

REGULAR REPORT

FROM THE COMMISSION

ON

ESTONIA'S

PROGRESS TOWARDS ACCESSION

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A. Introduction

a) Preface

In Agenda 2000 the Commission said it would report regularly to the European Council on progress made by each of the candidate countries of Central and Eastern Europe in preparations for membership and that it would submit its first report at the end of 1998. The European Council in Luxembourg decided that

“From the end of 1998, the Commission will make regular reports to the Council, together with any necessary recommendations for opening bilateral intergovernmental conferences, reviewing the progress of each Central and East European applicant State towards accession in the light of the Copenhagen criteria, in particular the rate at which it is adopting the Union acquis. Prior to those reports, implementation of the accession partnerships and progress in adopting the acquis will be examined with each applicant State in the Europe Agreement bodies. The Commission's reports will serve as a basis for taking, in the Council context, the necessary decisions on the conduct of the accession negotiations or their extension to other applicants. In that context, the Commission will continue to follow the method adopted by Agenda 2000 in evaluating applicant States' ability to meet the economic criteria and fulfil the obligations deriving from accession.

A dynamic approach should be maintained in assessing the progress made by applicant States in the regular reports which the Commission will submit to the Council.”

The European Council in Cardiff supported those conclusions, stating that “The Union’s priority is to maintain the enlargement process for the countries covered in the Luxembourg European Council conclusions, within which they can actively pursue their candidatures and make progress towards taking on the obligations of membership, including the Copenhagen criteria. Each of these candidate countries will be judged on the basis of the same criteria and will proceed in its candidature at its own rate, depending on its degree of preparedness. Much will depend on the efforts made by the candidate countries themselves to meet the criteria. All will benefit from strengthened relations with the EU including through political dialogue and tailored strategies to help them prepared for accession.”

In accordance with the guidance provided by these Council Conclusions, the progress report on Estonia follows the same structure as the Opinion. It

- describes the relations between Estonia and the Union, particularly in the framework of the Europe Agreement;
- analyses the situation in respect of the political conditions set by the European Council (democracy, rule of law, human rights, protection of minorities)
- assesses Estonia’s situation and prospects in respect of the economic conditions mentioned by the European Council (functioning market economy, capacity to cope with competitive pressures within the Union)
- addresses the question of Estonia’s capacity to adopt the obligations of membership, that is, the acquis of the Union as expressed in the Treaty, the secondary legislation and the policies of the Union.

It also covers judicial and administrative capacity as requested by the Madrid European Council which underlined the necessity for the candidate countries to adapt their administrative structures so as to guarantee the harmonious implementation of Community policies after membership.

This approach ensures equal treatment for all the candidate countries. The report takes into consideration progress since the Opinion. It looks at whether intended reforms referred to in the Opinion have been carried out and examines new initiatives, including those directly related to addressing Accession Partnership priorities. The report contains a separate section which examines the extent to which Estonia has addressed the short term priorities set out in the Accession Partnerships.

While the assessment of progress in meeting the political and *acquis* criteria focuses on that which has been accomplished since the Opinion, the economic assessment is based on a longer term evaluation of Estonia's economic performance. The assessment of progress made in adopting the *acquis* has been made on the basis of adopted legislation rather than legislation which is in various stages of either preparation or Parliamentary approval. Only in this manner was it possible to objectively measure and compare concrete progress in preparation for accession.

The report draws on numerous sources of information. The candidate countries were invited to provide information on progress made in preparations for membership since the publication of the Opinion. Their presentations at the meetings held under the auspices of the Europe Agreement, their National Programmes for the Adoption of the *Acquis* and the information provided in the context of the analytical examination of the *acquis* provided were additional sources of information. Council deliberations on the Opinion and the reports and resolutions of the European Parliament on the Commission Opinions¹ and in particular the report on the application of Estonia for accession to the EU prepared by Mr. Donner were taken into account in the preparation of the reports. The Commission also used assessments made by the Member States, particularly with respect to the political criteria for membership and the work of various international organisations, and in particular the contributions of the Council of Europe, the OSCE and the IFIs as well as that of non-governmental organisations in preparation of the regular reports.

¹ European Parliament Doc. 224.339 'Report on the Communication from the Commission Agenda 2000' (Rapporteurs: A. Oostlander and E. Baron Crespo; Co-rapporteurs: M. Aelvoet, J. Donner, O. Von Habsburg, E. Caccavale, F. Kristoffersen, M. Hoff, C. Carnero Gonzales, P. Bernard-Raymond, R. Speciale, J. Wiersma, J.W. Bertens)

b) Relations between the European Union and Estonia

The Enhanced Pre-Accession Strategy

On 30 March 1998 the accession process was formally launched by a meeting of the Ministers for Foreign Affairs of the fifteen EU Member States, the ten Central and East European applicant states and Cyprus. In advance of this meeting country specific Accession Partnerships were adopted to support the applicant countries in their preparations for membership. These documents set out the priorities for further work and the supporting financial assistance available from the EU. In April Estonia presented a first version of its National Programme for the Adoption of the Acquis (NPAA) which describes in more detail the actions needed to reach the objectives set out in the Accession Partnership. Following the opening of the Intergovernmental Conference, Estonia presented the main elements of its integration strategy at the opening session of the EU-Estonia accession negotiations in Brussels on 31 March. An analytical examination of the acquis ("screening") started on 3 April. Pre-accession aid will be increased substantially. Alongside the Phare programme, it will, as from the year 2000, comprise aid for agriculture and a structural instrument which will give priority to measures similar to those of the Cohesion Fund on environment and transport. The Phare programme will concentrate on institution building and investment in other areas.

Recent developments in bilateral relations

The Europe Agreement between the European Union and Estonia entered into force on 1 February 1998 following the completion of the ratification procedures. Estonia has implemented the Europe Agreement correctly and contributed to the smooth functioning of the various joint institutions.

The first meetings of the Association Council and the Association Committee were held in February and June 1998 respectively. The June 1998 meeting was the first to discuss the implementation of the Accession Partnership priorities. Since the entry into force of the Europe Agreement five sub-committee meetings have taken place.

Since the issuing of the Opinion the Joint Parliamentary Committee comprising representatives of the Estonian and European Parliament met three times, in October 1997, April 1998 and November 1998.

Estonia trade with the EU has continued to increase its share of total trade. In 1997 Estonian exports (except transit exports) to the EU accounted for 62% of total exports (Finland 19%, Sweden 17.1% and Germany 6.7%). Imports from the EU amounted to 75.4% (Finland 37%, Sweden 10.6% and Germany 10.4%) of total imports.

Under the Europe Agreement an adaptation protocol, covering in particular agricultural and processed agricultural products, has been signed to take into account the results of the Uruguay Round and the accession of Austria, Finland and Sweden to the EU.

There is no specific trade problem in the relations between Estonia and the EU. Bilateral negotiations with Estonia on a Protocol on European Conformity Assessment (PECA) started in October 1998.

The 1998 Phare programme consists of a national allocation (21 MECU), based on the Accession Partnership priorities, to support in particular administrative capacity reinforcement, environment, transport as well as the participation in Community programmes and Tempus. An additional 2,5 MECU have been allocated for a cross-border co-operation programme.

Estonia also participates in and benefits from Phare funded multi-country and horizontal programmes such as customs, environment, statistics, public administration reform and TAIEX.

B. Criteria for membership

1. Political Criteria

Introduction

In its 1997 Opinion on Estonia's application for EU membership, the Commission concluded that:

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

Furthermore, the Accession Partnership with Estonia indicates that measures to facilitate the naturalisation process and to better integrate non-citizens including stateless children and to enhance Estonian language training for non-Estonian speakers are considered a short-term priority.

Recent developments

There has been no change of government since the Opinion. A new parliamentary grouping and a new party were created to contest the next general elections in March 1999. The Foreign Ministry resigned recently but there has been no change in Estonia's foreign policy. There has not been any major shift in government policy since the Opinion and EU membership continues to be one of the key objectives of the Estonian policy.

1.1 Democracy and the rule of law

The Parliament

The Estonian Parliament (*Riigikogu*) continues to operate satisfactorily. Its powers are respected and the opposition plays a full part in its activities.

The Executive

The central institutions of the State continue to operate smoothly. There is presently an insufficient skilled capacity in the Estonian public administration and a high turnover of staff. However, a continued commitment to public administration reform is necessary to create a body of highly qualified civil servants which can ensure the adequate implementation and enforcement of the EU *acquis*".

Therefore, a continued commitment to public administration reform is necessary to improve the situation.

The police service is undergoing a process of reform and reorganisation. On 14 May 1998, a new Law on Police Service was adopted that will guarantee stability of the police forces. The law determines qualifications, grade and salaries for police officials.

The Judiciary

Although a series of reforms to improve the judicial system are being undertaken, further adjustments are needed in civil and penal law in order to complete the transition from the former system. In the fields of commercial and civil law reform will be completed with the adoption of the remaining legislation this autumn. But reform of the penal legislation is far behind, with the core of the old legislation still in force. The training of judges and elaboration of new penal legislation that meets European standards still remain top priorities for Estonia.

Currently, the heavy caseload of the courts, relative to the number of judges (221 judicial positions), continues to pose problems for the efficiency of the judicial process. Furthermore, a high proportion of the existing judges (192) were trained under the old system. Although the salaries of judges are above the average in the public administration, competition from the private sector makes it difficult to attract qualified lawyers to follow a career in the judiciary. The number of lawyers (only 335 barristers) and prosecutors (172 posts of which 12 are vacant) is also insufficient.

Uncertainty by judges applying the law and inexperienced judges continue to be the major difficulties faced by the judicial system. Justice at lower courts level is considered to be unsatisfactory, as there are many new inexperienced and overburdened judges. A significant number of local court decisions are invalidated by district courts. At the higher courts the quality of justice is considered satisfactory.

The target established by the Code of Penal Law Procedure to bring criminal cases to Court within two months of the pre-trial investigation being concluded has not always been met, and the gap between the conclusion of the investigation and trial has occasionally been up to two years.

Measures which have been taken in this area, include :

- The Probation Law that entered into force in May 1998, introducing probation in Estonia. It foresees 200 probation officer posts and appropriate training. Due to financial constraints, only 110 posts have been filled so far.
- The Public Prosecution Act entered into force in May 1998.

Anti-corruption measures

The situation in this field has improved, partly, due to a well-designed and integrated programme of prevention and control of corruption (National Crime Prevention Programme).

Concern has been expressed as to judges being susceptible to bribery. Only one case concerning bribery was brought to trial in 1997. It resulted in acquittal due to lack of evidence.

Estonia has signed but not ratified the Convention on Laundering, Search, Seizure and Confiscation of the proceeds from Crime.

It is not clear yet whether the measures taken until now have had a positive impact, but they reflect the commitment of the Estonian authorities to the fight against corruption. The situation needs to be monitored closely.

1.2. Human Rights and Protection of Minorities

Estonia has ratified the major international conventions in the field of Human Rights. It has not yet signed the European Social Charter.

Civil and Political rights

Basic civil and political rights continue to be respected in Estonia. However, pre-trial and prison conditions need continued attention. Progress has been made in the following areas:

- The death penalty was abolished in March 1998. In 17 April 1998, Estonia ratified Protocol 6 to the European Convention for the Protection of Human rights and Fundamental Freedoms concerning the Abolition of the Death Penalty.
- The Refugees Act entered into force in 9 July 1998, introducing the right of asylum in Estonia. It contains rules on the reception of refugees, on application of asylum and on the determination of refugee status. A chapter is devoted to the social rights of refugees. Furthermore, in October 1997, the Estonian Parliament amended several Social Security acts to provide refugees with social guarantees identical to those of citizens. Implementing regulations have not yet been adopted. The number of asylum seekers in Estonia has so far been limited (24). No decisions have yet been taken on these applications. It remains to be seen therefore how legislation will be implemented.

However, further improvement is needed in the following areas:

- Pre-trial conditions need to be improved in Estonia. In 1997 considerable improvements have been made, such as the opening of new, modern detention facilities. However, pre-trial conditions are still considered unsatisfactory in the country's only pre-trial detention centre in Tallinn. Some isolated cases of ill-treatment, suffered by prisoners in custody, including the use of punishment cells, have also been reported. The authorities are currently investigating these allegations.
- Prison conditions need further improvement. The Government has been implementing continued measures to address poor conditions in overcrowded prisons (300 inmates per 100,000 inhabitants) and to make prison staff, currently underpaid and lacking appropriate training, more professional. It has drafted a multi-year plan to refurbish and restructure the country's prisons, including the construction of a big modern prison in Tartu which should considerably improve the current situation. The introduction of probation should also alleviate the problem of overcrowded prisons.

The number of NGOs continues to increase although at a relatively slow pace. There are 3,200 estimated NGOs in Estonia. Most are devoted to education and training, protecting the cultural heritage, and children's rights and minorities. They operate without government restrictions. The EU's Phare programme is actively supporting NGOs in Estonia.

Economic, Social and Cultural Rights

The basic economic, social and cultural rights continue to be respected in Estonia.

Minority Rights and the Protection of Minorities

The Commission's Opinion of July 1997 underlined the need for Estonia to take measures to accelerate naturalisation procedures for the Russian speaking non-citizens and to reinforce integration measures for non-Estonian minorities. It is regrettable that the Parliament has not yet adopted the amendments to the Citizenship Law which would align it with OSCE recommendations and facilitate naturalisation of stateless children.

The naturalisation procedure

As of 1 August 1998, 101,239 non-Estonians have been granted Estonian citizenship since the Citizenship Law entered into force in 1992. The number of non-Estonians requesting citizenship is decreasing. Since the publication of the Opinion (July 97-June 98), 9,762 persons received citizenship as against 22,000 in 1996.

On 9 December 1997, the Estonian government adopted a draft amendment to the *Citizenship Law* that will allow children, born after 26 February 1992 to legally stateless parents, to become citizens upon their parents' application. This measure would affect around 10,000 children in Estonia. It is all the more regrettable that the Parliament has postponed the adoption of these amendments since this *de facto* postponement implies that the vote will not take place before elections in March 1999.

The government has simplified both the language test and the test on civic knowledge for applicants for Estonian citizenship by omitting 10% of the most difficult questions. Success rates are high, around 90%.

Residence permits and special passports for non-citizens

An improvement which addresses a weakness identified in the Opinion is the adoption on 24 September 1997 by the Riigikogu of an amendment of the Aliens Act (1993) allowing non-citizens who applied for temporary resident permits before 12 July 1995 to obtain a permanent residence permit after 12 July 1998 (2 years earlier than envisaged by the original Act). People who have lived with a temporary residence permit in Estonia for at least three years, with permanent accommodation and regular legal income are eligible for permanent residence permits. So far, only 11,728 non-citizens hold permanent residence permits. The following groups are excluded: foreigners working or studying temporarily in Estonia, retired military officers who have received a resident permit on an extraordinary basis and criminals sentenced for more than one year. Between 20,000 and 50,000 non-citizens are estimated to be illegal. The government has invited these persons to regularise their situation, but only a few of them have actually filed applications for residence.

In 1994 the government began issuing special passports to resident non-citizens not in possession of any other travel document. By 1 August 1998 184,733 persons were in possession of an alien passport.

Integration of minorities

The rights of the Russian-speaking minority (with or without Estonian nationality) continue to be observed and safeguarded. Russian continues to be widely used in courts and in the administration in those areas where Russian speakers represent a majority of the local population. However, non-citizens are still subject to some restrictions such as the right to sit on the boards of state-owned companies, to belong to a political party and to be employed in certain areas of the public administration.

The adoption on 10 June 1998 by the Parliament of a document on "The Integration of non-Estonians into Estonian Society" is also intended to support existing integration measures. It

sets out the guidelines for implementing a national programme of integration from the beginning of 1999. At the same time, a Non-Estonian Integration Foundation has been established in March 1998 to facilitate the overall integration process.

Language training is one of the main instruments for the integration of the ethnic minorities into Estonian society. Currently, 36% of the population has, as a first language, a language other than Estonian. The Phare programme has provided important support to efforts in this area.

Positive developments that prove a commitment to improve the teaching of Estonian to non-citizens include:

- The National Court resolved a dispute between the President and the Parliament by rejecting the latter's amendments to the Language Law adopted on 19 November 1997. These amendments would have required that members of parliament and of local councils prove a good level of knowledge of Estonian and would have allowed government agencies to regulate the use of Estonian in the private sector. This would have limited the involvement of non-Estonians in politics, private business and associations.
- The Education Act was amended in November 1997 to establish a new "state language teacher" post. These posts should be filled by highly qualified teachers experienced in teaching Estonian as a second language. In June 1998 the first 18 teachers out of a total of 50 were appointed. Progress should be continued in this area.
- In September 1997, an Amendment to the Basic and Secondary Schools Act was adopted. The amendment extends the existing system until 2007/2008 (it would otherwise have been abolished by the year 2000) and ensures the public funding, with no time limit, of Russian elementary schools covering the period of compulsory education in Estonia.
- In April 1998, the government adopted a language strategy document for the non-Estonian speaking population.

1.3 General Evaluation

Developments in Estonia confirm the conclusion of the Opinion that Estonia's institutions continue to function smoothly. However it is regrettable that the Parliament has not adopted amendments to the citizenship law to allow stateless children to become citizens.

Continuing attention needs to be paid to public administration reform and the reinforcement of the judiciary, particularly to training of judges and promotion of Estonian language learning among non-citizens.

2. Economic criteria

2.1. Introduction

In its 1997 Opinion on Estonia's application for EU membership, the Commission concluded :

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

In examining the economic developments in Estonia since the Opinion, the Commission's approach was guided by the conclusions of the European Council in Copenhagen in June 1993 which stated that membership of the Union requires:

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

In the analysis below, the Commission has followed the methodology applied in the Opinion.

2.2. Economic developments since the commission published its opinion

Since mid-1997, Estonia has emerged as one of the world's fastest growing economies. Important progress has been made in reducing inflation and controlling public finances. Productivity growth has also been remarkably high. Although the external imbalances associated with the rapid expansion of domestic demand have remained large, and the rapid development of the local financial sector has created new risks, the authorities have been decisive in addressing these issues by taking restrictive policy measures in 1997 and 1998. The growth in exports and the continuing inflows of foreign direct investment (FDI) have been key factors underpinning the continued confidence in the Estonian economy. Structural reforms have also continued, albeit at a slow pace in some areas, such as land privatisation.

Macroeconomic developments

1997 was characterised by a sharp acceleration of real GDP growth, which reached 11.4% after only 4% in 1996. Investment and foreign demand were particularly buoyant, but the 7.3% increase in real wages also provided support for an expansion of private domestic consumption. On a sectoral basis, forestry and manufacturing were the two main engines of growth in 1997, with value added increasing by 30% and 20%, respectively, in real terms. Real estate and the financial sector were also very dynamic. The contribution of agriculture to growth continued to be negative; at the end of 1997, the agricultural sector represented only 4.4% of GDP (excluding forestry and fishing).

Inflation declined from an annual average of 23.1% in 1996 to 11.2% in 1997. It picked up in most of the second half of 1997 and early 1998, linked to higher adjustment of regulated prices, the depreciation of the Deutsche mark against the US dollar, and also partially to the strong growth in internal demand. Price developments since the spring of 1998, and the evolution of the producer and export prices in particular, suggest that the disinflationary process will continue in 1998.

Registered unemployment has decreased steadily, reaching 3.3% of the labour force in August 1998, against 3.5% one year earlier. Some shortages of skilled labour have appeared in Tallinn. However, the overall situation on the labour market remains contrasted. Labour force surveys, using the International Labour Organisation methodology, show that unemployment increased in 1997 to 10.5% of the active population (from 10% a year earlier). In a context of a rapidly expanding economy, this suggests that more and more of the many people who had left the labour market in previous years want to go back to work.

The buoyancy of growth, combined with a strict control of expenditures (which fell as a share of GDP) had a dramatic impact on fiscal performance. In 1997, the total revenues of the state budget were 12% higher than originally anticipated. The surplus of the general government accounts reached 2.1% of GDP in 1997. This is a marked turnaround from the 1.5% deficit recorded in 1996. In the first six months of 1998, the budget surplus has further increased to an estimated 2.6% of GDP.

The strong economic growth of 1997 led to a further deterioration of the external accounts. The current account deficit increased to 12% of GDP; the trade deficit reached 24% of GDP. More than the level of the deficit, it is the structure of its financing that has been a cause of concern. Indeed, while net FDI inflows reached 2.7% of GDP, debt-creating inflows and portfolio investments sharply increased in 1997 and accounted for 14% of GDP. While the government managed to reduce its external debt from 6.8% to 5.4% of GDP, these inflows have led to a sharp increase of Estonia's net foreign debt, though from a very low base. In fact, Estonia has been confronted with the challenge of managing large capital inflows and addressing some of their unintended macroeconomic consequences. The difficulties are compounded by the limited scope for an autonomous monetary policy in the context of the currency board arrangement, which has been in place since 1992.

Estonia: Main economic trends		1994	1995	1996	1997	1998 latest	
Real GDP growth rate	<i>per cent</i>	-1.8	4.3	4.0	11.4	7.3	Jan-Jun
Inflation rate							
annual average	<i>per cent</i>	47.7	29.0	23.1	11.2	11.6	Jan-Sep
December-on-December	<i>per cent</i>	41.7	28.8	14.9	12.5	8.9	Sep-on-Sep
Unemployment rate, end-year							
ILO definition	<i>per cent</i>	7.6	9.7	10.0	10.5		
registered	<i>per cent</i>	4.5	4.1	4.3	3.6	3.3	Aug
General government budget balance	<i>per cent of GDP</i>	1.3	-1.2	-1.5	2.1		
Current account balance	<i>per cent of GDP</i>	-7.1	-5.1	9.2	-12.0		
	<i>billion ECU</i>	-0.2	-0.2	-0.3	-0.5	-0.2	Jan-Jun
Foreign debt							
debt/export ratio ¹	<i>per cent</i>	NA	NA	3.6	5.6		
gross foreign debt	<i>billion ECU</i>	NA	NA	0.8	1.8		
Foreign direct investment inflow							
net inflow according to EBRD	<i>per cent of GDP</i>	9.2	5.6	2.6	2.7		
balance of payments data	<i>million ECU</i>	186	153	87	113	120	Jan-Jun

Source: Commission services, national sources, EBRD, IMF

¹ Gross hard currency debt as a percentage of exports of goods and services

In the autumn of 1997, the prospect of further large capital inflows and their consequences for credit expansion and the external imbalances prompted the authorities to take a number of restrictive policy measures. They clearly recognised that in the eventuality of a rapid reduction of these capital inflows, Estonia would have to cut imports sharply, as it would no longer be possible to finance trade deficits in the order of one quarter of GDP. Furthermore, the importance and reliance on short-term capital expose Estonia to the risk of a shift in private investors' confidence, which might be influenced by factors unrelated to the country's economic situation.

In this context, the Central Bank took measures to reduce credit expansion and strengthen the financial system, through a tightening of prudential regulations. The government also announced the creation of a stabilisation reserve fund, which collects government savings and is invested abroad. The fund totalled 3.1% of GDP at the end of June 1998. These measures added to a liquidity crisis on the local money market, induced a substantial increase in interest rates and a decline in lending activity in the last quarter of 1997 and the early months of 1998.

However, by the beginning of Spring 1998, monetary conditions improved and interest rates fell. It became clear that further restrictive measures were warranted. A new package was announced in June 1998, the main elements of which were a further tightening of fiscal policy (the consolidated budget surplus was raised to 2.5% of GDP for 1998), and a strengthening of the control over the financial sector.

At the beginning of the fall of 1998, there were clear indications that the two successive restrictive packages had succeeded in bringing down growth to levels consistent with the goal of reducing the external imbalances. The growth of banks' total loan portfolio slowed down to an annual 33% at the end of August 1998, compared to more than 100% at the end of September 1997. GDP growth in the first half of 1998 was 7.2% according to preliminary data, well below the 10.1% achieved in the first half of 1997, but still quite comfortable. The current account deficit in the first half of the year has declined to about 11% of GDP, and reserves have further increased; the growth of the net external debt of residents slowed down considerably between the first and second quarter of 1998.

While it remains premature to assess the full impact of the Russian crisis on Estonia, there are three main channels through which negative effects could be felt: lower direct exports to Russia, impact on the local banking system because of its exposure to the Russian market and a more difficult and costlier access to international finance. This third channel, given the need to finance the large external imbalances, could be potentially the more serious.

Structural reforms

Estonia has made further progress on structural reforms since mid-1997. The privatisation of industrial companies has advanced further. The government reaffirmed its commitment to the privatisation of public utilities and infrastructure. Privatisation plans for Estonian Energy and Estonian Oil Shale were approved at the end of 1997. The sale of a 49% stake in Eesti Telekom should take place in the second half of 1998, thus ensuring majority private ownership of the main telephone operator. Negotiations with foreign investors on the sale of a large share in the energy generation company have restarted, following an earlier unsuccessful attempt.

Ever since Estonia's banking crisis of 1992, the financial sector has been an area of particular attention for the authorities. The recent years have been characterised by the strong growth of the banking sector, the quick development of the non-bank financial institutions and the successful launch and development of the Tallinn Stock Exchange. But the rapid decline in the stock market in the second half of 1997 and in the first half of 1998 revealed corporate malpractice, speculative operations on the stock market, and faulty control mechanisms in a number of financial enterprises. Excessive optimism, easy access to funds and sharp competition for market share in the financial sector, in a context of a rapidly expanding economy, were among the key factors that led to the emergence of these problems. The Russian crisis exacerbated problems already existing in two small banks, which were closed in September. It also caused difficulties for the merger of Forex Bank and Investment Bank (which led the central bank to acquire a temporary majority stake to ensure the completion of the merger).

In this context, the authorities took a number of prudential measures. First, in the fall of 1997, the capital adequacy ratio was increased from 8% to 10%, reserve requirements were strengthened, and it was decided to implement consolidated supervision of financial conglomerates in 1998. Additional measures were taken in June 1998: in particular, banks had to create a general 2% reserve fund on all loans in the context of the introduction of a uniform loan classification system; Estonia decided to accept all 25 core Basle principles by the end of 1998 and reserve requirements were extended to include financial guarantees to financial institutions.

At the same time, the consolidation of the commercial banking sector has progressed further. In particular, two mergers among Estonia's four largest banks have created the two largest financial institutions in the Baltic countries. Foreign investors have continued to increase their stakes in the banking system, most notably in the largest Estonian banks. In the context of Estonia's currency board, the growing participation of foreign capital in local banks is an important development. With the role of the central bank as lender of last resort strictly limited, easy access by banks to foreign funds (in particular via their parent company) improves confidence in the resilience of the financial system in case of a slow down of the economy or large capital outflows.

Estonia: Main indicators of economic structure in 1997		
Population	<i>million</i>	1.5
GDP per head	<i>PPS-ECU</i>	7 000
as % of EU-15 average	<i>per cent</i>	37
Share of agriculture in: gross value added employment	<i>per cent</i>	6.3
	<i>per cent</i>	9.9
Investment-to-GDP ratio	<i>per cent</i>	27
Gross foreign debt/GDP	<i>per cent</i>	44
Exports of goods & services/GDP	<i>per cent</i>	73
Stock of foreign direct investment ¹	<i>billion ECU</i>	0.7
	<i>ECU per head</i>	489

Source: Commission services, national sources, EBRD, IMF
¹ FDI stock converted at end-1997 exchange rate of 1 ECU=\$1.10421

The government has launched the reform of the pension system. In June 1997, it approved a concept framework programme for pension reform, which is based on the usual three pillars. In April 1998, the Parliament approved the bill on the social tax, which will serve as a source

of revenue for the state-managed first pillar. In June 1998, the government approved the draft bill on the third pillar (private voluntary scheme).

As a result of the measures taken in 1996 and late 1997, land reform has progressed further: 95% of restitution claims have been processed and the percentage of land covered by the land registry doubled between the end of 1996 and the end of 1997. However, the process of land privatisation has been more difficult than originally expected. Indeed, while the government committed itself, in its Memorandum of Economic Policies (MEP) agreed with the IMF, to more than double private land ownership to at least 35 percent of all land at the end of 1998, it was obliged to revise this goal downward. In the supplementary MEP agreed in June 1998, the authorities reckon that only 27% of all land will be privatised by the end of the year.

2.3. Assessment in terms of the Copenhagen criteria

The existence of a functioning market economy

The existence of a functioning market economy requires that prices, as well as trade, are liberalised and that an enforceable legal system, including property rights, is in place. The performance of a market economy is enhanced by macroeconomic stability and consensus about economic policy. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy.

Estonia has maintained its very liberal trade policy. Free trade agreements entered into force with a number of EU accession candidates, and negotiations were started with all the remaining candidates as well as with other CIS countries. WTO accession negotiations have not been concluded yet.

While the majority of prices were liberalised quite rapidly following independence, price liberalisation has not made much further progress. Regulated prices still account for about 26% of the CPI basket, which is roughly the same level as at the beginning of 1997. Decisions by the government on the timing and size of administered price changes therefore continue to have a large impact on the rate of inflation. Also, the authorities have maintained a relatively low price for electricity and oil-shale, which is a major impediment to making the investments required to modernise the energy sector and thus to tackling some of Estonia's environment problems.

Estonia is using the examples of the EU member states to bring its legal system up to date. Improved legislation was introduced in the field of competition, industrial property rights, energy and the financial sector (notably the deposit guarantee fund). To guarantee a competitive environment, the authorities will set up regulatory bodies for the relevant markets (telecommunications, energy, railways). The energy market inspectorate has already started its work. Improving the working conditions in the public administration, creating new skills and adapting to a new environment are crucial challenges not only to ensure the effective implementation of the new laws, but also to ensure a high quality of service. To that effect, the authorities have developed a comprehensive public administration strategy, yet to be approved.

The overall legislative framework in Estonia is well developed. It supports and regulates most aspects of business activity. Most of this legislation is recent and follows the German and Scandinavian models. Although there have been cases in the past of inconsistent application

and interpretation of the law due to experience in the courts, there has been progress in clarifying the legislation and improving enforcement of civil and commercial law.

The privatisation of land and the establishment of a properly functioning market for land are still at an early stage. At the end of 1997, 16% of total land was in private hands, and more than a third of total land had been registered in the land registry by the end of July 1998. In the agricultural sector, the absence of a properly functioning land market, legal uncertainty with regard to ownership rights and weak institutional structures mean that market mechanisms are not yet entirely established.

In 1998, the authorities have increased significantly their support for the agricultural sector. Direct income support is now granted to milk producers and cereal growers, through hectare and headage payments. However, only the most efficient producers are entitled to these payments, according to precise criteria. This should ensure a rationalisation of production and an increase of the average farm's size, and thus lead to efficiency gains. Moreover, while the introduction of direct support is a significant break with Estonia's original approach towards the sector, which was characterised since the onset of reform by the near-absence of direct or indirect aid, the new support remains limited in extent and scope. There are still no import tariffs on agricultural products in Estonia, ensuring strong competition on the domestic market.

Privatisation – based on the privatisation law passed in 1993 – has advanced further, including in infrastructure (a small railway line was sold and two power grids were put for sale). Competition is strong, notably because of the liberal trade regime. At the end of 1997, almost 80% of industrial production originated in the private sector.

The importance of external imbalances and the reliance on foreign capital to finance a large part of the current account deficit continue to create risks for macroeconomic stability. The strong growth of the external debt of Estonian residents (especially debt held by the private sector) in 1997 and in the first quarter of 1998 cannot continue for many years without raising doubts about the sustainability of the economic policy stance, including the exchange rate regime.

However, the resolve of the authorities to use the limited number of economic instruments available to them, exemplified by the adoption of a second package of restrictive measures in 1998, has strengthened the credibility of the exchange rate commitment both domestically and internationally. Also, by closing down three banks between mid-1997 and October 1998, the authorities have reaffirmed their commitment to market principles. While the supervision authorities could probably have acted earlier to close down the Land Bank, when clear cases of fraud have been discovered, legal proceedings have been initiated.

In difficult economic circumstances, the broad consensus on the main tenets of economic policy was preserved. Despite calls for fresh spending, the government was successful in reaching political agreement on the need for a strong tightening of fiscal policy. The automatic adjustment mechanism of the currency board system has continued to function as intended, even though it leads to severe adjustment costs. Also, the government reached agreement with the IMF on a Memorandum of Economic Policies (MEP) in November 1997 and on a supplementary MEP in June 1998. It successfully completed the mid-term review under the precautionary Stand-by arrangement. It has also started work on a mid-term

economic strategy, with a view to carry out a Joint Assessment of medium term economic policy priorities with the services of the European Commission.

The wide fluctuations in interest rates and the volatility on the domestic and international financial markets have affected the financial sector, but its development has not gone off course. Even the voluntary or forced closure of some of the banks does not seem to have dented the general confidence in the financial sector. Deposits by residents briefly fell at the end of 1997, but then continued to grow. Also, the consolidation of the financial sector has led to the emergence of banks that are not only larger but also stronger, and thus in a better position to channel savings to productive investments.

However, the rapid development of the non-bank financial institutions has not been matched by a strengthening of the relevant supervisory agencies. While work has started on establishing a consolidated financial supervisory authority, it is important to make further progress on strengthening existing supervisory agencies and extending the regulatory framework to all parts of the capital market.

Estonia continues to be a functioning market economy. It has strengthened the institutions of a market economy and improved the legal environment for market participants. The authorities have been able to adopt the correct economic policy measures when required although prudent macroeconomic management is needed to limit the risks associated with its large external imbalances. However, there is a need for further progress in land privatisation, in the liberalisation and adaptation of prices and in the strengthening of the regulatory framework of financial activities and capital markets.

The Capacity to Cope with Competitive Pressure and Market Forces within the Union

Estonia's ability to fulfil this criterion depends on the existence of market economy and a stable macroeconomic framework, allowing economic agents to make decisions in a climate of predictability. It also requires a sufficient amount of human and physical capital, including infrastructure. State enterprises need to be restructured and all enterprises need to invest to improve their efficiency. Furthermore, the more access enterprises have to outside finance and the more successful they are at restructuring and innovating, the greater will be their capacity to adapt. Overall, an economy will be better able to take on the obligations of membership the higher the degree of economic integration it achieves with the Union prior to accession. Evidence of this is provided by both the volume and the range of products traded with EU Member States.

In 1997, gross inflows of foreign direct investment strongly increased compared to the previous year and represented nearly 6% of GDP. The large accumulated stock of FDI has helped to modernise the supply side of the economy, and has been the driving force behind Estonia's export performance.

Investment has remained very buoyant and a key engine of growth. The high investment ratios of past years (about 31% of GDP in 1997) have been essential factors behind the surge in productivity recorded in 1997 (estimated at 11% for the whole economy). In 1997, for the first time in many years, the growth in productivity exceeded the growth in real wages, thereby contributing to improve profitability and reduce inflationary pressures.

In 1997, the number of registered enterprises has increased by more than a quarter. The rise was particularly strong (+44%) for companies with less than 5 employees. This trend, which is general to all sectors of the economy, shows that entrepreneurs are taking advantage of a favourable economic environment. These new companies are a source of future growth and employment opportunities.

There has been a clear revival of manufacturing industry in Estonia. Its gross value added grew by almost 20% in 1997, the second most important contribution to growth after forestry. Some industrial sectors have experienced extremely rapid output growth in 1997, in particular the paper, wood and wood products, and textiles sectors. Indeed, investment of past years has led to an 18% increase of productivity in the manufacturing sector, allowing a 13% fall in real unit labour costs.

Although the rate of appreciation has slowed down considerably, the real exchange rate has continued to appreciate. In this context, Estonian industry's capacity to sell on foreign markets is remarkable. Not only has non-price competitiveness improved, but the fall in real unit labour costs has offset the appreciation of the currency. Excluding transit trade, exports of goods increased by 47% in 1997. In the first half of 1998, growth in exports continued to be strong (+28% compared to the same period of the previous year) and outpaced that of imports (on a balance of payments basis).

There has also been a further diversification of the product composition of exports. The share of machinery and other processed equipment has increased to about one fifth of total exports (excluding transit trade), while the share of foodstuffs, timber and textiles has fallen. Moreover, this trend reflects an increase in exports of Estonian-produced machinery. Indeed, excluding both transit trade and goods re-exported after processing in Estonia, exports of machinery and equipment jumped by two thirds between 1996 and 1997, when total exports only increased by one third.

Estonia's trade integration with the European Union further progressed in 1997. Excluding transit trade, EU countries' share in Estonia's exports reached 62% (57% in 1996) and their share of imports was 75% (73% in 1996). It is clear that Estonia has achieved a high degree of commercial and financial integration with the European and global economy. A further deepening of trade relations with the EU has taken place in the first half of 1998.

However, Estonia's foreign trade remains mostly concentrated on four countries. They account for roughly 60% of both exports and imports. In addition to the need to further diversify the geographic base of exports, the innovation and technological content of exports must be enhanced if Estonian is to compete successfully with countries which have broadly similar endowments.

In this respect, increasing the technical skills and the flexibility of the labour force is an important challenge. It is a key condition for continuing to attract FDI inflows. Already, some shortage of skilled labour has appeared, while large numbers of workers have few modern skills. This is particularly true outside Tallinn. More ambitious policies will have to be developed to ensure the development of skills that are necessary to sustain the shift from light industry relying on cheap labour to products with a greater content of high technology and skilled labour.

The proper working of the mechanisms of the market economy, together with the strong growth in GDP and investment, the continuing restructuring of the enterprise sector and the open trade regime, have increased Estonia's capacity to cope with the competitive pressure and market forces within the Union in the medium term. Further reductions in inflation, increasing research and development and developing new skills for the labour force are among the key factors that will further strengthen structural reforms.

2.4. General Evaluation

Estonia can be regarded as a functioning market economy, and should be able to cope with competitive pressure and market forces within the Union in the medium term, provided that prudent macroeconomic management is pursued so as to limit the risks associated with its large external imbalances.

Since the Opinion, Estonia has made further progress in strengthening the structures of a market economy, notably by significantly tightening banking supervision. Structural reforms, including pension reform, have continued and foreign direct investment has increased. Estonia has improved its competitiveness. Moreover, significant progress has been made in tackling macroeconomic imbalances.

As many reforms have been advanced, Estonia should now focus on a few key areas. Priority should be given to further reducing the external imbalance and inflation in order to enhance policy credibility. Prices should be liberalised further, and land reform should be accelerated. Measures to stimulate research and development and to develop new skills for the labour force are required. The regulatory setting and supervision of the non-bank financial sector should also be completed and strengthened.

3. Ability to assume the obligations of membership

This section aims to up-date the Commission's Opinion of 1997 as concerns Estonia's ability to assume the obligations of membership - that is, the legal and institutional framework, known as the *acquis*, by means of which the Union puts into effect its objectives.

In the 1997 Commission's Opinion on Estonia's application for EU-membership, the Commission concluded that

"Estonia has made considerable progress in transposing and implementing the *acquis* relating particularly to the single market. With further effort it should become able to participate fully in the single market in the medium term. Particular efforts, including investment, will be needed to apply the *acquis* fully in sectors such as environment."

The presentation below of the different subject matters follows the same structure as the 1997 Opinion, but the general descriptions of each sector have been omitted. Instead, the report focuses on the progress made since July 1997. Under each heading legislative decisions and progress in implementing and enforcing the legislation is reported.

3.1 Internal Market without frontiers

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

Effective implementation and enforcement of these four freedoms requires not only compliance with such important principles as, for example, non-discrimination or mutual recognition of national legislation but also the effective application of common rules, such as those designed for safety, environmental or consumer protection, and effective means of redress. The same principles apply to certain common rules, for example in the areas of public procurement, intellectual property and data protection, which are important in shaping the general framework within which the economies operate.

General Framework

In the area of public procurement, amendments to the Public Procurement Act have been adopted in April 1998 in order to eliminate domestic preferences. It is early to assess the effectiveness of these amendments. However, no decisions have been taken on alignment with the remedies system. Finally, the Estonian authorities have undertaken steps to implement the Community Common Procurement Vocabulary and the Information Technology tools developed.

Amendments and secondary implementing legislation, to the Trade Marks Act, and the Patent Act have been adopted. The latter meet the requirements of WTO Agreement on trade of intellectual property. The Parliament has ratified the Madrid Protocol and accession is foreseen by December 1998. In November 1997 Estonia submitted its application to accede to the Munich Convention and has obtained observer status at the European Patent Organisation. The Industrial Design Protection Act and implementing regulations have also been adopted but amendments to the Copyright legislation are still needed. Weaknesses in the administrative and institutional capacity of Estonia to ensure effective implementation of copyright legislation still remain.

Estonia has not signed yet the European Convention on data Protection. Creation of an independent data protection agency is needed in order to become part of the Convention. In relation to company law, no major developments have taken place.

Finally, the Law on Accounting of 1995 is largely in line with the Fourth Directive.. There is a shortage of qualified auditors and efforts will be required if they are to be solved in the medium term.

The four freedoms

Free movement of goods

Since last year the work on the legislation that should implement the basic principles of the EC New Approach on standardisation, conformity assessment, accreditation and market surveillance has progressed slower than expected. The Act on Product Conformity

Assessment that entered into force in March 1998 still needs some amending to ensure the maximum compatibility. The Act on Technical Regulations and Standards has not yet been adopted by the Parliament. Therefore, the adoption of Community compatible framework texts is still to be completed.

There has been little progress on the transposition of harmonised European standards, mainly due to the obligation of translation into Estonian. This obligation will be repealed in 1998 with the adoption of the Act on Technical Regulations and Standards. A programme for the implementation of European standards has been established. At present 57 European standards have been adopted.

The slow progress on the adoption of the appropriate framework legislation explains the delays in the effective implementation of sectoral directives in the areas covered by the New Approach.

On motor vehicles, foodstuffs and chemicals steady progress has been made towards full implementation of the *acquis*. The EC type-approval system for all motor vehicles except wheeled agricultural and forestry tractors became operational in 1998. In addition a number of implementing decrees have been adopted. The necessary administrative structures for inspection and control of foodstuffs are in place and apply Community principles. The framework Chemicals Act, largely in line with the *acquis*, has been adopted. Legislation, implementing EU rules on fertilisers, synthetic drug precursors and civil explosives was adopted in 1997. However, this legislation presents some incompatibilities with the relevant directives. The necessary administrative structures for implementation are in place.

The framework legislation on pharmaceuticals, which covers most directives in the sector was adopted in 1996. Since last year progress has focused on semi-medicinal products and advertising. The necessary administrative structures for implementation are in place. A government regulation on the rules regarding the preparation, safety assurance and importation of cosmetic products has entered into force at the end of 1997. Legislation implementing most of the *acquis* on textiles and wood has also entered into force.

Free movement of capital

Since the Commission's Opinion work has been progressing on issues connected with the identification of residual restrictions and their liberalisation. Abolition of restrictions on issuing mining licences to aliens and foreign legal persons took place in March 1998. However, restrictions to investments in real estate by non-residents still remain. It can only be acquired by non-residents under licences of the county governor. In special areas such as islands and border areas, acquisition of land is not permitted for non-residents. These restrictions should be eliminated progressively over the coming years.

Free movement of services

Steps have been taken to work out proposals for the establishment of a single supervision authority for banking, securities markets and insurance.

In the banking field, new laws have entered into force concerning consolidated supervision, and capital adequacy for market risks. A new law on Deposit guarantee schemes was adopted in April 1998. There is an urgent need for the Parliament to adopt legislation on the

prevention of money laundering. Efforts to implement the real time gross settlements system should be continued.

As regards securities, amendments to the Securities Market Act have been adopted with the aim to give the Securities Inspectorate more adequate supervisory powers. Also a new system of qualification exams for securities market specialists and professional fund managers was implemented in November 1997.

In the area of insurance, and following the provisions of the Insurance Law, an implementing decree was adopted in January 1998, aligning the legal framework with Community provisions on annual accounts and consolidated accounts of insurance undertakings. The former state monopoly continues to have its market share reduced. There is still a substantial market share in Life assurance but a rather modest share in Non-Life insurance (less than 20%).

Free movement of persons

a) Free movement of persons, freedom of establishment and mutual recognition of diplomas and qualifications

Access to the labour market is currently restricted by a quota based on the number of immigrants. This quota does not apply to the nationals of the Member States of the European Union, the United States, Norway, Iceland, and Switzerland. Negotiations on free movement of workers have begun with Latvia and Lithuania.

b) Abolition of Checks on Persons at Internal Frontiers

Estonia has taken steps to bring its visa policy closer to that of the EU (see 3.7 under Justice and Home Affairs)

The participants in the Baltic consular service consultations in January 1998 agreed on the need to introduce a joint information system based on the model of the Schengen information system. This will increase the effectiveness of cooperation in migration control and the issuing of entry documents (visas and resident permits).

Competition

A new Competition Act entered into force in October 1998. The law is broadly in line with Community competition law, although it does not provide for full merger control.

There is no separate law regulating the granting of state aid. The most important development is the inclusion of State aid provisions in the new *Competition Act*, which lays down the conditions and procedures for granting State aid. An *Annual Report on State Aid* granted in Estonia in 1996 was submitted to the Commission in July 1998. The report broadly follows the methodology and the presentation of the Commission's survey on State aid in the Union. Rules on the granting, notification and recovery need to be implemented rapidly.

Conclusion

Estonia has made partial progress in addressing the short term priorities of the Accession Partnership in the areas of industrial property rights and financial services. Further progress is needed in areas such as the New Approach, company law, public procurement and data protection.

Estonia is on track to meet the internal market acquis in the medium term assuming current efforts are continued and greater attention is dedicated to ensuring an effective implementation and enforcement of the legislation. Even though Estonia has taken positive steps to improve the necessary infrastructure (e.g. supervisory structures in the financial services sectors) major efforts still have to be made in this respect in a number of areas (in particular with regard to the enforcement of the protection of copyright and data protection). State aid control needs to be further developed. Efforts should be continued to create full transparency in the granting of State aids in order to establish a comprehensive and updated State aid inventory. Also the legal framework for the granting of State aid needs further alignment to Community law. Finally, the necessary powers and procedures must be adopted for the State Aid Monitoring Authority to control existing and future aid measures on a systematic basis.

3.2 Innovation

Information society

Estonia participates in the joint High-Level Committee on Information Society and actively supports the development of the information society.

The Estonian school computerisation program Tiger Leap has been launched aiming at achieving a full-computerisation/Internet access goal, with parallel implementation of the computerisation of schools administration. Estonia enjoys high rates of computerisation and internet access.

Education, Training and Youth

Although steps have been taken in the area of mutual recognition of diplomas, there is a need for legislation to regulate access to professions in line with the acquis.

Estonia is reforming its vocational training system. To this aim, the level of information about vocational training and the employment prospects of those who have completed courses is being improved. This is helping to boost the attractiveness of such courses to students.

From November 1998 Estonia will participate in the Socrates, Leonardo da Vinci and Youth for Europe programmes.

Research and Technological Development

Estonia has officially asked to start the negotiations for the full association with the 5th Framework Programme in June 1997. Three rounds of exploratory talks aiming at preparing the negotiations have already taken place.

The importance of improving the Research and Technological Development infrastructure is reflected in the National Programme for the Adoption of the *Acquis*.

A Law on Co-ordination of the Research and Development Activities has been adopted and the Principles and Framework Program of Estonian Information Policy have been approved. Also, in June 1998, the Government adopted the Estonian National Innovation Programme that foresees that the amount of investment in R&D will increase to 1,2 % of GDP by year 2000.

Telecommunications

Estonia's legislation on telecommunications and postal services is not yet fully in conformity with Community legislation. Nevertheless progress has been made and the Estonian market for telecommunications services and terminal equipment is now open to competition, except for voice telephony. A new regulatory body, the Estonian National Communications Board, became operational in 1998.

Estonia became a member of the National Standardisation Organisation and joined the European Telecommunications Standardisation Institute in March 1998.

The postal sector operates under free market conditions, there being no legal monopoly. The state enterprise Eesti Post has been reorganised into a joint stock company and acts on basis of new statutes since November 1997.

Estonia has made some progress towards conformity with Community law although the crucial legislation needed has not yet been enacted. The Opinion's statement is therefore still valid.

Audio-visual

No progress has been made in Estonia with respect to the adoption of the audio-visual *acquis*. Estonia's legislation on television broadcasting is not yet in conformity with Community legislation, and there is a need to amend and align it with the *acquis*

Conclusion

Information society as well as research and technological development are a priority in Estonia. Progress should be made towards conformity with the *acquis* in the fields of education, training, youth and telecommunications. No progress has been made in the audio-visual sector.

3.3. Economic and Fiscal Affairs

Economic and Monetary Union

Estonia has made some additional progress in its preparation for joining the Economic and Monetary Union.

The currency board arrangement, in which the Kroon is pegged to the German mark, has functioned well despite serious strains on financial markets. The authorities have used well the limited number of monetary policy instruments to restrict credit growth and cool down the economy.

The Bank of Estonia continues to enjoy a high degree of independence.

Taxation

Since 1997 Estonia has continued to align its VAT legislation in order to bring it further in line with Community requirements. In June 1997, amendments to the VAT legislation, introduced a refund scheme for foreign taxable persons not established within Estonia. Although progress has been made, substantial efforts are still required in the field of VAT, in particular as regards provisions for foreign traders to be registered for VAT without having to establish a branch in Estonia.

In the field of excise duties, the Act on Tobacco Excise Tax has been amended and a new tax rate has been introduced from 1 January 1998. Full harmonisation with Community's minimum tax rates will be attained by raising the tax rates by stages. Nevertheless, considerable differences from Community requirements remain, in particular, Estonia has yet to apply the Community's "mixed" system to cigarette taxation. As regards certain mineral oils full harmonisation of tax rates will also be done by stages as foreseen in the Law on Motor Fuel Excise Tax adopted at the end of 1997. In the field of alcohol taxation, Estonia has introduced in July 1997 a lower rate for small national brewers. Community permits such lower rates only if they apply equally to comparable imported beer and if certain other conditions are met. Estonia to introduce a warehousing system as required by Community legislation concerning excise duties.

Conclusion

Estonia has made progress in aligning its VAT legislation to the *acquis* in order to meet the short-term priorities identified in the Accession Partnership. However, substantial efforts are still required in to prepare for the Community's transitional VAT regime and to align the excise legislation. Also, improvements in administrative capacity should be made as well as arrangements for administrative co-operation and mutual assistance.

Statistics

An Official Statistics Act was adopted in June 1997 and establishes the legal bases for the conduct of systematic statistical surveys. This law has brought major progress in aligning Estonian legislation with EU rules, practices and classifications. A preliminary harmonisation plan for the adoption of the statistical *acquis* was compiled in October 1997. According to the

same law, the Statistical Office has the status of a government agency depending from the Ministry of Finance. Together with the Bank of Estonia it is the only official producer of statistics.

In order to implement the changes needed to introduce the Community legislation, an administrative reorganisation of the Statistical Office has been undertaken. Most required administrative structures are already in place. However, cooperation and coordination between the Estonian Statistical Office and other institutions, in particular the various registers, the Ministry of Finance and the National bank need further improvement. These and other changes will depend on the availability of sufficient financial and human resources within the Statistical Office budget.

The Statistical Office is fully committed to the adoption and implementation of the statistical *acquis communautaire*, including the non-binding acts. Major progress has been made in aligning Estonia legislation with EU rules, practices and classifications. However, further efforts are needed in the field of business registers, debt and financial indicators and agricultural statistics. Also, improvements in the administrative organisation are needed, as well as in the allocation of resources in this area.

3.4 Sectoral Policies

Industry

A horizontal industrial competitiveness policy has been gradually developed in Estonia. The framework conditions for industry are implemented through other governmental policies such as the 'development of the technological innovation system', 'the quality policy of Estonia' and 'the strategy for export development'. The only sectoral intervention of the state concerns support for investors in the pulp and paper industry in the form of a long-term guarantee of wood supply and infrastructure development.

So far, the Estonian industrial policy has not been defined explicitly in a specific governmental document. This is mainly because the Ministry of Economic Affairs, which is the co-ordinating body for industrial matters, considers that industrial policy is an integral part of general economic policy, the principles of which are outlined in the 'Medium term economic policy priorities for the years 1998-2002'.

It appears that the horizontal approach and the instruments used by the Estonian authorities to strengthen the competitiveness of industry are broadly in line with those recommended by the EU.

The positive results and trends of Estonian industry and economy in general would suggest that the government's strategy to create a market-based business environment is proving successful. In particular, since last year, there have been very significant increases in industrial output, exports of industrial products, labour productivity as well as in the number of new companies in the manufacturing sector (for further details see Chapter 2. Economic criteria). Restructuring of the food processing industry remains however a key issue in the restructuring of the agricultural sector. The main challenge lying ahead Estonia in the industrial sector is the enlargement of the export base. This would be achieved by improving

both the value added and quality standards of production at competitive costs. To that end new skills need to be developed, which requires adequate allocation of financial and human resources for education and quality policies. The lack of emphasis from the government in 1997 towards the implementation of EU compatible quality system prevents economic operators in Estonia from gaining experience in taking full responsibility for the conformity of their products, thus preventing them from acquiring important skills which they will need in order to compete on the internal market, both before and after accession.

Conclusion

The competitiveness policy, in line with the EU one, is having positive results. Efforts should however be made to implement EU compatible quality systems.

Agriculture

Agricultural situation

Gross agricultural output decreased by a further 2 % in 1997, following the 3.6 % fall in 1996. This was the eighth consecutive year of declining agricultural production. However, in some sectors (milk, poultry meat), production has increased, showing the first signs of recovery since the beginning of the transition period. In 1997, agriculture's share of GDP was further reduced to 5,5 %. The agricultural and food trade deficit increased by 70 % in 1997. All agricultural sectors, excluding dairy products, had a negative trade balance. As an illustration, almost 40 % of domestic demand for meat has been met by imports.

The pace of land privatisation has increased in 1997-1998. Nevertheless, by 30 June 1998, only one-third of the total land was registered in the land cadastre, and almost 75 % of agricultural land was remaining under state control, most of it being leased to farmers on the basis of short term contracts. The delays in land titling have seriously constrained the development of a proper land market, hampering the necessary structural adjustments. Despite these difficulties, the number of family farms has continued to increase, from about 19 700 in 1996 to 22 700 in 1997. The new provisions of the Land Reform Act should in principle facilitate the effective privatisation of the non-claimed state-owned land.

Agricultural Policy

Some of core laws harmonising the internal market regulations (veterinary and phytosanitary sectors) already entered into force, but some others still need to be adopted.

The agricultural budget allocation has been rising constantly during the four previous years, and reaches 34.8 MECUs in 1998, or 3,7 % of the total budget expenditure. In the absence of any border tariff, no market price support similar to the CAP can be applied. In 1998 Estonia has introduced for the first time direct payments' schemes for dairy and cereal producers, with a significant 12 MECUs budget allocation. Conditions for eligibility include a field register, precise data on the crops and milk production.

Another support mechanism that started to function in 1998 is the investment subsidy for agricultural producers. The Agriculture and Rural Life Credit Fund started to grant capital support (up to 25 % of the total investment) to investments related to agricultural or rural entrepreneurship. 1.25 MECUs have been specified for investment subsidies in 1997 and 3.25 MECUs in 1998. The Rural Credit Guarantee Fund launched in 1997 aims to give additional guarantees to rural enterprises when they are borrowing more than their own collateral assets.

Up to now, Estonia has not introduced any laws on rural development.

The agro-food sector represents 4.1% of the GDP. Since 1996, the whole sector has been privatised. In the last year, the concentration trend and the subsequent restructuring of the sector has considerably increased national and foreign investment, paving the way for the modernisation and adaptation needed to improve the competitive capacity and to meet Community quality and sanitary standards.

Conclusion

Steps towards meeting the short-term priorities of the Accession Partnership have been taken. Estonia has started preparations to introduce the structures and instruments to apply the Common Agricultural Policy upon Accession. These efforts need to be strengthened, particularly to build the adequate administrative capacity. However, the pace of agricultural land privatisation remains slow, thus hindering the chances of a more efficient production reorganisation. Substantial progress in adopting the legislation mentioned in the White Paper should allow Estonia to sustain its efforts to implement and enforce the Community veterinary and phytosanitary requirements and to upgrade the establishments to meet the Community standards.

Fisheries

No specific legislation has been adopted in the area of fisheries.

Restructuring of the Fisheries Department of the Ministry of Environment is underway with the view to setting up a structure of implementing the Common Fisheries Policy. There is a need for additional staff and for specialised training.

Energy

The Long Term National Development Plan for the fuel and energy sector has been adopted. This plan comprehensively sets targets which have implications for all energy sectors. It will be revised every second year and gives specific forecasts until 2005 and general guidelines up to the year 2018.

The Energy Act entered into force on 1 January 1998. It covers fuel trading, fuel networks and power and heat networks and deals with issues such as liberalisation of energy markets (third party access, price transparency, etc...) and transit of power and gas. Its underlying

market principles are modelled on the EU Electricity Directive. More progress on adapting to all internal energy market rules is however necessary.

The Act provides for a regulator in the sector, the Energy Market Inspectorate, which was established in January 1998. In addition to the independence of the regulator, attention needs to be paid to the relationship between the Energy Market Inspectorate and the Estonian Competition Commission. The Inspectorate could prove to be a useful precursor of a regulator in the future enlarged Internal energy market.

As regards energy prices, they still do not cover the production costs despite the increases already made.

Estonia's oil shale sector, providing 99% of locally generated primary electricity supply, has been highlighted by Estonia's policy makers as a major challenge for regional (the Narva region) and sectorial restructuring. Privatisation of the two major oil shale power plants has begun.

With regard to privatisation, reference may also be made to the Government plan of December 1997 for restructuring and privatisation of Eesti Energia (national electricity company) and to the partial privatisation of Eesti Gaas (shareholders include Ruhrgas and Gazprom). The State has decided to sell its remaining 27% shareholding to strategic investors in 1998. The Commission has reiterated the need for transparent privatisation procedures in these areas.

Estonia continues to give priority to regional energy cooperation in the Baltic Sea/ Nordic area. In the gas sector, studies on interconnection with the Nordic Gas Grid and with the EU continued.

Emergency preparedness in the energy sector including the obligation to hold ninety days of oil stocks does not yet comply with acquis. Energy efficiency and emissions, including approximation with acquis, continue to need attention. Participation in the relevant EU energy programmes will play an important role for improving energy efficiency and also to promote renewable energy.

A full scope safeguards agreement between Estonia and the IAEA came into force in November 97.

Conclusion

Estonia has made some progress in the adaptation to the internal energy market rules, although further efforts are needed in the adjustment of monopolies, access to networks, energy pricing; state interventions as well as the restructuring of the oil shale sector, emergency preparedness including the building up of mandatory oil stocks; energy efficiency and environmental norms.

Transport

In the past year Estonia strengthened its efforts to establish a regulatory framework for transport in accordance with EC legislation.

Concerning road transport, all the necessary legislation as regards weights and dimensions, access to the profession and roadworthiness tests for motor vehicles has been adopted by the Government and has entered into force.

Estonian railway restructuring has made progress in compliance with the EC *acquis*. The Railways Act has been amended, to ensure financial transparency in this sector. The State enterprise Estonian Railway has been reformed into a joint-stock company.

In the field of maritime transport, the Port and Maritime Safety Acts and the Ship's Property, Ship's Flag and Ships Register Acts entered into force in 1998. The Port Act regulates the obligations of the owner in following safety requirements and state surveillance in port. The Maritime Safety Act regulates the obligations of the owner of port in following safety requirements and procedures pertaining to state supervision in ports. The law applies to ships flying Estonian flag as well as to foreign ships in Estonian territorial waters and inland waterways. Their aim is to transpose most of the EC maritime safety *acquis*. The Ship's Flag and Ship Registers Act regulates the rules for entering ships into register and the activities concerning flag documents. Safety of ships remains a concern.

Concerning air transport, several government regulations meeting EU requirements on rules for investigation of civil aviation accidents and incidents and establishing common rules for a denied-boarding compensation system in scheduled air transport have been adopted. The draft of a new Aviation Act, which covers a substantial part of the *acquis*, was completed in the first quarter of 1998.

As far as transport infrastructure development is concerned, Estonia is cooperating closely within the Transport International Needs Assessment (TINA) to link with the Trans-European Networks. The national priority is to improve east and southeast west links, in particular by rail.

Conclusion

Important progress has been achieved so far in implementing the transport *acquis* in the different transport areas. Consideration should be given to the adoption of a specific transport infrastructure and financing strategy to be supported by the national budget. Further progress needs to be done to increase safety standards in ships.

Small and Medium Size Enterprises

The development of SMEs is one of the priorities of economic policy in Estonia. The Estonian Government Policy aims at encouraging an environment favourable for SMEs development and improving their competitiveness with a view to their internationalisation. The SMEs contribution to the total employment increased to 60% in 1997 from 55% in 1996. SME sector accounts for almost 98 % of total number of enterprises.

Estonia has been invited to participate in the Third Multiannual EU Programme for SMEs from the end of 1998.

3.5 Economic and social cohesion

Employment and social affairs

The unemployment rate represented 3.3% of the labour force in August 1998 and 10.5% of the active population (ILO methodology). Regional disparities are very important.

State employment offices have been active in the field of labour market policy and unemployment issues. Training of unemployed persons has so far given positive results: in 1997 13,575 persons seeking vacancies attended labour market training and 70% of them were engaged in work after graduating the training. Nevertheless, Estonia is lacking a clearly defined policy and strategy in the field of labour market and human resources development. A guarantee fund was set up in 1998 to support workers employed in companies in bankruptcy proceedings.

As regards the social dialogue, tripartite dialogue has developed further and involves such issues as the social insurance reform, e.g. pension insurance and health insurance. Following the agreement between social partners reached in 1997, the Social and Economic Council is being set up.

In the field of health and safety at the workplace, the National Policy on Working Environment has been approved by the Estonian Government. The policy intends to focus on strengthening the supervision and the role of the Labour Inspectorate. .

There are considerable differences in pay between women and men. Steps to strengthen equal opportunities within the public administration have been taken.

Conclusion

Progress has been made in the fields of labour law and social protection reform. However, further efforts are needed in transposing and implementing the employment and social affairs acquis. In particular, Estonia needs to define a strategy in the field of labour market and human resources development. Further efforts need to be made to implement legislation in the area of equal opportunities. Estonia needs to pay particular attention to the establishment of the adequate administrative capacity to enforce legislation in the social area, in particular regarding health protection and health and safety in the work place.

Regional Policy and cohesion

Estonia has launched a number of regional development programmes targeting specific regions or socio-economic problems. To provide coherence for those regional development actions, a strategy for regional policy is currently under preparation. This strategy will determine the main guidelines and priorities for Estonia's regional policy. On this basis, Estonian authorities will design the national development programme. Estonia has also initiated a reform of its territorial organisation. Current efforts in the area of Public Administration reform aim at clarifying the tasks of the different levels of administration.

The Estonian Regional Development Agency was created in May 1997 to co-ordinate and provide technical support to these programmes. It also co-ordinates the activities of the 17

Business Support Networks, which advise local business, and is responsible for financial monitoring. The first evaluation report of regional policy activities was finished in March 1998.

Further progress is still necessary in all these areas. The degree of co-ordination of sectoral measures is weak and there are no clear selection criteria for the existing programmes. The financial resources available for regional policy remain limited although the scope of instruments has been broadened. Monitoring and control procedures also need to be strengthened but Estonian authorities have started to address the issues.

Conclusion

Estonia has addressed some of the short-term priorities identified in the Accession Partnership, but concrete progress is still limited. Estonia has made some progress in adopting legislation strengthening institutions, and making budgetary provisions. While Estonia has made general progress efforts need to be speeded-up if it is to be ready to participate in EU structural policy at the date of its accession.

3.6 Quality of life and environment

Environment

Since 1997, Estonia has adopted an important number of legal acts, with a view to aligning its legislation with the *acquis* in the field of environment, including the environmental impact assessment directives, the waste framework directive, the hazardous waste directive, the packaging and packaging waste directives, the emission from motor-vehicles directives, the nitrate directive and the drinking water directive.

As recommended in the Accession Partnership, Estonia is currently developing several directive-specific implementation strategies concerning all sectors. In co-operation with the two other Baltic States, Estonia is developing implementation programmes for the Genetically Modified Organisms, Good Laboratory Practice and the noise Directive.

Regarding enforcement Estonia should further concentrate its efforts on the licensing and monitoring systems, human resource developments and improvement of equipment in the Environmental Inspectorate and the regional environmental departments.

Estonia has made good progress generally in approximation of legislation. However, a lot of work still needs to be done in the noise, industrial pollution, genetically modified organisms, chemicals and water quality sectors.

Conclusion

Estonia has made steps towards meeting the relevant short-term priorities of the Accession Partnership, in particular as regards legal transposition in waste management and nature protection sectors. Estonia should further develop directive-specific implementation strategies especially for the framework legislation, and for the implementation of costly and administratively difficult Community legal acts. Attention needs to be paid to future financing strategies. Efforts to increase the levels of private and public investment in the environmental

field to meet Community standards will need to be continued. Close cooperation should be developed with the International Financial Institutions in this regard.

Consumer protection

The existing legislation on general product safety and misleading advertising is broadly in conformity with Community legislation. However, amendments need to be made in the latter in order to include comparative advertising. Harmonisation with non-safety related directives such as distance selling, unfair contractual terms, , consumer credit, door-step selling, time - share and package travel are under preparation.

Approximation of legislation is proceeding satisfactorily. The Consumer Protection Board will need to be further reinforced to cope with implementation concerning Unfair Contract terms. The consumer movement is relatively weak and needs to be supported.

3.7 Justice and Home Affairs

In its July 1997 Opinion, the Commission called on Estonia to fill a number of substantial gaps in its legislation, to improve its handling of issues involving refugees and asylum-seekers and to crack down more efficiently on organised crime and money laundering.

Immigration/Border control

Concerning visa policy, new visa rules (which are compatible with the EU *acquis*) have been adopted. Some types of visa (such as exit and resettlement visas) have been abolished, and new types (such as tourist and business visas) have been introduced. Furthermore, the rules governing the extension of visas and the maximum length of stay in Estonia have been clarified. A new visa sticker which is suitable for optical readers and is in line with EU standards has been introduced.

Estonia has an agreement with Russia that allows persons living in the Narva–Ivangograd area to enter Estonia with a special permit instead of a visa. This practice is not in line with EU rules. Estonia has concluded readmission agreements with a number of countries, the latest being with Switzerland (January 1998).

Amendments to the *Aliens Act* have been introduced to grant permanent resident permits to non-citizens under certain conditions (see political criteria). The settlement of aliens in Estonia is limited by the annual immigration quota (since October 1997, 0,05% of the permanent Estonian population). Other amendments introduced in 1998 to the *Aliens Act* regulate the issuing of residence permits outside this quota to nationals of the United States, the European Union, Norway, Iceland and Switzerland, and to nationals of other countries who are spouses, under-age children or parents of Estonian citizens.

With regard to border controls, substantial progress has been made in negotiating a border agreement with Russia. Most of the technical issues have been resolved, and Estonia has signalled its readiness to sign the agreement when Russia is ready. Border and customs check procedures were finalised in March 1998. The legislation on border controls gives sufficient

authority to the Border Guard and other organisations responsible for checks to enable them to operate properly. Coordination between departments is good. In July 1998, an electronic surveillance system was put in place, and most of the eastern border is now covered by radar and special sensors.

Asylum

The *Refugees Act* entered into force on 9 July 1998; it introduces the right of asylum in Estonia and contains rules on asylum-seekers, the reception of refugees, and the determination of refugee status. However, no regulations to apply this Act have yet been adopted. So far, only 25 asylum applications have been submitted, and no decisions have yet been made regarding them.

Police cooperation

In connection with the fight against organised crime, an overall programme of prevention and control (National Crime Prevention Programme) has been put in place and a police drugs unit has been set up, with members posted to each prefecture. As a follow-up to these measures, sustained effort is still needed to tackle rising economic crime, money laundering and drug trafficking. Methods and technical aids for use in fighting organised crime need to be developed and staff numbers boosted (the prefectures still have no specialist staff to handle organised crime other than drug-related crime, and even in the latter case, training is still needed).

Since the adoption of the Opinion, Estonia has acquired a large body of legislation in the fields of police and security. The Security Arrangement Act establishes the legal basis for safeguarding state security and to that end defines the responsibilities and status of the relevant institutions. The new police law will guarantee stability of the police forces. The law determines qualifications, grade and salaries for police officials.

The police service is undergoing a process of reform. The criminal police is being reorganised into criminal investigation departments (with the aim of avoiding overlapping of investigative functions). The staff numbers of the Internal Control Department of the Police have been increased to improve detection and handling of breaches of the law by police officials.

Estonia has formally concluded police cooperation agreements with around fifteen countries. There is also bilateral cooperation with other countries, including Russia.

Drugs

The *Narcotic Drugs and Psychotropic Substances Act*, adopted in July 1997, has entered into force, as have an act ratifying the Council of Europe Anti-Doping Convention and a decree on precursors and essential chemicals. In addition, Estonia adopted (in November 1997) guidelines for its policy on drugs, covering the period 1997 to 2007.

Estonia still has to rapidly ratify the 1988 UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances and adopt the draft bill on preventing money laundering, which is a vital weapon in the battle against drug crime. The planned deadline for entry into force (2000) is too far off.

With the prospect of Estonia being involved in the European Monitoring Centre for Drugs and Drug Addiction (EMCDDA) in Lisbon, the national contact point with the national drugs information system needs to be strengthened.

Judicial cooperation

Estonia is cooperating closely with a number of Member States to continue improving the operation of its judicial structure and to adopt the EU *acquis*.

Conclusion

Estonia has made significant efforts in connection with immigration, border controls and asylum, though it still lacks implementing measures. Organisation of the police has also been the focus of considerable work.

In the light of the short-term priorities of the Accession Partnership, Estonia needs to go beyond what it has already done and devote more resources to combating organised crime and drugs issues, and rapidly adopt the appropriate national and international legal instruments in that connection (1988 UN Convention, money laundering bill, etc.) It will also need to push ahead with combating corruption (another short-term priority of the Accession Partnership), a concern it has already addressed by reinforcing the police's Internal Control Department.

Among the tasks connected with the medium-term priorities are the continued installation of equipment on Estonia's eastern border and appropriate staff training (in quantity and quality terms).

3.8 External Policies

Trade and International Economic Relations

Estonia has a very liberal trade regime, with very few import duties or quantitative restrictions being applied. Exports duties are applied on objects of cultural value (100%). Since the adoption of the Opinion, Estonia has concluded free trade agreements with several EFTA Countries, Faroe Islands (not ratified yet), Czech Republic, Slovenia, Slovakia and Turkey. Furthermore, negotiations to establish free trade agreements have concluded (not signed yet) with Poland and Hungary.

Estonia has entered the final stages of its WTO accession negotiations. It is expected that the Accession Protocol will be finalised during 1999. In view of Estonia's future membership of the EU, Estonia's close alignment with EC Common Commercial Policy in the context of WTO accession negotiations is a positive development.

Cooperation among the Baltic States in implementing gradual liberalisation and regional integration policies is developing and a Baltic Common Economic Area is being introduced. An agreement on the abolition of non-tariff barriers to trade has recently been concluded and negotiations are proceeding on liberalisation of services market.

Development

Estonia has plans to allocate a sum of the state budget for humanitarian aid and development assistance to third countries. However, no specific measures have been taken in this area.

Customs

A new amended Custom Act entered into force in January 1998. Although an improvement in comparison with the former Act, it is still not in compliance with the Community Customs Code requirements. Main changes include a new classification of goods more in line with the EC nomenclature; provisions on rules of origin; a new procedure for «processing under customs control», an improvement of the guarantee system and a more precise customs-debt evaluation procedure. The new Act prohibits trade in counterfeit and pirated goods.

Since November 1997, the Customs Tariff Act has provided a legal basis for custom tariffs. However, no tariffs except for furs, motorcycles, cycles and recreational boats, are being applied. The application of customs duties is a precondition to the effective adoption of the Community acquis in the customs area. Priority must also be given to training and other preparatory measures which enable customs staff and administration to implement and enforce Community compatible legislation

Preparation of a Customs Code, compatible with the acquis began in January 1998. In addition, the legal procedures for issuing of certificates of origin of goods entered into force in May 1998, and the process of harmonisation of the Estonian Goods Nomenclature with the Community CN continues.

The Customs Strategic Plan (1998-2002) is currently being prepared. The strategy covers five main areas: human resources, infrastructure, customs technology, legislation and international co-operation. Other positive developments include the construction of new, modern customs facilities at the Russian and Latvian borders.

In the field of international co-operation, joint customs controls have been introduced on the border between Latvia and Estonia. An Agreement on Common Baltic Transit Procedures has been signed between Estonia, Latvia and Lithuania. A common customs computer system has been chosen by the three Baltic States and bilateral mutual administrative assistance agreements have been signed with Sweden, Denmark, Finland, Turkey and the Netherlands. Applications for joining the EC/EFTA joint transit convention and the convention on simplification of trade formalities have been submitted. There are no obstacles for joining the latter convention as the single administrative document (SAD) is already in use in Estonia.

Conclusion

Whereas Estonia has made some progress in the customs field, there have been important delays, regarding preparations for the introductions of customs duties. The absence of short-term plans to remedy this situation is of concern. Estonia needs to introduce in the short-term a strategy to apply customs duties, in order to conform to the community acquis in customs.

Common Foreign and Security Policy

Estonia has continued to participate actively in the multilateral political dialogue within the framework of the Common Foreign and Security Policy (CFSP) since July 1997. It

participates in the regular meetings of political directors, European and European associate correspondents and in CFSP working groups.

It has regularly aligned its positions with those of the Union and, whenever invited, it has adhered to the Union's statements, declarations and démarches, including those in the context of the UN and OSCE..

Estonia continues to orient its foreign and security policy towards the EU and NATO and strives to contribute to regional stability through active cooperation in the Baltic Sea Region. In relation to NATO, Estonia is now focused on the practical preparations to fulfil the requirements of NATO membership. Estonia constructively participates in the WEU as an associated partner.

Estonia has overall good relations with neighbouring countries. The further development of good relations with Russia remains a key element of Estonia's foreign policy. Important progress has been made in the negotiations of a border agreement with Russia. All technical issues are solved and the Estonian government has shown its readiness to sign the agreement as soon as Russia is ready to do so.

Estonia supports the EU policy regarding anti-personal land mines, although it has not yet signed the Ottawa Convention since the state defence policy needs to be adapted to the requirement of this convention.

3.9 Financial Questions

Financial Control

With regard to external control, the State Audit Office, which is under restructuring, will in the future only focus on external ex-post controls. It needs to be strengthened and training needs to be provided for its staff.

Preparations for establishing an internal control system for governmental institutions have started. In July 1998, the Government decided to create a central and independent internal control structure, within the Ministry of Finance. A law should, however, specify the role and operation of the new structure. Amendments to the State Budget Act are required as well. Training needs should also be provided.

An Administrative Cooperation Arrangement with the Commission is expected to provide for co-operation measures on internal control and to support for accession preparations.

Conclusion

Efforts are still needed to establish the necessary management and control mechanisms in particular in view of the pre-accession aid and, the future participation in the structural funds.

3.10 General Evaluation

Estonia has made general progress in the approximation process, although increased attention needs to be paid to the enforcement of internal market legislation (in particular intellectual property, standards and certification and state aids) and to the preparation of a strategy to introduce customs duties and the corresponding administration. Estonia has taken important steps to put legislation in place in the justice and home affairs area and is taking steps to ensure its effective implementation.

Estonia has addressed aspects of all the short term Accession Partnership priorities, although efforts related to the internal market, in particular establishing a credible system of state aid control, need to be enhanced.

4. Administrative Capacity to apply the *acquis*

This chapter updates the information given in the Opinion. The European Council in Madrid in December 1995 referred to the need to create the conditions for the gradual, harmonious integration of the candidates, particularly through the adjustment of their administrative structures. Taking up this theme Agenda 2000 underlined the importance of incorporating Community legislation into national legislation effectively, but the even greater importance of implementing it properly in the field, via the appropriate administrative and judicial structures. This is an essential pre-condition for creating the mutual trust indispensable for future membership.

In this year's report the Commission has worked with the candidate countries to identify an illustrative list of enforcement bodies in key areas of the *acquis*. Wherever possible information is provided on whether these bodies have sufficient legal powers to implement the *acquis*, on staffing levels and on staff qualifications and on budget availability. In some cases it is already possible to give information on the quality of decisions being taken. The Commission intends to further develop this aspect in future reports.

Strengthening of the administrative structure will be indispensable if Estonia is to have the structures to apply and enforce the *acquis* effectively.

4.1. Administrative structures

There are around 18,800 employees in the Estonian administration², including ministries (10%), government agencies (83%) and county governments (8%). In addition, local governments employ around 3,300 persons. The Estonian administration lacks highly qualified staff at the medium and technical levels of the civil service. This is mainly due to strong competition from the private sector which is able to offer higher salaries to recruit young, motivated professionals.

In July 1998, the Government set out the spheres of responsibility among ministries for the co-ordination of public administration development. At the government level, public administration reform issues are co-ordinated by the Ministerial Commission on Public Administration Reform and the state agencies are involved with various aspects of public administration reform in their everyday work. Since July 1998, the State Chancellery has been given new responsibilities in the area of administrative reform.

The approximation of laws is done by ministries. The timetable for legal approximation has been outlined in the National Programme for the Adoption of the Acquis. Adherence to the timetable is overseen by the Office of European Integration (OEI). Compliance of the national legislation with the *acquis communautaire* is monitored by the Ministry of Justice. In order to facilitate the process all draft bills are complemented by a memorandum explaining compliance with the Community law.

The priority target groups, the contents and methods of training of civil servants on EU matters have also been established. Basic training will be carried out centrally. Sector specific training will be organised by the training units in each ministry. The OEI serves as a link between the ministries and provides assistance in the identification of the training needs. A special allocation of has been made for training of officials on EU matters.

Staff has also been recruited to strengthen the public awareness on EU activities. The OEI has also participated in the process of creating a regional network of EU information centres. In summer 1998, with a view of increasing EU awareness among the general public, it was decided to transfer the public information task from the OEI to a new separate EU Information Secretariat at the State Chancellery.

4.2 Administrative and Judicial capacity: key areas for implementation of the *acquis*

Uniform application of EC law : Currently, the heavy caseload of the courts, relative to the number of judges (221), continues to pose problems for the efficiency of the judicial process. Furthermore, a high proportion of the existing judges (192) were trained under the old system. Since 1995 the training of judges and prosecutors has been carried out by the Estonian Law Centre. Also, 39 judges have participated in seminars abroad. Training of practising judges is complicated by the relative low number of judges in Estonia, making it difficult for them to take time off work to participate in courses.

Estonia has to made further efforts to extend training of judges in the area of Community law, by intensifying participation of judges in relevant courses. Training should be accompanied by an increase in the number of judges.

² Includes police, border guard and prisons staff. Does not include education and healthcare personnel

Single Market : The Public Procurement Office employs currently 24 persons. In the field of intellectual and industrial property, progress has been made to strengthening the administrative capacity by reinforcing staff and training. The Board of Appeals, under the Ministry of Economic Affairs is in charge of resolving complaints in this area. . There are several training programs provided for the employees (70) of Patent Office. Also efforts have been made to improve enforcement in the copyright supervision within the Ministry of Culture: a new post has been created to ensure the supervision related to protection of intellectual property.

The capacity of certification bodies, testing laboratories and market surveillance authorities need to be strengthened in order to effectively implement the New Approach directives. Progress in institution building and strengthening of administrative capacity in this area is slow. The increase the technical and financial participation of Estonian industry in standardisation activity needs to be increased to enable the Estonian Standards Board which is fully depending on state resources to become independent. The Estonian Standards Board employs currently 23 persons, of which 7 working in the Standards Department and 5 in the Metrology and Accreditation department. Accreditation is separated from certification and testing.

In the financial sector, a plan to unify the supervision of the financial sector has been adopted but not yet implemented. The Securities Inspectorate needs to increase efforts to train staff in several fields such as supervision techniques, security markets and investment strategies. The Insurance Supervisory Authority has a staff of 17 persons. The supervisory capacity and the independence of the Banking Supervision Department of the Bank of Estonia have been strengthened. The Banking Supervision Department has a staff of 21 persons. It is assisted by a Supervisory Committee. Training of specialists in the relevant inspectorates has to be reinforced.

Competition : In order to fulfil the obligations provided for by the new Competition Act, the Competition Board recruited 12 new officials in 1998 (currently 20 persons are employed). This Board is responsible for investigations and examination of anti-trust cases while civil courts have the competence to impose fines. At present, the number of notifications is very limited and most cases are taken up by the Board ex officio.

While progress has been made in reinforcing the staff and training of competition officials Estonia still lacks a proper monitoring system for State aid. Major problems exist for instance in collecting information on State aid granted by local authorities.

Telecommunications : Legislative amendments have been adopted in order to create a relevant regulatory structure that meets the EU standards in the field of telecommunications. A new regulatory body, the Estonian National Communications Board, became operational in 1998 with a staff of 55 persons. No problems are foreseen in the implementation of the administrative capacity in the field of telecommunications.

Indirect Taxation : The National Tax Board (1,030 employees) consists of 18 local tax offices. A fraud fighting unit has been set up. Within the Ministry of Finance, the Tax Policy Department is in charge of indirect taxes (VAT and excises). Administrative capacity related to the implementation of the EU acquis should be strengthened. Human resources should be reinforced, particularly in the anti-fraud area.

Agriculture : The nine departments of the Ministry of Agriculture (127 employees) have been restructured into five. Additional staff has been recruited in the central organisation of the Ministry, mainly on the basis of contracts that will have to be transformed as soon as possible into permanent staff positions. The new units formed in the administrative field of the Ministry of Agriculture since June 1997 are the Veterinary and Food Inspectorate and Laboratory. The number of local veterinary and food control laboratories was reduced from 12 to 7, three of which are accredited. The phytosanitary sector has also been reorganised into two new departments, the Plant Production Inspectorate and the Control Centre of Plant Production. General training has been provided for veterinary border inspectors and county veterinary and food inspectors.

In order to effectively control the management of the direct payment schemes, the Agricultural Registers and Information Centre was set up. Preparatory work has begun for the creation of the Intervention Agency.

These measures are first steps towards adapting the administrative capacity in the agricultural area to meet the requirements of Community legislation. However efforts need to be pursued with a view of reinforcing the existing structures.

Transport : The bodies responsible for implementing transport legislation are the Railways Administration, the National Maritime Board, including the Sea Safety Service, and the Civil Aviation Administration, including the Air Safety Service

Further efforts should concentrate on air and maritime safety. Whereas in air transport only a few problems exist regarding translation of technical provisions and language training, there are certain open questions on the institutional structure and content of implementing the maritime safety acquis. The problems to meet safety standards of Estonian flag vessels in port inspections indicates that the administration is not yet able to fulfil entirely its supervision and control tasks.

Employment and Social Policy : The National Social Insurance Board is responsible for developing social security programmes, co-ordinating the implementation of the social security policy, and collecting revenues and paying pensions. It has currently a staff of 36. The National Working Environment Board has been reorganised into the National Labour Inspectorate and Working Environment Department. The Working Environment department is responsible for the overall co-ordination and management of the activities in the field of occupational health and safety, and particularly drawing up legislation. Only 8 people work currently in this department. The National Labour Inspectorate is in charge of the enforcement of labour law and occupational health and safety legislation. Of the staff is of 142, 82 are labour inspectors.

At the end of 1997, the State Health Protection Board was reorganised into the Health Protection Department and the Health Protection Inspectorate. The Inspectorate has 251 employees and is in charge of enforcing health protection legislation.

A reinforcement of the administrative structures enforcing health and safety in the work place and health protection should be undertaken. The current number of employees in this areas is insufficient to undertake the additional responsibilities resulting from the transposition of EC legislation.

Regional Policy and Cohesion : The Estonian Regional Development Agency (16 employees) has been created (May 1997) to co-ordinate the activities carried out through the 17 Business Support Networks, which advice local business. The agency also provides technical support and coordinates the Regional Development Programs. It is also responsible for financial monitoring.

Environment : Fifteen additional jobs have been created in the Environmental Inspectorate for co-ordination and supervision of the use and protection of natural resources. Ten additional posts have been created in the Radiation Protection Centre and two in the Environmental Information Centre in 1998.

Environmental civil servants have received specific training on EU structures, administrative procedures and negotiation skills. Also, important progress has been achieved in training of forest management specialists.

Regarding enforcement Estonia should further concentrate its efforts on the licensing and monitoring system, human resources development and equipment provision in the Environmental Inspectorate and the regional environmental departments. Capacity at local levels should be strengthened.

Consumer protection : The Consumer Protection Board (CPB) is the national authority responsible for protecting consumers and enforcing Consumer Policy. The Consumer Protection Board is an independent institution with its own budget, under the jurisdiction of the Ministry of Economic Affairs. In 1997 the CPB had a staff of 49 persons which increased to 52 in 1998. The Consumer Protection Board will need to be further reinforced to cope with the implementation of some aspects of the EU acquis, such as legislation on Unfair Contract terms.

Justice and Home Affairs : An important reform of the Estonian Citizenship and Migration Board took place in July 1998. The current staff is 705 persons. Various departments have been established (e.g. refugees and illegal immigration, integration and immigration, visa, foreign relations and European integration and the legal departments)

The total strength of the Estonian Border Guard is (January 1998) 2,185. The deployment of personnel among regions is as follows: 47 % on the northern border, 30 % on the eastern border, 18 % on the southern border and 5 % at headquarters. There are currently 42 Border Guard Stations and 30 Border Check-Points open for international traffic. The target of the Border Guard is to build up a professional organisation of 3500 people.

In May 1998, there were 5,600 police posts of which only 4,863 were filled. One of the reasons for the shortage of police officers is the salary level (from 2,000 to 2,500 EEK), lower than the average salaries in Estonia. During the first quarter of 1998, 145 officers resigned from the police force, 100 of them for poor salaries. This could have a negative impact on the independence of police officers and increases the risks of corruption. Supplementary training has been provided not only by Estonia but as well by foreign bilateral and multilateral (the EU, the Council of Europe and the UN) assistance. In 1997, 428 police officials received supplementary training abroad.

The structure of Border Guard is adequate but staff has still to be reinforced. More attention should be paid to improving working conditions of police officers, to increase training and to introduce modern investigation techniques.

Customs : A reorganisation of the Customs Administration began in 1997, including the creation of an internal audit department. A Development Department now exists which is responsible for European integration matters. A Customs Council has been established to ensure co-ordination and the definition of priorities in the Customs strategy.

In 1997, the number of officials working in the National Customs Board was 1,538. Overall, there are 18 border checkpoints for international traffic. The National Customs Board estimated that a budget of 180,000 ECUs is needed for the enforcement of its institutional capacity.

Estonia has still to develop a strategy to reinforce its administrative capacity in order to be able to implement customs tariffs in the future.

Financial control : The State Audit Office is in the process of reorganisation. At present there is a staff of 81 people. In the future, the State Audit Office will deal only with external ex-post financial control. The process of restructuring should take one or two years. At present there is only a six persons unit in charge of internal controls which are limited to payments. The planned internal control body will have a staff of 35 people.

Considerable efforts are still needed to establish management and control mechanisms. Provisions for an upgrading of the Estonian control capacities so that the pre-accession aid and, in the future, structural funds can be satisfactorily implemented need to be made.

4.3 Twinning

In order to help candidate countries meet the challenge of strengthening their administrative capacity and adapting their administrations to implement the acquis the Commission and the Member States are developing a process of twinning under the Phare programme. In the EU the acquis is implemented in the Member States by national administrations (at central, regional and local level) and by agencies, professional bodies and the private sector. This vast body of administrative and technical expertise is now being made available to the candidate countries. Initially twinning will cover four sectors – agriculture, environment, finance and justice and home affairs but will gradually be extended to the whole of the acquis.

Estonia is participating actively in twinning.

4.4 General Evaluation

Although Estonia has taken some steps to reform public administration and the judiciary, due in particular to limited human resources, progress is slow and administrative shortcomings exist in key areas such as financial market supervision, state aid monitoring, maritime transport and employment and social policy. The current reorganisation of financial control institutions and the development of regional development structures need to be sustained and consolidated in order for Estonia to be in a position to effectively use EU funds.

There is a human resource problem in the judiciary: there are not enough judges and those in place are either young and inexperienced or have been trained under the previous regime. There is thus an important need for training and career development in the judiciary.

C. Conclusion

Estonia continues to fulfil the political Copenhagen criteria, although decisions are needed on the naturalisation of stateless children. In addition there is an important need for training and career development in the judiciary.

Estonia can be regarded as a functioning market economy, and should be able to cope with competitive pressure and market forces within the Union in the medium term, provided that prudent macroeconomic management continues to limit the risks associated with its large external imbalances.

Provided the problem of administrative capacity is resolved Estonia will be able to take on the obligations of membership in the medium term although a particular effort should be made in the internal market and justice and home affairs.

D. Accession Partnership and National Programme for the Adoption of the *Acquis* : Global Assessment of Implementation

The purpose of the Accession Partnership is to set out in a single framework the priority areas for further work identified in the Commission's Opinions, the financial means available to help the candidate countries implement these priorities and the conditions which will apply to that assistance. Each candidate country was invited to adopt a National Programme for the Adoption of the *Acquis* setting out how it would deal with the Accession Partnership, the timetable for implementing its priorities and outlining human and financial resource implications. Both the Accession Partnerships and the National Programmes for the Adoption of the *Acquis* will be revised regularly to take account of progress made and to allow for new priorities to be set.

1. Accession Partnership: Assessment of short-term priorities

The Accession Partnership³ sets out the following short term priorities for Estonia :

- **Political criteria** : take measures to facilitate the naturalisation process and to better integrate non-citizens including stateless children. Enhance Estonian language training for non-Estonian-speakers.

³ Council Regulation 622/98, OJ L85 of 20 March 1998

- **Economic reform** : establishment of medium-term economic policy priorities and joint assessment within the framework of the Europe agreement; in particular with a view to sustain the high growth rates of recent years, while reducing inflation and increasing the level of national savings; acceleration of land reform with a view to increase private ownership and introduction of key legislation linked to pension reform.
- **Reinforcement of institutional and administrative capacity** : in particular as regards regulatory and monitoring bodies and the development of a comprehensive national training strategy for civil servants and developing a strategy and timetable for the consolidation of the various supervisory agencies in the financial sector, strengthen internal financial control, reinforcement of phytosanitary and veterinary administrations, particularly as regards facilities at external borders, institutional strengthening in the area of environment, begin to set up structures needed for regional and structural policy.
- **Internal Market** : including further alignment in the areas of public procurement, intellectual and industrial property, financial services, taxation, technical legislation and competition (especially the transparency of state aids). Adoption of new competition law, covering both anti-trust and state aid, reinforcement of the state aid monitoring authority and the establishment of a first state aid inventory.
- **Justice and Home Affairs** : in particular further efforts to implement measures to combat corruption and organised crime and continue judicial reform.
- **Environment** : continue transposition of framework legislation, establishment of detailed approximation programmes and implementation strategies related to individual acts. Planning and commencement of implementation of these programmes and strategies.

Progress concerning the short term objectives of the Accession partnership can be summarised as follows:

- **Political criteria** : It is regrettable that the Parliament has not yet adopted the amendments to the Citizenship Law facilitating naturalisation of stateless children.
- **Economic reform** : Estonia has elaborated a medium-term economic strategy and a joint assessment with the Commission is under preparation. The privatisation process of SMEs is almost complete. Privatisation of the big utilities companies is still to be completed. Further efforts in enterprise restructuring will be needed during several years. The financial sector has been considerably strengthened by new government measures aimed at increasing supervision. Land reform and establishment of the agricultural census need further progress. Legislation related to pension reform has been completed.
- **Reinforcement of institutional and administrative capacity** : Estonia needs to make further efforts to increase the institutional and administrative capacity of its administration. Steps towards adopting a strategy of public administration reform need to be taken. Special efforts need to be made in the establishment and reinforcing of supervisory and enforcement bodies. A plan to consolidate supervisory agencies in the financial sector has already been adopted. A decision has been taken on the separation of internal and external financial control and preparations for regional and structural policy have started.

- **Internal Market** : Partial legislative and institutional steps have been taken in the public procurement, intellectual and industrial property rights, financial services, taxation, technical legislation and competition. Further efforts need to be done, including reinforcement of state aid control and the establishment of an state aid inventory has to be completed.
- **Justice and Home Affairs** : Estonia has made efforts in the fight against corruption and organised crime. Besides an important legislative package, steps to restructure and modernise the police service have been taken. However, further efforts need to be made to improve the efficiency of the police forces. Limited training and low salaries may also jeopardise achievements attained in this area. The same applies for the judiciary where training of judges and prosecutors has to be intensified, particularly in regard to Community law.
- **Environment** : Significant progress has been made in the approximation of the environment legislation, particularly in the field of waste management and nature protection sectors. Efforts are still needed in the noise, industrial pollution, GMOs and chemicals and water quality sectors. Estonia should also take steps to improve the licensing and monitoring system, human resources development and equipment in the Environmental Inspectorate and the regional environmental departments. Capacity at local levels needs to be strengthened.

With the exception of the political priority, Estonia has addressed aspects of all of the short term Accession Partnership priorities. However, efforts related to the administrative capacity and internal market (in particular by strengthening enforcement structures and establishing a credible system of state aid control) need to be enhanced.

2. National Programme for the Adoption of the *Acquis* Assessment

The Estonian National Programme for the Adoption of the *Acquis* was adopted in April 1998. Overall, it is a comprehensive structure and concise document, well that follows the structure of the Commission's Opinion on Estonia's Application for Membership.

Most of the short and medium term priorities of the Accession Partnership have been covered in the National Programme for the Adoption of the *Acquis*, reflecting the Estonian will to progress in the implementation of the *acquis*. There are however, some elements included in the Accession Partnership, for which the National Programme for the Adoption of the *Acquis* does not provide any or sufficiently detailed information such as fight against corruption, land reform, competition policy and particularly state-aids and measures and actions in the regional policy field.

The National Programme for the Adoption of the *Acquis* only partially covers the following parts of the *acquis*: competition rules in the energy and telecommunications field, audio-visual legislation, environment, mutual recognition of professional qualifications, provisions aiming at guaranteeing the principle of non-discrimination between students originating in the country and those from other EU Member States.

In most areas where the timetable for implementation of legislation is detailed, it seems that the time frame objectives of the National Programme for the Adoption of the *Acquis* are quite

realistic. Full implementation of EU legislation appears to be foreseen for the year 2002, with the exception of transport where for certain initiatives the year 2003 is indicated. As regards large infrastructure investments in the field of environment - in particular waste management - the time horizon is much longer. There are, nevertheless, some areas where the National Programme for the Adoption of the *Acquis* does not mention the detailed time plan for implementation (fisheries, technical regulations, or regional policy).

The detail in the description of necessary implementation structures is not homogeneous for all sectors considered in the National Programme for the Adoption of the *Acquis*. The National Programme for the Adoption of the *Acquis* provides in most cases an adequate basis to further identify institution building needs. However, attention has to be paid to ensuring adequate enforcement capacities in all areas of the *acquis*.

Cost estimates are provided for many of the specific activities foreseen although not all these needs have been budgeted. In most cases, there is also no distinction between national and external sources of funding in each sector. Finally, the National Programme for the Adoption of the *Acquis* does not include an overall estimate of the cost of the accession preparations. The National Programme for the Adoption of the *Acquis* needs to be revised to:

- ensure that the Community *acquis* is fully and that individual EU acts are linked as much as possible with the priorities identified and the corresponding domestic legislation.
- ensure the establishment of the adequate enforcement and application capacities in all areas of the *acquis*.
- provide budget sources, cost estimates and make a distinction between national and external financing resources.

On the basis of the revised National Programme for the Adoption of the *Acquis*, the Commission will take a position on the programme which it will communicate to the Council during the second semester of 1999, at the time of the re-examination of the Accession Partnership.

Annex

STATISTICAL DATA

STATISTICAL DATA

	1993	1994	1995	1996	1997
Basic data	in 1000				
Population (end of period)	1507	1492	1476	1462	:
	in 1000 hectares				
Total Area	4523	4523	4523	4523	4523
National Accounts	in Bn Kroon				
Gross Domestic Product at current prices	21.6	29.6	40.7	52.4	65.4
	in Bn ECU				
Gross Domestic Product at current prices	1.4	1.9	2.7	3.4	4.2
	in ECU per capita				
Gross Domestic Product at current prices	900	1300	1800	2300	2800
Structure of Production	in % of Total Gross Value Added				
- Agriculture	:	:	7.9	:	:
- Industry	:	:	23.1	:	:
- Construction	:	:	5.9	:	:
- Services	:	:	63.1	:	:
Structure of expenditure	as % of Gross Domestic Product				
- Final consumption expenditure	:	:	86.6	84.8	80.2
- household and NPISH	:	:	61.2	60.7	57.3
- general government	:	:	25.4	24.1	22.9
- Gross fixed capital formation	:	:	26.0	26.7	26.5
- Exports of goods and services	:	:	72.3	66.6	72.9
- Imports of goods and services	:	:	80.4	78.7	85.2
	% change over the previous year				
Gross Domestic Product	-9.0	-2.0	4.3	4.0	11.4
	in Purchasing Power parities				
Gross Domestic Product per capita	5100	5200	5600	6100	7000
Inflation rate	% change over the previous year				
Consumer Price Index	89.8	47.7	29.0	23.1	:
Balance of payments	in millions of ECU				
-Exports of goods	693	1116	1419	1408	1843
-Imports of goods	817	1414	1934	2230	2886
-Trade balance	-124	-299	-515	-822	-1043
-Services, net	64	88	290	408	536
-Income, net	-12	-25	2	1	-131
-Net current transfers	90	96	97	79	102
-of which government transfers	90	91	77	66	84
-Current account balance	18	-139	-126	-333	-536
-Reserve assets (incl. gold)	375	363	444	511	688
-Reserve assets (excl. gold)	346	360	441	508	686
Public Finance	in % of Gross Domestic Product				
General Government Deficit/Surplus	2.5	3.3	0.6	0.1	:
Gross foreign debt	:	8.9	9.4	10.6	:

	1993	1994	1995	1996	1997
Financial indicators					
Monetary Aggregates	in Bn ECU				
- M1	0.3	0.4	0.5	0.7	0.8
- M2	0.4	0.5	0.7	0.9	1.2
- Total credit	:	:	:	:	:
Average short-term interest rates	% per annum				
- Lending rate	27.3	23.1	16	13.7	19.8
- Deposit rate	:	11.5	8.7	6.1	6.2
ECU exchange rates	(1ECU=..National currency)				
- Average of period	15.484	15.453	14.996	15.28	15.743
- End of period	15.483	15.24	15.064	15.587	15.83
- Effective exchange rate	:	:	:	:	:
Foreign Trade	in millions of ECU				
Imports	764	1391	1942	2545	3895
Exports	687	1096	1405	1638	2567
Balance	-77	-295	-537	-907	-1329
	corresponding period of the previous year = 100				
Terms of trade	:	:	:	:	:
	as % of total				
Imports with EU-15 (EU-12 for 93-94)	23.3	23.9	66	64.7	59.2
Exports with EU-15 (EU-12 for 93-94)	17.8	19	54.1	51	48.6
Demography	per 1000 of population				
Natural growth rate	-4.0	-5.3	-4.9	-3.9	:
Net migration rate	-8.9	-4.9	-5.4	-5.7	:
	per 1000 live-births				
Infant mortality rate	15.8	14.5	14.8	10.4	:
	at birth				
Life expectancy : Males	62.5	61.1	61.7	64.5	:
Females	73.8	73.1	74.3	75.5	:
Labour market	in % of labour force				
Economic Activity rate (ILO methodology)	70.2	70.1	68.5	68.1	64.2
Unemployment rate (ILO methodology) : Total	6.5	7.6	9.7	10	10.5
< 25 years	11	11.6	14.1	16	17.8
> 25 years	5.8	6.9	9.1	9.1	9.4
Average employment by NACE branches (LFS)	in % of total				
- Agriculture and Forestry	16.6	14.6	10.5	10	9.9
- Industry	25.6	25.1	28.6	27.8	28.1
- Construction	7.4	7.2	5.4	5.7	5.3
- Services	50.4	53.1	55.5	56.5	56.7
Infrastructure	in Km per 1000 Km2				
Railway network	:	:	22.6	22.6	:
	in km				
Length of motorways	:	:	64	66	68
Industry and Agriculture	previous year = 100				
Industrial production volume indices	81.3	97	101.9	102.9	113.4
Gross agricultural production volume indices	90.5	87.1	100.2	93.7	97.8

Methodological Notes

Gross domestic Product per capita in PPS : Revised data using the new PPP results from the 1996 International Comparison Project.

Reserve assets : are end-year stock data. They are defined as the sum of central bank holdings of gold, foreign exchange, and other (gross) claims on non-residents. Gold is valued at end-year market price.

General government deficit / surplus : is an approximation of the national accounts definition, derived from data based on the IMF's GFS (government finance statistics) methodology. The general government deficit / surplus is obtained by adding the central government deficit / surplus (normally including certain extra-budgetary funds) to the local government deficit / surplus. The total is adjusted for net lending / borrowing for specific policy purposes, which is a financing item in the national accounts.

Monetary aggregates : are end-year stock data. M1 generally means notes and coin in circulation plus bank sight deposits. M2 generally means M1 plus savings deposits plus other short-term claims on banks. Total credit generally means domestic credit to the government and private sectors. It should be noted that the problem of measuring the circulation of foreign currency in some Applicant Countries may affect the reliability of the data.

Interest rates : Annual average rates. Lending rates generally consist of the average rate charged on loans granted by reporting banks. Deposit rates generally refer to average demand and time deposit rates.

Exchange rates : Where available, the ECU exchange rates are those officially notified to DG II. The effective exchange rate index is weighted by major trading partners, with a base year of 1990.

Imports and exports (current prices) : The data is based upon the "general trade" system. Trade data exclude trade in services as well as licences, know-how and patents, exports and imports at bank notes in circulation, monetary gold, goods for use by embassies, supplies by duty and tax-free shops at ports and airports. Since 1994, temporary exportation/importation with commitment of re-exportation/re-importation in unchanged state are excluded. Value of external trade turnover includes the market value of the goods and the additional costs (freight, insurance etc.). Trade Classification: Merchandise trade flows are using the commodity classification according to the Combined Nomenclature. Imports are recorded on CIF basis. Until 1997, the data were captured with the date of acceptance of the customs declaration by customs authorities. Since 1997, they are captured with the date on which the commodities cross the customs border. Exports are recorded on FOB basis and are captured in the same way as imports.

Eurostat has converted the National Currency to the US dollar by applying the International Monetary Fund annual average exchange rates.

Terms of trade : Export price index is calculated by the Statistical Office of Estonia since 1994. The weight structure of the export price index is based on the value of exports according to the adjusted customs statistics. The price data (fob prices) are collected directly

from major exporters. The export price index have been calculated by using Laspeyre's formula

Imports and exports with EU-15 : Data declared by Estonia. Data for years 1993 and 1994 refer to trade with EU-12 only.

Economic activity rate (ILO Methodology) : - Percentage of labour force in total population aged 15+.

Unemployment rate (by ILO methodology) : - Percentage of the unemployed labour force. Average employment by NACE branches (LFS):

These indicators are derived from LFSS (Labour Force Sample Survey) observing the following ILO definitions and recommendations:

Labour force: employed and unemployed persons in the sense of the ILO definitions stated below.

The employed : all persons aged 15+, who during the reference period worked at least one hour for wage or salary or other remuneration as employees, entrepreneurs, members of cooperatives or contributing family workers. Members of armed forces and women on child-care leave are included.

The unemployed : all persons aged 15+, who concurrently meet all three conditions of the ILO definition for being classified as the unemployed: (i) have no work, (ii) are actively seeking a job and (iii) are ready to take up a job within a fortnight.

For the years 1993-1994 the data refer to the Estonian Labour Force Survey 1995 (ELFS 95) conducted in January-April 1995. For the years 1995-1997 the data refer to the Estonian Labour Force Survey 1997 (ELFS 97) conducted in April-June 1997. The questionnaire of both surveys consisted of two parts: the reference week and retrospective part: ELFS 95 covered the period 1989-1995, ELFS 97 the period 1995-1997. Data presented in tables for the years 1993-1996 are retrospectively collected data about population 15-69. Data for the year 1997 are reference week data referring to the 2nd quarter of 1997 and population aged 15-74.

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

Sources

Basic data, National Accounts, Foreign trade, Demography, Labour market, Infrastructure, Industry and Agriculture : New Cronos.

Reserve assets and Financial indicators : Where possible Eurostat B-4's questionnaire on monetary and financial statistics has been used as the source. Applicant Countries are asked to supply regularly an update of tables contained in the questionnaire. The statistics covered include foreign official reserves, monetary aggregates, interest rates, and exchange rates. Failing this, the IMF's 'International Financial Statistics' publication has been used as the source. The European Commission (DG II) is used as the source for exchange rates against the ECU, where possible.

Concerning gross foreign debt, the OECD External Debt Statistics publication has been used as the source.

Concerning general government deficit / surplus, Applicant Countries are presently unable to provide reliable data. Unit B-4 is working closely with these countries with the aim of improving their national accounts based government finance statistics. Given the lack of reliable data, an approximation for general government deficit / surplus is derived from the IMF's Government Finance Statistics Yearbook (for an explanation of methodology, see below).