



# **Accession of Estonia to the OECD**

## **Review of international investment policies**



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## FOREWORD

This review is based on the report prepared by the Investment Committee as part of the process of Estonia's accession to OECD membership.

The OECD Council decided to open accession discussions with Estonia on 16 May 2007 and adopted an Accession Roadmap, setting out the terms, conditions and process for accession, on 30 November 2007.

In the Roadmap, the OECD Council requested a number of OECD Committees to provide it with a formal opinion. In light of the formal opinions received from OECD Committees and other relevant information, the OECD Council decided to invite Estonia to become a Member of the Organisation on 10 May 2010.

In the Accession Roadmap, the Investment Committee was requested to examine Estonia's position with respect to OECD instruments, standards and benchmarks, to assess the adequacy of its policies taking into account its economic and social situation and to provide the Council with its formal opinion on the willingness and ability of Estonia to assume the obligations of membership in the field of investment.

The accession review of Estonia was based on the following information:

- The Initial Memorandum of Estonia setting out its preliminary position under all OECD legal instruments;
- The responses of Estonia to a questionnaire prepared by the Investment Committee;
- A Secretariat mission on 9-11 February 2009;
- A Secretariat report which was revised following each accession review meeting;
- Accession review meetings of the Investment Committee on 25 March and 5 October 2009 comprised of a question and answer session with the Estonian Delegation and a closed session during which the Committee discussed its conclusions;
- The response by Estonia to a letter from the Chair of the Investment Committee Accession Examinations requesting further improvements, confirmations and clarifications of the country's position under the instruments, following the first accession review meeting and the letter from Estonia following the second accession review meeting; The technical assessment of the Committee's Working Group on International Investment Statistics (WGIIIS) which considered Estonia's position under the Benchmark Definition of Foreign Direct Investment, its response to the Survey of Implementation of Methodological Standards for Direct Investment (SIMSDI) and its commitments regarding the reporting of statistics on international investment;

- Information on recent macroeconomic and financial developments provided by the Secretariat of the Economic and Development Review Committee;
- The outcome of the review of Estonia by the Committee on Financial Markets concerning the parts of the Codes of Liberalisation dealing with banking and financial services, as reflected in its formal opinion;
- The outcome of the review of Estonia by the Insurance and Private Pensions Committee and its Working Party of Governmental Experts on Insurance concerning the parts of the Codes of Liberalisation dealing with insurance and private pensions.

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<sup>1</sup> This review was finalised on the basis of information available as of 25 March 2010, date of its approval by the OECD Investment Committee.

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## 1. INTRODUCTION AND SUMMARY

### 1.1. Accession Review Procedure

In the Accession Roadmap for Estonia [C(2007)101/FINAL], the Investment Committee was requested to "examine Estonia's position with respect to OECD instruments, standards and benchmarks, to assess the adequacy of its policies taking into account its economic and social situation" and to "provide the Council with its formal opinion on the willingness and ability of Estonia to assume the obligations of membership" in the field of investment.

The Accession Roadmap provided that Estonia should commit to the following core principles in the investment area [Annex 1]:

- i) full compliance with the principles of non-discrimination, transparency and 'standstill', in accordance with the OECD Codes of Liberalisation and the National Treatment instrument of the OECD Declaration on International Investment and Multinational Enterprises (reservations under the Codes must be limited to existing restrictions);
- ii) an open and transparent regime for FDI including in key sectors. Restrictions must be limited and concern sectors where restrictions are not uncommon in OECD countries;
- iii) liberalisation of other long-term capital movements, including equity investment and debt instruments of a maturity of one year or more; commercial credit and other capital operations relating to international trade are also to be liberalised; a timetable for the abolition of remaining controls on short-term capital movements is required;
- iv) no restrictions on payments or transfers in connection with international current account transactions; the candidate countries must comply with all IMF Article VIII requirements;
- v) relaxation of restrictions on cross-border trade in services, particularly banking, insurance and other financial services;
- vi) fair and transparent implementing practices and proportionality of the measures relative to the stated objective pursued;
- vii) effective enforcement of intellectual property rights;
- viii) key commitments under investment protection and other international agreements;
- ix) capacity to present a credible plan for the establishment of a visible, accessible, transparent and accountable National Contact Point for the OECD Guidelines for Multinational Enterprises;

evidence of the candidate's commitment to the various international instruments cited in the Guidelines.

The Roadmap specifically provided for:

- i) A review and assessment by the Committee of the willingness and ability of Estonia to assume the obligations of the Decisions on the Codes of Liberalisation of Capital Movements and Current Invisible Operations (1961 and subsequent amendments) and of the Decisions Related to the Declaration on International Investment and Multinational Enterprises (1976 and subsequent amendments).
- ii) A review and an assessment by the Committee of Estonia's position under the Recommendation on the OECD Benchmark Definition on Foreign Direct Investment (1995, recently revised) and under the Declaration on International Investment and Multinational Enterprises (1976 and subsequent amendments). In addition, Estonia would be required to comply with statistical reporting requirements associated with the Benchmark Definition.
- iii) An assessment of Estonia's position under the Recommendation on OECD Principles for Private Sector Participation in Infrastructure.

In January 2008, the Committee adopted a procedure to be followed for the review of the candidate countries in the investment field. It was decided that the Committee would hold at least two accession review meetings including a discussion with the candidate country. The Committee agreed that its Working Group on International Investment Statistics would review the position of the candidate countries under the Fourth Edition of the OECD Benchmark Definition of Foreign Direct Investment [C(2008)76] and associated reporting requirements, notably their responses to the OECD Survey of Implementation of Methodological Standards for Direct Investment (SIMSDI) and their agreement to report data on FDI trends in accordance with the timetable and template agreed by Members.

The Committee also noted that, in accordance with the Accession Roadmaps, the Committee on Financial Markets (CMF) and the Insurance and Private Pensions Committee (IPPC) would assist the Investment Committee in reviewing and assessing the willingness and ability of candidate countries to accept the financial services obligations of the Codes in their respective areas of competence. [C(2007)100-104/FINAL, Appendices A.VII and A.VIII].

The Investment Committee's Report on Estonia's Position under the OECD Investment Instruments presents the full account of the Investment Committee's examination of Estonia. The Report was transmitted to Council separately for the adoption of the lists of proposed reservations by Estonia to the Code of Liberalisation of Capital Movements and to the Code of Liberalisation of Current Invisible Operations, as well as proposed updated exceptions to the National Treatment instrument.<sup>2</sup> The Report also includes the updated list of measures reported for transparency in accordance with the Declaration on International Investment and Multinational Enterprises.<sup>3</sup>

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<sup>2</sup> Information on the OECD Codes of Liberalisation can be found at [www.oecd.org/daf/investment/codes](http://www.oecd.org/daf/investment/codes)

<sup>3</sup> Information on the OECD Declaration on International Investment and Multinational Enterprises, including the National Treatment instrument, can be found at [www.oecd.org/daf/investment/declaration](http://www.oecd.org/daf/investment/declaration)

## 1.2. Estonia's position under OECD instruments relating to investment

This section presents the summary of Estonia's position under the OECD legal instruments in the investment field, including Estonia's position on the Codes of Liberalisation.

Of the 18 OECD instruments in the investment field Estonia has already formally adhered to two: the Declaration on International Investment and Multinational Enterprises in 2001 and the Declaration on Sovereign Wealth Funds and Recipient Country Policies at the time of its adoption on 5 June 2009.

Estonia accepts all of the OECD investment instruments with the following qualifications:

- *Decision of the Council adopting the Code of Liberalisation of Capital Movements [OECD/C(61)96]*

Estonia accepts this Decision subject to a list of proposed reservations to the Code of Liberalisation of Capital Movements [Annex 2].

- *Decision of the Council adopting the Code of Liberalisation of Current Invisible Operations [OECD/C(61)95]*

Estonia accepts this Decision subject to a list of proposed reservations to the Code of Liberalisation of Current Invisible Operations [Annex 3].

- *Declaration on International Investment and Multinational Enterprises [C(76)99]*

Estonia accepts the Declaration and related Decisions and Recommendations [C(89)76; C(88)131; C(88)41; C(87)76 and C(86)55] subject to a list of proposed exceptions to the National Treatment instrument. Estonia also updates a list of other measures reported for transparency under the instrument [Annexes 4 and 5].

### *The Codes of Liberalisation*

Estonia has endorsed the objectives and principles of the Codes of Liberalisation of Capital Movements (CLCM) and Current Invisible Operations (CLCIO), hereinafter "Codes of Liberalisation". Estonia's acceptance of the obligations of the Codes of Liberalisation is subject to reservations, which are listed in Annexes 2 and 3 of the Investment Committee's Report. The Report examines the conformity of measures maintained by Estonia with the Codes of Liberalisation, as well as the implications of Estonia's proposed adherence to the OECD Codes of Liberalisation. Estonia's proposed position under the OECD Codes of Liberalisation can be summarised as follows:

In the field of inward direct investment, Estonia has opened up all sectors to investors from EU and other European Economic Area (EEA) countries,<sup>4</sup> except the acquisition of real estate, where certain restrictions apply to all non-residents. In the area of real estate, the restriction on the acquisition of agricultural land and forests will cease to apply to investors from OECD countries as from 31 May 2011. Restrictions on investment apply to non-EEA investors in the field of air transport and to non-EU investors, in the field of maritime transport.

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4. In addition to the EU countries, OECD members of the EEA include Iceland and Norway.



Estonia maintains very few restrictions on capital movements other than inward direct investment. As mentioned above, the purchase in Estonia of real estate by foreigners is restricted but the restriction on the acquisition of agricultural land and forests will cease to apply to investors from OECD countries as from 31 May 2011. Another restriction concerns portfolio investment, which may be affected in the air and maritime transport sectors since restrictions on inward direct investment apply to aggregate foreign ownership. Resident open-ended funds set up as Undertakings for Collective Investments in Transferable Securities (UCITS) may not invest in covered bonds issued by non-EEA residents.

In the field of exchange controls, residents and non-residents may freely carry out payments and transfers in connection with international current transactions, as well as with permitted capital account transactions. Estonia accepted the obligations of Article VIII of the Articles of Agreement of the International Monetary Fund in August 1994.

In the area of cross-border trade in services, Estonia maintains very few restrictions, which apply to non-EEA based service providers in banking, professional services and road transport.

Non-discriminatory treatment among members is another obligation of the Codes (Articles 8 and 9). Estonia has confirmed that existing reciprocity clauses will not apply to any OECD country. In the field of maritime transport cabotage, Estonia has prepared amendments to its legislation to eliminate reciprocity considerations for OECD Members and the amendment was expected to be adopted before Estonia's accession to the OECD.

Liberalisation vis-à-vis EEA countries, not extended to other OECD members is another form of discriminatory treatment. Estonia has already eliminated discrimination in the areas of investment by resident open-ended funds in foreign covered bonds and the cross-border provision of most insurance and asset management services.

In the field of financial services, at the beginning of the accession process, Estonia's domestic legislation included restrictions on most cross-border services and private pension branching by non-EEA residents. However, Estonia's legislation was not in line with its prior commitments under the GATS to liberalise most of the services concerned. Under international law, the acceptance of reservations under the Codes for items covered and liberalised under the GATS could be interpreted as limiting the scope of Estonia's obligations under the GATS vis-à-vis non-EEA OECD Member countries. Accordingly, Estonia did not propose any reservations under the Codes vis-à-vis operations which it had liberalised under the GATS vis-à-vis all WTO Members.

Estonia has also undertaken to amend its legislation to reflect liberalisation of the relevant items of the Codes. A legislative amendment in January 2010 eliminated the restriction on non-EEA institutions to provide custodial and safe keeping services in Estonia without establishment (item E/3 of the CLCIO) as well as asset management and safekeeping of assets services (item E/4 of the CLCIO). In the area of the cross-border provision by non-residents of insurance services all required legislative changes were adopted by Estonia's Parliament in January 2010, except the income tax incentives given to clients of life insurers and pension fund managing companies from EEA countries. The remaining legislative changes to the Income Tax Act to eliminate the restriction on tax incentives were expected to be adopted in 2010. The discrepancies between Estonia's position under the GATS and its domestic legislation would thus be eliminated.

In all cases where Estonia has committed to a liberalisation measure and has undertaken to amend its legislation, the Estonian authorities expected that the legislative amendments would be in force by the time of Estonia's accession to the OECD. However, Estonia submitted that, even if the legislation was not adopted in time, these liberalisation measures would have effect from the date of Estonia's accession to the

OECD, by virtue of the fact that, according to Estonia's Constitution, international obligations, including those set out in the Accession Agreement with the OECD, prevail over national law.

In a letter to the Chair following the second accession examination, Estonia made a declaration to the effect that it "wishes to reaffirm that it fully adheres to the principles of liberalisation and non-discrimination contained in the OECD Codes of Liberalisation and notes that it has taken a number of liberalisation measures during the accession process, which apply to all OECD Members. Estonia will continue to make progress after accession, giving special attention to extending the benefits of liberalisation on a most-favoured-nation basis to all OECD Members. Estonia will report to the Committee on progress within a reasonably short timeframe after eventual accession."

Estonia does not maintain national security related measures affecting investment. Estonia has committed to observe the guiding principles of non-discrimination, transparency and predictability, proportionality, and accountability in the implementation of national security related investment measures as expressed in the Recommendation on Guidelines for Recipient Country Investment Policies relating to National Security, adopted by the OECD Council on 25 May 2009 [C(2009)63]. Estonia took part in the development of this Recommendation as a participant in the Freedom of Investment process and formally accepts the Recommendation.

#### ***Declaration on International Investment and Multinational Enterprises***

Estonia's updated lists of exceptions to national treatment and of other measures reported for transparency are presented in Annexes 4 and 5 of the Investment Committee's Report.

With regard to the Guidelines for Multinational Enterprises contained in the Declaration on International Investment and the subsequent Council Decision on the OECD Guidelines for Multinational Enterprises [C(2000)96], Estonia has made efforts to promote the Guidelines and the establishment and operation of a National Contact Point (NCP). No specific instance has been brought before the Estonian NCP so far.

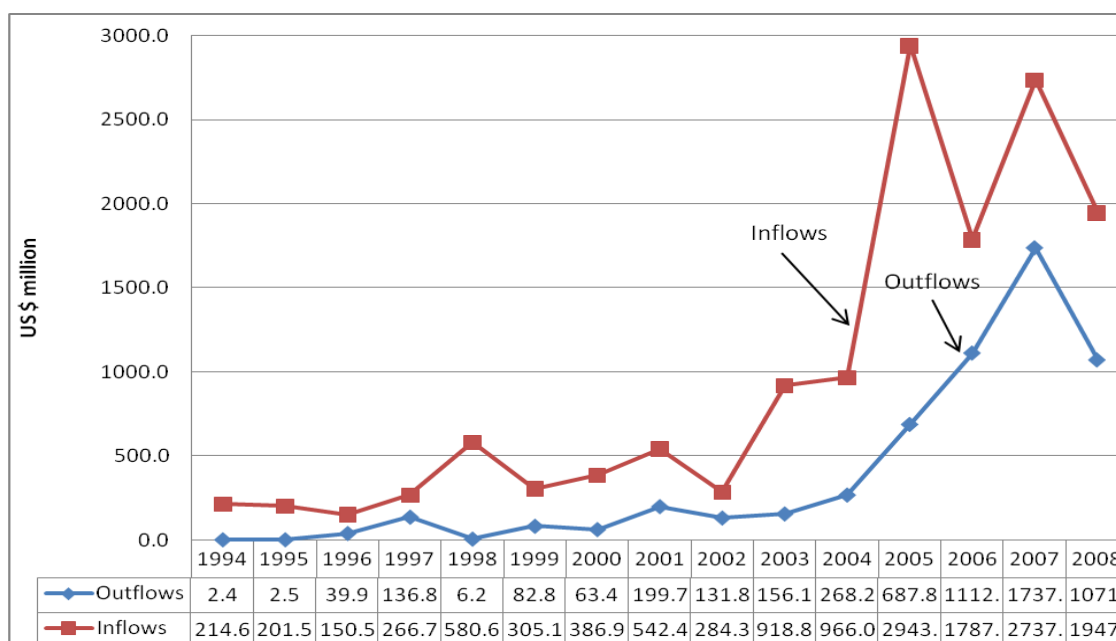
## 2. INWARD DIRECT INVESTMENT

### 2.1. Foreign direct investment trends

After regaining its independence, Estonia pursued a policy of opening up its borders to foreign trade and investment. In November 1999 Estonia became a member of the World Trade Organisation (WTO). In May 2004, it joined the EU. This early exposure to foreign competition contributed to the country's comparatively quick transformation to a full-fledged market economy. Today, the country is considered to have one of the most open and competitive economies in the world. The dynamism of the business environment is reflected in high rates of firm and job creation, as well as in large inflows of foreign direct investment (FDI).

FDI flows, both inward and outward, have shown considerable dynamism since the mid-nineties and received an important boost following Estonia's accession to the EU. Direct investment in Estonia peaked in 2005, when inflows reached the equivalent of 21% of GDP, over twice the figure of 9.4% recorded in 1993. Outward foreign investment flows have also been boosted in the process of European integration to reach the equivalent of 7.4% of GDP in 2007, a substantial increase from 0.4% in 1993 (Table 1).

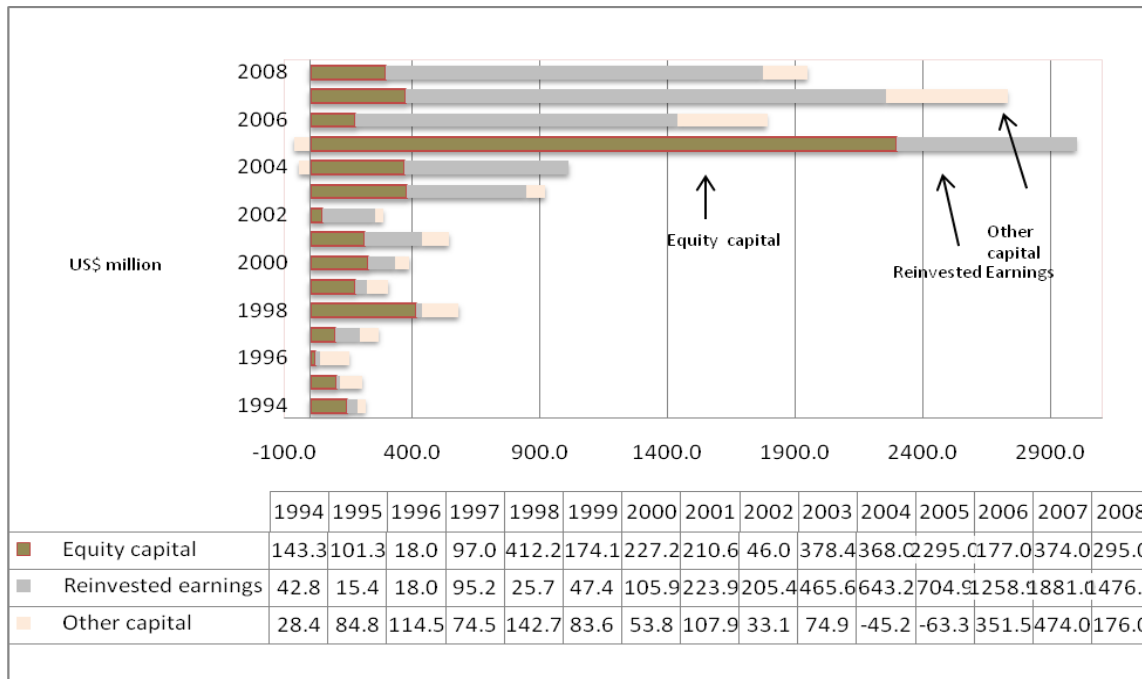
Table 1. FDI flows of Estonia



Source: Bank of Estonia

In recent years, re-invested earnings have represented a large share of total inflows. Inflows originate in an overwhelming proportion from other EU countries, which are also the most important recipients of outflows. Sweden is by far the first foreign direct investor in Estonia with about USD 1,4 billion in 2007 – or slightly over half of total inflows – followed by Finland (USD 450 million) and Denmark (USD 300 million).

**Table 1. Table 2. FDI Inflows of Estonia**



Source: Bank of Estonia

FDI inflows and outflows are primarily in the financial sector, followed by real estate, rental and business activities and by manufacturing industries. At the end of 2007 their share in the stock of inward investment was 33%, 27% and 15%, respectively. These same sectors are also the major sources of outflows.

## 2.2. General legal framework for FDI

### *Legislation governing FDI*

Up to 2000, FDI was primarily governed by the Foreign Investment Act. The Act established equal rights and obligations for foreign and domestic investors, guaranteed the free transfer of profits, dividends and invested capital, and provided investor protection in case of expropriation and offered dispute settlement rights. However, it allowed the Estonian government to specify areas of activity in which establishment or investment could be prohibited or subject to a foreign investment licence. Following the Law's repeal in 2000, the Government no longer has a right to introduce new FDI restrictions. As an EU Member, Estonia has aligned its investment legislation with the requirements of the EU *acquis*.

At present, the framework for doing business is determined essentially by the Commercial Code of 2005 as well as a few sectoral regulations. Establishment can take place in five forms of business organisations: general partnerships, limited partnerships, private limited companies, public limited companies and branches. Foreign investors may establish all these forms of business organisation and fully own them. At least half of the members of the management board of public or private limited companies must be resident in Estonia, the EEA or Switzerland. Legislation will be modified to narrow the residency requirement to allow for the possibility that half or more of half of the members of the management board not be resident in Estonia, the EEA or Switzerland, subject to the provision by the company of the address

of a person resident in Estonia to whom procedural documents and other official documents addressed to the company can be delivered.

Branches of foreign companies are deemed established after registration in the Commercial Register. The application for registration must contain the same data about the branch and the parent company as for a joint stock company. The application must also indicate the country under whose legislation the corporation operates. At least one director of the branch must be resident in Estonia, the EEA or Switzerland.

### ***Transparency, consultation and accountability in public decision-making***

The Accession Roadmap requires the Investment Committee to review transparency and fairness of implementing practices of the candidate countries in the regulatory domain. In Estonia, the Public Information Act of 2001 ensures access to information intended for public use. Laws and regulations of interest to investors, as well as requirements to obtain permits and licences, are described and available through the websites of relevant government bodies. Enterprise Estonia ([www.eas.ee](http://www.eas.ee)) is a governmental organisation in support of entrepreneurship in Estonia, providing financial assistance, advisory functions, cooperation opportunities and training. Its portal provides investors with information, including on relevant legislation and administrative procedures ([www.investinestonia.com](http://www.investinestonia.com)).

The Estonian authorities have made special efforts to promote transparency and accountability in the making and implementation of laws and regulations affecting foreign investment, and to ensure judicial redress. Estonia, which has one of the highest Internet penetration levels in the world, is regarded as a pioneering country in e-government.<sup>5</sup> The web is widely used to disseminate information and facilitate administrative procedures. For example, a Company Registration Portal allows creating certain types of enterprises online in just 2 hours (<https://ettevotjaportaal.rik.ee/index>). The Ministry of Economic Affairs and Communications, in cooperation with the Ministry of Justice responsible for a programme on the development of better regulation, leads and coordinates a programme aimed at reducing administrative burdens.

Engaging interest groups in drafting legislation and preparing policy documents is currently not mandatory under Estonian law. A governmental decree of 1999 on preparation of legal acts provides that the explanatory memoranda of draft laws should also include the opinions of NGOs and interest groups. According to the Estonian authorities, in practice such consultations generally take place prior to the adoption or amendment of laws, either directly or through institutions like the Central Union of Employers and the Chamber of Commerce. There have been several initiatives to improve the current system of consultations. For example, in 2005, representatives of the public sector and NGOs developed a “Code of Good Practice on Consultation” describing the key principles that support active and meaningful participation of NGOs in developing laws, regulations and policies. However, the recommendations of the study and the Code have yet to be put fully into practice by the government.

Draft laws are published on the following public websites: [www.osale.ee](http://www.osale.ee) (consultation of draft laws with citizens and stakeholders); <http://eoigus.just.ee> (co-ordination of draft laws between ministries and other state agencies before they are discussed and accepted by the Government); [www.riigikogu.ee/?op=ems&page=eelnou\\_otsing](http://www.riigikogu.ee/?op=ems&page=eelnou_otsing) (an overview of the drafting process in Parliament).

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5. E-government implies providing higher quality public services more efficiently and effectively by using information and communication technologies as a tool.

According to the Estonian authorities, regulatory impact assessment is a relatively new feature in the country's policy-making and reforms are under way to improve the system. An expert working group and an inter-ministerial commission (including representatives from academia and research institutions, the Parliament and the Statistics Office) were set up in 2007 to this end. Preliminary proposals have already been discussed in the leading working group and are expected to be adopted by the Government in the near future. These proposals include developing impact assessment check-lists and guidance material.

The Constitution guarantees access to appeal and judiciary redress to both nationals and foreigners.

### ***Real estate***

The Restrictions on Acquisition of Immovables Act of 2003 restricts the purchase of real estate by foreigners. Acquisition of agricultural land and forest by foreign citizens and foreign legal persons requires the permission of the relevant county governor. Permission may be granted only to qualified agricultural or forestry producers. In practice, only very few applications have been turned down. Nationals of EU and other EEA countries, who have been legally resident and active in farming in Estonia for at least three years continuously, are not subject to any restrictions. In accordance with the special provisions applicable to Estonia under the Act of Accession to the European Union,<sup>6</sup> as from May 2011, the authorisation requirements for the acquisition of agricultural land and forest will be eliminated for nationals and legal persons of EEA countries. The Estonian authorities have indicated that at that time they intend to extend the liberalisation to all other OECD members, as there may be more effective, non-discriminatory ways of achieving public policy objectives related to the exploitation of Estonia's arable land and forest. Amendments to the Restrictions on Acquisition of Immovables Act have already been prepared in order to extend liberalisation to all OECD Members as from 31 May 2011.

Full prohibition applies to the acquisition by non-EEA nationals and legal persons of land and other real estate in Estonia's islands (except the four biggest ones – Saaremaa, Hiiumaa, Vormsi and Muhu) and in 18 local government units bordering the Russian Federation. However, the prohibition can be lifted by a Government decision. The areas covered by this prohibition amount to 5-6% of the national territory.

These restrictions are recorded in Estonia's list of exceptions to National Treatment (Annex 4). They also give rise to proposed reservations under items I/A (inward direct investment by non-residents) and III/A (operations in real estate in the country concerned by non-residents) of the CLCM (Annex 2). The reservations on the acquisition of agricultural land and forest include a time limit to reflect the Estonian authorities' commitment to extend liberalisation to all OECD members as from 31 May 2011.

### ***Essential security interests***

There are no measures restricting participation of foreigners in defence and other so-called "strategic sectors". No exceptions are made, and there is no list of sectors differentiated as "strategic" or "off limits". Estonia's approach is that while protecting national security is a legitimate concern, as in every country, but foreign investment policies are not the sole, nor necessarily an effective tool to address this concern. Estonia accepts the Recommendation of the Council on Guidelines on Recipient Country Investment Policies relating to National Security [C(2009)63].

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6. Annex VI of the Act of Accession.

### ***Monopolies and concessions***

Estonia maintains few monopolies and concessions, which are recorded in the list of measures reported for transparency purposes under the NTI (Annex 5). State ownership is particularly high in the electricity sector (through the company Eesti Energia or companies owned by it). State ownership is 100% in transmission and import, 99% in wholesale supply, 95% in generation and 86% in electricity distribution and retail supply. There are no concessions in the electricity sector. Since 1 January 2009, the electricity market is open at 35%, *i.e.* all customers with an annual consumption of 2 GWh or more have the right to choose their supplier. According to the Estonian authorities, the electricity market will be fully opened by 1 January 2013; all customers, including households, will be free to purchase electricity from the supplier of their choice, regardless of their annual consumption. The Estonian authorities have confirmed that no discriminatory restrictions apply to the establishment of foreign operators in Estonia: rules for operating in the sector (e.g. licensing) apply equally to all market operators in a given field of activity.

Other public monopolies at national level include the railway infrastructure. Estonian Post AS, a 100% state owned company, had an exclusive right to deliver letters weighing up to 50 grams until 31 March 2009, when this market was completely opened. It still has the exclusive right to issue postage stamps. The provision of pilotage services and the organisation of lotteries whose prize exceeds the value of EUR 1000 are exclusive rights held by state-owned companies. Gas pipelines are owned by Eesti Gaas, a 100% privately owned company.

At the level of territorial subdivisions, a public monopoly exists for district heating utilities. Private or mixed monopolies remain in the field of public transport, where exclusive rights are granted for limited periods.

Concessions are granted for precious metal assaying services; the provision of technical inspection of lifting equipment and of machinery, and (until 2016) public transport services with electric trains. At the sub-national level, concessions are granted for water distribution and waste collection.

### ***Privatisation***

The Privatization Act of 1993, last amended in 2006, provided for the possibility of limiting foreign ownership. In practice, however, no restrictions have been imposed on foreign investment. No requirements of “golden shares” or similar measures are currently applied, and the Privatization Act specifically provides that the Estonian Government should not receive any such special rights in the future. Today the privatisation process has ended and no property is sold under the Privatization Act.

### ***Conflicting requirements***

As an adherent to the Declaration on International Investment and Multinational Enterprises, Estonia has committed to co-operate with a view to avoiding or minimising the imposition of conflicting requirements on multinational enterprises and to report any measures which may conflict with the legal requirements or policies of an OECD Member country and lead to conflicting requirements being imposed on MNEs in different jurisdictions. At this stage, Estonia does not maintain any such measures.

### ***Sovereign Wealth Funds***

Estonia adhered to the OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies the day of its adoption, 5 June 2008.

### 2.3. Sectoral regulations other than financial services

At the time of its adherence in 2001 to the Declaration and Decisions on International Investment and Multinational Enterprises, Estonia maintained restrictions on foreign investment in a limited number of sectors. Today, restrictions in the areas of energy, post and telecommunications have been removed and foreign investment in those sectors is totally liberalised. This section reviews the restrictions that remain.<sup>7</sup>

#### *Air transport*

Before EU membership, the right to register an aircraft in Estonia, to own aircraft registered in Estonia and obtain an operating licence was limited to Estonian citizens or holders of a permanent residence in Estonia and companies registered in Estonia and owned directly or through majority ownership by the Estonian State, a local government and/or Estonian citizens.

As part of its accession to the EU, Estonia adapted its civil aviation regime to align it with the requirements of the EU Single Market for aviation. Consequently, the right to own and register an aircraft in Estonia has now been extended to nationals and legal persons from EU and other EEA countries. Companies which have an operating licence have to be at all times under the control of an Estonian or EU national.

The EU *acquis* provides that majority ownership and effective control must remain with EU Member States, their nationals, or both. Thus, Estonia is under an EU legal obligation to renegotiate its bilateral air service agreements with non-EU countries by introducing standard clauses which bring such agreements in line with EU requirements. Estonia proposes to lodge a reservation under item I/A of the CLCM to reflect the fact that liberalisation has not been extended to non-EU investors.

#### *Maritime transport*

According to the 1998 Law of Ship Flag and Registers of Ships Act, as amended, the right to fly the national flag of Estonia is granted to vessels owned by Estonian citizens; vessels in common ownership if the majority of the vessel is owned by Estonian co-owners; or vessels that are the object of shared succession, if the majority of the succession is owned by Estonian citizens or Estonian legal persons which have inherited the sea-going vessel in common. Majority ownership of a vessel flying the Estonian flag is also possible for nationals from and legal persons established in an EU member country, subject to certain conditions, namely that : (i) the person has its residence or permanent establishment in Estonia (the vessel itself is not deemed to be a business establishment) or (ii) the person has a permanent representative whose residence or seat is in Estonia, who is responsible for compliance with the technical, social and administrative requirements applicable to sea-going vessels in Estonia and who directly controls and monitors the use of the vessel. The restriction that non-EU nationals and legal persons may not acquire majority ownership of a vessel flying the Estonian flag, gives rise to a proposed reservation under item I/A of the CLCM (inward direct investment by non-residents).

Under the 1991 Merchant Shipping Code, cabotage is reserved to sea-going vessels flying the national flag of Estonia or an EU member country. Vessels under the flag of a country outside the EU are allowed to carry out cabotage on the basis of an agreement granting reciprocal rights. No such agreement has been signed so far. Estonia has agreed not to apply reciprocity requirements to investors from OECD countries and will remove the reference to reciprocity from the Merchant Shipping Code. An amendment to this effect has already been prepared. In case the necessary legislative changes are not completed before

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7. Restrictions in the financial, banking and insurance sectors are dealt with in chapters 3-4 of this report.



Estonia's eventual accession to the OECD, Estonia submits that the reciprocity requirement will not apply to investors from OECD countries by virtue of the fact that, according to Estonia's Constitution, obligations under international agreements, including the Accession Agreement with the OECD, prevail over domestic legislation.

The restrictions applicable in maritime transport are also recorded in Estonia's list of exceptions to National Treatment.

#### **2.4. Special incentive schemes to attract foreign investment**

Estonia has no special incentives to attract foreign investment. Estonia's policy is to compete for such investment by means of the quality and predictability of its broader policy framework. This is consistent with the preferred OECD approach, as reflected, inter alia, in the OECD Checklist for FDI Incentive Policies.

#### **2.5. International investment agreements**

##### ***Bilateral investment treaties in force***

Estonia has concluded agreements for the promotion and protection of investments (or bilateral investment treaties – BITs) with the following countries: Austria (entered into force in 1995), Belgium and Luxembourg (1999), China (1994), the Czech Republic (1995), Denmark (1993), Finland (1992), France (1995), Germany (1997), Greece (1998), Israel (1995), Italy (2000), Latvia (1996), Lithuania (1996), the Netherlands (1993), Norway (1992), Poland (1993), Spain (1998), Sweden (1992), Switzerland (1993), Turkey (1999), Ukraine (1995), the United Kingdom (1999) and the United States (1997).

As a member of the EU, Estonia is also Party to the Partnership, Cooperation and Association agreements signed between the European Communities and their Member States and third countries. Some of these agreements contain investment-related provisions, such as “most favoured nation” (MFN) treatment for the establishment of subsidiaries and branches. Examples include the agreements with Armenia (1999), Azerbaijan (1999), Chile (2005), Croatia (2005), the Former Republic of Macedonia (2004), Georgia (1999), Jordan (2002), Kazakhstan (1999), the Republic of Korea (2008),<sup>8</sup> the Kyrgyz Republic (1999), Moldova (1998), the Russian Federation (1997), Ukraine (1998) and Uzbekistan (1999). The Economic Partnership Agreement with the Cariforum States, signed in October 2008, includes a chapter on investment with provisions directed at facilitating commercial presence and cross-border supply of services.

##### ***Main characteristics of Estonia's model BIT***

Estonia accepts the principles embodied in the OECD Draft Convention on the Protection of Foreign Property of 1967. These principles are reflected in Estonia's model BIT. Under the model BIT, Parties engage to *promote investments* in their territory by investors of the other Party and admit such investments, in accordance with the Parties' laws and regulations. The model also calls for each Party to grant treatment to investments and returns of investors of the other Party which is fair and equitable and not less favourable than treatment granted to those of its own investors or investors of any third State, whichever is more favourable.

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8. Not ratified yet.

As regards *restitution, indemnification, compensation* or other settlement, the provision on compensation for losses requires that in cases of armed conflict, a state of national emergency, revolt, insurrection etc., Parties accord investors of the other Contracting Party treatment not less favourable than its own investors or those of third countries. Resulting payments must be prompt, adequate and effective, and freely transferable in a freely convertible currency.

*Expropriations* of investments of investors of either Party on the other Party's territory are to be limited to public purposes and must be carried out under due process of law, on a non-discriminatory basis, and accompanied by provisions for the payment of prompt, adequate and effective compensation. Such compensation has to amount to the market value of the expropriated investment immediately before the expropriation; include interest at a commercial rate; be paid without undue delay and be freely transferable.

Parties also commit to ensure the *free transfer* into and out of the territory of investments and transfers payments related to investments of the other Party and to ensure that transfers are made without any restriction, immediately and in a freely convertible currency.

The model BIT provides for *settlement of investment disputes* between an investor and a Contracting Party, either by submission of the case to the competent courts of the Party in whose territory the investment is made, to the ICSID, or to an arbitrator or arbitral tribunal. It also provides for dispute settlement between the Parties, first through consultation and negotiation, or, if no settlement can be reached, through an arbitral tribunal. So far, there have been no disputes brought against Estonia under a BIT.

## **2.6. Intellectual property rights**

### ***Regulatory framework***

Estonia is aware of the importance of adequate protection of intellectual property rights (IPRs) of both domestic and foreign right holders and has revised its legal framework in this area to adapt it to the requirements of EU directives and international instruments. This review focuses on the impact that Estonia's regime for the protection and enforcement of IPRs may have on the investment environment and notes that the review of Estonia by the Trade Committee includes a more comprehensive review of IPR protection and enforcement.

IPR legislation includes the following acts: the Principles of Legal Regulation of Industrial Property Act of 2003, amended in 2008; the Patents Act of 1994, amended in 2008; the Utility Models Act of 1994, amended in 2008; the Trade Marks Act of 2002, amended in 2008; the Industrial Design Protection Act of 1997, amended in 2008; the Layout-Designs of Integrated Circuits Protection Act of 1998, amended in 2008; the Geographical Indications Protection Act of 1999, amended in 2006; and the Copyrights Act of 1992, which according to the Estonia authorities conforms to EU directives and international standards in this field. In addition, certain aspects of IPR enforcement are covered by the Law of Obligations Act of 2001, amended in 2007 and the Code of Civil Procedure of 2005, amended in 2008. Estonia also has criminal sanctions for IPR infringement, which are regulated in the Penal Code of 2001, amended in 2008.

Estonia is a member of the World Intellectual Property Organisation (WIPO) since 1994, and as a WTO member, is a Party to the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS Agreement). It is also a Party to the principal multilateral agreements covering intellectual property rights (IPRs), including: the Paris Convention for the Protection of Industrial Property; the Convention Establishing the World Intellectual Property Organization; the Patent Cooperation Treaty; the Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks; the Budapest Treaty on the International Recognition of the Deposit of

Microorganisms for the Purposes of Patent Procedure; the Locarno Agreement Establishing an International Classification for Industrial Designs; the Strasbourg Agreement Concerning the International Patent Classification; the Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks; the European Patent Convention; the Trademark Law Treaty; the Geneva Act of the Hague Agreement Concerning the International Registration of Industrial Designs and the Patent Law Treaty. Estonia is in the process of ratifying the Singapore Treaty on the Law of Trademarks. Estonia is also a Party to the Berne Convention for the Protection of Literary and Artistic Works in its last revision; the 1971 Paris Act; the Rome Convention (International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations) and the Geneva Convention for the Protection of Producers of Phonograms Against Unauthorised Duplication of their Phonograms. It signed the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty on 29 December 1997.

### ***Enforcement***

Violations of IPRs can result in civil or criminal liability. IPR infringements and related acts, such as piracy and sale of counterfeited goods are subject to fines or up to 3 years' imprisonment. Each police prefecture has specialised units responsible for investigating IPR crimes. Estonia's Police Board investigates more than 50 IPR infringements per year.

Civil actions against infringers of patent, utility model and design rights may be brought in civil courts, and can include claims for damages, surrender of illegal gains, ceasing and desisting. Damages may be claimed for not more than five years in arrears. The defendant may counterclaim in a specialised civil court (Harju County Court) for invalidation of the right in question. Apart from the main claim, preliminary injunctions, including seizure of the infringing goods, may be applied by all civil courts. In trademark cases the owner may claim from the infringer to cease and desist from the infringing activity and compensate wilfully or negligently caused pecuniary and moral damages.

Penal measures, stipulated in the Penal Code, may be applied, *inter alia*, in the cases of appropriation of authorship; manufacture and trade of pirated copies; commercial possession or use of illegally reproduced computer programmes; general infringement of an exclusive right to an object of industrial property (including manufacture of counterfeited goods); plant variety or geographical indication and trade in counterfeited goods. The offences are investigated by the police on an *ex-officio* basis; however, in most cases (except cases of severe trademark counterfeiting and copyright or related rights piracy) it is technically necessary that the victim, a representative thereof or an organisation of collective representation notify the alleged infringement.

According to the Estonian authorities, a widespread enforcement problem in the country concerns Internet piracy. During 2005-2008, the growth of Internet piracy, especially via File Transfer Protocol (FTP) servers and peer-to-peer (P2P) systems, grew significantly. One key organisation in combating Internet piracy is the Estonian Organisation of Copyright Protection (EOCP), a non-profit organisation established in 1999. Its primary purpose is to protect the rights of producers of music, film and interactive games and to support the interests of its members in Estonia. The EOCP co-operates closely with the police and customs authorities, and provides experts' statements on copyright violations to courts and national investigation institutions. In 2001 it signed a Memorandum of Understanding with different Estonian Internet service providers (ISPs), to enable the removal of infringing materials. In 2004 this memorandum was updated to allow removal of illegal copyright material from the public servers of major ISPs. In 2008, this cooperation led to 957 home pages being closed, 69 417 files removed from the public FTP-servers and 1053 warnings sent to online-advertisers.

Another important concern related to IPR protection is transit of counterfeited goods. The Estonian government is putting measures in place to limit this transit. The Estonian Tax and Customs Board is in

charge of enforcing border measures, based on EU Regulation (EC) No 1383/2003 concerning customs action against goods suspected of infringing certain intellectual property rights, which allows for *ex-officio* seizure of allegedly infringing goods and destruction of infringing goods by the customs authorities. In 2004, Estonia's Police Board and the Tax and Customs Board signed an agreement to improve exchange of information on operations, investigations and procedures. The agreement also provides for close co-operation with the EOCP to gather information and secure evidence on IPR infringements. In 2007, the Tax and Customs Board brought 91 cases of IPR infringements and seized 53 007 infringing items. At the end of 2008, the Board launched a public campaign to fight the use of pirated and counterfeited goods.

### 3. OTHER CAPITAL MOVEMENTS

#### 3.1. Macroeconomic and financial policy context<sup>9</sup>

Estonia experienced a period of overall macroeconomic stability and buoyancy of economic activity following its accession to the EU in 2004. The period of growth came to an end in the second half of 2008 and forecasts for 2009 have been significantly downgraded as the country has entered a severe recession. The shift in the domestic economic outlook follows a collapse of domestic demand that was brought about by the build-up of domestic imbalances. Thus, following GDP growth of 6.3% in 2007, the economy entered into recession in 2008. The contraction in economic activity became more accentuated in the second semester and GDP recorded a decline of 9.4% in the fourth quarter of 2008 with respect to the same quarter of the previous year and a decline of 3.6% for the whole year.<sup>10</sup> The deteriorating external environment further aggravates the risks to the economic outlook. These risks have materialised in the course of 2009, as according to Statistics Estonia, GDP decreased by 15.1% in the first quarter of 2009 and 16.1% in the second quarter, compared to the same quarters in the previous year.

Estonia was one of the first of the former rouble zone countries to introduce its own national currency following the June 1992 monetary reform which established the kroon as legal tender and the currency board arrangement that remains in force today. The currency board rule provided a firm anchor for expectations and helped to keep interest rates low. In this framework, an expansion of credit took place, spurring growth of domestic demand as residential investment was boosted. However, the margin of manoeuvre for domestic policy action has been reduced, leaving no scope of adjustment in monetary conditions, while realignment of the real exchange rate must be accomplished by means of inflation differentials. The latter has become all the more challenging as inflation has risen above the EU average (10.4% for 2008). Since the end of 2008, however, prices have been declining and by the end of September 2009, the consumer price index showed a 1.6% decline compared to the same period of the previous year.

The current macroeconomic environment has resulted in larger risks for financial stability. During the years of the economic boom, growth in mortgage lending boosted private sector credit, which largely mirrored capital inflows and contributed to the widening of the current account deficit (18% of GDP in 2007). As a consequence, the net foreign asset position of domestic banks deteriorated and risks to financial stability have increased as housing prices by end-2008 had dropped by about 20% in comparison to their mid-2007 values. These risks are somewhat mitigated by the fact that foreign financial institutions are important players in the Estonian market, and their home supervisors had a significant role in assuring their stability. The Estonian authorities have also taken measures aimed at lessening the risks and have extended government guarantees on domestic deposits held in all banks, including foreign branches.

An improving international environment and the domestic policy correcting imbalances, point to a better outlook for Estonia in the near future. Based on these factors, the authorities expect that the downturn in economic activity will be short-lived, growth will be restored by 2010 and that by 2011 Estonia will meet the convergence criteria to join the euro.

The Estonian authorities consider that their commitments to free capital movements have brought tangible benefits and are sustainable. As an EU member, Estonia's possibilities to return to capital controls

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9. This section draws on "2009 Economic Review – Estonia".

10. Statistics Estonia.

are further limited by the fact that derogations are for situations where free capital movements cause or threaten to cause serious difficulties for the operation of economic and monetary union, are subject to decision by the European Community as a whole and are for maximum periods of six months.<sup>11</sup>

### **3.2. Capital Inflows**

#### *Securities*

There are no restrictions on the purchase by non-residents of either publicly offered or privately placed domestic securities.

The proposed reservation under item IV/C1 (purchase of shares in Estonia by non-residents) is needed to reflect the fact that portfolio investment may be affected in sectors where restrictions on inward direct investment (reflected in proposed reservations under item I/A of the CLCM) apply to aggregate foreign ownership rather than individual investors' shares of the enterprise's capital.

#### *Credit, loans and deposits*

There are no restrictions on items VIII/A (credits granted by non-residents to residents, linked with international commercial transactions or with the rendering of international services) or IX/A (financial credits and loans granted by non-residents to residents).

#### *Other operations*

The Estonian authorities have indicated that there are no restrictions on capital inflows arising from operations in negotiable instruments and non-securitised claims (item VI), sureties, guarantees and financial backup facilities (item X), operations of deposit accounts (item XI), operations in foreign exchange (item XII), life assurance (item XIII), personal capital movements (item XIV) and the physical movement of capital assets (item XV).

### **3.3. Capital Outflows**

#### *Securities*

There are no restrictions on the issue and introduction of securities by non-residents on the Estonian securities market. The rules for such issue and introduction are the same for domestic, EEA and third country issuers and include transparency and other requirements consistent with IOSCO standards<sup>12</sup>.

The Investment Funds Act (IFA) of 2004 stipulates that the Minister of Finance may lay down "more precise requirements and additional limitations" on the investments of domestic money market funds than those included in the Act. The Minister of Finance has not availed himself of this right and no additional

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11. "Maastricht Agreement: implications for capital movements", Note by the representative of the EC Commission [DAFFE/INV(92)14].

12. Under the CLCM, the definition of issue of securities that constitutes a private placement and can thus derogate from the requirements for a public offer is left to each country's decision. In the case of Estonia, a private placement is defined as the placement of securities with no more than 99 acquirers, or only with "qualified investors." Estonian legislation establishes a long list of such qualified investors, including foreign entities. Small and medium enterprises (SMEs) from EEA countries are included as far as the private placement of corporate bonds and stocks are concerned. This legislation was changed in January 2010 to eliminate this provision.

requirements for the investment of domestic money market funds than those stipulated in the IFA have been laid down. Therefore, funds may purchase foreign money market securities with no restrictions.

Regarding item VII/C2 (sale of collective investment securities in the country by non-residents), the IFA allows non-resident mutual fund managers to offer units of foreign funds if: (i) they enter into a contract in Estonia with a management company, investment firm or credit institution who or whose branches are operating in Estonia or (ii) if the non-resident fund manager itself has a branch in Estonia. While condition (ii) contradicts the free sale of securities on a cross-border basis and if left as the sole option, would give rise to a reservation under item VII/C2, condition (i) is an option permitted under the Code if it is merely a requirement that the transaction be carried out through authorised agents. The Estonian authorities have confirmed that in order to offer units of foreign funds, the requirements of entering into a contract with a branch operating in Estonia and having a branch in Estonia are options and not simultaneously applicable.

In addition, these non-resident funds are obliged to register with the Estonian Financial Supervisory Authority (EFSA). Registration with the EFSA can be denied if the “refusal to register is necessary in order to protect the legitimate interests of investors for other reasons.” Until now, there have been no applications for such registration.

The European Union’s UCITS Directive<sup>13</sup> allows EEA countries to give preferential treatment to each other regarding investments by UCITS in covered bonds, if they meet certain conditions. Based on this Directive, until recently, the IFA prescribed that assets of UCITS and other open-ended public funds may be invested in covered bonds “which are continuously and repeatedly issued by a credit institution of...” an EEA member.

In January 2010, the Estonian authorities changed the IFA to liberalise investments of open-ended funds (except UCITS) in covered bonds. The remaining restriction on UCITS leads to the proposed reservation under item IV/D1 of the CLCM. Estonia observed that other EU Members have implemented the UCITS Directive in the same manner as Estonia while not having lodged reservations. The Committee agreed to look into the issue of the position of other EU members in this area in due course.

The IFA, before its modification in January 2010, stipulated that domestic open-ended public funds may not invest more than 25% in real estate “located in states which do not have an effective and reliable registration system for immovables which proves the right of ownership.” This rule did not apply to EEA countries. The Estonian authorities have had no application from open-ended public funds to invest their assets in non-EEA countries. The amendments to the IFA adopted in January 2010 allow open-ended public funds to invest their assets in immovables located in any OECD country, regardless of whether it is an EEA country or not.

### ***Other operations***

The Estonian authorities have confirmed that there are no restrictions on operations in negotiable instruments and non-securitised claims (item VI), sureties, guarantees and financial backup facilities (item X), operations of deposit accounts (item XI), operations in foreign exchange (item XII), life assurance (item XIII), personal capital movements (item XIV) and the physical movement of capital assets (item XV). There are no non-resident-owned blocked funds (item XVI).

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13. Undertakings for Collective Investment in Transferable Securities (UCITS) on the basis of the provisions of EU Directive 85/611/EEC and related acts.

## 4. FINANCIAL SERVICES: ESTABLISHMENT AND CROSS-BORDER TRADE

### 4.1. Overview of financial sector developments

Financial sector reforms during the last 15 years have been directed at legal harmonisation with the EU *acquis* and at enhancing competition and preserving stability in a liberalised capital account environment in which domestic and foreign financial service providers can freely compete.

Increased foreign participation helped the banking system recover after the period of consolidation that followed the banking crisis of the mid-1990s and the repercussions of the Russian crisis of 1998. First, two large Swedish financial groups, Swedbank and SEB, acquired the two largest banks in Estonia, Hansabank and Eesti Ühispank. Later, the Finnish Sampo Group acquired a medium-sized bank and Nordea established operations as a branch. By the end of 2000, the market share of foreign-owned banks had increased to some 97% of banking sector total assets and since then has remained at that level. During the period 2002-2007, financial deepening progressed at a rapid pace. To support the expansion of domestic lending, domestic banks increasingly relied on external sources of finance, mainly deposits from the respective parent institutions.

Banks continue to be predominant in the Estonian financial sector despite the development in recent years of non-bank financial institutions (see Table 3). The number of institutions operating in Estonia has expanded and by the end of 2009 there were seven companies licensed as banks, eleven branches of foreign banks and over 200 cross-border banking service providers operating on the Estonian market. Also established in Estonia by end-2009 were nine non-life insurance companies, five life insurance companies and the Estonian Traffic Insurance Fund, as well as the branches of six foreign insurers offering non-life insurance services. In addition, a total of 303 providers of non-life insurance services and 78 providers of life insurance services have been entered in the register of providers of cross-border services in Estonia. By the end of 2009, the list of insurance intermediaries included 33 Estonian insurance brokers, about 700 cross-border insurance brokers and about 1200 cross-border insurance agents who are entitled to provide insurance brokerage services in the Estonian market. By end 2008, there were seven investment firms operating in Estonia.

**Table 2. Table 3. Relative size of various types of financial institutions at end-2008**  
(% of GDP)

Financial Sector	Basis of calculation	Relative size
Banks	volume of assets	138
Pension funds	volume of net assets	4.9
Investment funds (except pension funds)	volume of net assets	3.5
Non-life insurance	total gross premiums	1.7
Life insurance	total gross premium	0.5
Investment firms	total assets	0.3

Source: Estonian authorities

The government did not have ownership stakes in banks, insurance companies, securities firms, investment funds management companies, regulated securities markets or securities settlement systems operators until recently, when it established a state-owned credit insurance company.



Until the end of 2008 the international financial crisis has had a modest direct impact on the Estonian financial system. For banks, which play a central role in the system, the exposure was small on both the asset and liabilities sides of their balance sheets. On the asset side, low holding of structured products, and of foreign securities altogether, reduced the potential losses. The funding structure of the banks also helped, as it is mainly built upon the resources from the large Scandinavian parent banks, which acted as a buffer protecting Estonian banks during the period of turbulence in money and capital markets. The Estonian authorities consider that strong capitalisation (average capital adequacy of banks was 18.8% on solo and 13.1% at a consolidated level) and high profitability (17% at consolidated level during 2008, despite already high credit losses in that year) puts banks in a strong position to absorb expected future losses and weather the crisis.

As far as the rest of the financial sector is concerned, the life insurance sector suffered the largest losses as a result of the typically larger allocation of assets to equity markets, which have undergone significant decline. The losses suffered on their securities portfolios have depleted capital reserves of some life insurance companies, leading to calls for raising additional capital. The authorities' assessment is that, in response to sudden losses, many companies in the sector have re-balanced their investment portfolios towards less volatile instruments and that further losses on the same scale will most likely be avoided. The authorities' appraisal is that other non-bank intermediaries (including fund managers, non-life insurance and investment companies) remain on average well-capitalised and the main impact of the crisis will be on their income base as the demand for their services declines during the economic downturn.

#### **4.2. Estonia's commitments under the General Agreement on Trade in Services (GATS)**

Before the beginning of the accession discussions, Estonian laws and regulations included restrictions on most cross-border financial services and on private pension branching by non-EEA residents. Most of these restrictions were in conflict with Estonia's commitments under the GATS, except a restriction on cross-border banking services (acceptance of deposits and other repayable funds from public), where Estonia has not made any commitments in the GATS to liberalise and certain financial services to UCITS, which the UCITS Directive requires EU countries to liberalise vis-à-vis EEA countries only. Except for these two areas, under the GATS Estonia has committed itself not to apply restrictions to any GATS members, including therefore all current OECD Members.

The Estonian authorities were made aware of the fact that in the area of financial services the Codes include liberalisation obligations which are similar to the GATS's obligations and their respective provisions relating to prudential measures are in many respects equivalent. In international law, when two treaties cover the same subject matter and there is no express provision on the precedence of one treaty over the other, "the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty" (Article 30(3) of the Vienna Convention on the Law of Treaties). Accepting reservations under the Codes for items covered and liberalised under the GATS could therefore be interpreted as limiting the scope of Estonia's current obligations under the GATS vis-à-vis non-EEA OECD Member countries.

The Estonian authorities have indicated that they intend to eliminate the discrepancy between Estonia's position under the GATS and their proposed position under the Codes by changing their legislation before accession to the OECD in order to liberalise all related items. Should the calendar of the Parliament not permit the amendments to be passed in time, the Estonian authorities have stated that, by virtue of the fact that under Estonia's Constitution international obligations, including those derived from OECD accession, prevail over national law, the discrepancy between their GATS commitments and domestic legislation will still be eliminated.

In light of the above considerations, in January 2010 the Estonian authorities passed legislative changes to the Insurance Activity Act and the IFA. These changes led to the elimination of all inconsistencies between domestic legislation and Estonia's GATS commitments, except in the area of the income tax incentives given to clients (natural persons residing in Estonia) of life insurers and pension fund managing companies from EEA countries, which are not provided to clients of non-EEA companies. This area falling under the Income Tax Act still has to be modified.

The Estonian authorities have amended their laws to allow the provision of financial services by non-EEA residents on a cross-border basis subject to certain non-discriminatory conditions. These include the requirement that non-resident services providers be subject, in their countries of operation, to prudential requirements equivalent to those applicable to domestic providers, compliance with supervisory requirements and Estonian consumer protection (conduct of business) rules. In addition, provisions for effective co-operation between the Estonian authorities and the home country authorities for supervisory purposes, such as agreements on exchange of information, will be established.

In summary, in the financial sector there are two categories of restrictions reflected in reservations under the Codes:

- Restrictions allowed by Estonia's schedule of GATS commitments. This concerns item E/2 (specifically, deposit-taking from the public).
- Restrictions required by obligations arising from EU Membership. This concerns item I/A of the CLCM and E/7 of the CLCIO (both in the area of the establishment of branches of UCITS) and item E/3 of the CLCIO (specifically, depository services for UCITS).

### **4.3. Establishment**

#### ***Banks***

Rules for bank licences, set in the Credit Institutions Act of 1999, are harmonised with EU legislation. They ensure that owners are fit and proper and do not distinguish between resident and non-resident investors except to the extent that the Estonian Financial Supervisory Authority (EFSA) may refuse an authorisation to a non-EEA financial institution in the absence of co-operation with its home country supervisor.

Domestic or non-resident investors intending to acquire a qualified holding (10, 20, 33 or 50 %) in a bank, have to notify the EFSA – the unified supervisor of the financial system – which may, within two months of receiving all necessary information, block such an acquisition.

Both in the case of the establishment of a bank subsidiary by non-EEA country investors and the acquisition of a qualified holding, the supervisor may refuse the authorisation if the financial supervisory authority of the home country is not willing or able to cooperate with the EFSA, including exchange of information for the purpose of EFSA's effective assumption of its supervisory responsibilities.

The Estonian authorities confirm that the EFSA is subject to the obligations of the Financial Supervision Authority Act, which establishes, among others, the principles of co-operation with other countries' supervisory authorities, exchange of information and confidentiality requirements. The relevant provisions about cooperation that the EFSA is obliged to follow are articles 47 and 47<sup>1</sup> of the Supervisory Activity Act. Article 47 introduces the general basis for the EFSA to cooperate with other countries' supervisory authorities, including exchange of information and confidentiality requirements. Article 47<sup>1</sup>

establishes the rights and obligations of the EFSA in relation to other countries' supervisory authorities in the course of carrying out its supervisory tasks.

In practice, to date there have been no obstacles to co-operation between the EFSA and the authorities of non-EEA countries. The EFSA has already concluded several co-operation agreements with supervisory authorities from other countries.

Non-EEA based investors may establish a bank branch in Estonia subject to an authorisation from the EFSA, which involves providing information commonly required in all OECD countries on the owners and the business plan of the branch. In addition, the EFSA requires: (i) the consent of the financial supervisory authority of the home state to establish a branch in Estonia; (ii) confirmation that the foreign bank establishing the branch holds a valid activity licence in the home state; and (iii) the details of the deposit insurance scheme valid in the home country. No reservation under the CLCM is needed, as these provisions are not discriminatory in respect of non-EEA based banks. Branches of foreign banks are not required to put up capital in Estonia.

The Credit Institutions Act requires that the EFSA's decision to grant an authorisation to create a bank or a branch in Estonia should be made within six months after the receipt of all necessary documents and information that meet the requirements, but in any case no later than within 12 months of receiving the application. The refusal to authorise the acquisition of qualified holding or the authorisation to establish a branch in Estonia should be made within two months of receiving all necessary information, but not later than three months after receiving the application. These rules are in conformity with the provisions on controls and formalities in the CLCM and Annex I to Annex A of the CLCIO.

Estonian banks may establish subsidiaries and branches abroad. They only need to notify the EFSA in case of establishment in an EEA country, but for establishment outside the EEA area, they must meet requirements tailored to ensure effective consolidated supervision by the Estonian authorities. The EFSA may reject an application if supervisory arrangements in the host country, including access to information by the home country authorities, are inadequate. No authorisations have been refused on these grounds. The EFSA may revoke an authorisation granted to a credit institution to open a branch abroad if – among others – “the risks arising from the activities of the branch are significantly higher than risks arising from the activities of the credit institution.” The main rationale for this is to cover risks which cannot be mitigated by the parent company and to protect the depositors of the parent company. The same principle also applies in the insurance and securities sectors.

### ***Insurance and private pensions***

The conditions for the establishment of insurance subsidiaries are the same for resident and non-resident applicants. Investors, whether resident or non-resident, intending to acquire a qualified holding (10, 20, 33 or 50%) have to obtain authorisation from the EFSA. Both in the case of the establishment of a subsidiary by non-EEA country investors and the acquisition of a qualified holding, the supervisor may refuse the authorisation if the financial supervisory authority of the home country is not willing or able to cooperate with the EFSA, including exchange of information for the purpose of EFSA's effective assumption of its supervisory responsibilities.

To open a branch in Estonia, non-EEA insurers must apply for an authorisation from the EFSA, which involves providing information on the owners and the business plan of the branch. In addition, the applicant has to provide: (i) the confirmation by the guarantee fund provided in the Motor Third Party Liability Insurance Act that the branch – once authorised – will become the member of that fund; (ii) a certificate from an Estonian bank that the applicant has deposited at least 25% of the minimum solvency margin and possesses assets in Estonia of an amount equal to at least half of the minimum solvency

margin; and (iii) applicants are also required to possess in EEA countries assets that are at least equal to the required solvency margin. These requirements for branches of non-EEA country insurance companies aim to ensure that the Estonian branch has enough assets in Estonia or the EEA to cover their liabilities towards the resident insured persons. These rules do not require the lodging of a reservation.

The EFSA may refuse to authorise the establishment of a branch of an insurance company from a non-EEA country if it considers that the latter's financial supervision authority lacks either the legal basis or the capacity for effective co-operation. Since Estonia's accession to the EEA, there has been no refusal on these grounds of an application by a non-EU insurer for the establishment of a branch.

Branches of Swiss non-life insurance undertakings are treated preferentially in two respects: there are less burdensome requirements to confirm that the capital requirement is fulfilled and the EFSA has an obligation to consult the Swiss Financial Supervisory Authority before withdrawing a branch licence. The preferential treatment has been extended to Switzerland in conformity with the EU-wide recognition that aspects of the Swiss insurance regime meet provisions of the EU directives. Preferential treatment of Switzerland by EU countries for these reasons was identified during the 7<sup>th</sup> examination of Members' reservations to the insurance and private pension provisions of the CLCIO. The Investment Committee and the IPPC concluded that the "equivalent treatment" test is met [C(2008)4, paragraph 80].

According to the Investment Funds Act, voluntary funded pension funds<sup>14</sup> may be established in Estonia by foreign pension fund asset managers.

#### ***Securities firms and other non-bank financial institutions***

Like in banking or insurance, non-residents may establish securities and investment firms on the same terms as applicable to domestic investors.

Non-EEA securities and investment firms may establish branches in Estonia after obtaining authorisation from the EFSA on non-discriminatory terms relative to resident applicants. No prior authorisation is required for EEA investment firms since authorisation to provide investment services has already been granted in the country of origin on EU-harmonised conditions.

Based on saver protection considerations, EU Directive 85/611/EEC requires Estonia to ensure that a depository of an undertaking for collective investment in transferable securities (UCITS) either have its registered office in the same EU country as that of the undertaking or be established in the EU country if its registered office is in another EU country. This rule calls for a reservation under item I/A of the CLCM and E/7 of the CLCIO.

#### **4.4. Cross-border provision of financial services**

##### ***Insurance services***

Before the amendment of the Insurance Act in January 2010, cross-border insurance was reserved for EEA-based insurers if the risks to be insured are situated in Estonia. The insured risk is considered to be situated in Estonia if (i) the object of insurance is real estate situated in Estonia, including construction works and their contents, in so far as the contents are covered by the same insurance policy; (ii) the object of insurance is entered in an Estonian register and a corresponding licence plate is attached to the object,

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14. The CLCM does not require the liberalisation of the establishment of mandatory pension funds since that is understood to cover the state's activity on its own account.

where the insurance relates to vehicles of any type; or (iii) an insurance contract covering risks related to travel services for a duration of four months or less has been entered into in Estonia.

The insured risk is also considered situated in Estonia if (i) in the case of natural persons the policyholder has his or her permanent residence in Estonia or (ii) in the case of a legal person, the seat of the policyholder, as indicated in the insurance contract, is in Estonia. The amendments to the Insurance Activities Act will allow for more flexibility in deciding where the seat of the policyholder is, as it will be enough for the risk to be considered situated in Estonia if one of the seats of the company is in Estonia.

Before the amendment of the Act, only insurance intermediaries from EEA countries were authorised to provide cross-border services, and these measures would have constituted restrictions under items D/2 (insurance relating to goods in international trade), D/3 (life assurance), D/4 (all other insurance), D/7 (entities providing other insurance services) and D/8 (private pensions). Due to the amendment of the Act, the cross-border provision of these insurance services by non-residents is not restricted anymore.

Regarding items D/2, D/3, D/4 and D/8, foreign proposers are also permitted to sell insurance or engage in insurance intermediation services, respectively, in Estonia through their branches.

Estonian legislation does not distinguish between insurance contracts concluded at the initiative of the provider (*i.e.* a non-established foreign insurer) and those concluded at the initiative of the proposer (“correspondence insurance”). The term “insurance activities”, as stipulated in article 2 (1) of the Insurance Activities Act covers the conclusion in Estonia of any insurance contract, regardless of which party took the initiative to conclude it. However, there is no specific legal prohibition for foreign insurers to engage in promotional activities in Estonia.

Deduction of insurance premiums and contributions to voluntary (third pillar) private pension schemes is allowed under the Income Tax Act of 2000 to the extent that the purpose of the contract is the subsequent provision of a pension. Such deduction is limited to 15% of the taxpayer’s income. Presently this advantageous tax treatment is allowed in the case of contracts with domestic insurers and pension fund managers from EEA countries. The preferential tax advantage would constitute a restriction under item D/3 (life assurance) and D/8 (private pensions) of the CLCIO. Estonia has indicated that the Income Tax Act will be amended in 2010 to extend the income tax incentives also to clients (natural persons residing in Estonia) of life insurers and pension fund managing companies from outside the EEA, operating on cross-border basis. Clients of non-EEA life insurers and pension fund managing companies will be allowed to avail themselves of this preferential tax treatment if:

- The life insurer or the pension fund managing company has been licensed to operate in Estonia. The licenses will be issued by the appropriate supervisors and based on non-discriminatory prudential requirements.
- A tax treaty or as a minimum a treaty on exchange of tax information has been concluded between Estonia and the country of origin of the service provider, enabling the exchange of information necessary to avoid the misuse of the above tax deduction clause.

The above pre-conditions for licensing the cross-border provision of services and to benefit from the tax preferences appear to be in line with Article 5 of the CLCIO on controls and formalities. Estonia has not proposed to lodge a reservation with respect to the tax incentives provisions of the Income Tax Act. In case the necessary amendment is not passed before Estonia’s eventual accession to the OECD, Estonia submits that the liberalisation measure will have effect from the date of Estonia’s accession to the OECD by virtue of the constitutional principle that international obligations, including those set out in the Accession Agreement with the OECD, prevail over national law.

### ***Banking and investment services***

The Credit Institutions Act of 1999 allows deposit-taking services on a cross-border basis only for EEA-based banking undertakings. This measure is a restriction under item E/2 (banking and investment services) of the CLCIO and it is in conformity with Estonia's GATS schedule of commitments<sup>15</sup>. The Estonian authorities confirm that there are no restrictions on underwriting and broker/dealer services or access to financial market information, communications and execution systems, also covered by item E/2. Estonia thus proposes to lodge a reservation only on deposit-taking from the public under item E/2 of the CLCIO.

Item E/3 of the CLCIO requires that non-residents have access to the settlement and clearing systems of a country. In Estonia, according to the SMA, the settlement of securities transactions must be performed through the securities settlement system operated by the Bank of Estonia or a person to whom the EFSA has issued a relevant activity licence. Membership in the securities settlement system is open to (i) investment firms or credit institutions from Estonia or another EEA country and (ii) institutions registered in a foreign state (including non-EEA countries) holding the appropriate activity licence, provided that the prudential ratios applicable to these institutions comply with requirements which are at least as strict as those established by EU legislation and that the securities market supervision agency or financial supervision authority of the state of registration exercises supervision over them. The CLCIO allows members to require that participation in their settlement and clearing systems take place through an established institution. Hence, no restriction is applicable for the settlement and clearing services part of item E/3. The restriction on non-EEA institutions to provide custodial and safe keeping services (also falling under item E/3) in Estonia without establishment was contrary to Estonia's GATS obligations. Consequently, Estonia agreed to make the necessary legislative changes to align its legislation with its GATS commitments. The Estonian authorities have confirmed that the amendments to the Investment Funds Act were adopted by the Parliament in January 2010.

The cross-border provision of certain depositary services, which is also covered by item E/3, is possible only for service providers from EEA countries. The restriction is applicable to UCITS, where EU Directive 85/611/EEC mandates that this preference be given to EEA countries. Because of this mandatory requirement, Estonia proposes a reservation under item E/3 (settlement, clearing and custodial and depositary services) of the CLCIO.

Non-EEA investment firms may provide asset management services and safekeeping of assets only through an established branch or through the stock exchange, while EEA investment firms may provide portfolio management services and safekeeping of assets directly or through an established branch. These measures constitute restrictions under item E/4 (asset management services). Estonia agreed to make the necessary legislative changes to eliminate these restrictions. The Estonian authorities have confirmed that the amendments were adopted by the Parliament in January 2010.

As regards services under item E/5 (advisory, agency, credit reference and analysis, investment research and advice, mergers, acquisitions, restructurings, management buyouts and venture capital services), their contents are very similar to non-core investment services as defined in the SMA (the provision of advice to companies on capital structure, business strategy and related matters and advice and service relating to mergers of companies and participation therein, as well as provision of advice to companies on capital structure, business strategy and related matters, and advice and service relating to mergers of companies and participation therein). There is no need to apply for an authorisation from the

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15. The GATS schedule includes the requirement of authorisation by Eesti Pank and registration under Estonian Law as a joint stock company, a subsidiary or a branch.

EFSA in order to provide these non-core investment services in Estonia. Hence, no restriction applies under item E/5 of the CLCIO.

## 5. CURRENT INVISIBLE OPERATIONS OTHER THAN FINANCIAL SERVICES

### 5.1. Current transfers and payments

Estonia provides for free payments and transfers in connection with current international transactions. It has accepted Article VIII of the IMF's Articles of Agreement in August 1994.

### 5.2. Trade in non-financial services

#### *Transport*

Road transport services in Estonia may be provided by EU residents and service providers from EU countries. In addition, Estonia is party to several bilateral agreements covering road transport, and to the "Interbus agreement".<sup>16</sup> The restriction that non-EU countries may not provide these services in Estonia leads to the proposed reservation under item C/3 (road transport) of the CLCIO, equivalent in scope to the reservations of most other EU countries.

#### *Printed films*

Estonia is a Party to the European Convention on Transfrontier Television of the Council of Europe and has transposed the provisions of the EU Television Without Frontier Directive into its legislation. These EU rules include a provision by which quotas in favour of European productions are imposed "where applicable and by appropriate means". The Estonian authorities are aware that the flexibility built into this provision enables them to ensure the conformity of their practice with the obligations of item H/1 of the CLCIO and do not propose a reservation under item H/1.

Item H/1 of the CLCIO does not cover all audiovisual works; it only covers the exportation, import, distribution and use by an OECD country of printed films and other recordings originating from another OECD country, for private or cinema exhibition and for television broadcasts. Item H/1 does not establish obligations on the use of films in public television broadcasting. Estonia accepts the Recommendation of the Council concerning the Conclusion of Bilateral Agreements for the Co-Production of Films C(64)124.

#### *Professional services*

Under item L/6 (professional services), cross-border auditing services may be provided after passing an exam and becoming a member of the Estonian Board of Auditors. Under the current legislation, the aptitude test can be taken in both Estonian and English. As there has not been any demand for aptitude tests in English, the test was made available only in Estonian. According to the Auditing Act adopted in January 2010 non-resident auditors will be allowed to take the aptitude test only in Estonian. There are no

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16. The Interbus Agreement (or Interbus Agreement on the International Occasional Carriage of Passengers by Coach and Bus) is a multilateral agreement on occasional carriage of passengers by coach and bus between EU and other states. A country can accede to the agreement at any time. A summary and the whole text are available at <http://europa.eu/scadplus/leg/en/lvb/l24264.htm>.



restrictions applicable to non-resident auditors that would require a reservation under item L/6 of the CLCIO.

The profession of notaries, bailiffs and sworn translators can be exercised in Estonia only by an EEA citizen. This leads to the proposed reservation under item L/6 of the CLCIO.

## **6. OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES**

### **6.1. Experience and performance of Estonia's National Contact Point**

Following Estonia's adherence to the OECD Declaration and related Decisions on International Investment and Multinational Enterprises in 2001, the Estonian National Contact Point (ENCP) was established within the Ministry of Economic Affairs and Communications. The Estonian authorities have revised its structure in order to make it operate in a more efficient and pro-active manner, in accordance with core criteria of visibility, accessibility, transparency and accountability. The re-structured ENCP, which is fully operational since September 2009, is now established within the Economic Policy Division (responsible for entrepreneurship policies and interaction with companies) of the Ministry's Economic Development Department. The ENCP's website has recently been revised and linked to other relevant webpages, including that of other NCPs offering information to entrepreneurs. The ENCP has renewed its contacts with social partners and has carried out promotional activities, including an article in the Gazette of the Chamber of Commerce, introducing the activities and functions of the ENCP. A seminar to promote the OECD Guidelines for Multinational Enterprises is planned for March 2010.

The ENCP co-operates with, and draws on the experience and expertise of other ministries and social partners, for example the Ministries of Social Affairs, Environment, Justice, the Estonian Competition Authority, the Consumer Protection Board, the Estonian Chamber of Commerce and Industry, the Estonian Tax and Customs Board, the Estonian Labour Market Board, Enterprise Estonia and the Estonian Employers' Confederation. The government also established an Advisory Committee to the ENCP, consisting of representatives from the Ministry of Finance, the Ministry of Foreign Affairs, the Association of Trade Unions and business associations.

The Ministry of Economic Affairs and Communications is envisaging developing an online "virtual point of contact" for all investors in cooperation with Enterprise Estonia, with the perspective of making the Guidelines and other information regarding investment and entrepreneurship more widely and conveniently available in the future. This initiative is linked to the obligation, under EU legislation, to develop a single contact point for companies wishing to invest in Estonia.

Estonia participates in and submits annual reports to the Annual Meetings of National Contact Points. The Estonian authorities consider that these meetings constitute an important source for sharing experience and learning more about the functioning and practices of NCPs, such as inclusiveness of NCPs operations, capacity-building to facilitate conciliation and mediation and ensuring objectivity of NCP assessment in the handling of specific instances arising under the Guidelines.

The Guidelines have been translated into Estonian. The translation and the original text have been published in the official gazette and the Estonian version is available on the webpage of the Ministry of Foreign Affairs. On request, the ENCP also provides paper copies of the Guidelines. So far, promotional activities by the ENCP have been very limited. Some promotional activities have been carried out in cooperation with Enterprise Estonia, the Confederation of Estonian Trade Unions, the Estonian Employers' Confederation, the Estonian Chamber of Commerce and NGOs.

## **6.2. Government policies and initiatives to promote responsible business conduct**

The concept of responsible business conduct is relatively new in Estonia, but the government has taken initial steps to promote it. The Ministry of Economic Affairs and Communication is planning, in collaboration with social partners, to initiate a process to develop a common understanding of corporate social responsibility (CSR) policy in Estonia. The aims of this process, which will take place in 2010, include capacity-building for Estonian companies to integrate CSR in their operations and reporting on their social and environmental impact.

Currently there are only few (30-40) Estonian companies operating abroad, but investment activities abroad are increasing, and so will the government's efforts to promote responsible business conduct.

Recent regulatory developments aim, among others, to develop an enabling environment in support of responsible business conduct.

Estonia has ratified or otherwise adheres to the various international instruments mentioned in the Guidelines. These include the following: Universal Declaration of Human Rights; Copenhagen Declaration for Social Development; ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (1977 Tripartite Declaration); ILO Declaration of Fundamental Principles and Rights at Work (1998 Declaration); ILO Convention 29 of 1930 and C.105 of 1957 (Elimination of all forms of compulsory labour); ILO Convention 111 of 1958 (Principle of nondiscrimination with respect to employment and occupation); ILO Convention 138 of 1973 (Minimum age for admission to employment); ILO Convention 182 of 1999 (Elimination of the worst forms of child labour); ILO Recommendation 94 of 1952 (Consultation and Co-operation between Employers and workers on the Level of Undertaking); ILO Recommendation 146 of 1973 (Minimum age for admission to employment); Rio Declaration on Environment and Development; Agenda 21; Convention on Access to Information, Public Participation in Decision-making, and Access to Justice in Environmental Matters (Aarhus); and the UN Guidelines on Consumer Policy.

The principles set out in the MNE Guidelines are reflected in Estonian legislation, including in the Estonian Constitution, the Competition Act, the Consumer Protection Act and the Product and Service Safety Act; the Employment Contracts Act of 1992, the Working and Rest Time Act of 2001; the Personal Data Protection Act of 2003; the Consumer Protection Act of 2004; the Competition Act of 2001 and the Taxation Act of 2002.

Estonian environmental laws and regulations follow internationally accepted principles reflected in the Rio Declaration on Environment and Development and Agenda 21. Recent developments in environmental law which are particularly relevant for responsible business conduct include strengthening producer responsibility in connection with emissions into air and water, waste generation and treatment and soil contamination.

Estonia is Party to the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions since January 2005 as well as to other international legal instruments such as the Council of Europe Civil Law Convention on Corruption and the Criminal Law Convention on Corruption. It adopted an Anti Corruption Act in 1999, and has since then amended it several times. The Act includes rules on disclosing official economic interests and on preventing conflicts of interest. A revision of the latter is planned for 2009 and the Ministry of Justice will analyse and ensure that these rules are in line with the Guidelines. Estonia has also adopted a Public Service Code of Ethics, annexed to the Public Service Act.

Recent measures to enhance integrity and resistance to corruption in the public service in Estonia include the adoption of anti-corruption strategies (covering 2004-2007 and 2008-2012); comprehensive training on ethics and preventing conflicts of interest of civil servants; several anti-corruption twinning projects (with Finland, Germany, Netherlands), two of them targeted at local governments; amendments to the Penal Code (*e.g.* the definition of public official, specifying corruption offences etc.); restructuring of the Prosecutors Office and appointing prosecutors specialised in corruption and economic crimes. In order to better inform entrepreneurs about the Government's Anti Corruption Strategy, and to promote ethical behaviour, the Ministry of Justice will carry out a series of seminars in conjunction with the Estonian Chamber of Commerce and Industry and the Estonian Association of Small and Medium Enterprises, to inform entrepreneurs of amendments to legislation and develop further measures to prevent fraud and corruption in the private sector.

In addition to government efforts to promote responsible business conduct, a private initiative is the "Responsible Business Forum", a non-profit organisation with the aim of furthering corporate social responsibility (CSR) in Estonia through advice, competence building and communication on CSR. The network of experts of the Responsible Business Forum contributes to supporting and providing consultation on CSR-related initiatives in Estonia.

## 7. OECD PRINCIPLES FOR PRIVATE SECTOR PARTICIPATION IN INFRASTRUCTURE

Estonia accepts the Recommendation of the Council on Principles for Private Sector Participation in Infrastructure [C(2007)23]. Though the Estonian government considers it important to promote public-private partnerships (PPPs), it does not have specific regulation in place. The Public Procurement Act of 2007, which governs adjudication of contracts between the public and the private sector, is also used for PPPs. The Ministry of Finance is considering developing guidelines on how best to involve the private sector in infrastructure projects. It is also considering the need for a PPP framework law and the establishment of a PPP-unit. The unit would establish criteria to take into account when designing PPP projects to ensure added value by involving private partners; act as an interface with consultants and experts and develop best practices. No decision on either the guidelines or the unit has been taken yet.

So far there have only been few public projects carried out in partnership with the private sector. All of them involved local governments (waterworks, industrial parks, municipal housing and schools). One example is the Tallinn Municipal Housing project of 2006, involving construction of 600 apartments, with a budget of EUR 25 million. There was private participation in the design, construction, financing, long-term maintenance and administration of the buildings. Another project, initiated in 2006, involved the renovation of 10 secondary school buildings in Tallinn, with a budget of EUR 31 million. Private participation involved the design, reconstruction, financing, long-term administration and maintenance of the school buildings. There have been no PPPs involving the central Government yet, though there have been discussions about involving private sector partners in the reconstruction of one of Estonia's main roads and the Saaremaa road bridge. No decision on this project has been taken yet. According to the Estonian authorities, the low interest in PPP-development is related to the low number and relatively small size of infrastructure projects.

The Secretariat has examined Estonia's practice and regulation and has held discussions with Estonian experts in the area of private sector involvement in public projects and has concluded that:

- Estonia is aware of the high importance of private sector participation in infrastructure for economic development. It is also aware of the challenges involved in increased private sector participation, among others, in terms of financial risks, performance, public buy-in, etc., and of the advantages, such as bringing in innovation, improving synergies between the public and the private sector and between domestic and foreign companies, increased competition, entry of financial and human resources, new technologies and know-how, etc.
- The practice developed so far by Estonia in developing partnerships with the private sector appears broadly in line with the principles set out in the OECD Recommendation on Private Sector Participation in Infrastructure. Moreover, the Estonian government has committed to take the principles of the OECD Recommendation into consideration when developing a regulatory framework on PPPs.

Estonia's approach to PPPs in general, and to private sector involvement in infrastructure more specifically, can be summarised as follows, along the headings of the OECD Recommendation.

### *Deciding on private or public provision of infrastructure services*

According to best practice, a cost-benefit analysis is carried out in Estonia before a decision is taken to carry out a project in partnership between the public and the private sector. The cost-benefit analysis generally involves experts from international auditing firms. If the project involves granting the private partner permission to perform public administration duties, according to the Administrative Co-operation Act a detailed legal and economic analysis has to be performed. This analysis includes economic estimations of the conditions for granting authority to perform the tasks, the legal and material implications, the costs to be incurred by the state or a local government, the measures to ensure the consistency and quality of performance, etc. The results of the analysis must be made public.

Under Estonian accounting rules, PPP projects must usually be recorded as liabilities on public sector balance sheets. This eliminates the possibility to choose to carry out a project in partnership with the private sector simply to remove liabilities from the public sector's balance sheet.

### *Enhancing the enabling institutional environment*

According to the Estonian authorities, Estonia has developed a good environment for investment, and no particular restrictions for projects involving private investment in infrastructure exist. There are no financial restrictions either which could limit private partner access to local capital markets or the free movement of capital. The rule of law applies and anti-corruption legislation is enforced to prevent corruption in all stages of PPP projects.

### *Goals, strategies and capacities at all levels*

According to best practice in Estonia, wide discussions among all stakeholders take place before deciding on carrying out a PPP project. Government institutions cannot take up loans, finance leases or similar obligations unless provided for in the State budget. As the State budget must be enforced by parliament, government institutions may not decide on carrying out a PPP project without the parliament's approval. This involves exhaustive and wide discussions of each project. In accordance with the Rural Municipality and City Budget Act, the Ministry of Finance may request information from local municipalities on finance leases and other liabilities, including a copy of the contract. This ensures co-operation between local and central government.

### *Making the public-private co-operation work*

According to the Public Procurement Act, all relevant information related to tenders must be published. Once the tender is published, no significant changes can be made to the project. Infrastructure projects are usually awarded through an international tender. The Public Procurement Act prohibits discriminating among suppliers from the EEA or States which are Parties to the WTO Government Procurement Agreement. If the principles of transparency and non-discrimination are not respected, a complaint may be brought before the public procurement dispute office.

### *Encouraging responsible business conduct*

No particular guidance is in place to ensure and monitor responsible business conduct in the framework of private sector participation in infrastructure projects.

## ANNEX 1 EXTRACTS FROM THE ROADMAP FOR THE ACCESSION OF ESTONIA TO THE OECD CONVENTION [C(2007)101/FINAL]

### A. APPENDIX A.I

#### Investment Committee

*Candidate countries should commit to the following set of core principles on cross border capital movements and services, foreign direct investment and multinational enterprises:*

- full compliance with the principles of non-discrimination, transparency and standstill, in accordance with the OECD Codes of Liberalisation and the National Treatment instrument of the OECD Declaration on International Investment and Multinational Enterprises (reservations under the Codes must be limited to existing restrictions);
- an open and transparent regime for FDI including in key sectors. Restrictions must be limited and concern sectors where restrictions are not uncommon in OECD countries;
- liberalisation of other long-term capital movements, including equity investment and debt instruments of a maturity of one year or more; commercial credit and other capital operations relating to international trade are also to be liberalised; a timetable for the abolition of remaining controls on short-term capital movements is required;
- no restrictions on payments or transfers in connection with international current account transactions; the candidate countries must comply with all IMF Article VIII requirements;
- relaxation of restrictions on cross-border trade in services, particularly banking, insurance and other financial services;
- fair and transparent implementing practices and proportionality of the measures relative to the stated objective pursued;
- effective enforcement of intellectual property rights;
- key commitments under investment protection and other international agreements;
- capacity to present a credible plan for the establishment of a visible, accessible, transparent and accountable National Contact Point for the OECD Guidelines for Multinational Enterprises; evidence of the candidate's commitment to the various international instruments cited in the Guidelines.

*These principles are reflected in the Instruments, Recommendations, Guidelines and Best Practices outlined below.*

#### A) OECD Decisions and other legally binding instruments

- Decisions on the Codes of Liberalisation of Capital Movements and Current Invisible Operations (1961 and subsequent amendments).
- Decisions related to the Declaration on International Investment and Multinational Enterprises (1976 and subsequent amendments).

*The Investment Committee (and its subsidiary bodies) will review and assess the willingness and ability of the candidate countries to accept the obligations of these instruments.*

#### B) OECD Recommendations and Declarations

*i) The following key instruments have specific policy implications requiring an assessment of the candidate countries' position through a review by the Investment Committee and the subsidiary bodies concerned:*

- Recommendation on the OECD Benchmark Definition of Foreign Direct Investment (1995, currently being revised).
- Declaration on International Investment and Multinational Enterprises (1976 and subsequent amendments).

In addition, the candidate countries would be required to complete the IMF/OECD Survey of Implementation of Methodological Standards for Direct Investment and agree to report data for the compilation of the OECD International Direct Investment Yearbook and the annual report on FDI trends published in International Investment Perspectives, in accordance with the timetable and template agreed by Members.

*ii) The following instruments are primarily of a technical or operational nature. The position of the candidate countries will be assessed through a technical review by the Secretariat:*

- Recommendation on OECD Principles for Private Sector Participation in Infrastructure (2007).

### **B. OECD LEGAL INSTRUMENTS UNDER THE PURVIEW OF THE INVESTMENT COMMITTEE FOR THE PURPOSE OF THE ACCESSION DISCUSSIONS**

#### **Decisions**

Decision of the Council on the OECD Guidelines for Multinational Enterprises C(2000)96

Decision of the Council on National Treatment C(91)147

Decision of the Council on Conflicting Requirements being imposed on Multinational Enterprises C(91)73

Second Revised Decision of the Council on International Investment Incentives and Disincentives C(84)92

Decision of the Council adopting the Code of Liberalisation of Capital Movements OECD/C(61)96

Decision of the Council adopting the Code of Liberalisation of Current Invisible Operations OECD/C(61)95



## **Recommendations**

Recommendation of the Council on Guidelines on Recipient Country Investment Policies relating to National Security C(2009)63

Recommendation of the Council on the OECD Benchmark Definition of Foreign Direct Investment C(2008)76

Recommendation of the Council on Principles for Private Sector Participation in Infrastructure C(2007)23

Recommendation of the Council on Member Country exceptions to National Treatment and Related Measures concerning Access to Local Bank Credit and the Capital Market C(89)76

Recommendation of the Council on Member Country Exceptions to National Treatment and National Treatment related Measures in the Category of Official Aids and Subsidies C(88)131

Recommendation of the Council on Member Country Exceptions to National Treatment and National Treatment related Measures concerning the Services Sector C(88)41

Recommendation of the Council on Member Country Exceptions to National Treatment and National Treatment related Measures concerning Investment by Established Foreign-Controlled Enterprises C(87)76

Recommendation of the Council on Member Country Measures concerning National Treatment of Foreign-Controlled Enterprises in OECD Member Countries and Based on Considerations of Public Order and Essential Security Interest C(86)55

Recommendation of the Council concerning the Conclusion of Bilateral Agreements for the Co-Production of Films C(64)124

## **Other Instruments**

Declaration on Sovereign Wealth Funds and Recipient Country Policies C/MIN(2008)8/FINAL

Declaration on International Investment and Multinational Enterprises C(76)99, including the Guidelines for Multinational Enterprises

1967 Draft Convention on the Protection of Foreign Property

**ANNEX 2**  
**ESTONIA'S RESERVATIONS**  
**TO THE CODE OF LIBERALISATION OF CAPITAL MOVEMENTS**

List A, Direct investment:

I/A

- In the country concerned by non-residents.

*Remark: The reservation applies only to:*

- i) *the acquisition of agricultural land and forest, real estate in Estonia's islands (except the four largest ones) and in 18 local government units bordering the Russian Federation. The reservation on the acquisition of agricultural land and forest will cease to apply on 31 May 2011;*
- ii) *majority ownership of an Estonian flag maritime vessel by non-EU residents except through an enterprise established in Estonia;*
- iii) *majority ownership of an air company by non-EU residents;*
- iv) *to the extent that under EU Directive 85/611/EEC, a depository of an undertaking for collective investment in transferable securities (UCITS) must either have its registered office in the same EU country as that of the undertaking or be established in the EU country if its registered office is in another EU country.*

List B,  
III/A1

Operations in real estate:

- Building or purchase in the country concerned by non-residents.

*Remark: The reservation applies only to the acquisition of agricultural land and forest, real estate in Estonia's islands (except the four largest ones) and in 18 local government units bordering the Russian Federation. The reservation on the acquisition of agricultural land and forest will cease to apply on 31 May 2011.*

List A,  
IV/C1

Operations in securities on capital markets:

- Purchase in the country concerned by non-residents.

*Remark: The reservation applies only to the purchase of shares and other securities of a participating nature which may be affected by the laws on inward direct investment and establishment.*

List A,

IV/D1

Purchase of bonds or other debt securities abroad by residents:

*Remark: The reservation applies only to the extent that undertakings for collective investment in transferable securities (UCITS) may not invest in covered bonds which are issued by a non-EU credit institution."*

**ANNEX 3**  
**ESTONIA'S RESERVATIONS TO THE CODE OF LIBERALISATION OF CURRENT**  
**INVISIBLE OPERATIONS**

C/3 Road transport: passengers and freights, including chartering.

*Remark: The reservation applies to the following operations:*

i) *for passengers:*

- *transit;*
- *“closed-door” tours;*
- *picking up or setting down on an international journey;*
- *transport within the country;*

ii) *for freights:*

- *transit;*
- *delivery on an international journey;*
- *collection on an international journey;*
- *return cargo where collection is authorised;*
- *return cargo where delivery is authorised;*
- *transport within the country.*

E/2 Banking and investment services.

*Remark: The reservation applies only to the acceptance in Estonia of deposits and other repayable funds from the public by undertakings not headquartered in the EU.*

E/3 Settlement, clearing and custodial and depository services.

*Remark: Under EC Directive 85/611/EEC, a depository of an undertaking for collective investment in transferable securities (UCITS) must either have its registered office in the same EU country as that of the undertaking or be established in the EU country if its registered office is in another EU country.*

E/7 Conditions for establishment and operation of branches, agencies, etc. of non-resident investors in the banking and financial services sector.

Annex II to Annex A, paragraph 1

*Remark: Under EC Directive 85/611/EEC, a depository of an undertaking for collective investment in transferable securities (UCITS) must either have its registered office in the same EU country as that of the undertaking or be established in the EU country if its registered office is in another EU country.*

L/6 Professional services.

*Remark: The reservation applies only to EU citizenship requirements for notaries, bailiffs and sworn translators.*

**ANNEX 4**  
**ESTONIA'S UPDATED LIST OF EXCEPTIONS UNDER THE NATIONAL TREATMENT**  
**INSTRUMENT**

**A. Exceptions at national level**

**I. *Investment by established foreign-controlled enterprises***

*Real-estate:* Ownership of large pieces of agricultural land and forest (exceeding 10 hectares) can be transferred to foreigners and foreign legal persons only with the permission of the relevant county governor. This exception will cease to apply on 31 May 2011.

On smaller islands (except for the 4 biggest islands) and 18 local government units bordering Russia – acquisition of land and real estate is forbidden for foreigners, foreign legal persons and foreign states. Nationals of EEA states, who have been legally resident and active in farming in Estonia for at least three years continuously, are not subject to any restrictions.

*Authority: Restrictions on Acquisition of Immovable Property Act of 2003.*

*Air transport and related services:* A licence to operate an air transport enterprise is granted only to companies majority-owned by the Estonian state, a local government and/or Estonian citizens. In accordance with the EU aviation acquis, this restriction does not apply to companies registered in the EU servicing flights within the EU.

*Authority: Article 40 of Aviation Act of 1999.*

*Maritime transport and related services:* Cabotage is reserved to sea-going vessels flying the national flag of the Republic of Estonia or of an EU member State. The right to fly the national flag of the Republic of Estonia is granted to sea-going vessels owned by Estonian citizens; sea-going vessels in common ownership if the greater share of the vessel is owned by Estonian co-owners; sea-going vessels that are the object of shared succession, if the greater share of the succession is owned by Estonian citizens or Estonian legal persons which have inherited the sea-going vessel in common.

*Authority: Merchant Shipping Code of 1991; Ship Flag and Registers of Ship Act of 1998.*

**II. *Official aids and subsidies***

None.

**III. *Tax obligations***

None.

**IV. *Government purchasing***

None.

**V. *Access to local finance***

None.

**B. **Exceptions by territorial subdivisions****

None.

**ANNEX 5**  
**ESTONIA'S UPDATED LIST OF OTHER MEASURES REPORTED FOR TRANSPARENCY**  
**UNDER THE NATIONAL TREATMENT INSTRUMENT**

**A. Measures reported for Transparency at the Level of National Government**

Management boards and branches: At least one half of the members of the management board of public or private limited companies must be resident in Estonia, in another European Economic Area (EEA) country or in Switzerland. At least one director of a branch must be resident in Estonia, the EEA or Switzerland.

**B. Measures reported for Transparency at the Level of Territorial Subdivisions**

None.

**C. Activities covered by Public, Private or Mixed Monopolies or Concessions**

**At the level of national government**

***I. Public monopolies***

- Estonian Post AS is a company whose shares are 100% state owned. It has an exclusive right to issue postage stamps.
- Eesti Energia AS is a 100% state-owned energy company that owns the company that owns and maintains the transmission network (OÜ Põhivõrk).
- The provision of pilotage services is reserved to a company founded by the state (AS Eesti Loots).
- AS Eesti Loto, a state-owned lottery company has an exclusive right to arrange lotteries involving prizes above 1000 €.
- AS Eesti Raudtee owns the railway infrastructure.

***II. Private or mixed (public/private monopolies)***

- Eesti Gaas AS owns gas pipelines.

***III. Concessions***

- Precious metal assaying services is subject to exclusive rights.
- The provision of technical inspection of lifting equipment is granted by an exclusive right to a state-owned company.

- The provision of technical inspection of machinery is granted by an exclusive right to a State-owned company.
- Elektriraudtee AS has an exclusive right to provide public transport services with electric trains until 2016.

#### **At the level of territorial subdivisions**

##### ***I. Public monopolies***

- District heating utilities by owning stations and networks.

##### ***II. Private or mixed (public/private monopolies)***

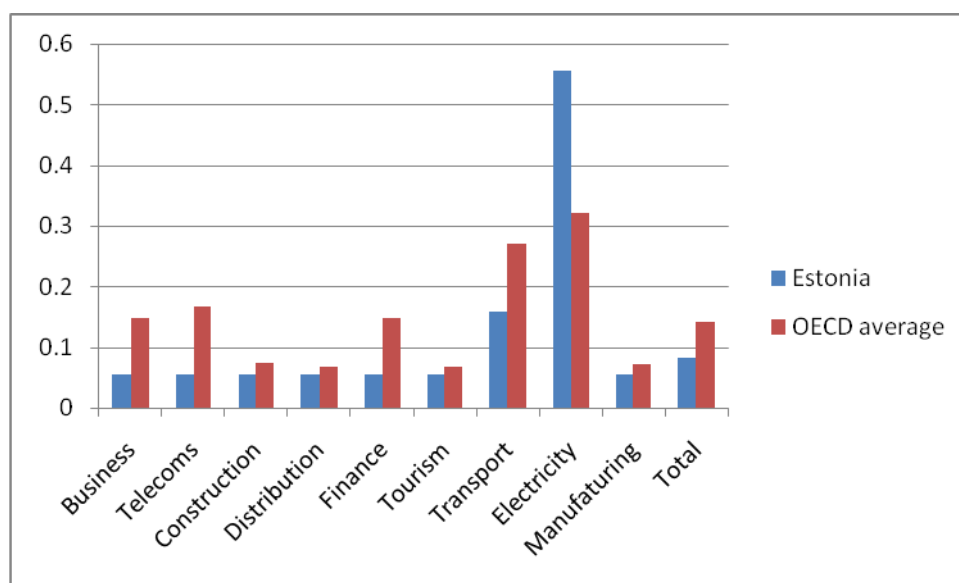
- Public transport by granted exclusive rights for limited periods.
- Tallinna Trammi- ja Trollibussikoondise AS has an exclusive right to provide public transport services with trolley buses and trams in the capital Tallinn until 2015.

##### ***III. Concessions***

- Water distribution by granted exclusive rights for limited periods.
- Waste collection by granted exclusive rights for a maximum of three years.



**ANNEX 6**  
**ESTONIA'S FDI REGULATORY RESTRICTIVENESS INDEX**



Source: OECD Secretariat

**Methodology:**

The OECD FDI Regulatory Restrictiveness Index covers the following sectors: investments in i) professional services (including legal, accounting, architectural and engineering services); ii) telecommunications (fixed and mobile); iii) transport (air, road and maritime); iv) finance (insurance and banking); v) distribution; vi) construction; vii) tourism; viii) electricity and ix) manufacturing.

For each sector, the scoring was based on the following elements: 1) the level of foreign equity ownership permitted; 2) the screening and discriminatory notification requirements; and 3) other restrictions (including nationality and residency requirements for companies' key personnel and restrictions on branching). The restrictions are evaluated on a 0 to 1 scale ("0" is the absence of restrictions and "1" is a closed sector). The overall restrictiveness index is a weighted average of the indices, using fixed average FDI and trade shares as weights. There are a number of important qualifications in using the index, in particular: national security related investment measures are not reflected and primary sectors are not covered. While only statutory restrictions are taken into account and not their actual enforcement, when combined with other factors beyond statutory restrictions, the Index has proven to be a good predictor of FDI performance.

