced manufacturers. Especially the pulp industry is technologically obsolete and causes great environmental damage. Given the backwardness of this sector considerable investments have to be carried out to improve its competitive.. In its present state this industry is not sufficiently competitive..

Mechanical and electrical engineering: Privatisation is largely completed. Due to low-labour costs the sectors attracted subcontracting and now accounts for a quarter of total OPT imports and exports. Overall, however, most production is still destined for the former Soviet Union and CEECs. The **chemical** industry is very small, mostly producing fertilisers. Production facilities strongly need modernisation and large investments to protect the environment. The **pharmaceutical** industry has completed impressive reforms, including privatisation, the establishment of regulatory authorities, and a harmonised legislative framework. Most **mining** activities are connected with oil-shale-mining which has devastated large parts of the countryside in the North East.

Estonia has followed a rapid and determined privatisation policy. With the creation of the Estonian Privatisation Agency (EPA) the earlier organisational problems of the privatisation process have been overcome. The privatisation of small businesses is now practically complete. By May 1996 virtually all of the 450 large and medium-scale-enterprises that were included in the government's original programme for assets sales have been privatised. According to EBRD estimates by 1996 the private sector already contributed around 70% to GDP, and this is expected to rise further. The focus is now on the restructuring and privatisation of monopoly infrastructure companies (in particular utilities).

Current and Prospective Assessment

Industry is only a small part of the Estonian economy, smaller than in any other of the applicant countries. It is heavily concentrated in only a few key sectors: food products, wood and paper, furniture, textiles and clothing, which together represent more than half of total industrial output. These sectors have a sound basis in terms of the raw materials available, the topography of the country, and prevailing low wage levels. Nonetheless, considerable modernisation is necessary in some subsectors such as the pulp industry in particular. Other sectors which have been developed as part of the planned economy of the Soviet Union, such as mechanical and electrical engineering, appear also to be vulnerable. The pharmaceuticals sector, on the other hand, can be considered as an example of impressive reform.

The strong points of Estonian industry are the favourable macroeconomic environment and the high investment rate. Moreover, as a result of their sound financial policies and the consolidation of the banking sector industry can already obtain medium to long term credits.

Privatisation of industry is largely completed. While some sectors of Estonia's industry such as textiles and clothing, pharmaceuticals and the construction sector) have largely been privatised and modernised - often with the help of FDI - and hence perform well on export markets, other sectors (like the food industry, wood processing and paper production, mechanical and electrical engineering, chemicals and construction materials) are still in the process of restructuring and in need of further capital investments for modernisation to gain competitiveness.

Conclusion on Industrial Competitiveness

Estonia has made good progress in industrial restructuring and in the adoption of EU industrial legislation. Provided that current efforts and foreign capital inflows are continued, in the mid term one can expect that only very limited problems for industrial competitiveness will remain, which should not develop into obstacles for full participation in the enlarged EU market.

An evaluation of the *acquis* specific to the free circulation of industrial goods is to be found in the separate section on the internal market.

Agriculture

The Common Agricultural Policy aims to maintain and develop a modern agricultural system ensuring a fair standard of living for the agricultural community and the supply of food at a reasonable price for consumers, and ensuring the free movement of goods within the EC. Special attention is given to the environment and rural development. Common market organisations exist to administer the CAP. These are complemented by regulations on veterinary health, plant health and animal nutrition and by regulations concerning food hygiene. Legislation also exists in the area of structural policy, originally developed primarily to modernise and enlarge agriculture, but more recently with an increasing emphasis on the environment and the regional differentiation of the policy. Since reforms in 1992, increasing contributions to farm support have come from direct aid payments increasingly compensating for reduced market support prices.

The Europe Agreement provides the basis for agricultural trade between Estonia and the Community and aims to promote co-operation on the modernisation, restructuring and privatisation of Estonia's agriculture sector as well as on the agro-industrial sector and phyto-sanitary standards. The White Paper covers the fields of veterinary, plant health and animal nutrition controls, as well as marketing requirements for individual commodities. The purpose of such legislation is to protect consumers, public health and the health of animals and plants.

Descriptive Summary

Agricultural Situation

The value of the agricultural production in 1995 was approximately 0.13 % of that of the Union.

Agriculture's share of GDP declined after independence from around 20 % to 7 % in 1995. Employment in agriculture contracted to 7%. Until 1994 the economy contracted and consumption shifted from dairy and meat products to bread and cereals. Around 46 % of the total land area is covered by forest (2 million ha) whereas 32 % serves as agricultural land (1.5 Mio ha).

The Estonian farm sector is currently in the process of privatisation. Large scale farming enterprises (former state farms) with different legal structures (co-operatives, limited liability and joint stock companies) still manage about 30 % of agricultural land (average size: 520 ha), whilst the remaining 70 % of the agricultural land is equally shared between 14,500 family farms (average size: 23 ha) and household plots (average size: less than 2 ha).

The return to legal owners of 1.2 million hectares of land has been requested. By May 1997 500,.000 hectares (42 %) have been returned and registered in the land register. Completion is planned for the year 2000.

850,.000 hectares of land has not been claimed back and will, for the time being, be left in state ownership and leased.

In 1995, Estonia produced 514,000t cereals, 539,000t potatoes, 2,000t oilseeds, 812,000t milk (self-sufficiency: 148%), 25,000t beef meat (92%), 46,000t pig meat (109%).

The food processing industry currently represents 34% of total industrial output and its employment has remained fairly constant at about 4% since 1986. The food processing industry has faced two main problems, falling domestic demand although this now seems to be stabilising, and increasing imports due to the absence of customs protection. Meat (22%), dairy (20%) and fish (17%) processing dominate agro-food activity. Nearly all food processing enterprises have been privatised. None of the Estonian meat processing facilities have been certified for export to the EU.

Trade in agriculture and fishery products has traditionally been an important element of the Estonian economy. In 1995, agricultural products represented 16.6% of total exports and 14.3% of imports. The majority (65%) of Estonian agricultural exports (mainly fish, meat and dairy products) go to New Independent States and 29% to the EU. Estonia is a net importer of agricultural products and the EU has a positive trade balance of 157 MECU (1995) with Estonia. Sugar, beverages, fats and oils are predominant on imports.

Agricultural Policy

The PSE (producer subsidy equivalent) calculated by the OECD was 3% in 1995, compared to 49% for the EU.

Estonia has until now followed a very liberal policy towards agriculture. Despite the fact that several laws foreseeing increased support for farmers have been adopted by the Parliament, they have so far only been implemented to a very limited extent and total budgetary spending on agriculture remains relatively low (16.4 MECU) or 3.4% of the total budget in 1993.

Few product-specific support policies exist. Programmes are mainly aimed at improving seed and breeding quality, registration and training. The main instrument used to provide support to the agricultural sector is the Agricultural and Rural Life Credit Fund (ARLCF), which provides credits for farms and the processing industry.

The only public intervention is the state procurement for the national grain reserve; this is equivalent to six months of human consumption (50,000t). However, in practice this policy objective has not been met.

Agricultural prices are not regulated and are significantly lower than EC prices although increasing since 1992; (in 1995 e.g. wheat: 73% of average EC price; beef meat: 38%; pig meat: 88.6%; milk: 47%). Rural development policies are still at the debating stage and no single ministry is responsible for policy formulation.

Estonia pursues a free trade policy and has no customs protection in place. The Free Trade Agreement between Estonia and the European Community entered into force on 1 January 1995. Estonia has completely liberalised its market access, while the Community has granted concessions either with unlimited access or in the framework of tariff quotas.

At this stage the impact of the Free Trade Agreement on animal products has been limited to the dairy sector, the only sector where some products (e.g. powdered milk) meet the minimum hygiene standards of the EU.

During 1996, the Baltic Free Trade Agreement was extended to agricultural products. The Agreement entered into force by 1 January 1997 and is intended to be the first step in the formation of a customs union. In May 1995, Estonia ratified a free trade agreement with the Ukraine. Estonia is currently negotiating membership of the WTO.

Estonia has started the process of adapting legislation identified in the White Paper.

Current and Prospective Assessment

Cereal production and yields might recover to reach near self-sufficiency levels in the medium term, and Estonia has the potential for increasing in livestock products. However Estonia's potential for exporting their dairy and livestock produce to the EU can only be realised once EC quality and hygiene standards are achieved. Due to over capacity and outdated technology this sector is still lagging behind the general recovery.

The main market policy instruments applied in the EC are not applied in Estonia. This includes key instruments such as dairy quotas, key features of the arable crop scheme (base area, set-aside, compensatory payments, and premiums in the livestock sector), as well as certain rural and structural development programmes.

Management and control of these measures would require relatively sophisticated administrative systems, including an appropriate land register and cattle identification and registration systems. As a general observation, it is clear that the administrative capacity would need to be further developed in these areas if these measures were to be applied in Estonia; the State grain board would need to be dismantled.

It is difficult to foresee at this stage what will be the development of agricultural support prices in Estonia in the period before accession; this will depend on a number of factors including the domestic economy, the situation on export markets, and the development of price support levels in the Union.

Estonia is introducing the legislation identified in the White Paper.

In the veterinary field, considerable work remains to be done in adapting Estonian national legislation to EC requirements. This includes approximation of legislation (the aim is to complete it by 1998) as well laboratories facilities and establishment of a fully resourced official veterinary service, including the imposition of effective controls at border inspection points, and on goods transiting the country. Certification procedures, introduction of an effective animal identification system need to be further developed. Legislation on animal welfare will be required.

There will be a need to upgrade certain food processing establishments both for trade and for the internal market.

In the field of animal nutrition current legislation appears to be inconsistent with Community rules. Approximation of legislation is in an initial stage, and no timetable is given for the completion of the work.

As regards plant protection products and organic farming, legislation is not harmonised with EC legislation but work on adoption of the legislation has been initiated. It appears that pesticide residue monitoring is not carried out in Estonia at present.

As regards seeds and propagation material legislation is stated to be harmonised with that of the EC. Estonia does not enjoy equivalence for any EC species and it seems that considerable amount of work still needed to truly approximate and establish necessary developed infrastructure.

Adoption of legislation approximating to EC legislation on plant health was anticipated for the end of 1996.

Conclusion

Substantial efforts of alignment to the *acquis* are still necessary, although progress has been made in adopting the measures mentioned in the White Paper.

Particular efforts are needed in relation to : -

- implementation and enforcement of veterinary and phytosanitary requirements and upgrading of establishments to meet EC standards; this is particularly important with regard to the inspection and control arrangements for protecting the EU external borders;

- strengthening of the administrative structures to ensure the necessary capacity to implement, and enforce policy instruments of the CAP including the import arrangements;

- further restructuring of the agro-food sector to improve its competitive capacity.

Since only a limited number of the mechanisms of the common agricultural policy presently exist, fundamental reform of the agricultural policy will be needed, and a substantial effort will be necessary to prepare for accession in the medium term.

Fisheries

The Common Fisheries Policy includes common market organisations, structural policy, agreements with third countries, management and conservation of fish resources, and scientific research in support of these activities.

The Europe Agreement includes provisions concerning trade in fisheries products with the Community and provides for cooperation. The White Paper includes no measures in this field.

Descriptive Summary

In 1995, Estonia's fisheries provided 2.6% of GDP. Fisheries employ approximately 20,000 workers. Estonia has privatised the entire fishing sector.

The distant water fleet (North West Atlantic) has been reduced from 75 vessels in 1991 to 31 vessels at 1 January 1996 with a corresponding catch reduction from 230,000 t to 70,000 t all of which is exported. Main species caught are horse mackerel, redfish and blue whiting (mainly NAFO area). In the Baltic, 161 vessels are deployed by small private companies and a further 500 boats under 12m length make up the coastal fleet. The total catch was 60,000 t in 1995 (mainly herring, sprat and cod - all under quota). Over half of the fleet is more than 20 years old.

Fisheries comprise a sizeable branch of the Estonian food industry, but it operates at only 40-50% of its capacity. 120 enterprises in 1994 produced 102,000t (down from 233 000t in 1990) of which 30,000t was canned produce. Shore-based production was 34,000t and relies on imports for variety and to maintain capacity. Total employment in this sector is 8,000.

The aquaculture production (mainly trout and carp) has fallen from a peak of 1,700t in 1989 to 317t (value: 0.4 million ECU). Total employment in this sector is 2,000.

As a trading partner of the Community, Estonia represents 0.15% of EU total imports (independently of origin) of fisheries products and 6% of EU imports of fisheries products from the candidate countries. As regards EU exports, Estonia receives 0.13% of the total EU exports of fisheries products and 1,5% of our exports of these products to the applicant countries (in terms of value).

Management of the resources in the Baltic Sea is currently accomplished between EU and Estonia in the framework of a common body - the International Baltic Sea Fishery Commission.

No protectionist import measures or national subventions are applied.

Current and Prospective Assessment

Estonia's production and foreign trade data, when compared to the corresponding EU figures, are low and unlikely to have any significant impact upon the whole Community.

Capacity adjustment of the fleet, the modernisation of the whole sector, and the determination of the necessary structural aid will become the main issues.

According to the data available as regards fisheries agreements concluded and Estonia's membership to international or regional fisheries organisations, no major problems should be expected.

It will be necessary for Estonia to establish a fisheries administration which is capable of implementing the Common Fisheries Policy - in particular, the management of resources, the keeping of a fishing fleet register, the application of structural policy for the sector, the management of the market scheme and the collection of all statistical data - as well as the EU's policies on health, hygiene and environmental matters.

Conclusion

The process of modernisation and *acquis* implementation will require significant efforts. The entry of Estonia into the Community fisheries policies does not appear to pose any major problems.

Energy

Main EU energy policy objectives, as reflected in the Commission White Paper "An energy policy for the EU" include enhancement of competitiveness, security of energy supplies and protection of the environment. Key elements of the energy *acquis* comprise of Treaty provisions and secondary legislation particularly concerning competition and state aids, internal energy market (including directives on electricity, price transparency, gas and electricity transit, hydrocarbons licensing, emergency response including security stock obligations, etc.), nuclear energy, as well as energy efficiency and environmental rules. Development of Trans-European Energy Networks and support for energy R&D are other important elements of energy policy. Ongoing developments include liberalisation of the gas sector, energy efficiency *acquis* and the Auto-oil programme.

In the field of nuclear energy, the Community *acquis* has evolved substantially from the original EAEC Treaty to a framework of legal and political instruments, including international agreements. At present, it addresses issues of health and safety, including radiation protection, safety of nuclear installations, management of radioactive waste, investment including EURATOM financial instruments, promotion of research, nuclear common market, supplies, safeguards, and international relations.

The Europe Agreement provides for co-operation to develop the progressive integration of the energy markets in Europe and includes provisions on assistance within the related policy areas. The White Paper preparing CEECs for the internal energy market underlines the need for full application of key internal market directives in combination with EC competition law. As to the nuclear sector, the White Paper refers to nuclear supply safeguards and shipments of nuclear waste

Descriptive Summary

Estonia's energy sector and particularly electricity production is dominated by indigenous oil shale (a solid fuel geologically not related to coal). Use of domestic peat, wood and wind is increasing and represents 5% of the country's energy balance. For the remaining 35% of its needs, particularly for oil and gas, but also coal the country is dependent on Russia. Electricity of nuclear origin is not generated in Estonia.

The energy sector is inefficient with an intensity 2-4 times higher than EU levels, due to its heritage of low prices, inadequate policies and obsolete technologies.

Estonia is presently looking into a better connection of its energy network to the EU. Although a possible future Baltic electricity ring could contribute to such a connection, it is expected that in the medium term Estonia will remain linked to the Russian power system.

Current and Prospective Assessment

Estonia's energy policy objectives are in line with those of the EU and include security of energy supplies, including diversification; introduction of more market principles; environmental protection, increase of efficiency; and enhanced Baltic energy co-operation. Particularly in the energy sector such Baltic co-operation is beneficial due to complementarities among the countries concerned.

The competition framework in the energy sector does not yet fulfil the directives of the internal energy market in combination with the application of EC competition law. Although the Estonian Competition Law of 1993 is applicable to energy utilities, there is no specific legal and regulatory framework for the energy sector which may ensure compliance with EU legislation including the rules of the internal energy market. The current efforts to adopt the Energy Act, including the necessary secondary legislation, should therefore be pursued. Implementation of this Act would bring Estonia nearer to EU*acquis*.

The energy sector is generally characterised, with the exception of oil and coal trade, by state dominated monopolies. Privatisation has however started and is likely to include certain large energy companies. Energy prices have been considerably increased but particular household prices need to be further adapted in order to recover costs.

Emergency preparedness in the energy sector including the obligation to hold ninety days of oil stocks does not comply with *acquis*. Although work has started internally there is not yet a time table or investment funds to comply with this part of the *acquis*.

Oil shale mining and burning are inefficient and present considerable environmental problems. They represent two thirds of Estonia's SO2 emissions. Reducing the dependency on oil shale will involve a major restructuring programme and Estonia will have to address its socio-regional consequences.

The country will have to step up efforts to adopt Community norms and standards on energy efficiency (e.g. labelling appliances and minimum efficiency standards) and on environmental protection (e.g. on fuel quality).

Although Estonia has no nuclear programme, it will need to comply with the Euratom Treaty and related policies in such fields as radioactive waste management, radiation protection, supply of nuclear materials, safeguards and accession to international agreements concluded by Euratom. As there is no nuclear programme, Estonia is not yet party to the international agreements and other regimes in the nuclear field nor has it implemented those conventions to which it is party (Convention on the Physical Protection of Nuclear Materials and the Vienna Convention on civil liability).

Furthermore, no full-scope safeguards agreement is yet in force with the IAEA, but it is party to the Treaty for the non-proliferation of nuclear weapons and is preparing for future full-scope safeguards.

As it has no nuclear reactors nor indeed any other nuclear industry, no particular problems are expected in applying Community legislation relating to supply and the nuclear common market or in implementing the Euratom safeguards system in Estonia.

Conclusion

The nuclear waste situation of the former Soviet Paldiski naval sub-marine base should be followed closely.

Provided that current efforts are intensified, no major problems are foreseen to approximate the energy related *acquis* in the medium term. Of specific importance in the pre-accession period will be the adjustment of monopolies including import and export issues, access to network, energy pricing, state interventions and restructuring of the oil shale sector, emergency preparedness including the building up of mandatory oil stocks, energy efficiency and environmental norms.

No major difficulties are foreseen for compliance with Euratom provisions.

Transport

Community transport policy consist of policies and initiatives in three fundamental areas:

- Improving quality by developing integrated and competitive transport systems based on advanced technologies which also contribute to environmental and safety objectives.
- Improving the functioning of the single market in order to promote efficiency, choice and user-friendly provision of transport services while safeguarding social standards;
- Broadening the external dimension by improving transport links with third countries and fostering the access of EU operators to other transport markets(The Common Transport Policy Action programme, 1995-2000).

The Europe Agreement provides for approximation of the legislation with Community law and co-operation aiming to restructure and modernise transport, the improvement of access to the transport market, the facilitation of transit and the achievement of operating standards comparable to those in the Community. The White Paper focuses on measures for the accomplishment of Internal Market conditions in the transport sector, including such aspects as competition, legislative harmonisation and standards.

Descriptive Summary

Estonia's virtually ice-free Baltic ports meant that it was a significant transit route for trade between the former Soviet Union and the West. As a result, its ports developed capacities for particular trades which are no longer fully exploited. The country's role as a transit corridor between Western Europe and Russia and the Central Asian States is however dependent on the state of relations with Russia, which have not always facilitated this traffic. The establishment of new frontiers with Russia and Latvia has also affected the competitiveness of Estonia as a transit route. Estonia needs therefore to invest in improvements to its East-West rail network and to improve border crossing infrastructures at all the new borders, as well as in its ports. Estonia territory is crossed by one Pan-European Transport Corridor, as identified at the Pan-European Transport Conference in Crete.

Although the general improvement in the Estonian economy has led to transport taking an increasing share of GDP, the changes in the Estonian economic situation induced a sharp decrease in absolute transport demand following the opening of the country. Nonetheless demand is rising again, without recovering to its former level. At the same time there is an accelerating change in the modal split, with road transport of goods increasing its share, and railways and inland waterways declining. Use of private cars has grown very rapidly and it is now dominant in passenger transport, partly as a result of relatively low petrol prices, resulting in an increase in congestion in the cities and around them, as well as at certain border crossings.

Current and Prospective Assessment

In terms of implementing the internal market, Estonia has made great efforts to adapt its legislation to the Community *acquis*. The international transport sector in Estonia to a large extent already applies rules similar to those applied in the Community, particularly in inland waterways and combined transport. Estonia should have no problems with road passenger transport, provided that Community rules on access to the profession are rapidly adopted. In the railway sector, the actual application of the *acquis* as regards public service provision and the standardisation of accounting systems will have to be monitored over the coming years.

Road haulage should not pose major difficulties for the accession of Estonia, provided that, during the pre-accession period, the Estonian authorities adapt their legislation on weights and dimensions and access to the occupation of road haulage operator to Community legislation. Roadworthiness tests will also have to be brought into line with Community rules.

As regards maritime traffic, Estonia still has some way to go in adopting the *acquis* in its safety legislation. Considerable progress has been made in the air transport sector, particularly as regards reorganisation and, provided progress continues, the sector should not pose any major problem for accession as long as the majority of the planned legislation actually enters into force in 1998/99.

The development of an integrated and competitive transport system is a goal accepted by the Estonian authorities. The main difficulties will probably be achieving satisfactory levels of safety and efficient use of the transport system. Estonia has made satisfactory progress on safety. However, achieving a coherent transport system appears to be more difficult. The share taken by road transport is likely to continue to grow and Estonia will have to put effort into promoting the use of the rail network.

In order to improve links with the Member States of the Community and with its neighbours, between 1995 and 1999 Estonia is planning to invest around ECU 100 million from the national budget in transport infrastructures used by international traffic, particularly the pan-European corridors. At around 0.7% of GNP, this will be insufficient.

Conclusion

Estonia has made significant progress in adapting its transport legislation to the *acquis*. Provided efforts are made, and legislation is actually implemented, in road haulage (access to the sector, weights and dimensions), the maritime sector (safety) and, to a lesser extent, air transport, and provided financial transparency is improved in the rail sector, transport should not pose major difficulties as regards the adoption of the internal market *acquis*.

However, steps should be taken to ensure that the means required to lay the basis for the future extension to the accession countries of the trans-European transport network are provided, which does not seem to be the case at the present time. Furthermore, Estonian administrative structures, including inspection bodies such as, for example, those in the area of safety, should be rapidly strengthened.

Small and Medium Enterprises

EU enterprise policy aims at encouraging a favourable environment for the development of SMEs throughout the EU, at improving their competitiveness and encouraging their Europeanisation and internationalisation. It is characterised by a high degree of subsidiarity. The complementary role of the Community is defined and implemented through a Multiannual Programme for SMEs in the EU. This programme provides the legal and budgetary basis for the Community's specific SME policy actions. The *acquis* has so far been limited to recommendations on specific areas, although legislation in other sectors also affects SMEs (e.g. competition, environment, company law).

The Europe Agreement provides for co-operation to develop and strengthen SMEs, in particular in the private sector, inter alia through provision of information and assistance on legal, administrative and tax conditions. The White Paper contains no specific measures.

Descriptive Summary

As a result of the reform policy creating a market economy and supported by the privatisation process, the number of private companies grew rapidly since the late 1980s. In 1995 10,000 new companies were established. Small and medium sized enterprises (SMEs) dominate in construction, wholesale and retail trade and in other services. Their contribution to employment has increased annually. By the end of 1995 it accounted for more than 54%. Although the share of large enterprises of the economy has declined considerably, large companies still dominate in industry and in energy production.

The Estonian enterprise policy is quite general as it aims at stimulating the business climate for all enterprises regardless of size. However, the Law of State Support for Entrepreneurship of 1994 establishes a Small Business Loan and Guarantee Fund and a Rural Life and Agricultural Credit Fund. There are no specific accounting rules applicable for SMEs, except for an exemption from audit in the case of very small enterprises. Support for SMEs is available through the SME Office at the Ministry of Economy and the Department of Local Government and Regional Development at the Ministry of Internal Affairs, as well as through non-governmental intermediaries such as the Estonian Small Business Association, the Chamber of Commerce and Business Advisory Service Centres.

Current and Prospective Assessment

The basic structures for SMEs are in place, but there is a need for further refinement and increased coherence of policy, simplification of legislation to make it more SME friendly, strengthening of support infrastructures, improvement of the tax environment and development of SMEs' access to financing.

Due to the liberal trade regime of Estonia, the SMEs are already, also on the domestic market, exposed to considerable pressures from international competition. It is however likely that the competitive pressures on Estonian SMEs will become even stronger by participation in the internal market. The on-going efforts to strengthen the SMEs during the pre-accession period will therefore need to be continued.

Conclusion

No specific problem areas are expected identified regarding Estonia's integration into the Community's SME Programmes.

3.5 Economic and Social Cohesion

Employment and Social Affairs

Community social policy has been developed through a variety of instruments such as legal provisions, the European Social Fund and actions focused on specific issues, including public health, poverty and the disabled. The legal *acquis* covers health and safety at work, labour law and working conditions, equal opportunities for men and women, social security co-ordination for migrant workers and tobacco products. Social legislation in the Union has been characterised by laying down minimum standards. In addition, the social dialogue at European level is enshrined in the Treaty (Article 118B), and the Protocol on social policy refers to the consultation of the social partners and measures to facilitate the social dialogue.

The Europe Agreement provides for approximation of legislation with Community law and co-operation on improving standards of health and safety at work, labour market policies and the modernisation of the social security system. It also provides for Community workers legally employed in Estonia to be treated without discrimination on grounds of nationality as regards their working conditions. The White Paper provides for measures for approximation in all the areas of the *acquis*.

Descriptive Summary

Social dialogue takes place both on bipartite and tripartite levels and mainly involves two unions, with regular contacts to the European Trade Union Confederation (ETUC), and two employers' organisations which are not members of the Union of Industrial and Employers' Conference of Europe (UNICE). The social dialogue appears to be developing well.

According to ILO methodology, the unemployment rate was about 7.6% in 1994 (latest figures). However, a labour market survey carried out by the Labour Market Board in 1995 according to EU standards shows unemployment at approximately 9%. The regional disparities are considerable.

On labour market policy, Estonia has developed a regionalised employment service structure to deliver active labour market policy. This is one precondition for functioning labour markets, which has to be supplemented with a range of labour market policy measures to ensure an efficient allocation of labour and a capacity for continuous adaptation to structural change.

Estonia is in the process of preparing a number of social reforms replacing earlier laws. There is a draft law on social security on the way which will form the framework for social legislation and provide the basis for discussions on new financing arrangements and the pension reform. At the present, social contributions are paid by employers as a special tax while employers and employees might share the cost under a new system. New laws are under preparation on social benefits for disabled persons and pensions. Continued efforts are required to ensure that measures of social protection are developed.

The health system in Estonia will need to be significantly improved.

Current and Prospective Assessment

Estonia adopted in December 1996 a new Occupational Health and Safety Act laying down the basic principles for the protection of health and safety at work, which was modelled on the EU framework directive. But many of the specific measures have still not been introduced.

Some are apparently under preparation. Estonia has set up a plan which provides for the conclusion of approximation in the social field by 1999. Independent inspection structures, in accordance with the ILO rules, are not yet in place but are expected to be operational in 1998.

Estonia has already incorporated some of the main principles of the Community labour law in its national legislation. But new laws and substantial adjustments to existing laws are needed to ensure conformity with the *acquis* on collective redundancies, transfer of undertakings and the protection of employees in case of insolvency of the employer. In a number of other areas such as information applicable to the work contract or employment relationship and working time, further steps will be needed to ensure compliance with the *acquis*. The information and consultation of workers on company level as requested by a number of EC Directives needs to be strengthened.

The basic provisions of EC non discrimination law between women and men are covered by the Estonian legislation. The non discrimination principle is not always respected in practice, particularly in the field of equal pay for equal work and in gender based advertising. The difference in pay between women and men is considerable. Adaptation is necessary in the field of parental leave for fathers.

Concerning the right to the free movement of workers, there would appear to be no obstacles to prevent Estonia from being able to implement the provisions of the *acquis* in this area. The introduction of the right to free movement will however require changes in the national law, particularly as regards access to employment and a treatment free from discrimination on grounds of nationality.

In the field of social security of migrant workers accession does not, in principle, pose major problems, although some technical adaptations will be necessary. More important is the administrative capacity to apply the detailed co-ordination rules in co-operation with other countries. Estonia appears to have many of the administrative structures required to carry out these tasks, but further preparation and training will be necessary before accession.

The two Directives on the warning labelling of cigarettes and maximum tar content have not yet been transposed into the national legislation. The Estonian authorities have announced that legislation covering the Directives is under preparation, and approval is expected before the end of 1997.

Conclusion

Social reform should be pursued, and the public health system needs to be significantly improved. In addition, the social dialogue should be further developed. Estonia will need to make efforts to ensure the realignment of its legislation with EC requirements in areas such as of health and safety, labour law and equal opportunities and continue to develop the structures to ensure effective implementation of legislation. If Estonia pursues its efforts, it should be possible to take on the obligations of EU membership in the medium term.

Regional Policy and Cohesion

In accordance with Title XIV of the Treaty, the Community supports the strengthening of cohesion, mainly through the Structural Funds. Estonia will have to implement these instruments effectively whilst respecting the principles, objectives and procedures which will be in place at the time of its accession.

The Europe Agreement provides for co-operation on regional development and spatial planning, notably through the exchange of information between local, regional and national authorities and the exchange of civil servants and experts. The White Paper contains no specific provisions.

Descriptive Summary

Estonia was at some 23% of EU average GDP in 1995. In spite of the country's small size, there are considerable differences between the regions as with regard to economic development. These disparities can be generalised as a division between the eastern and the most prosperous western parts.

Estonia is divided into 15 regional administrative units, the "maakond", and 254 self-governing municipalities with independent budgets and the right to impose local taxes.

Regional Policy Guidelines were approved by the Government in 1994 and by the Parliament in 1995. Special efforts are targeted at areas with specific economic problems:

- counties in eastern and southern Estonia,
- the small islands,
- the border areas,
- monofunctional industrial areas.

Estonia's regional development policy constitutes an integral part of its national development policy. Indeed, regional development initiatives are implemented through sectoral policies, in accordance with the « Regional Policy Guidelines ». The

Ministry for Internal Affairs assumes overall responsibility for regional development actions. The National Regional Policy Council, composed of representatives from concerned ministries, insures proper inter-ministerial co-ordination. Spatial planning is under the responsibility of the Ministry of Environment.

Government programmes have been launched to stimulate the development in such fields as conversion of large industrial conglomerates, conversion of former military activities, integration of the non-Estonian population and village development. A network of regional business promotion centres has been established.

Estonia's regional policy instruments are very limited. Moreover, the share of total development related expenditure constituting potential counterpart funds to EU structural policy cannot yet be determined. Therefore, Estonia's co-financing capacity cannot presently be evaluated with sufficient reliability.

Current and Prospective Assessment

Within the framework of its national economic policy, Estonia implements certain regional development initiatives. However, the financial resources at the disposal of these initiatives are very restricted and need to be strengthened in the perspective of accession to match the EU's structural initiatives.

Ministerial responsibility seems well entrenched but procedures to insure proper interministerial co-ordination cannot solely rely on the National Regional Policy Council. Moreover, administrative and budgetary procedures should be established in order for Estonia to be able to channel EU actions.

Conclusion

Estonia's progress in establishing a regional development policy is limited. A differentiated policy addressing regional disparities should be introduced. Moreover, given Estonia's size, its regional policy should continue to constitute an integral part of the national development strategy. Yet, Estonia's administrative capacity suggests that, given the necessary political support, the administrative and budgetary structures to manage the integrated EC structural actions could be established. Thus, subject to the necessary reforms, Estonia should, in the medium-term, be ready to apply the Community rules and to channel effectively the funds from the EC structural policies.

3.6 Quality of Life and Environment

Environment

The Community's environmental policy, derived from the Treaty, aims towards sustainability based on the integration of environmental protection into EU sectoral policies, preventive action, the polluter pays principle, fighting environmental damage at the source, and shared responsibility. The *acquis* comprises approximately 200 legal acts covering a wide range of matters, including water and air pollution, management of waste and chemicals, biotechnology, radiation protection, and nature protection. Member states are required to ensure that an environmental impact assessment is carried out before development consent is granted for certain public and private projects.

The Europe Agreement stipulates that Estonian development policies shall be guided by the principle of sustainable development and should fully incorporate environmental considerations. It also identifies environment as an area for bilateral co-operation, as well as for approximation of legislation to that of the Community.

The White Paper covers only a small part of the environmental *acquis*, namely product-related legislation, which is directly related to the free circulation of goods.

Descriptive Summary

The environmental situation in Estonia is comparatively good having improved in recent years, partly as a result of the rapid decline in industrial and agricultural production in recent years, and partly as a result of high levels of environment related investment. However, there are still important problems, a major challenge being the highly polluting *oil shale industry*, which accounts for a major portion of energy production.

Although sulphur emissions from the plants have halved since 1990, due to reduction in power generation, Estonia is still a net exporter of sulphur dioxide, and substantial remediation measures such as flue gas desulphurisation and anti-particulate filters are necessary. Oil shale use also causes leaching from toxic ash dumps and contamination of agricultural land. The government is currently considering plans to replace the old boilers with new technology, but no timetable has been fixed.

Over the years, Estonia has accumulated significant quantities of *wastes* including military, industrial and hazardous waste. A programme to provide technical and financial assistance for municipalities, which are responsible for waste water treatment and drinking water supply, has been adopted. Estonia has ratified both the 1974 and the 1992 Helsinki Conventions on the protection of the Baltic Sea and has made a good start in reducing untreated *waste water* discharges to the Baltic Sea. An international working group has been set up to assist Estonia with the *radioactive* waste aspects of the development of a decommissioning plan for Paldiski site (former Soviet Navy training centre). The country contains important reserves of natural marine, lake and forest biodiversity.

Public environmental expenditure as a percentage of GDP is high with respect to average EC levels, and there is government commitment to fund environmental investment, especially for Baltic Sea 'hot-spots'. Estonia has been very successful in mobilising foreign assistance, with some 40% of investments financed by international loans. A high level of public awareness exists on environmental issues, though particular attention is needed to problems that could arise from uncontrolled economic development.

Estonia embarked in project development before reforming its legislation. However, some important environmental legislation was passed in 1994, including amongst others a water act, regulation of waste water discharge, on the movements of hazardous waste and the setting up of the Environmental Fund. In 1995 followed the act on Sustainable Development. Recently the National Environmental Strategy was adopted, and a detailed National Environment Action Plan is being implemented. However, although sectoral legislation has been passed, applicable standards and regulations are often still those of the former Soviet Union. The new legislation tends to be of a framework nature, needing to be fleshed out with standards, implementation measures and administrative structures.

Current and Prospective Assessment

Approximation of Estonian environment legislation to the EC *acquis* is under way, and should be achievable in the medium term. The Government's objective is to adopt by the end of 1998 all White Paper legislation. An approximation strategy for the non-White Paper legislation should be ready in 1998. Efforts will be needed in order to make the recent waste, water and nature legislation fully compatible with EU legislation. Radiation protection and radioactive waste legislation are still missing. In this area there is generally a lack of safety culture. Particular attention should be given to the quick transposition of framework directives dealing with air, waste, water and the Integrated Pollution Prevention and Control directive (IPPC), as well as the establishment of financing strategies for legislation in the water, air and waste sectors requiring major investments.

Effective compliance to the EC *acquis* will be most difficult to achieve in the large combustion plant area and in the water sector (especially waste water treatment for small and medium size towns), because of the importance of investment needs. High levels of investment will also be needed in industry. Urban air pollution, solid and hazardous waste management, and management of municipal waste are also areas where investment together with greater public awareness is required. The radioactive waste situation of the former Soviet Paldiski naval submarine base should be followed closely. Adequate implementation and enforcement structures will have to be developed. An important bottleneck which needs to be addressed is the lack of human resources with expertise to conduct the approximation process. The country's environmental accession strategy should include implementation timetables for meeting the EC environmental *acquis* starting amongst others with implementation of the framework and IPPC directives mentioned above.

Conclusion

Given the prevailing trends in innovative policy reform and relatively high investment levels, and with a major effort towards development of legislation enforcement structures, Estonia should be able to fully transpose the environmental *acquis* and make substantial progress in effective compliance in the medium term. However, effective compliance with a number of pieces of legislation requiring a sustained high level of investment and considerable administrative effort (e.g. urban waste water treatment, drinking water, aspects of waste management and air pollution legislation) could be achieved only in the long term.

Consumer Protection

The Community *acquis* covers protection of the economic interests of consumers (including control of misleading advertisement, indication of prices, consumer credit, unfair contract terms, distance selling, package travel, sales away from business premises and timeshare property) as well as the general safety of goods and the specific sectors of cosmetics, textile names and toys.

The Europe Agreement provides for approximation of legislation with Community law and co-operation with a view to achieving full compatibility between the systems of consumer protection in Estonia and the Community. Stage I measures of the White Paper focus on improving product safety, including cosmetics, textile names and toys, and on the protection of the economic interests of the consumer, notably measures on misleading advertising, consumer credit, unfair contract terms and indication of prices. Stage II measures relate to package travel, sales away from business premises and time-share property. New EC legislation which has been adopted recently (distance selling) or will be adopted soon (comparative advertising, price indication) will also need to be taken into account.

Descriptive Summary

The Ministry of Economy has overall responsibility for consumer policy. The Ministry supervises the Consumer Protection Board which is a public body with the authority to protect and pursue consumer complaints. The Consumer Protection Act of 1993 defines the rights of consumers in transactions with merchants, producers and intermediaries and establishes an institutional framework for consumer protection. Several other legal acts and rules regulate specific aspects of consumer protection.

The Estonian Consumer Protection Union is a voluntary, independent organisation which aims at protecting the interests of consumers, to educate and inform them and to co-operate with State and local bodies. The organisation is represented in the Consumer Consultative Council, which advises the Consumer Protection Board, but is relatively weak due to a shortage of resources.

Current and Prospective Assessment

Although the Consumer Protection Act provides considerable protection of consumer interests, Estonia needs to make a number of adjustments before her legislation is complies with the requirements of EU standards. Concerning the protection of economic interests, the existing rules on the indication of prices and misleading advertising are generally in line with the Community provisions, although amendments are still required in fundamental areas to secure a complete realignment with the EC *acquis*. New legislation is needed in areas such as sales away from business premises, distance selling, package travel and timeshare property. In some cases, draft laws are under preparation. Existing rules on unfair terms of consumer contracts and consumer credit need to be amended to strengthen the protection of consumers.

The provisions of The Consumer Protection Act on general product safety are insufficient and need to be more precise, including more competence to the public authorities. The elaboration of new legislation has been announced. Draft laws in the specific sectors of cosmetics and the safety of toys are under discussion.

The development of a strong and independent consumer movement, sustained by public authorities will need to accompany the introduction of the *acquis*.

Conclusion

Important progress has been made in aligning the legislation in the field of consumer protection with the *acquis*. But reform of the Estonian legislation will need to be continued since the existing laws only to a limited extent comply with the *acquis*. At the institutional level, Estonia appears to have the structures and bodies required to implement consumer policies. Taking on the consumer policy is unlikely to cause major problems for Estonia in the medium term.

3.7. Justice and Home Affairs

The Present Provisions

The Justice and Home Affairs (JHA) *acquis* principally derives from the framework for co-operation set out in Title VI (Article K) of the Treaty on European Union (TEU), "the third pillar", although certain "first pillar" (EC Treaty) provisions and legislative measures are also closely linked.

The EU JHA framework primarily covers: asylum; control of external borders and immigration; customs co-operation and police co-operation against serious crime, including drug trafficking; and judicial co-operation on criminal and civil matters. The TEU stipulates key principles upon which such co-operation is based, notably the European Convention on Human Rights and the 1951 Geneva Convention on the Status of Refugees. It is also based implicitly on a range of international conventions concerning its fields of interest, notably those of the Council of Europe, the United Nations and the Hague Conference. The legislative content of third pillar *acquis* is different from the first pillar; it consists of conventions, joint actions, joint positions and resolutions, (including the agreed elements of draft instruments which are in negotiation). A number of EU conventions (including the 1990 Dublin Convention, and conventions relating to extradition, fraud and EUROPOL) have been agreed by the Council and are now in the process of ratification by national Parliaments; several other conventions, including one on external frontiers are in various stages of negotiation in the Council. The JHA *acquis* involves a high degree of practical co-operation, as well as legislation and its effective implementation.

The New Treaty

For many of the above matters, the entry into force of the Treaty resulting from the Amsterdam Inter-Governmental Conference will mark the end of the current cooperation framework.

Reiterating the objective of developing the Union into an "area of freedom, security and justice", the new Treaty brings these matters, including the free movement of persons, asylum and immigration, into the Community's sphere of competence.

On the free movement of persons in particular, the new Treaty provides for the incorporation of the Schengen *acquis* into the framework of the European Union and binds any candidate for EU membership to accept that *acquis* in full.

With regard to matters remaining within the cooperation framework, i.e. policing and criminal justice, the new Treaty provides for the reinforcement of the cooperation system.

The Europe Agreement and the White Paper

The Europe Agreement includes provision for co-operation in the fight against drug abuse and money laundering.

The White Paper does not deal directly with third pillar subjects, but reference is made to first pillar matters such as money laundering and freedom of movement of persons which are closely related to Justice and Home Affairs considerations. Reference is also made to the Brussels and Rome conventions.

Descriptive Summary

General Preconditions for JHA Co-operation

Estonia joined the Council of Europe in 1993 and has signed or ratified the most important instruments concerning human rights. The Constitution provides for an independent judiciary according to the rule of law. Reform in JHA institutions is underway, and progress has been made concerning the protection of the border. The Government has prepared a strategy for the JHA sector, and in February 1997 set up an inter-ministerial working group. Estonia has not yet ratified the 1990 data protection convention, but a law on Personal Data Protection was passed by the Estonian Parliament in June 1996. (See also separate section on Single Market).

Asylum

Estonia ratified the Geneva Convention and the 1967 Protocol in February 1997. At the same time the Estonian Parliament adopted the Law of Refugees which implements the Convention. The Estonian authorities are currently making provision to bring the law into effect and to appoint and train a competent authority (the Citizenship and Migration Board). The law is based on the Geneva Convention and incorporates a number of EU provisions such as the "safe country concept".

Immigration/Border Control

Estonia has visa-free agreements with the UK, Ireland, Denmark, Finland, Sweden, Norway, Iceland and several central European countries, including Latvia and Lithuania with which it operates a common visa space.

Further visa-free regimes are being negotiated with other EU member states. Estonia has adopted the EU third country list for which visas are required. The Estonian immigration administration has been streamlined and a register has been created for the issuance of permanent and temporary residence permits to persons without Estonian citizenship.

A readmission agreement is in place with Finland, Sweden, Denmark, Norway, Latvia and Lithuania. Negotiations are underway with other EU countries Progress has been made on border management, including significant reform of the border guard; and further improvements are underway. A border control system is being developed in cooperation with Nordic countries. Estonia has introduced machine-readable passports. Estonia and Russia work together on the management of the mutual border, although difficulties persist due to the absence of agreement with Russia on readmission.

Police Co-operation

Organised crime exists in Estonia in the fields of drug trafficking, money laundering, car theft, security services, and fraud. To tackle organised crime (and drugs-related crime) more effectively, specialist units have been established in the police service and co-operation has been strengthened between the law enforcement bodies. Reform in the police service is on the way. Training in specific areas such as the fight against drugs, economic crime and money laundering is being intensified with the assistance of several EU countries and through bilateral training programmes. Estonia is preparing to ratify the 1990 money laundering convention. (See also separate section on Single Market). Estonia experiences no domestic or international terrorism. Estonia has ratified the key international conventions on terrorism, and domestic legislation in place.

Drugs

Estonia is used as a transit country for drug trafficking, between East and West. There is a small domestic market and a modest production of amphetamines. Estonia has ratified, or is preparing to ratify, the main international drugs conventions, and is active in the anti-drugs programmes of the UNDCP and Phare. Domestic anti-drugs legislation and systems are currently being developed, and a law on narcotic drugs and psychotropic substances is under preparation.

Judicial Co-operation

Estonia has made considerable progress in preparing the judiciary for EU accession in the JHA sector. Estonia has ratified four Hague Conventions (evidence abroad, service of documents, access to justice, and maintenance) and will apply for the Lugano Convention. Estonia also ratified several key Council of Europe Conventions on criminal matters, in April 1997, and the additional protocols.

Current and Prospective Assessment

There are some important gaps still to be filled in Estonia's legislation but some useful progress has been made. An important priority for the near future will be the ratification and application of the necessary international legal instruments, and improvements in the levels of education and experience of the legal profession.

The main institutional challenge lies in the field of resource constraints, both of personnel and finance. The Government is taking steps to prepare the institutions for participation in the JHA process, for example by familiarising officials with practical co-operation with EU counterparts, through targeted education and on-the-job training.

Efforts still have to be made to improve the administration to deal with issues related to refugees and asylum seekers, as well as further to develop systems to deal with organised crime and money laundering.

Conclusion

Estonia is starting from a very low base in terms of the JHA *acquis* (present and future). There are some encouraging signs of progress, notably in respect of border control, but Estonia will need to sustain a major effort if it is to meet the justice and home affairs *acquis* in the medium term.

3.8 External Policies

Trade and International Economic Relations

The *acquis* in this field is made up principally of the Community's multilateral and bilateral commercial policy commitments, and its autonomous commercial defence instruments.

The Europe Agreement includes provisions in several areas requiring parties to act in accordance with WTO/ GATT principles, or other relevant international obligations.

The White Paper includes no provisions in this field.

Descriptive Summary

Estonia has developed an open, trading economy and is expected to become a member of the World Trade Organization (WTO) by the end of 1997. Estonia has observer status in the Government Procurement Agreement and, upon accession would have to comply with the obligations of the plurilateral WTO agreements to which the Community is a party.

At present Estonia does not maintain quantitative restrictions on any textile or clothing products. On accession the Community textiles policy would be extended to Estonia; any Community restrictions still maintained at the date of accession would require adjustment by an appropriate amount to take account of Estonian accession.

Current and Prospective Assessment

At present, Estonia does not apply import duties. On accession Estonia would have to apply the Community's Common Customs Tariff, and the external trade provisions of the Common Agricultural Policy. The post Uruguay Round weighted average level of most favoured nation duties for industrial products will be 3.6% for the Community.

In its relations with international organisations Estonia should ensure that its actions and commitments respect the Europe Agreement and ensure a harmonious adoption of its future obligations as a member of the Community.

On accession Estonia would become party to the Community's various preferential agreements. Preferential agreements between Estonia and third countries would, in general, have to be terminated on accession.

In the area of trade in services and establishment, Estonia is expected soon to join GATS on terms largely consistent with those of the Community, and it should be possible to resolve any remaining, significant inconsistencies between the commitments of Estonia and those of the Community.

On accession Estonia would have to repeal national legislation in the field of commercial defence instruments, and EC legislation would become applicable there.

Experience from previous accessions has shown that the automatic extension of existing anti-dumping measures to new member states prompts third countries to raise problems in terms of the compatibility of this approach with relevant WTO provisions. It has also shown that accession creates a potential for circumventing measures adopted by the Community under the commercial defence instruments. This happens when, prior to accession, substantial quantities of the products subject to measures are exported to the territory of the future member state and, on accession, are automatically released for free circulation in the enlarged customs territory. These two problems would have to be addressed during Estonia's pre-accession phase.

Estonia is not a member of any non-proliferation regime, although it has expressed interest in membership. The Estonian control list of dual-use items resembles the Community control list. Arms export is also controlled. There appears to be no obstacle in principle to Estonia applying EC legislation in this field.

Conclusion

Estonia is well placed to be able to meet Community requirements in this field within the next few years.

Development

The *acquis* in the development sector is made up principally of the Lomé Convention, which runs until early 2000.

Neither the Europe Agreement or the White Paper include provisions in this field.

Descriptive Summary

Estonia has no preferential trade agreements with ACP countries, and no GSP schemes apply. However, access to the Estonian market is very liberal.

Estonia has no budget for development aid, although it has contributed financially to the reconstruction of Bosnia and Herzegovina.

Current and Prospective Assessment

On accession, Estonia should apply its preferential trade regime to the ACP States and participate, together with the other member states, in financing the European Development Fund (EDF), which provides financial aid under the Lomé Convention.

Applying the Lomé trade regime should not generally be a source of difficulties for Estonia.

Normally, new member states accede to the Lomé Convention by means of a protocol on the date of their accession to the EU.

Conclusion

Estonia should be able to meet EU requirements in this field in the next few years.

Customs

The *acquis* in this sector is the Community Customs Code and its implementing provisions; the EC's Combined Nomenclature; the Common Customs Tariff including trade preferences, tariff quotas and tariff suspensions; and other customs-related legislation outside the scope of the customs code.

The Europe Agreement covers the establishment of a free trade area with the Community and the progressive removal of customs duties on a wide range of products, according to clear timetables starting from the date of entry into force of the agreement.

The White Paper includes in Stage I, measures to consolidate and streamline the free trade established under the Europe Agreement, including legislation compatible with the Customs Code, Combined Nomenclature, etc. Stage II concerns the adoption of the full Community legislation, with a view to joining the customs union upon accession.

Descriptive Summary

On accession the Estonian customs authorities would be required to assume all the responsibilities necessary for the protection and control of their part of the EU's external border. Besides the provisions on indirect taxation, they would be responsible for the implementation and enforcement at the external border of the Community's common commercial policy, the common agricultural policy, the common fisheries policy etc.

Estonia's capacity fully to apply the *acquis* presupposes the possibility to adopt and implement the Community legislation; and the existence of an adequate level of infrastructure and equipment, in particular in terms of computerisation and investigation means and the establishment of an efficient customs organisation with a sufficient number of qualified and motivated staff showing a high degree of integrity.

With the support of the technical assistance provided by customs programmes, Estonia is currently in the process of amending its present customs code and preparing 38 implementation acts. At present, the legislation in force is not EC compatible. Furthermore, no legislation concerning customs reliefs on counterfeit and pirated goods exists at this stage.

Estonia has almost aligned its national goods nomenclature to the Community's Combined Nomenclature. In addition, Estonia will have to be familiarised with the methodology of the Binding Tariff information system used in the EC.

Estonia adopted on 1 April 1997 the new system of cumulation of origin between European countries.

Estonia has applied to become a contracting party to the EC/EFTA Common Transit Convention and the Single Administrative Document Convention. A Community Task Force is assisting Estonia in this field.

Current and Prospective Assessment

Estonia would need to adapt its national procedures to the Community legislation regarding suspensive arrangements and customs procedures with economic impact. At the moment of accession, some technical transitional arrangements would be needed, notably for operations beginning before the date of accession but which are concluded after that date.

Estonia will have to align its tariff structure to meet the Common Customs Tariff rates. Estonia is not familiar with the operation of a system of tariff suspensions or with the management of tariff quotas and ceilings which are fundamental mechanisms to apply the Community Commercial policy. This raises significant concern in relation to Estonia's capacity to cope with the complexity of the Community mechanism in these domains.

It will be important that the Estonian customs authorities can participate appropriately in the various computerised systems necessary for the management, in the customs union/internal market, of the customs and indirect tax provisions, as well as the computerised systems for mutual administrative assistance in customs, agricultural and indirect tax matters. Computerisation is at a very preliminary stage of development in Estonia.

Estonia would need on accession to dismantle customs controls at the borders with EU member states and with other acceding countries. The resources needed for the reinforcement of the border posts along its frontiers with non-EU member states should be taken it into account in its strategic planning.

Conclusion

Estonia will need to continue major efforts to draft customs legislation compatible to that of the Community and to align its organisation and staff to the duties that have to be carried out by a modern customs administration. If it does so it may be able to meet EU requirements in the medium term.

<u>Common Foreign and Security Policy</u>

Since regaining its independence in 1991, Estonia has orientated its foreign and security policy towards the EU and NATO. Improvement of relations with neighbouring countries has also been a priority for Estonia. Estonia has been an active participant in the dialogue arrangements provided for under the Union's Common Foreign and Security Policy and whenever invited has supported EU policies within that framework.

Estonia is a member of the UN, OSCE, Council of Europe and many other international organisations. It is an associate partner of WEU, participates in the NACC, the PfP and has made clear its desire to become a member of the WEU and NATO as soon as possible. It has sent troops to participate in IFOR/SFOR and provided assistance to the post-war reconstruction of Bosnia. It also participates in a number of regional organisations including the Council of Baltic Sea States.

There are no territorial disputes between Estonia and any member state of the Union, although a formal delineation of the maritime border with Finland and Sweden remains to be undertaken. Neither does Estonia have any major disputes with neighbouring associated countries. Negotiations concerning the delineation of sea borders with Latvia have been completed and await ratification.

The development of good relations with Russia is a key element of Estonian foreign policy. Important positive developments include the agreement on the withdrawal of Russian troops from Estonia and the accompanying agreement on the treatment of (Russian) military pensioners. An important remaining issue between Estonia and Russia is the absence of a border agreement. Important progress was made in the border negotiations in the last quarter of 1996 when Estonia renounced its demands that Russia recognise the validity of the 1920 Tartu Peace Treaty. The draft border agreement includes a full description of the frontier following, with only minor amendments, the existing control line. The Estonian government has expressed its readiness to sign the agreement as soon as Russia is ready to do so.

Estonia has a new and small diplomatic service with limited experience and resources. In due course it should nevertheless be able to play a full role as a member of the Union. It maintains 23 representations abroad and employs some 220 diplomatic staff.

Estonia supports non-proliferation of nuclear, biological and chemical weapons and is a signatory to all relevant international arms control agreements Estonia itself does not manufacture or export weapons. The small Estonian armed forces, which are under democratic control, are being reorganised to meet NATO requirements. Estonia is a member of the Baltic peacekeeping battalion (BALTBAT) and participated in a major PfP exercise (Baltic Challenge) in 1996.

In the statement accompanying its application for membership of the Union, the Estonian government confirmed that it was ready and able to participate fully and actively in the CFSP of the Union.

The assessment of Estonian foreign and security policy to date leads to the expectation that as a member it could fulfil its obligations in this field.

3.9. Financial Questions

Financial Control

The implementation of Community policies, especially for agriculture and the Structural Funds, requires efficient management and control systems for public expenditure, with provisions to fight fraud. Approximation of legislation is moreover needed to allow the system of "own resources" to be introduced, with satisfactory provision for accounting.

The Europe Agreement provides for cooperation in audit and financial control, including technical assistance provided by the Community as appropriate. The White Paper includes no measures in this field.

Descriptive Summary

The State Audit Office, which was established in 1990, is the principal, independent, external financial control authority in Estonia. In 1992 the Office became a member of the International Organisation of Supreme Audit Institutions, the standards of which were taken into account in drawing up the Law on the State Audit Office of 1995.

The State Audit Office reports to the Parliament its observations of how ministries, agencies and state-owned enterprises account for and use State funds and other assets. The Office further controls the use and repayment of foreign loans contracted by the State as well as the use of foreign assistance. The controls are *a posteriori.*

Internal audit of tax collection is assured by the National Tax Board along the lines of international audit standards. The National Customs Board is responsible for collecting import duties.

The economic activities of local governments are controlled by an Audit Committee, appointed by the Council of each local government. Within Ministries, State agencies, State enterprises, and similar organisations independent internal control mechanisms will be established. Several laws form the system for penalising fraud against financial and economic interests, but there is no central authority responsible for fighting fraud.

Current and Prospective Assessment

The required instruments for a successful implementation of EU policies will need to be established, including the necessary internal financial control mechanisms.

The Estonian authorities will have to ensure the efficient administration of the "own resources" system, and this would need to include amendments of the existing accounting system. Further cooperation with the Commission will be desirable in this field.

Conclusion

The field of financial control does not appear to present major obstacles for accession in the medium term, although considerable preparations will be required to establish the necessary management and control mechanisms for the satisfactory implementation of the Community policies.

Budgetary Implications

The communication entitled "Agenda2000" sets out the overall financial framework which should accommodate the budget impact of any future enlargements in the medium term. This is to ensure that any enlargement is compatible with proposed Community policy guidelines within reasonable budget limits.

As things stand, it would be difficult, not to say premature, to attempt precise country-by-country evaluations of the budgetary implications of each of the applicants joining the Union. Exactly what the impact would be may vary considerably depending on a whole series of factors:

- the date on which the applicant country joins;
- developments in Community policies between now and then, in particular the decisions to be taken on further reform of the common agricultural policy and new guidelines for structural measures;
- the progress made by the applicant countries in terms of growth, increasing their competitiveness and productivity and their ability to absorb the *acquis*;
- the transitional measures that will come out of the negotiations.

Only a few orders of magnitude for certain budget categories and an overall estimate can be given purely as a guide.

Expenditure

If the common agricultural policy were to be reformed along the lines suggested by the Commission, once the reforms were fully up and running and in terms of just market intervention measures, Estonia's accession would give rise to only marginal additional expenditure in relation to likely expenditure on the present fifteen Member States.

After a gradual phasing-in period, allocations for Estonia for structural funds would be likely to be around 4% of its GNP.

Application of the other internal Community policies in the new member countries would be likely to involve additional expenditure probably in excess of their relative proportion of Union GNP, since for certain policies the additional implementing costs also depend on the target population, the geographical area covered or the number of Member States involved in the coordination and harmonisation measures. The GNP of Estonia is currently less than 0.1% of total Union GNP.

By contrast, Estonia's accession should not involve significant additional expenditure as far as Union external action is concerned.

It should not be forgotten that when an applicant country joins, the Community budget will no longer have to bear the costs of grants the country was eligible for under the various pre-accession programmes, such as PHARE.

In light of the above, the estimated costs in the three areas mentioned arising from Estonia's accession should fall within the range of, annually, ECU 0.3 to 0.4 billion in 2005-06 (at constant 1997 prices).

Revenue

Assuming full application of the own resources system, the new members' contributions to the Community budget should, in terms of total GNP and VAT resources (taking account of the capping rules applying to VAT), be close to the proportion of the Union's GNP they account for, which in Estonia's case is less than 0.1%. Estonia's portion of traditional own resources will depend on the structure of its trade flows at the time of accession.

To ensure that the own resources are established, monitored and made available in line with Community regulations, Estonia will have to overhaul its current customs system. In addition, for the purposes of accurately calculating the GNP resource considerable improvements will have to be made to the national accounts to ensure that they are reliable, homogeneous and complete. Improving the statistics will also be essential for drawing up the VAT own resources base, which will mean bringing Estonia's VAT system fully into line with the Community directives.

4. Administrative Capacity to Apply the *Acquis*

The European Council in Madrid in December 1995 concluded that the harmonious integration into the EU of the central and eastern European applicant states would, in particular, require the adjustment of their administrative structures. This chapter examines the current state of the public administration in Estonia, including relevant aspects of the judicial system, and assesses the current and prospective ability to carry out the functions required of it in a modern, democratic state, with a particular focus on the need to administer matters related to the *acquis*.

4.1 Administrative Structures

A description of Estonian constitutional structures, their powers and responsibilities, including those of regional and local government, is given in Chapter 1.

The Estonian central administration consists of 14 Ministries and a number of Boards and inspections services. The State Chancellery, which is the office of the Prime Minister, plays an important role in evaluating and coordinating the work of all government officials. The Office of European Integration, which reports directly to the Prime Minister, works on a permanent basis and is responsible for technical support and co-ordination of matters related to EU accession.

The Law on Government and the Public Service Act, which both entered into force in January 1996, define the relations among the ministries and between central and local levels of government as well as the role and conditions for officials and public servants.

The principle of political independence of the civil service is recognised in Estonia, although senior positions are not always free of party political influence.

Since 1991 there have been significant reductions in the numbers of administrative staff. Government ministries employ 2,150 staff, government agencies 9,620, and the regional councils 1,390; numbers in local government are not available. Pay in the civil service is far lower than in the private sector.

Training programmes to upgrade the staff of the public administration on EU related issues and efficient public management within a democratic society based on a market economy have been implemented by the government with international assistance, resulting in a substantial upgrading of staff qualifications. To co-ordinate the reform process, a specific administrative structure has been established by the Government, consisting of a Ministerial Commission which formulates the policy and submits proposals for the government, as well as a Council of Senior Civil Servants which represents the main involved ministries. A national training institute for civil servants operates under the authority of the Chancellery.

In spite of its limited staff resources the Office of European Integration has progressively developed its coordinating capacity. (See also the section of the Introduction concerning relations between the European Union and Estonia).

4.2 Administrative and Judicial Capacity

Estonia was part of the Soviet Union until 1991 and administered under central planning until then. The communist system rejected the primacy of the rule of law and subjugated the law and the administration to the implementation of Party policy. Against this background, both the administration and the rule of law itself increasingly came to be seen by the public as instruments of political control.

The structures and systems of the Estonian public administration still require significant development. The extent of what has already been achieved should not, however, be underestimated. Despite the problems, and perhaps in part because of the need to create new structures, the Estonian civil service has in many cases shown a considerable flexibility.

Most ministries are small, and heavily burdened with work. The effective functioning of a ministry is often dependent more on the quality of leading personalities than by the structures of the institution itself. Lack of funding is a constant problem for all ministries. But the 1997 budget favoured defence particularly and that ministry is improving in range and capacity. The State Chancellery is still developing its role, with international help. Overall, the use of information technology is already at a high level in the Estonian public service.

The legal basis for the civil service is adequate. Political pressures on civil servants are considerable, especially at municipal level, but also in central ministries. The trend appears nonetheless to be in the direction of a reinforcement of civil service independence.

The civil service is under-staffed. Although the limited size of the Estonian administration in some respects facilitates staff development and reforms of the administrative structure, the small number of staff also means that important functions often depend on a quite limited number of people, which makes the ministries vulnerable to a "brain drain" to the private sector (connected to pay levels in particular), and can call into question the ability of ministries fully to fulfil their functions.

Public confidence in the civil service is not assured. There is widespread dissatisfaction at perceived abuses in some parts of the administration, including local government. Often, detailed evidence to back up such perceptions is lacking, although confirmed cases do exist.

The Government's reform initiatives, while pointing in the right direction, will need to be better targeted and much intensified as a part of the pre-accession process. The level of professionalism and training varies widely. Considerable international assistance is being provided in these areas.

The most serious concern in this area in the context of EU accession is the very considerable number of legislative and administrative initiatives which need to be taken at the same time, the co-ordination of which will be a difficult challenge for the Estonian administration. The Government's approach includes a coherent, though not exhaustive, plan for the implementation measures outlined in the Commission White Paper. The Office of European Integration will need reinforcement.

Key Areas for the Implementation of the Acquis

The uniform application of EC law: The effective application of the *acquis* presupposes that the judicial authorities of member states are able to apply the provisions of the Treaty dealing with ensuring the unity and application of the *acquis*, and are able to ensure the proper functioning of the Single Market and Community policies in general. A high quality and well trained and resourced judiciary is necessary for the application by the courts of EC law, including cases of direct effect, and cases of referral to the European Court of Justice under the terms of Article 177 EC.

The judicial system in Estonia has important weaknesses, particularly concerning resources, and relevant expertise. Given this situation, the Commission has significant doubts about the ability of the system to ensure the effective application of the *acquis*.

Single market: The ability of Estonia to ensure the correct application of Community requirements in the Single Market, particularly concerning the free movement of goods and services presupposes the existence of highly developed and effective regulatory, standardisation, certification and supervisory authorities, able to act fully in accordance with EC rules. An analysis of these points is made in Chapter 3.1 (under "The Four Freedoms").

Concerning the administrative capacity in respect of free movement of goods, the situation in Estonia is not yet satisfactory, due mainly to limitations on staff resources. Progress towards a separation of functions between assessment and certification is underway, leading to improved compatibility with the EU system. Concerning the free movement of services the situation is in some respects satisfactory, but while the Central bank and private bank supervisions function well (there are 28 staff involved at the Bank of Estonia), the Insurance Supervisory authority, which employs 14 supervisors, and the Insurance Inspectorate, which employs only 12 staff, are inadequately resourced.

In order to meet EU requirements in this area a considerable reinforcement of staff resources will be required.

Competition: As explained in Chapter 3.1 (under "Competition") enforcement of competition law requires the establishment of anti-trust and state aid monitoring authorities, and that the judicial system, the public administration and the relevant economic operators have a sufficient understanding of competition law and policy.

In Estonia the central authority is the Competition Board which has 22 staff; this is inadequate. The level of expertise is not high, although the Competition Board is currently functioning satisfactorily. The ability to implement EU requirements in this field will require a reinforcement of the human resources.

Telecommunications: In order to formulate and implement the many liberalisation regulations contained in the *acquis* in this field it is necessary to have a regulatory and policy making body that is effectively separated from any operating company.

In Estonia the regulatory competence in the telecommunications field lies with the Ministry of Transport and Telecommunications (60 staff, 4 on telecommunications) as well as with the Inspection of Telecommunications (35 staff) which arranges the usage of radio frequencies, type approvals for radio equipment and surveillance of the usage of radio equipment. As a whole these services appear to have the potential capacity required to administer the telecommunications *acquis*.

Indirect taxation: The effective administration of the indirect taxation *acquis* presupposes structures capable of implementing the EC legislation concerning the harmonisation of Valued Added Tax and excise duties in an environment in which fiscal controls at internal EU frontiers have been abolished; and the excise system is based on the tax warehouses, duty being payable at the local rate in the member state at the time the goods are consumed. This requires a highly developed and well trained and resourced service, with a high degree of integrity.

In Estonia the relevant authority is the Ministry of Finance with a total of 800 staff. Due to a large turnover of staff, resulting partly from trained staff being recruited by the private sector, it is difficult to estimate the capacity of existing staff. In order to ensure the effective administration of the *acquis* in this area it will be necessary to consolidate and improve the overall professional standards of the staff, including training measures and improvements in pay.

Agriculture: The administrative requirements in the agricultural area primarily concern veterinary and phytosanitary control, to protect public health and ensure the free movement of agricultural goods; and the ability to administer the mechanisms and requirements of the CAP, including high standards of financial control and official statistics. These points are dealt with in Chapter 3.4 (under "Agriculture"); general standards in the statistical field are examined in Chapter 3.3 (under "Statistics").

The administrative capacity in respect of veterinary and phytosanitary controls in Estonia requires considerable development. Concerning numbers of staff, the State Veterinary and Food Control Inspection has 571, and the three main plant health institutions have 106. For the administration of general CAP requirements, appropriate administrative structures need to be created. The Ministry of Agriculture has 115 staff.

In order to meet EU requirements in this area considerable improvements will be required.

Transport: The application of the EU Internal Market and competition requirements to the transport sector, the development of relevant infrastructure products, and other aspects of the transport *acquis* will present administrative challenges to new member states.

The responsible government authority in Estonia is the Ministry of Transport and Telecommunications with a total of 60 staff (56 on transport). There are problems arising from a lack of qualified staff. This raises particular concerns with regard to the enforcement of safety controls.

Employment and social policy: A central administrative requirement in respect of the *acquis* in this area is adequate inspection capacity, particularly concerning health and safety at work.

In Estonia the labour inspectorate (77 inspectors) requires considerable reinforcement of staff resources and expertise.

Regional policy and cohesion: The main administrative requirements in this area are the existence of appropriate and effective administrative bodies , and in particular a high degree of competence and integrity in the administration of Community funds.

In Estonia the Department of Local Government and Regional Development at the Ministry of the Interior, with 20 staff in this area, coordinates regional development initiatives. These arrangements are not yet fully adequate. And the situation concerning financial control is not yet satisfactory (see the section, below, on "Financial control"). The effective administration of the *acquis* in this area will require, in particular, the creation of the necessary administrative, budgetary and control frameworks.

Environment: Because EU environmental policy, involves the integration of environmental protection into EU sectoral policies the administrative requirement is potentially very wide, affecting many bodies not normally associated with environmental protection. However, the main responsibility lies with environment ministries and various subsidiary bodies.

In Estonia, the Environment Ministry employs 105 staff. Monitoring is carried out by sectoral authorities, enforcement by the State Inspectorate and 17 Country Environment Departments. These arrangements are not yet adequate since the services do not have the means to enforce legislation. The effective administration of the *acquis* in this area will require improvements in training, upgrading equipment, and greater investment in human resources.

Consumer protection: In this area, the effective administration of the *acquis* requires the allocation of overall responsibility to a specific State body through which the formulation, implementation and enforcement of consumer policy and consumer protection legislation can be undertaken.

In Estonia the government Domestic Market Division within the Ministry of Economy shares its responsibility for consumer affairs with the semi-independent Consumer Protection Board (55 staff). As regards non-governmental consumer bodies these remain weak in the Estonia. There remains confusion about the exact scope and objectives of consumer policy. This in part explains difficulties in the effective enforcement of consumer laws; however, other factors which need to be addressed include a lack of expert staff, organisational deficits, and a lack of sensitivity to consumer questions among the judiciary.

Justice and home affairs: Oversight of justice and home affairs questions falls to justice and interior ministries. The administrative structures need to be able to deal effectively with asylum and migration questions, border management, police cooperation and judicial cooperation. There is an overriding need for sufficient and properly trained staff with a high degree of integrity.

In Estonia the justice and interior ministries are adequately staffed. The capacity to handle asylum and migration questions is not yet assured through the Citizenship and Migration Board, but significant progress is being made. Border management has been reformed, and further improvements are underway. Similarly, the police is being reformed, and specialist units have been created. Considerable progress has been made to improve judicial cooperation. The effective administration of the *acquis* in this area will require greater financial and human resources and an intensification of the current reform efforts.

Customs: Applying the *acquis* in this area requires an adequate level of infrastructure and equipment, including computerisation and investigation resources, and the establishment of an efficient customs organisation with a sufficient number of qualified and motivated staff showing a high degree of integrity.

In Estonia the customs service employs 1,100 staff. Due to a high turnover of staff, it is difficult to estimate their efficiency, and therefore the adequacy of staffing levels. The effective administration of the *acquis* in this area will require the retention of qualified and experienced staff, and greater resources directed at customs control at the borders.

Financial control: The protection of the Community's financial interests requires the development of anti-fraud services, training of specialised staff (investigators, magistrates) and the reinforcement of systems of specific cooperation. The implementation of Community policies, especially for agriculture and the Structural Funds, requires efficient management and control systems for public expenditure, with provisions to fight fraud. Administratively it is essential to have a clear separation between external and internal control. Police and judicial authorities need to be able effectively to handle complex transnational financial crime (including fraud, corruption and money laundering) which could affect the Community's financial interests.

In Estonia the main external control body is the State Audit Office employing 80 staff. This is a modest level given the scale of the tasks. The effective administration of the *acquis* in this area will require considerable efforts to establish the necessary management and control mechanisms.

4.3 General Evaluation

Estonia's administrative structures will require a major effort of reform if there is to be adequate capacity in the medium term effectively to administer the *acquis*.

Concerning the judicial capacity effectively to apply Community law, a definite evaluation at this stage is difficult.

C. SUMMARY AND CONCLUSIONS

Estonia submitted its application for membership of the European Union on 24 November 1995. Its request is part of a historic process of ending the division of Europe and consolidating the establishment of democracy across the continent.

In accordance with the provisions of Article O of the Treaty, the Commission has, at the request of the Council, prepared an Opinion on Estonia's request for membership.

Estonia's preparation for membership is going forward notably on the basis of the **Free Trade Agreement** which entered into force on 1 January 1995. The European Union and Estonia signed a **Europe Agreement** on 12 June 1995. Once the ratification procedures are complete and it enters into force, it will supersede the Free Trade Agreement. Implementation of the **White Paper** of May 1995 on the Internal Market, another essential element of the pre-accession strategy, is going ahead on the basis of an Action Plan drawn up by the government in June 1996. The government has put in place the necessary mechanisms to coordinate its policies for European integration.

In preparing its Opinion, the Commission has applied the **criteria established at the Copenhagen European Council** of June 1993. The Conclusions of this Council stated that those candidate countries of Central and Eastern Europe who wish to do so shall become members of the Union if they meet the following conditions:

- stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;

- the existence of a functioning market economy, as well as the ability to cope with competitive pressures and market forces within the Union;

- the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.

A judgment on these three groups of criteria - political, economic, and the ability to take on the acquis - depends also on the capacity of a country's administrative and legal systems to put into effect the principles of democracy and the market economy and to apply and enforce the acquis in practice.

The **method** followed in preparing these Opinions has been to analyse the situation in each candidate country, looking forward to the medium term prospects, and taking into account progress accomplished and reforms already under way. For the political criteria, the Commission has analysed the current situation, going beyond a formal account of the institutions to examine how democracy and the rule of law operate in practice.

1. Political Criteria

Estonia's political institutions function properly and in conditions of stability. They respect the limits on their competences and cooperate with each other. Elections in 1992 and 1995 were free and fair, and in the latter case led to an alternation of power. The Opposition plays a normal part in the operation of the institutions. Efforts to improve the operation of the judicial system and to intensify the fight against corruption need to be sustained.

There are no major problems over respect for fundamental rights. But Estonia needs to take measures to accelerate naturalisation procedures to enable the Russian-speaking non-citizens to become better integrated into Estonian society.

Estonia presents the characteristics of a democracy, with stable institutions guaranteeing the rule of law and human rights.

2. Economic Criteria

After a sharp contraction of output immediately following independence, the economy has been growing since the second half of 1993 (4.0% in 1996). The government has more or less maintained a principle of balanced budgets in public finances. External debt is low, though Estonia runs a high trade deficit. Inflation rates have declined over recent years, but still stood at 23.1% in 1996. GDP per head is about 23% of the EU average, for a population of 1.5 million. The agricultural sector employs 8% of the labour force, and accounts for 7% of Gross Value Added. 54% of Estonia's exports are directed to the EU, and 66% of its imports originate in the EU.

On the basis of its analysis, the Commission's judgment as to **Estonia's ability to meet the economic criteria** established at Copenhagen is as follows:

Estonia can be regarded as a functioning **market economy**. It has liberalised foreign trade and privatised the public sector. Prices have been liberalised to a very large extent. The currency board system and the prudent fiscal stance have helped to reduce inflation. The legislative framework is largely in place. But land reform has been slow, and reform of the pension system has not yet started.

Estonia should be able to make the progress necessary to cope with **competitive pressures and market forces** within the Union in the medium term, provided in particular that the export base is broadened. The setting of a low exchange rate and low unit labour cost have facilitated the switch to light manufacturing industry as a source of foreign reserves. The banking sector is healthy and expanding strongly. Estonia has been a major recipient of foreign direct investment, although the inflow has decreased recently. But the export base is rather narrow, and the need to finance rising trade and current account deficits is a matter for concern.

3. Capacity to take on the obligations of membership

Estonia's ability to take on the acquis has been evaluated according to several indicators:

- the obligations set out in the Europe Agreement (even though this has not yet entered into force), particularly those relating to the right of establishment, national treatment, free circulation of goods, intellectual property and public procurement;

- implementation of the measures set out in the White Paper as essential for establishing the single market;

- progressive transposition of the other parts of the acquis.

Estonia has already made serious efforts to apply some of the obligations which will come into effect with the Europe Agreement, even before this has entered into force. It is meeting its obligations under the Free Trade Agreement, and according to the timetable for implementation set out in it. No serious bilateral problems have arisen. Estonia has also adopted significant elements of the acquis relating to the **single market**, and has made a good start in transposing the rules and directives set out in the White Paper. In the fields of company law, accounting, data protection and capital liberalisation, it is well on the way to putting in place the necessary legislative foundation. There is still substantial work to be done on public procurement, intellectual property, financial services, taxation and competition (especially the transparency of state aids).

Despite the progress achieved in the field of legislation, there are doubts about the capacity of the Estonian administration to implement this legal framework. But the present significant weaknesses should be temporary, given the high quality of existing staff.

As for the **other aspects of the *acquis***, Estonia should not have difficulty in applying it in the medium term in the following fields: education, training and youth; research and technological development; audio-visual; small and medium enterprises; trade and international economic relations; and development.

By contrast, substantial efforts will be needed in the fields of statistics; fisheries; consumer protection; and customs.

Estonia has made good progress in industrial restructuring. Provided that current efforts are maintained, its **industry** should be able to cope with integration into the single market in the medium term.

Estonia has moved quickly to liberalise its **telecommunications**. Provided that current efforts at liberalisation and transposition of laws are maintained, it should be able to apply the *acquis* in the medium term.

For the **environment**, very substantial efforts will be needed, including massive investment and strengthening of administrative capacity to enforce legislation. Partial compliance with the *acquis* could be achieved in the medium term. Full compliance could be achieved only in the long term.

Estonia has made progress in taking on the acquis in the **transport** sector, but needs to make improvements in the road freight and maritime sectors, and pay particular attention to safety issues. Provided this is achieved, accession in the medium term should not pose major problems. But investment will be needed to extend the European transport network so as to ensure that the single market functions well.

It should be possible for Estonia to apply the **employment and social affairs** *acquis* in the medium term, provided that it works to align its legislation with EU standards eg for health and safety and labour law.

In the field of **regional policy and cohesion**, provided that Estonia creates the necessary administrative and budgetary framework, and takes the steps necessary to create adequate structures of financial control, it should be able in the medium term to use regional and structural funds to support its development effectively.

The **agriculture** sector needs restructuring, and only a limited number of the mechanisms of the common agricultural policy presently exist. A substantial effort will be needed to prepare for accession in the medium term.

In the field of **energy**, Estonia has no nuclear energy programme, so no difficulties are foreseen for Estonia to comply with Euratom provisions. Estonia should be able to comply with most of the energy *acquis* in the medium term, provided that work is maintained on monopolies, access to networks, energy pricing and restructuring of the oil shale industry.

On the basis of the analysis of Estonia's capacity to apply the *acquis*, it is not yet possible to be sure when it could become able to take and implement the measures necessary to remove the controls at **borders** between Estonia and member states of the Union.

Estonia's participation in the third stage of **economic and monetary union**, which implies coordination of economic policy and complete liberalisation of capital movements, should pose few problems in the medium term. It is premature to judge whether Estonia will be in a position, by the time of its accession, to participate in the Euro area. That will depend on how far the success of its structural transformation enables it to achieve and sustain permanently the convergence criteria. These are, however, not a condition for membership.

In **justice and home affairs**, Estonia has started from a low base and made encouraging progress, notably in the field of border control. But a major, sustained effort will be needed if it is to meet the acquis in the medium term.

Estonia should be able to fulfil its obligations in respect of the **common foreign and security policy**.

In addition, Estonia has no territorial disputes with Member States or neighbouring candidate countries. Estonia gives high priority to its relationship with Russia, and has achieved important progress, though there is still no border agreement between them.

4. Administrative and Legal Capacity

For Estonia to have in the medium term the administrative structures necessary for the essential work of applying and enforcing the *acquis* effectively, there will need to be a major effort of reform.

It is not yet possible to judge when Estonia's judicial system, which has an equally important role to play, will acquire the capacity to play it effectively, even though Estonia has recently undertaken an extensive programme of recruitment of new judges.

CONCLUSION

In the light of these considerations, the Commission concludes that:

- Estonia presents the characteristics of a democracy, with stable institutions, guaranteeing the rule of law, human rights and respect for and protection of minorities. But measures need to be taken to accelerate naturalisation of Russian-speaking non-citizens, to enable them to become better integrated into Estonian society;

- Estonia can be regarded as a functioning market economy, and it should be able to make the progress necessary to cope with competitive pressure and market forces within the Union in the medium term;

- Estonia has made considerable progress in transposing and implementing the *acquis* relating particularly to the single market. With further effort it should become able to participate fully in the single market in the medium term. Particular efforts, including investment, will be needed to apply the *acquis* fully in sectors such as environment. Strengthening of the administrative structure will be indispensable if Estonia is to have the structures to apply and enforce the acquis effectively.

In the light of these considerations, the Commission recommends that negotiations for accession should be opened with Estonia.

The reinforced pre-accession strategy will help Estonia to prepare itself better to meet the obligations of membership, and to take action to improve the shortcomings identified in this Opinion. The Commission will present a report no later than the end of 1998 on the progress Estonia has achieved.

ANNEX

COMPOSITION OF PARLIAMENT

Political parties	Number of seats
Coalition and Rural Union Party	41
Reform Party	19
Centre Party	16
"Motherland" (Isamaa)	8
Moderates	6
"Our House is Estonia"	6
Right	5

SINGLE MARKET: WHITE PAPER MEASURES

This table is based on information provided by the Estonian authorities and confirmed by them as correct as at the end of June 1997. It does not indicate the Commission's agreement with their analysis. The table includes directives and regulations cited in the White Paper which total 899. These have been listed in accordance with the categorization used in the White Paper and in relation to the policy areas covered. The table shows the number of measures for which the Estonian authorities have notified the existence of adopted legislation having some degree of compatibility with the corresponding White Paper measures.

White Paper chapters		Directives		Regulations		Total
		Stage I	Stage II/III	Stage I	Stage II/III	
1.Free Movement of Capital	Estonia	3	1	0	0	4
	Number of White Paper measures	3	1	0	0	4
2.FM and Safety of Industrial Products	Estonia	16	3	0	0	19
	Number of White Paper measures	56	104	4	1	165
3.Competition	Estonia	0	0	1	0	1
	Number of White Paper measures	3	0	1	0	4
4.Social policy and action	Estonia	9	5	0	2	16
	Number of White Paper measures	12	15	0	2	29
5.Agriculture	Estonia	10	0	10	0	20
	Number of White Paper measures	93	46	62	2	203
6.Transport	Estonia	3	6	0	0	9
	Number of White Paper measures	19	15	8	13	55
7.Audiovisual	Estonia	1	0	0	0	1
	Number of White Paper measures	1	0	0	0	1
8.Environment	Estonia	4	0	3	0	7
	Number of White Paper measures	31	7	7	0	45
9.Telecommunication	Estonia	0	0	0	0	0
	Number of White Paper measures	9	7	0	0	16
10.Direct Taxation	Estonia	1	2	0	0	3
	Number of White Paper measures	2	2	0	0	4
11.Free movement of goods	Estonia	0	0	0	0	0
	Number of White Paper measures	0	0	0	0	0
12.Public Procurement	Estonia	2	0	0	0	2
	Number of White Paper measures	5	1	0	0	6
13.Financial services	Estonia	8	6	0	0	14
	Number of White Paper measures	13	8	0	0	21
14.Protection of personal data	Estonia	0	2	0	0	2
	Number of White Paper measures	0	2	0	0	2
15.Company Law	Estonia	2	3	0	0	5
	Number of White Paper measures	2	3	0	1	6
16.Accountancy	Estonia	2	1	0	0	3
	Number of White Paper measures	3	2	0	0	5
17.Civil law	Estonia	0	0	0	0	0
	Number of White Paper measures	1	1	0	0	2
18.Mutual rec. of prof. Qual.	Estonia	0	0	0	0	0
	Number of White Paper measures	2	16	0	0	18
19.Intellectual property	Estonia	1	2	0	0	3
	Number of White Paper measures	5	3	0	3	11
20.Energy	Estonia	5	1	1	0	7
	Number of White Paper measures	10	2	3	0	15
21.Customs law	Estonia	0	0	7	112	119
	Number of White Paper measures	2	1	14	184	201
22.Indirect Taxation	Estonia	15	26	0	2	43
	Number of White Paper measures	15	54	0	6	75
23.Consumer Protection	Estonia	5	0	0	0	5
	Number of White Paper measures	8	3	0	0	11
Total	Estonia	87	58	22	116	283
	Number of White Paper measures	295	293	99	212	899

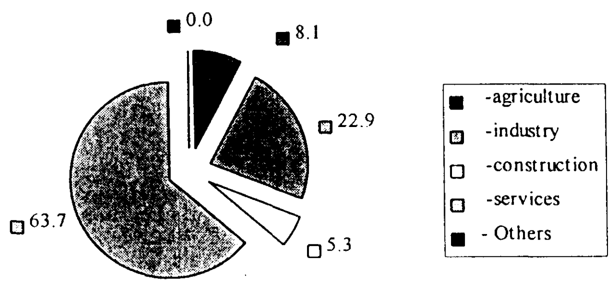
STATISTICAL DATA

If not explicitly stated otherwise, data contained in this annex are collected from „ Statistical Office of Estonia (EESTI STATISTIKAAMET)" with whom Eurostat and Member States' statistical offices are co-operating since several years in the framework of the Phare programme. Regular data collection and dissemination are part of this co-operation process with the aim to enable the application of EU laws and practices in statistics. The data presented below have been compiled as far as possible using EU definitions and standards which in some cases differ from national practices. This may occasioinally give rise to differences between the data presented here and those shown elsewhere in the opinion, which are generally based on the individual applicant countries' updated replies to the questionnaire sent to them in April 1996. The exact compatibility with EU standards on statistics and thus the comparability with EU figures can still not be guaranteed, particularly those statistics that have not been supplied through Eurostat, but have been delivered direcctly by the countries concerned. Wherever available, methodological notes are given describing content and particularities of statistical data presented in this annex. Data correspond to the informtion available as of May 1997.

BASIC DATA

	1990	1993	1994	1995	1996
	1000 hectares				
Total Area		4522.7	4522.7	4522.7	4522.7
Population (end of the period)	in 1000				
- Total		1506.9	1491.6	1476.3	
- Females		803.3	795.7	788.3	
- Males		703.6	695.9	688.0	
	per 1 km2				
Population density	34.7			32.6	
	in % of total population				
Urban Population	71.5			69.8	
	per 1000 of population				
Deaths rate		14.0	14.8	14.1	
Births rate		10.0	9.5	9.1	
Income and GDP per capita	European Currency Unit				
-Average monthly wage and salary per employee				150	
-GDP per capita				1854	
Structure of production: share of branch GVA	in % of Total Gross Value Added				
-agriculture				8.1	
-industry				22.9	
-construction				5.3	
-services				63.7	

share of branch GVA in 1995



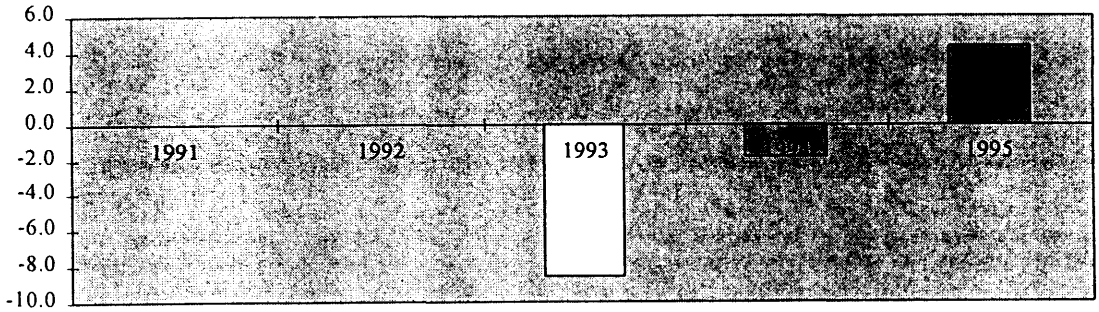
Population density: Data for population density refer to data on the end of period.

Urban population: Data for urban population refer to data on the end of period.

NATIONAL ACCOUNTS

	1990	1991	1992	1993	1994	1995
	in Millions of National Currency					
Gross Domestic Product (Current Prices)	797.7	1832.0	13157.7	22059.9	30102.9	41503.4
	in Billions of ECU					
Gross Domestic Product (Current Prices)				1.4	1.9	2.8
	in Purchasing Power Standard per capita					
Gross Domestic Product				3508.9	3592.8	3917.2
	% change over the previous year					
Gross Domestic Product				-8.5	-1.8	4.3
Final consumption expenditure						
-of households and NPISH						
-of general government						
Gross fixed capital formation						
Exports of goods and services						
Imports of goods and services						
	in % of Gross Domestic Product					
Final consumption expenditure	77.7	67.8	71.0	77.8	81.8	81.8
-of households and NPISH	64.4	54.7	55.2	57.5	59.4	58.0
-of general government	13.2	13.1	15.8	20.3	22.4	23.8
Gross fixed capital formation				23.9	26.4	25.6
Exports of goods and services		31.9	60.0	68.9	78.6	75.8
Imports of goods and services		27.0	54.1	73.1	89.8	84.0

GDP (% Change over the previous year)



MAIN ECONOMIC INDICATORS

	1990	1991	1992	1993	1994	1995	1996
	percentage change over the previous year						
Inflation rate			1076	89.8	47.7	29	23.1
	previous year = 100						
Industrial production volume indices				81.3	97	101.9	
Gross agricultural production volume indices				88.3	85.8	98.8	
Unemployment rate (ILO methodology)	in % labour force						
- Total				6.6	7.6		
- less then 25 years				11.3	11.8		
- 25 years and more				5.8	6.9		
	in Billions of USD						
Gross Foreign debt			0.022	0.17	0.212		
Balance of payments	in millions of USD						
-Exports of goods			457	812	1329	1857	2064
-Imports of goods			-547	-957	-1684	-2531	-3122
-Trade balance			-90	-145	-356	-674	-1058
-Services, net			42	75	105	379	512
-Income, net			-13	-13	-30	3	7
-Current account balance			36	22	-165	-166	-443
-Capital and fin. acc.(excl. reserves)			52	219	167	245	565
-Reserve assets			-82	-195	-31	-106	-101

Inflation rate: Percentage change of yearly average over the previous year - all items index (data are based on national CPIs which are not strictly comparable)

Industrial production volume indices: Industrial production covers mining and quarrying, manufacturing and electricity, gas and water supply (according to the NACE Classification Sections C,D,E). Index of Industrial Production covers total industrial production including estimates for enterprises up to 19 employees.

Gross agricultural production volume indices: The gross agricultural output has been calculated in 1993 prices.

Unemployment rate (by ILO methodology): Percentage of the unemployed in labor force. This rate is derived from LFSS (Labor Force Survey) observing the following ILO definitions and recommendations:
Labor force employed and unemployed persons in the sense of the ILO definitions stated below.
The employed all persons aged 15+, who during the reference period worked at least one hour for wage or salary or other remuneration as employees, entrepreneurs, members of cooperatives or contributing family workers. Members of armed forces and women on child-care leave are included.
The unemployed all persons aged 15+, who concurrently meet all three conditions of the ILO definition for being classified as the unemployed: (i) have no work, (ii) are actively seeking a job and (iii) are ready to take up a job within a fortnight.
Data refer to the Estonian Labour Force Survey 1995 (ELFS 95). ELFS 95 was carried out in January-April 1995. The questions were asked about the years 1989-1995. The next survey will take place in April-June 1997 and will collect information since the beginning of 1995. According to this for the time being, annual average numbers about 1993 and 1994 can be given. The object of ELFS 95 were people who in 1995 were 16-75 years old. In 1989 the same people were 10-69 and in 1994 15-74 years old. In order to guarantee the comparability of the data between years 1989-1995, data presented in the tables are about population aged 16-69.

Gross foreign debt: Debt is extracted form the OECD's External Debt Statistics.

Balance of payments: Data is derived from IMF database, their comparability with respective EU statistics can not be guaranteed, but balance of payments is compiled mainly in accordance to IMF standards. Balance in trade of goods in accordance with balance of payments principles. Exports and imports are both in f.o.b. values. Net income includes direct, portfolio and other investment income, compensation of employees. Current account balance by definition of IMF 5th Manual, capital transfers are excluded. Reserve assets: it means changes in reserve assets during the year; (+) signifies an increase, (-) a decrease in reserve assets.

FOREIGN TRADE

	1993	1994	1995	1996
Imports and exports (current prices)	in millions of USD			
- Imports	894.7	1655.7	2539	3204.1
- Exports	804.4	1302.7	1836.7	2077.9
- Balance of trade	-90.4	-353	-702.3	-1126.3
External trade volume indices	previous year = 100			
- Imports				
- Exports				
Structure of Import by SITC (current prices)	in % of total Import			
- (0+1) food and live animals, beverage and tobacco	13.7	14.8	13.1	14.7
- 2 crude materials, inedible	3.2	3	3.7	3.5
- 3 mineral fuels and lubricants	15.2	13.7	11	9.3
- 4 animal and vegetable oils etc.	0.6	0.7	0.7	0.5
- 5 chemicals and related products	7.7	9.1	9.6	10.8
- 6 manufactured goods classified chiefly by material	15.5	18.1	20	19.9
- 7 machinery and transport equipment	32.3	28.8	29.8	29.6
- 8 miscellaneous manufactured articles	11.8	11.8	12	11.7
Structure of export by SITC (current prices)	in % of total Export			
- (0+1) food and live animals, beverage and tobacco	22.8	21.3	15.7	15.2
- 2 crude materials, inedible	10.3	10.8	11.9	10.1
- 3 mineral fuels and lubricants	7	7.1	7.1	6.4
- 4 animal and vegetable oils etc.	0.2	0.2	0.2	0.1
- 5 chemicals and related products	5.3	7.1	8.3	9.7
- 6 manufactured goods classified chiefly by material	18.8	18.5	18.8	20.6
- 7 machinery and transport equipment	18.5	16.8	19.9	19.8
- 8 miscellaneous manufactured articles	17	18.2	18.1	18.1
External trade price indices	previous year = 100			
- Imports			137.4	
- Exports		141.3	124.7	

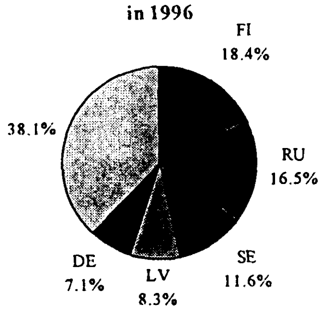
Imports and exports (current prices); Structure of external trade by SITC (current prices): Trade data exclude direct re-exports, trade in services and trade with customs free zones as well as licenses, know-how and patents. The data are based upon the special trade system and are regularly updated. ***Trade Classifications***: Estonia is using the commodity classification according to the ***Combined Nomenclature***. ***Imports*** are recorded on ***CIF*** basis and are captured with the date of acception of the customs declaration by customs authorities. ***Exports*** are recorded on ***FOB*** basis and are captured with the date of acceptation of the customs declaration by customs authorities. The customs statistics are utilised for monitoring of foreign trade data. Eurostat has converted National Currencies to the US dollar by applying the International Monetary Fund annual average exchange rates.

External trade price indices: The price indices have been calculated by "unit value" method.

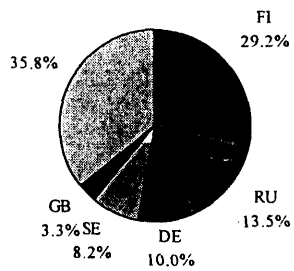
FOREIGN TRADE

	1993		1994		1995		1996	
Structure of imports by main countries (current prices)	in % of total imports							
1st partner	**FI**	27.9	**FI**	29.9	**FI**	32.6	**FI**	29.2
2nd partner	**RU**	17.2	**RU**	16.8	**RU**	16.1	**RU**	13.5
3rd partner	**DE**	10.8	**DE**	10	**DE**	9.6	**DE**	10
4th partner	**SE**	8.9	**SE**	8.9	**SE**	8.5	**SE**	8.2
5th partner	**NL**	3.6	**NL**	3.1	**NL**	3.1	**GB**	3.3
others		31.6		31.3		30.1		35.8
Structure of exports by main countries (current prices)	in % of total exports							
1st partner	**RU**	22.6	**RU**	23.1	**FI**	21.5	**FI**	18.4
2nd partner	**FI**	20.7	**FI**	17.8	**RU**	17.6	**RU**	16.5
3rd partner	**SE**	9.5	**SE**	10.8	**SE**	10.8	**SE**	11.6
4th partner	**LV**	8.6	**LV**	8.2	**LV**	7.5	**LV**	8.3
5th partner	**DE**	8	**DE**	6.8	**DE**	7.2	**DE**	7.1
others		30.6		33.3		35.4		38.1

Structure of export by main partners in 1996



Structure of import by main partners in 1996



DE	Germany	NL	Netherlands
FI	Finland	RU	Russian Federation
GB	United Kingdom	SE	Sweden
LV	Latvia		

SOCIAL INDICATORS

	1991	1992	1993	1994	1995
Population on 1 January	thousand				
	1570.45	1562.22	1526.53	1506.93	1491.6
Proportion of population by age (1 January 1995)	in % of total population				
y0_14					20.7
y15_24					14.2
y25_44					28.5
y45_64					23.5
y65_max					13.1
	total number				
Live births	19320	18006	15170	14178	
Deaths	19705	20115	21267	22150	
Infant deaths					
- Less than 1 year	258	285	239	205	
- Still birth	148	175	121	126	
Marriages	10292	8878	7745	7378	
Divorces	5738	6651	5757	5606	
	per 1000 of population				
Crude marriage rate	6.57	5.75	5.11	4.90	4.7
Crude divorce rate	3.66	4.31	3.8	3.70	5.0
Natural growth rate	-0.3	-1.37	-4.02	-5.30	
Net migration rate	-5.13	-21.9	-9.08	-5.10	
Total population growth rate	-5.37	-23.27	-13.1	-10.40	
Total fertility rate	1.77	1.69	1.45		
Infant mortality rate	13.35	15.83	15.75	14.50	14.8
Late foetal mortality rate	7.6	9.63	7.91	8.81	
Life expectancy	at birth				
- Males					61.7
- Females					74.3
Life expectancy	at 65 years				
- Males					12.0
- Females					16.1

LABOUR MARKET

	1993	1994	1995	1996
Economic Activity Rate (ILO methodology)	in % of population age +15			
	70.5	70.4		
Average employment	in thousand			
	703	687		
Unemployment rate (ILO methodology)	in % of labour force			
- Total	6.6	7.6		
- less then 25 years	11.3	11.8		
- 25 years and more	5.8	6.9		
Registered unemployment (end of period)	in % of economically active population			
	4	4.1	4	4.3

	1993	1994	1995	1996
Average paid employment indices by NACE classes	previous year = 100			
- Agriculture, hunting, forestry and fishing	74.7	83.3		
- Mining and quarrying	96.3	101.5		
- Manufacturing	86.4	95.2		
- Production and distribution of electricity, gas and water	105	109.6		
- Construction	88.6	95.6		
- Transport, storage and communication	98.8	100		
Monthly wages and salaries indices				
- real				
- nominal				

Economic activity rate (ILO Methodology) - Percentage of labor force in the total population aged 15+. This rate is derived of LFSS (Labor Force Survey) observing the following ILO definitions and recommendations:
Labor force employed and unemployed persons in the sense of the ILO definitions stated below.
The employed all persons aged 15+, who during the reference period worked at least one hour for wage or salary or other remuneration as employees, entrepreneurs, members of cooperatives or contributing family workers. Members of armed forces and women on child-care leave are included.
The unemployed all persons aged 15+, who concurrently meet all three conditions of the ILO definition for being classified as the unemployed: (i) have no work, (ii) are actively seeking a job and (iii) are ready to take up a job within a fortnight.

Unemployment rate (by ILO methodology): - Percentage of the unemployed in labor force.

Average employment and Average paid employment indices by NACE classes:. The data cover also all budgetary, subsidised organisations and persons with secondary job are included. Armed forces, apprentices, employees on child-care and additional child-care leaves are excluded.

Unemployment rate (by ILO methodology, Average employment and Average paid employment indices by NACE classes:
Data refer to the Estonian Labour Force Survey 1995 (ELFS 95). ELFS 95 was carried out in January-April 1995. The questions were asked about the years 1989-1995. The next survey will take place in April-June 1997 and will collect information since the beginning of 1995. According to this for the time being, annual average numbers about 1993 and 1994 can be given. The object of ELFS 95 were people who in 1995 were 16-75 years old. In 1989 the same people were 10-69 and in 1994 15-74 years old. In order to guarantee the comparability of the data between years 1989-1995, data presented in tables are about population aged 16-69.

Registered unemployment (end of period): Registered unemployment in per cent - percentage of unemployed registered in civil economically active population, based on Labour force sample survey (LFSS). Data of the State Labour Market Board. Registered unemployment covers unemployed job seekers registered in state employment offices. The unemployment rate is the share of the registered unemployed job seekers from the population between 16 and pension age.

PUBLIC FINANCE

	1990	1991	1992	1993	1994	1995
Government budget	in millions of national currency					
-Consolidated central government revenue		448.1	2994.8	6320.3	10566.8	
-Grants		14.9	219.9	243.7		
-Consolidated central government expenditure		404.7	3024	6088.5	9590.3	
-Consolidated general government expenditure		539.9	3917	7805.7	11282	
-Consolidated central government deficit/surplus		58.3	190.7	475.5	976.5	
-General government deficit/surplus		73	272.4	539.2	973.4	
Government budget	in % of Gross Domestic Product					
-Consolidated central government expenditure		22.1	21.2	27.5	31.9	
-Consolidated general government expenditure		29.5	27.5	35.3	37.5	
-Consolidated central government deficit/surplus		3.2	1.3	2.2	3.2	
-General government deficit/surplus		4.0	1.9	2.4	3.2	

Government budget: These data relate to central and general government as published in the IMF's *Government Finance Statistics Yearbook (1996) (GFSY)*; included also is the country's presentation in the *GFSY.*

Because the *GFSY* does not present statistics for general government, but for individual levels of government separately, the consolidated series presented here were obtained from central and local government data and adjusted in consolidation for the identified intergovernmental transfers.

Even though the statistics cover the central and local government published in *GFSY*, the coverage may not be exhaustive if some central or local government units are not included in that coverage. A measure of the exhaustiveness of the coverage can be obtained by comparing in the *GFSY* the note on the coverage of data for individual countries with the list of central and local government units provided.

It should be noted that the deficit/surplus used here is equal to revenue and grants minus expenditure, and does not take lending minus repayments into account (see further below).

The netting of inter-government transfers carried-out in the attached tables is limited to the current and capital transfers consisting of the identified grants and current and capital subsidies between the levels of government. Other types of transactions occurring between government levels, such as the payments of taxes and employers' social security contributions, and the reciprocal purchases of goods and services are not normally classified as inter-governmental transfers have not been eliminated in the consolidation process. Finally, whether the absence of data for current and capital transfers should be attributed to the absence of transfer or to lack of data is unclear; in all cases absence of information on transfers have been deemed to represent zero-transfers.

a. ***Government expenditure*** consists of general government cash expenditures on current and capital goods and services, interest payments and current and capital transfers but excludes non-cash transactions.

b. ***Deficit/surplus*** equals cash revenue and cash grants minus cash expenditure. This measure of the deficit/surplus differs from that used in GFS which equals cash revenue and cash grants, minus cash expenditure, minus net lending. This exclusion of net lending(consisting, in the *GFS* methodology, of operations in financial assets and liabilities carried out for specific policy purposes, rather than for liquidity purposes) brings the measure of the deficit/surplus presented here closer to the national accounts concept of net borrowing/net lending. Also, as a result of this exclusion, receipts from privatisation (classified as repayments in the *GFS* methodology) do not enter in the determination of the deficit/surplus presented in the attached tables (and therefore do not reduce the deficit).

FINANCIAL SECTOR

	1990	1991	1992	1993	1994	1995	1996
Monetary aggregates	Billions (10^9) of US Dollars						
- Monetary aggregate M1				0.38	0.51	0.72	0.87
- Quasi money				0.06	0.13	0.19	0.27
Total reserves (gold excluded, end of period)	Millions (10^6) of US Dollars						
				386.12	443.35	579.91	636.82
Average short term interest rates	% per annum						
- lending rate				27.3	23.1	16	13.7
- deposit rate					11.5	8.7	6.1
Official discount rate (end of period)				6.3	5.4	4.3	3.6
USD exchange rates	1 USD = ...EEK						
Average of period				13.223	12.991	11.465	12.034
End of period			12.912	13.878	12.39	11.462	12.44
ECU exchange rates	1 ECU = ...EEK						
Average of period				15.484	15.453	14.996	15.758
End of period			15.635	15.483	15.240	15.064	15.587

Monetary aggregates (end of period): *Money (M1)* Includes demand deposits and currency outside banks. *Quasi money* Include time, savings and foreign currency deposits. Monetary aggregates are calculated on a monthly basis; according to the monetary survey M1 comprises currency outside banks and demand deposits (excluding government deposits), Quasi-money comprises time deposits, savings deposits and foreign convertible and non-convertible currency deposits (excluding government deposits). Eurostat has converted National Currencies to the US dollar by applying the International Monetary Fund annual end of period exchange rates.

Official discount rate (end of period): No official discount rate, no official central bank base or primary rate either; all the rates are market-determined.

Average short term interest rates: Data are extracted from the IMF's monthly International Financial Statistics (IFS). Average short-term lending and deposit rates relate to period averages. ***Lending rates*** generally consist of the average interest rate charged on loans granted by reporting banks. ***Deposit rates*** relate to average demand and time deposit rates or average time deposit rates. These rates may not be strictly comparable across countries to the extent the representative value of the reporting banks and the weighting schemes vary.

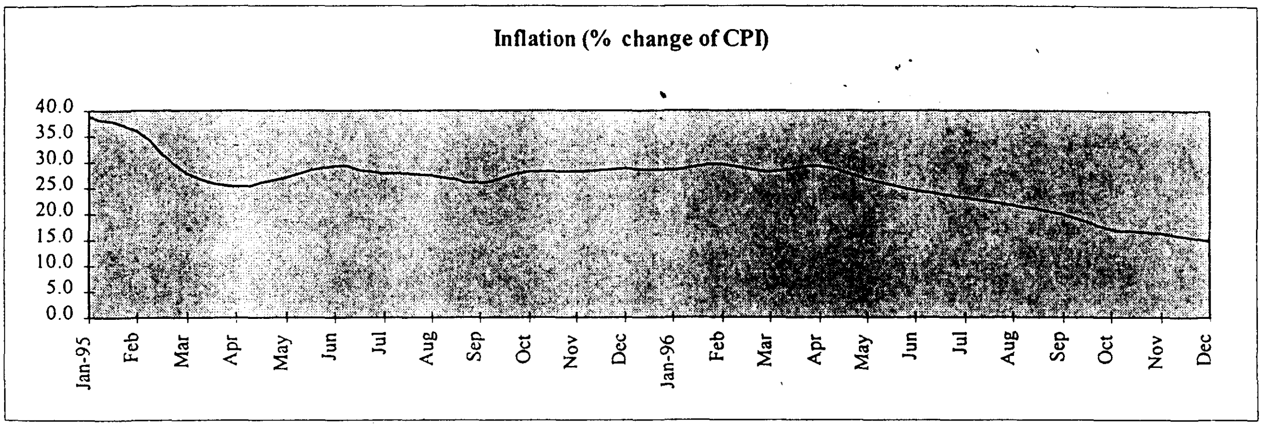
Total reserves (gold excluded, end of period): The statistics on official foreign reserves are extracted from the IMF's monthly International Financial Statistics (IFS). Total reserves (gold excluded) are defined as the sum of central bank holdings of foreign currencies and other (gross) claims on non-residents; this definition excludes claims on residents denominated in foreign currency. According to the definition; official foreign reserves are calculated at market exchange rates and prices in force at the end of the period under consideration. Total reserves (gold excluded) published in IFS may differ from the figures published by the national authorities. Some factors contributing to possible differences are the valuation of the reserve position in the Fund, and a different treatment of claims in non-convertible currencies.

USD exchange rates: International Monetary Fund exchange rates as present in the publication: "Statistiques Financieres Internationales".

INFLATION (12 months changes)

Percentage change of the CPIs with the current month compared with the corresponding month of the previous year (t/t-12)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1993												
1994												
1995	39.0	35.9	27.8	25.2	27.2	29.2	27.8	27.4	25.9	28.4	28.2	28.8
1996	28.7	29.5	28.4	29.3	26.7	24.7	23.1	21.8	20.1	17.3	16.4	14.9



Inflation (12 months changes): Inflation rates (12 months changes) are percentage changes of the CPIs with the current month compared with the corresponding month of the previous year. Inflation rates are based on national CPIs which are not strictly comparable between candidate countries or with those based on EU HICPs (different methods, concepts, practices in the calculation of CPIs).

INDUSTRY

	1993	1994	1995	1996
Structure of GDP by economic activities (NACE, current prices)	in % of Gross Domestic Product			
- Mining and quarrying	1.7	1.6	1.5	
- Manufacturing	17.1	16.6	15.2	
- Production and distribution of electricity, gas and water	3.2	2.9	3.5	
Industrial production volume indices by NACE classes	previous year = 100			
- Total	81.3	97	101.9	
- Mining and quarrying	72.8	98.9	95.6	
- Manufacturing	81.4	96.9	102.9	
- Production and distribution of electricity, gas and water	83.7	97.6	98	

Industrial production volume indices by NACE classes: Industrial production covers mining and quarrying, manufacturing and electricity, gas and water supply (according to the NACE Classification Sections C,D,E). Index of Industrial Production covers total industrial production including estimates for enterprises up to 19 employees. Electricity, gas and water supply covers only energy production (NACE Rev. 1.: 40101, 40301).

INFRASTRUCTURE

	1985	1990	1995	1996
	in Km per 1000 Km2			
Railway network	22.3	22.7	22.6	22.6
	Kilometre			
Length of motorways		60	64	66
	inhabitants			
Number of inhabitants per passenger car	6.6	6.5	3.9	3.6

AGRICULTURE

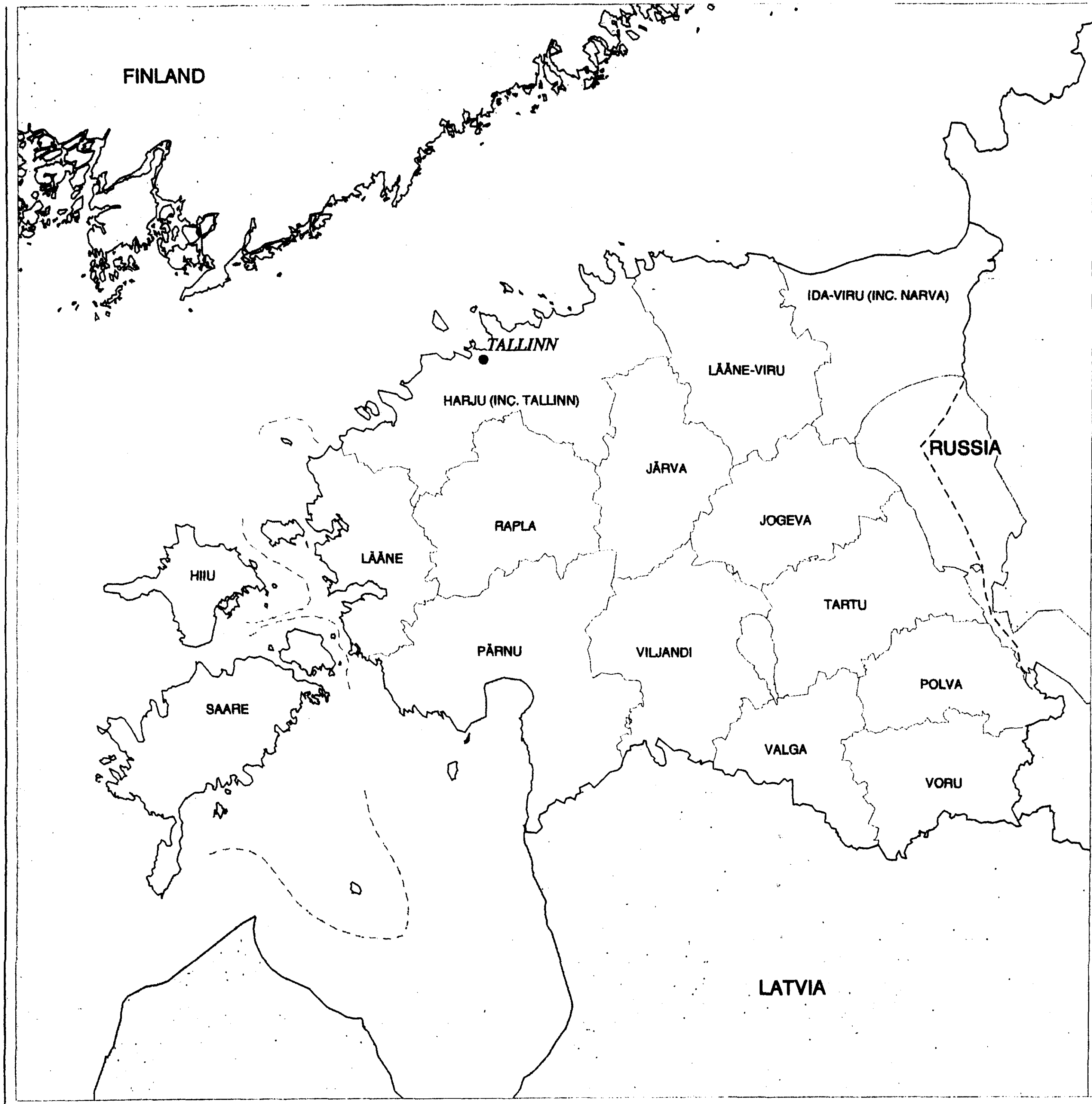
	1992	1993	1994	1995	1996
Land area by land-use categories	in 1000 Hectares				
- total	4522.7	4522.7	4522.7	4522.7	
- agricultural land	1455	1454.1	1449.5	1449.5	
- forest	2021.8	2016.6	2016.2	2016.2	
- arable land	1127.6	1128.9	1127.8	1127.8	1127.6
- permanent meadows and pastures	312.5	310.3	306.9	306.9	306.9
Agricultural land by legal status	in % of agricultural land				
- state enterprise		1.9	1.9	1.3	
- Cooperatives		36.4	33.7	29.2	
- others		61.7	64.4	69.5	

	1992	1993	1994	1995	1996
Share of GDP	in % of Gross Domestic Product				
- Agriculture, hunting, forestry and fishing (Nace A+B)		9.8	8.9	7.1	
	Previous year = 100				
Gross agricultural production volume indices		88.3	85.8	98.8	
Main crops by area	in 1000 Hectares				
- Cereals	423.1	375.1	319.5	304.3	290.2
- of which: wheat	43.5	50.3	34.2	38.6	46.9
- Potatoes	46	43	40	37	36
- Sugar beet	1	0	1	0	0
- Fodder beet					8.7
Main crops by yield	in 100 kg/Hectares				
- Cereals	14.1	21.6	16.0	16.9	
- of which: wheat	20.6	21.0	16.7	20.0	
- Potatoes	144.5	126.4	141.1	145.6	
- Sugar beet		250	212	317	
- Fodder beet					

	1992	1993	1994	1995	1996
Sales or procurement of animal for slaughter	in 1000 tons of live weight				
- pigs		52.5	45.9	52.2	48.1
- cattle		90.8	64.2	54.8	52.4
- poultry		7.5	9.9	8.5	8.3
Livestock breeding intensity (end of period)	heads per 1000 Ha of agricultural land				
- cattle		318	288	256	240
- of which: cows		156	145	128	119
- sheep		57	42	34	29
	heads per 1000 Ha of arable land				
- pigs		376.8	407	398.4	278.9

Gross agricultural production volume indices: The gross agricultural output has been calculated in 1993 prices.

Sales or procurement of animals for slaughter: Sales of animals for slaughter, killed animals in enterprises and private farms, household plots for sales, own consumption meat.



Estonia
1995

Legend:

Country boundary

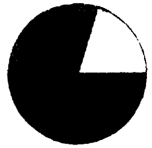
Region boundary

COUNTRY NAME
REGION NAME
CITY NAME

Selected major settlements:
(1 000 inhabitants)

- ○ 200 - 250
- ● 250 - 500
- ■ 500 - 1 000
- ■ > 1 000

General information about the country:
Age groups (in years):



- < 15
- 15 - 65
- > 65

Living standard (in 1993): ECU 1 003
(GDP per capita)

Area: 45 277 km²

Administrative regions: 15 counties

Population: 1 483 900

Source: Statistical Office of Estonia
Cartography and geographic information management: GISCO

0 25 75 km

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